

IN THE PIPELINE

Government Energy Project Newsletter



2nd Edition | Summer 2009

Buy Smarter - Use Less

- **Riding the Storm**
- **The Spice of Life**
 - **Getting the Balance Right**
 - **Making Change Happen**
 - **Value for Money**
- **Energy Event**
- **Aggregation Update**
- **Sustainability Update**
- **London Energy Project**
- **Ask the Team**
- **News and Events**
- **For further information**

Riding the storm – why price risk management matters

Making the best purchasing decisions is particularly challenging in the present volatile energy markets. The pan-Government Energy Project recommends that public sector organisations reduce the price risk by aggregating volumes into well-managed flexible framework contracts. This allows smaller organisations to benefit from direct access to the wholesale market. A key element of this approach is the employment of effective risk management strategies to guide purchasing decisions.

To develop a successful price risk management strategy you need to understand exactly what the risks are, i.e. to

have a thorough knowledge and experience of the energy markets. You also need to know what your customer needs and thus what you want your risk management strategy to achieve, for example, the relative importance of budget certainty or lowest price. In very general terms the aim of strategic price risk management is to smooth out volatility and make purchasing energy less of a gamble.

These are the arrangements offered by Central Purchasing Bodies whose flexible framework contracts have been assessed and recommended by the pan-Government Energy Project.



- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

The Spice of Life – three views of risk management

Getting the balance right – the Risk Manager

David Kwiatek heads the energy team for the Eastern Shires Purchasing Organisation (ESPO), a not-for-profit organisation set up to serve seven member authorities; Lincolnshire, Leicestershire, Warwickshire, Norfolk and Cambridgeshire County Councils and Peterborough and Leicester City Councils but also buying on behalf of a wider public sector customer base. David has had a diverse career in materials management and procurement before specialising in energy purchasing from the mid 1980s. He explains the attraction “Working on civil engineering projects was interesting but nothing else I’ve done is as dynamic and fast-moving as energy”.

“For example, last year I don’t believe anyone knew just how fast and how hard the credit crunch was going to hit. At the outset, market forecasters were predicting that oil would rise to between \$200 and \$250 a barrel, and we were being asked to lock prices out by some customers yet within six months the price had dropped blow \$40. In these conditions a fixed price, fixed term contract is a not such a good option for any organisation. Even if they get a good price, this will become the budget set for succeeding years and, if prices rise, services may have to be cut to make up the difference.”

ESPO offers flexible aggregated risk-managed frameworks for energy, combining volumes to make a more attractive portfolio for suppliers. Purchases are made in tranches, currently over an eighteen month period. David has secured continuing customer commitment to flexible purchasing by using a staged approach, working with them on risk management governance panel that meets every quarter to review the strategy and monitor price performance.



David’s team also use their market expertise in negotiations with suppliers. He says “Energy users will typically incur a penalty charge if their consumption varies outside a specified volume tolerance. Under our contract conditions, variations can be smoothed across the whole portfolio thus reducing the risk of any one customer incurring a penalty.

“Another example is putting together the electricity requirement for street-lighting and for metered electricity for the larger council buildings. As one has higher usage at night and the other in the day, the demand profile was smoothed out and peak usage (at 15% - 20% above baseload price) reduced. This benefits both users, regardless of market forces.”

continued on the next page →



- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

Making Change Happen – the Category Manager

Diane Ward was already an experienced private sector category manager when she joined the newly formed Lincolnshire shared procurement service, Procurement Lincolnshire, eighteen months ago. She says “I chose the Utilities category as this area offered plenty of interest and challenge, especially in terms of risk management. It has the variety that is the spice of life.”

“The partner authorities that we serve manage their own devolved budgets and my task is to devise the best procurement strategy for them and to convince them to adopt it by explaining the benefits. Buying energy flexibly through ESPO offers our customers many advantages, including access to falling markets, reduced costs of service and improved supplier performance.

“These improvements allow Energy managers to focus more on developing strategies for energy efficiency and carbon reduction.

“Initially some were reluctant to reduce budgetary certainty, but the staged approach, used by ESPO, which currently offers periodic budget certainty, has increased customer confidence in flexible purchasing.

“Another key success factor is the open forum, partnership approach to managing risk. I represent Procurement Lincolnshire on the governance panel, which includes senior budget holders and finance directors for all the member authorities. Rather than relying solely on ESPO to make the best purchasing decisions, we are all equally involved in shaping the risk management strategy.

“The smaller organisations in Lincolnshire are represented on the panel by senior managers, and part of my work is to deepen understanding of risk issues and improve information sharing, strengthening the network of budget holders, financiers and energy managers across all the customer organisations, including those not large enough to supply panel members.”

continued on the next page →



PROCUREMENT LINCOLNSHIRE
Together we are stronger



- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

Value for Money - the Chief Finance Officer

Steve Larter is the Chief Financial Officer for East Lindsey District Council. East Lindsey is a largely rural area on the east coast of Lincolnshire, which includes the towns of Louth, Mablethorpe and Skegness. Steve was instrumental in setting up Procurement Lincolnshire, and is part of the ESPO risk management governance panel, where he and Diane Ward represent the Lincolnshire local authorities.

He says "Although East Lindsey is, by area, the third largest local authority in England we are not big enough to buy flexibly on the wholesale market by ourselves. We are in the process of moving to an aggregated flexible framework with ESPO. ESPO are also managing the interim arrangements needed between the expiry of our previous fixed price contracts in April and the start of the flexible frameworks in July and September. The transition has been very smooth and easy so far, although I am keeping a close eye on developments."

In 1999 the council received a substantial capital receipt from the sale of its housing stock and Steve's experience as investment manager for these funds stood him in good stead when assessing the options for energy purchasing. He says "The energy market is similar

to the investment markets except that we are looking for the lowest prices rather than the highest returns. The reliance on market intelligence and professional expertise is the same and the principles of locking out prices in a rising market and buying in small chunks in a falling one is comparable.

"It is very early days for the ESPO framework and I would like to see the governance panel move towards giving ESPO a larger buying window, not placing such tight restrictions on the percentage of total volumes that have to be purchased by a certain date. It's important to remember that risk management doesn't mean making the right decision every time, that would be impossible, but getting the right result over the longer term."

Steve considers value for money even more important than budget certainty and points out that assumptions have always been part of local government finance: "For example, budgets are agreed in February and, if undertaking fixed contracts, procurement does not normally begin until March. By this time prices may be different, especially in a volatile market. With a flexible approach, a proportion of the likely costs for the following year will already be known when budgets are finalised."





- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- **Energy Event**
- **Aggregation Update**
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

Energy Event

The first Collaborative Energy Event was held in Bristol on 17th June, hosted by OGC, with contributions from Buying Solutions and the Pro 5 CPB group. Presentations were given on the Pan-Government Energy Project, flexible procurement and its benefits, the key characteristics of energy markets and the value-added services the CPB can provide.

Further Events are scheduled for:

July - W Midlands (tbc)
9th September - Preston
11th November - Reading
2nd December - Birmingham
16th December - Exeter

To book your place contact energy@ogc.gsi.gov.uk

Aggregation Update - Stockport College

Stockport College is typical of the smaller public sector organisations that are benefiting from moving to flexible aggregated risk-managed frameworks. The college spends on average £600k per year on energy and formerly used fixed price fixed term contracts. When prices began to rise sharply, Purchasing Officer Sarah Garnett needed to find another energy procurement method, to manage costs more effectively and increase value for money.

On the advice of Pippa Ford, FE Procurement Development Officer, Learning & Skills Council (LSC), Sarah consulted OGC's Susie Owen, who leads the Aggregation Workstream for the Pan Government Energy Project.



She explained to Sarah and Stockport's Head of Finance, Paul Greenhalgh, the work of the project and how approved frameworks provided a much more sophisticated approach to risk management than traditional fixed price contracts.

Paul said "I was particularly impressed with the potential for managing risk options over a longer term and the opportunity for Stockport College, a relatively small customer, to reduce their costs by being part of a much larger aggregated portfolio."

Sarah put forward a proposal to senior management at Stockport College recommending that they move to purchase gas and electric through a flexible, risk managed, approved solution via Buying Solutions commencing October 2009.



- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

Sustainability Update

The achievements of the Sustainability team include the shared ICT Power Management Framework (DCMS) awarded in May 2008 and the successful promotion of funding opportunities, such as Salix, Low Carbon Buildings Programme and Bio-energy Capital Grants Scheme.

Government departments and professional buying organisations are committed to future government projects. Additional pan government procurement solutions include the Automated Meter Reading Framework (from Buying Solutions) available September 2009 and the Voltage Optimisation Framework (from Defra) available October 2009

Further details of these and other initiatives will be in the next (Sustainability) issue of In the Pipeline. The Sustainability team are collecting information on how sustainability is being taken forward across the public sector.

We need your help. The Sustainability team are developing pan government frameworks for energy efficiency technologies that can deliver significant financial and carbon savings during CSR07 and beyond. And they need your help to complete their research. If your organisation is considering undertaking a framework agreement for energy efficiency equipment, please send details to the team via Madeleine Howell, DESComrclCC-EnergyCatMan1@mod.uk

London Energy Project Wins Top Procurement Award

The London Energy Project sponsored by Capital Ambition, has won the Excellence in Public Procurement Award, awarded by the Government Opportunities GO magazine, the national publication for the procurement profession.

LEP's Change Manager Amanda de Swarte said "We are delighted to receive this endorsement of our achievement from our peers, but the biggest winners are public services and local communities in London."

Over the past three years flexible contracts have delivered a 4.7% cost reduction on fixed price alternatives and further benefits are forecast. Soft benefits include a greater understanding of the strategic aspects of energy buying and carbon reduction, and improved longer-term relationships for customers with their utility suppliers.





- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

Ask the Team

If you have a question about any aspect of the project, please send them to the Energy Strategy Team, energy@ogc.gsi.gov.uk. All questions will be answered and the most topical will be printed, anonymously if preferred.

If you have a question about any aspect of the project, please send it to energy@ogc.gsi.gov.uk. All questions will be answered and the most topical will be printed, anonymously if preferred.

Q: I understand the cost benefits of buying flexibly, but budgets are tight and the need for budget certainty is an over-riding consideration. From this point of view, surely a fixed term fixed price contract is the lowest risk option?

A: The energy market is so volatile that fixing a price on a single day is always a high-risk strategy. The pan-Government Energy Project recommends buying flexibly through an aggregated, risk-managed contract which doesn't necessarily mean giving up budget certainty. Different Central Purchasing Bodies (CPBs) offer different risk strategies from which you can choose. Some offer flexible buying prior to the supply start date. An 'average' price is calculated and you will receive a locked price for the period. This offers the same budget certainty as a fixed price, fixed term deal.





- Riding the Storm
- The Spice of Life
 - Getting the Balance Right
 - Making Change Happen
 - Value for Money
- Energy Event
- Aggregation Update
- Sustainability Update
- London Energy Project
- Ask the Team
- News and Events
- For further information

News and Events in Brief

As part of the **Sustainabilitylive!** Event on 19 May MOD's Paul Eastel and OGC's Martina Lenaghan gave a well-received presentation on the work of the pan-Government Energy project, with particular emphasis on progress on sustainability.

On 20 May LEP and GSIUK hosted a supplier, service provider, and public and private sector industry day, to work towards a standard consolidated invoice solution. After some debate consensus was reached to move forward and in July the first workgroup will meet to initiate the process.

The Standard Terms and Conditions team held a round table discussion with suppliers on 3 June at MOD Main Building. The aim of the meeting was to agree on the inclusion of four important conditions in public sector contracts as standard: retirement of ROCs and LECs, the provision of management information, transparency of pricing and the option to purchase from energy third parties.

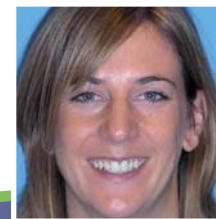
The Procurement Solutions live event was held on 9-10 June in Earls Court London. This is an annual government procurement event covering a range of categories. OGC's Susie Owen gave a presentation on 10 June on the work of the Pan-Government Energy Project.

NHS PASA and Buying Solutions are currently conducting a collaborative procurement exercise for liquid fuels which will complete in October 2009.

Look out for:

OGC's **Susie Owen** has been asked to speak at the Association of University Procurement Officers Event in September 2009

For further details see the AUPO website www.aupo.ac.uk



Further Information

I hope you have found this issue of **In the Pipeline** useful. The next issue will focus on sustainability in energy procurement plus the latest project news. Please send feedback to Madeleine Howell, **DESComrclCC-EnergyCatMan1@mod.uk**.

All feedback is welcome but particularly topics you would like to see in future editions.

For further information please see OGC website: **www.ogc.gov.uk**