



Report of Chief Officer, Sustainable Energy and Air Quality

Report to Director of Resources and Housing

Date: 9th September 2020

Subject: Extension of contracts for supply of gas and electricity to Leeds City Council

Are specific electoral wards affected? If yes, name(s) of ward(s):	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Has consultation been carried out?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Will the decision be open for call-in?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: Appendix number:	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

Summary

1. Main issues

- The current extensions of the contracts for supply of gas and electricity to the Council (exercised in 2018) are due to expire on 31st October 2020 and 31st March 2021 respectively. There is provision for a further 2 x 2 years of extensions under these contracts, and this report makes recommendations for the extension of both.
- These contracts ensure provision of heating and energy to the Council's portfolio of buildings and sites, including Council offices, civic buildings, workplaces, leisure centres, street lighting and some schools, as well as supplying fuel for combined heat and power units.
- The contractual offer from ENGIE provides a flexible purchasing and brokerage service to enable the Council to secure advantageous forward purchases of energy and hedge against potential market price increases. The 'balanced risk path' approach to energy purchasing has enabled the Council strike an effective balance between protecting itself against the volatility of energy prices whilst leaving some scope to take advantage of short-term low market prices.
- Although the proposal to extend the gas contract for 17 months to end March 2022 (see 'Recommendations' below) goes slightly beyond the maximum contract duration currently advised by CLT, given that: a) there is value in having both contracts aligned to start from 1st April since this is when many of the industry charges are published, thus reducing the scope for risk pricing by the supplier; b) it

would be necessary to extend again anyway if the gas contract were only extended for 5 months until end March 2021 in light of the timescales required for a full re-procurement, and; c) there is flexibility within the contract to accommodate potential future reductions in the Council's energy demand without penalty; this is the recommended approach.

2. Best Council Plan Implications (click [here](#) for the latest version of the Best Council Plan)

- The Council's energy strategy links closely into the Best City Ambition to be a net zero carbon city by 2030. This recommendations in this report support the Best Council ambitions to:
 - be efficient and enterprising;
 - become more financially sustainable and resilient, safeguarding public funds while achieving value for money;
 - have a modern, efficient, sustainable estate;
 - promote a more competitive, less wasteful, more resource efficient, low carbon economy.

3. Resource Implications

- Although high value contracts, with a combined annual value of £21.0m based on 2019/20 consumption (£4.1m for gas and £16.9m for electricity), the vast majority of the costs under these contracts
- ENGIE are deemed to represent value for money based on the original competitive tendering process, the ongoing level of margin which was fixed at this time, and the value provided through their brokerage service and flexible purchasing offer.

Recommendations

The Director of Resources and Housing is recommended to approve:

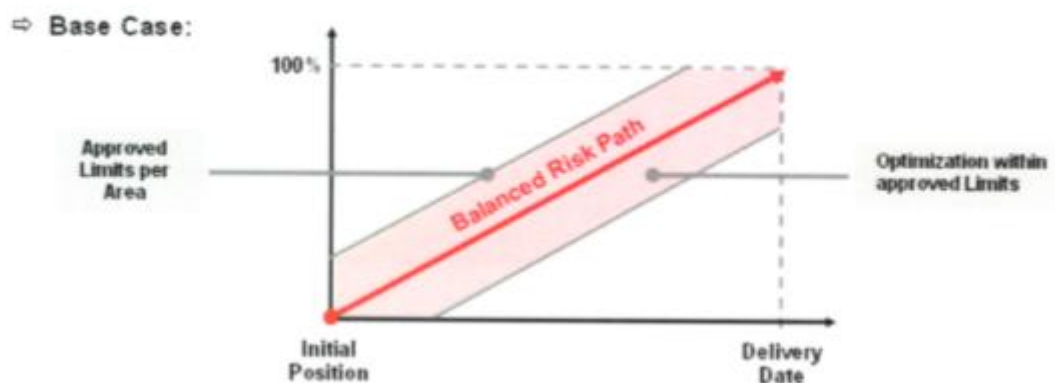
- a) the extension of the Supply of Gas including brokerage contract (DN210255) for 17 months (1st November 2020 – 31st March 2022) to ENGIE Gas Limited;
- b) the extension of the Supply of Electricity including brokerage contract (DN187954) for 12 months (1st April 2021 – 31st March 2022) to ENGIE Power Limited.

1. Purpose of this report

- 1.1 The purpose of this report is to confirm that the contracts for the supply of gas and electricity to the Council remain best value for money, and to seek approval to extend these contracts for a further period.
- 1.2 Contract Procedure Rule 21.1 states that any contract may be extended before the expiry date where it is in accordance with its terms and proves to deliver best value for money. Approval for such extension shall be sought in a timely manner and supported by an appropriate delegated decision.

2. Background information

- 2.1 The contracts were procured in 2014/15 and awarded for an initial period of 2 years to GDF Suez (now ENGIE Ltd). Both contracts were procured using YORtender and advertised in the Official Journal of the European Union (OJEU), and contain provision to extend for 4 x 2 year periods beyond the initial term, with two of these extensions already exercised since the original award.
- 2.2 In 2019/20 the cost of energy to the Council was approximately £21.0m (£4.1m for gas and £16.9m for electricity), with a budget of £22.6m for 2020/21. The vast majority of these costs relate to the wholesale market prices for the two commodities, or to fixed levies, transmission charges or other pass-through costs from the distribution network operator (DNO).
- 2.3 Savings have been delivered since initial award by bundling all electricity supply into one contract, thus providing a volume discount, and reducing the proportion of peak rate electricity.
- 2.4 Energy prices are constantly changing in the medium to long-term, although this tends to be at a relatively steady rate for the most part. In the short-term, however, prices can be very volatile indeed. The Council has therefore established an energy purchasing strategy for buying a significant proportion of its energy requirement in advance so as to provide greater certainty around the prices to be paid in the future, take advantage of dips in the market and also protect the Council from what could be very severe financial impacts of leaving the organisation wholly exposed to the prevailing market conditions.
- 2.5 In support of this, the contract includes an innovation clause that enables the Council and ENGIE to react to regulatory changes and to exploit opportunities that may present themselves during the lifespan of the contract, with ENGIE providing a brokerage service as part of their contractual offer to enable the Council to forward purchase a baseload of gas and electricity.
- 2.6 The Council's strategy sets a target for 80% of gas and electricity volumes to be purchased in advance, although this can be increased to up to 90% if separate written justification is provided and approved.
- 2.7 Purchases can be made up to 48 months in advance, but a 'balanced risk path' has been established to ensure that neither an insufficient nor excessive proportion is purchased, and includes 20% upper and lower tolerances either side of the pathway. Again, these limits can be breached provided there is formal written justification provided and approved. The diagram below illustrates the 'balanced risk path' approach:



- 2.8 Historical performance has shown that, overall, through the forward purchases made based on advice provided by ENGIE, the Council has successfully tracked closely to market average prices and has not been unduly exposed to the significant swings in short-term prices that have been observed during this time. It is important to note again that, while there may be periods where current market prices are well below the prices secured in advance, the risk of the Council leaving itself significantly exposed to the unpredictability of the market would be wholly unacceptable.
- 2.9 Generally a successful balance has also been achieved in terms of the proportion of the Council's energy requirements not purchased in advance. This has been evident through the recent impacts of COVID-19 and lockdown, which have resulted in significant reductions in both energy prices and energy demand. Although lockdown has resulted in very substantial, and wholly unforeseeable, reductions in the Council's energy consumption for this period compared to previous years, forward purchases for electricity, for example, only marginally exceeded the actual requirement for the month of April 2020 alone, even in light of these extraordinary circumstances (and this not beyond the contractual tolerances so as to result in any overpayment by the Council). Over the period since this time to date there has still been a substantial proportion of the Council's energy requirements remaining 'open', for which the current very low market prices have been enjoyed, bringing the average price paid down.
- 2.10 These examples illustrate the value of the market intelligence and brokerage service provided by ENGIE in ensuring that the Council can successfully implement its 'balanced risk path' approach.

3. Main issues

- 3.1 There are a range of issues to consider in relation to the decision to extend the contracts.
- 3.2 In terms of value for money, the award of the original contract to ENGIE was the result of a competitive tendering process, with the prices received at the time lower than any other bidder.
- 3.3 Furthermore, the supplier profit margin is fixed and will therefore remain at the same level as when the contract was tendered. This was deemed the best available on the market at the time, and the market has not changed significantly in terms of price build-up since the original tendering exercise.
- 3.4 As noted above, the brokerage service provided by ENGIE and included in the contract has enabled the Council to implement an effective risk strategy through securing forward purchases of a proportion of its energy requirements so as to hedge against unforeseeable price increases in what can be a volatile global market.
- 3.5 The scale and diversity of sites and energy supplies within the Council's portfolio, along with the complexity of energy pricing, means that billing is extensive and complex. As regards performance, the Council has experienced some issues in relation to the accuracy and consistency of invoicing from ENGIE, and in relation to some other supply related processes, and this has been burdensome for the Council's Energy Unit in terms of the resources required to validate, query and ensure correct billing.
- 3.6 However, this was escalated with ENGIE in early 2020, and since this time they have dedicated substantial resource and demonstrated significant commitment

towards resolving issues and improving the quality of billing and other service related processes. Whilst the full benefit of these improvements is only now starting to be fully realised, the relationship and level of partnership working with ENGIE has improved significantly, and there is now a much higher level of confidence in their ability to perform the contract to the expected standard.

- 3.7 Alongside this, it should also be considered that to fully re-procure this contract would be resource-intensive, there would be an administrative burden to the Council of having to change energy supplier, and the recent momentum that has been achieved in understanding sites and resolving complex issues would undoubtedly be lost, to the detriment of performance under these contracts.
- 3.8 As noted, 2 x 2 year extensions are provided for within the scope of the original contract, and in compliance within Contract Procedure Rules. In terms of the duration of the proposed extensions, there are a number of issues to consider.
- 3.9 In light of the financial uncertainty created by the COVID-19 pandemic, Corporate Leadership Team (CLT) has imposed a limit on the length of award of contracts to a maximum of 12 months unless there is sound justification.
- 3.10 In addition to this, the current expiry dates for the gas and electricity contracts are not co-terminus, being in October and March respectively, and it would be desirable to bring these into alignment such that there is the option to re-tender them together on expiry.
- 3.11 Lastly, it is considered preferable for the contracts to start on 1st April rather than mid-year, as the annual changes to many of the fixed, 'pass-through' industry charges are published just ahead of 1st April, therefore enabling the supplier to price more accurately when they set their charges for the contract year ahead, and without needing to risk-price for this element. From a budgeting perspective, this would also simplify matters in terms of the scope for rate changes during the financial year for the pass-through element of these charges.
- 3.12 If these factors are to be taken into account, the two main options therefore seem to be, firstly, to extend the gas contract for only 5 months such that the two come into line with each other from 1st April 2021. However, in reality, this will not allow sufficient time to fully re-tender the gas or electricity contracts to start from April 2021, with the result that further extensions will be required anyway, so this seems futile.
- 3.13 The second option is to extend the gas contract for 17 months and the electricity contract for 12 months. Although this goes slightly beyond the maximum contract duration advised by CLT in relation to the gas contract, given that it will be necessary to extend further anyway as explained above, and since there is flexibility within the contract to accommodate potential future reductions in the Council's energy demand without penalty (future contractual volume forecasts may be adjusted at any point in line with changing requirements), this is not considered a risk (it should also be noted that existing forward purchases, which go up to 2022, leave ample headroom for future reductions in the Council's consumption due to either reduced demand, or more sites being installed with our own renewable generation assets). This is therefore the recommended option.
- 3.14 This would then mean that, with the remaining available extensions, the two contracts could be fully re-procured either to start from 1st April 2022 at the earliest, or 1st April 2024 at the latest.

4. Corporate considerations

4.1 Consultation and engagement

- 4.1.1 Consultation has taken place within the Sustainable Energy and Air Quality (SEAQ) team, including the Chief Officer, with the relevant Head of Finance, and with Procurement and Commercial Services (PACS), including the relevant procurement category manager. Comments received are reflected in this report.
- 4.1.2 The assurances regarding value for money of extending the existing contracts are outlined in section 4.4 below. In addition, the contract already includes flexibility to adjust contractual energy volumes forecasts resulting from, for example, a reduction in the Council's future requirements.
- 4.1.3 The justification for slightly exceeding 12 months in terms of the duration of the extension of the gas contract is set out in section 3 above.

4.2 Equality and diversity / cohesion and integration

- 4.2.1 There are no particular implications for Equality, Diversity, Cohesion and Integration.

4.3 Council policies and the Best Council Plan

- 4.3.1 The Council's energy strategy links closely into the Best City Ambition to work towards being a net zero carbon city by 2030. The recommendations in this report support Best Council ambitions to:

- be efficient and enterprising;
- become more financially sustainable and resilient, safeguarding public funds while achieving value for money ;
- have a modern, efficient, sustainable estate;
- promote a more competitive, less wasteful, more resource efficient, low carbon economy.

Climate Emergency

- 4.3.2 The Council has a substantial portfolio of sites and buildings, and therefore a high level of energy consumption. In January 2020, the Executive Board committed to a rationalisation and energy efficiency programme to reduce emissions from Council buildings by 40% by 2025. The Council has already implemented renewable solar PV energy generation and a range of other energy efficiency measures across a number of its sites, including schools, and is pursuing Government funding to enable expansion of these measures across the whole portfolio wherever practicable. This will ensure progressive reductions in energy consumption, and these contracts for gas and electricity will not inhibit the Council's ambitions in this regard.
- 4.3.3 The Executive Board also approved a target to move to 100% electricity provided from green sources through entering into a corporate power purchase agreement, and officers from the SEAQ team are in discussion with ENGIE regarding the opportunities to bring forward new renewable energy generation assets through such an agreement.

4.4 Resources, procurement and value for money

4.4.1 As noted above, the vast majority of the costs under these contracts relate to the wholesale market prices for the two commodities, or to fixed, pass-through costs and levies, with the services provided by the energy supplier estimated at only around 1% of total costs as an industry rule of thumb. However, ENGIE are still deemed to represent value for money based on having undergone the original competitive tendering process, and due to the ongoing level of their margin which was fixed at this time and the benefits that ENGIE have realised for the Council through their brokerage service and flexible purchasing offer.

4.5 Legal implications, access to information, and call-in

4.5.1 The decision to extend the contract is a Significant Operational Decision under Article 13 of the Council's constitution, under footnote 1b to article 13.4a.

4.5.2 The report does not contain any confidential or exempt information, and the decision is not subject to call-in.

4.6 Risk management

4.6.1 There are no particular risks associated with this decision since the proposed extensions are provided for within the terms of the original contracts. The extensions will enable the Council's Energy team to continue to develop the partnership with ENGIE and deliver improved contractual performance.

4.6.2 The value of the recommended approach to the duration of extensions is discussed in section 3 above. To not extend at all would be a considerable risk given the timescales required for a full re-procurement and the implications of being outside of the safeguards of a formal contract, especially regarding exposure to fluctuating energy prices.

5. Conclusions

5.1 It has been concluded that, in accordance with the provisions already made under the original contracts, further extensions should now be awarded to ENGIE for the supply of gas and electricity.

6. Recommendations

6.1 The Director of Resources and Housing is recommended to approve:

a) the extension of the Supply of Gas including brokerage contract (DN210255) for 17 months (1st November 2020 – 31st March 2022) to ENGIE Gas Limited;

b) the extension of the Supply of Electricity including brokerage contract (DN187954) for 12 months (1st April 2021 – 31st March 2022) to ENGIE Power Limited.

7. Background documents¹

7.1 None.

¹ The background documents listed in this section are available to download from the council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.