







Scrutiny Report

The Council's Energy Purchasing Arrangements

January 2021

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Scrutiny Task Group Membership

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Foreword

This report epitomises the power and benefits of Scrutiny!

The initial questions and quick calculations carried out during an Economy and Environment Overview and Scrutiny Panel discussion about street lighting costs set us on the pathway to this Task Group.

Initially, a low-key exercise was carried out by the Corporate and Communities Overview and Scrutiny Panel with me, Councillor John Raine and Councillor Richard Morris. It soon, however, became apparent that the work would require a formal Task Group.

I was delighted that Councillor Brandon Clayton, Councillor Rebecca Vale and Councillor Luke Mallett were able to join us in the formal group.

Prior to us forming the Task Group, it was apparent that little was known by Members about West Mercia Energy, the Joint Committee and Worcestershire County Council's part in it. It has been a very interesting and informative journey for the Task Group dealing with the history of West Mercia Energy, the make-up of the Joint Committee and understanding the Business Plan and goals of the organisation.

Energy purchasing is complex, highly technical and the Report covers several areas. This Report can also serve as a guide and aide memoire to Members on the agreement in place and its operation and the Council's relationship with West Mercia Energy.

We recognise the varied views from Officers and Members and the high level of expertise in the organisation, our recommendations are clear and succinct.

I would like to thank all the Task Group members mentioned above and our support officers Samantha Morris and Alison Spall, the job they do in organising meetings, collating and disseminating information and the production of minutes and the final report should not be underestimated.

Also, thanks to all those who the Task Group met and spoke to, I hope you find the report balanced, informative and take on board the recommendations in the spirit in which they are delivered.

Councillor Adam Kent
Lead Member of the Council's Energy Purchasing Arrangements Scrutiny Task Group

The Council's Energy Purchasing Arrangements

Background and Purpose of the Scrutiny

1. During a budget monitoring discussion at the Economy & Environment Overview and Scrutiny Panel on 21 November 2019, the Panel was advised of a cost pressure relating to street lighting and as a consequence, the Corporate & Communities Overview and Scrutiny (C&C) Panel was asked to look into the Council's energy purchasing arrangements.
2. Initially, at its meeting on 10 December 2019 the C&C Panel received a report about the Council's current purchasing arrangements. At that time, the County Council was purchasing c.£6m of electricity and gas through the West Mercia Energy (WME) Joint Committee Agreement.
3. A small group of Panel Members carried out some initial research, following which, it was agreed by the Overview and Scrutiny Performance Board (OSPB), at its meeting in July 2020 that a Task Group would be set up to look into the matter further, led by Councillor Adam Kent, Chairman of the Corporate and Communities Overview and Scrutiny Panel.

Terms of Reference

4. The terms of reference for the Scrutiny were 'to review the Council's energy purchasing arrangements from West Mercia Energy (WME) to ensure best value for Worcestershire County Council'.

The Task Group's Approach

5. The Task Group sought to carry out this Scrutiny by gaining an understanding of the County Council's energy purchasing arrangements and the role of the West Mercia Energy Joint Committee. The Group met with a range of Council Officers, the Council's representatives on the WME Joint Committee, the Director of WME and the Cabinet Member with Responsibility for Transformation and Commissioning. Due to the COVID-19 restrictions, all of these meetings took place via Zoom.
6. A Schedule of Activity is attached at Appendix 1.

Recommendations

7. The Task Group has identified a range of measures that this Council could put in place to ensure greater transparency, accountability and oversight, including an enhanced role for Scrutiny. Members felt that knowledge and understanding of WME activities should be much wider within the Council.

Governance, Transparency and Oversight

8. The Task Group recommends that there should be greater transparency around the Council's energy purchasing arrangements and the operations of WME. Prior to joining this Task Group, some of the Members had limited or no knowledge of the operations of WME, or the role that the Council played in its Joint Committee. Whilst there are links to WME meetings available to Members through the Council's website, there is no direction or induction for Members about WME, nor information given directly to Members about what was being considered by the Joint Committee, to encourage their interest.
9. The Task Group was informed that in 2016, the governance arrangements of the WME Joint Committee Agreement were amended and one of the new provisions included, was that decisions of the Joint Committee would be subject to scrutiny by the constituent authorities, with the option being available for an authority to call-in a decision if deemed appropriate. For this to be effective, the Task Group felt that Scrutiny should receive an annual update on WME including the Business Plan and the activities relating to the Council. This would ensure that the best interests of the Worcestershire taxpayers were being met and enhance transparency and openness.
10. Shropshire Council is the Lead Authority for the Joint Committee and provide support services such as treasurer, legal, internal audit, procurement and payroll. As well as an Internal Audit annual programme, the Joint Committee have agreed to an annual External Audit. The Task Group felt, however, that the Council's Internal Audit Department (Risk Management Team) should also have an oversight and understanding of the Joint Committee arrangements given the potential financial risk to the Council.
11. Generally, the role of elected Members is to provide strategic and policy direction and for Officers to be empowered to put that into practice. Energy procurement is the only area of the Council's procurement not directly managed by the Council's Procurement Team and the Task Group thought that it would increase the general oversight of WME if the Strategic Director (or his delegate) had an awareness of the options being considered when energy purchasing contracts were being negotiated. It has been highlighted that the Council's representative on the WME Flexible Energy Advisory Panel is the Council's Deputy S151 Officer, whereas the other three Member Authorities are represented by either a Contracting (Procurement) or Energy Officer.

Recommendation 1

The Cabinet Member with Responsibility, the Strategic Director of Commercial and Change, the representatives on the WME Joint Committee and the S151 Officer should be invited to Scrutiny on an annual basis to provide an update on WME including the Business Plan and the activities relating to the Council. The Council's Overview and

Scrutiny Performance Board should determine the most appropriate body to carry this Scrutiny out and accordingly, should be added to the appropriate Scrutiny work programme.

Recommendation 2

The Joint Committee Agreement stipulates that decisions of the Joint Committee will be subject to Scrutiny by the constituent authorities and its decisions can also be called-in within each constituent authority, using their own respective mechanism. In practical terms, for this to happen within the timescale set i.e. any call-in must be exercised by 5pm on the 5th working day after the decision is published, it is recommended that the Members of OSPB are sent the agendas and minutes of all WME Joint Committee meetings.

Recommendation 3

Acknowledging that WME is subject to the auditing arrangements in place by the host authority (Shropshire Council), the Task Group nevertheless recommends that, due to the potential financial risks involved, the Council's Internal Audit Department should ensure that it has oversight of WME Joint Committee and Business Plan.

Recommendation 4

It is recommended that in line with two of the other Member Authorities, a County Council Contracting (Procurement) Officer should act as the Council's Representative on the WME Flexible Energy Advisory Panel. This would ensure that the Procurement function has oversight, understanding and influence of the Council's energy purchasing arrangements. It would also give improved networking opportunities for the Procurement Officer with the representatives of WME and the other Member Authorities.

Recommendation 5

It is recommended that, as part of the new Councillor Induction Programme, a session is included to explain the Council's Energy Purchasing arrangements via the WME Joint Committee Agreement.

Council Representation on the WME Joint Committee

12. The Council is represented on the WME Joint Committee by two Cabinet Members, who are appointed by Council at its Annual Meeting following the County Council elections, for a term which covers the life of the Council (normally four years). At the current time, the appointments are historic and not aligned with the CMR who has responsibility for this area within their portfolio. Given the significant role that the Council's representatives have, the Task Group felt that one of these places should always be allocated to the relevant CMR (currently the CMR for Transformation and Commissioning) and the other allocated on the basis of knowledge and experience.

Recommendation 6

The Task Group recommends that the relevant Cabinet Member with Responsibility should be one of the Council's two Representatives on the WME Joint Committee.

Risk

13. The Task Group identified a number of risk areas resulting from being a member authority of WME, including the political risk resulting from potentially differing political ideologies; the financial risk to the Council arising from whether value for money is being achieved and the Council's Best Value duties complied with; diminishing dividends in the case of a downward trend; the risk of reliance on a few key personnel (referred to in paragraph 14) and the risk to the WME Joint Committee if a Member Authority gives notice of their intention to withdraw from the arrangement.
14. The Task Group identified that the critical business knowledge, expertise and experience within WME is held by a very small group of employees. This presents a considerable risk, should one or more of these persons no longer continue in their role, particularly as there doesn't seem to be any succession planning as such. WME's approach is where appropriate to use external Consultants to provide additional advice.
15. There are also similar issues with regard to Joint Committee Members who have been the WME representatives for many years and one of whom is the current Chairman of WME. The Chairman's knowledge and expertise of the energy sector is extensive and of considerable benefit and value to the operation of WME. At the point in the future when he should stand down from this role, this expertise would be lost to the detriment of WME and to the Council.

Recommendation 7

The Task Group recommends that the Council gains a better awareness and understanding of the risks and liabilities associated with being a Member authority in a Joint Committee and that, to this end, Internal Audit be asked to review the WME Risk Register on an annual basis.

Recommendation 8

The Task Group recommends that it is imperative that succession planning should be given a very high priority to reduce the potential risk resulting from a reliance on a limited number of key personnel and should be included as part of the Annual Business Plan.

Long Term Planning of WME

16. There is a short to medium term approach to business planning within WME and an approach to grow the business on a gradual, incremental basis. There is major potential for the development of WME and the Task Group felt that a more strategic long-term approach could reap significant rewards.

Recommendation 9

The Task Group recommends that the Council should seek to encourage the West Mercia Energy Joint Committee to develop a long-term strategic plan for WME, to provide a more stable future and one where it is able to flourish to its full potential.

Findings

West Mercia Energy Joint Committee

17. WME is a central purchasing body established in 2012, following the termination of the West Mercia Supplies Joint Agreement. It is comprised of four partners (Member Authorities): Worcestershire, Shropshire, Herefordshire and Telford and Wrekin Councils. Each have an equal 25% share in WME and two representatives on the Joint Committee, appointed by their respective Councils.
18. The role of the Joint Committee is a strategic one, with the objectives being to maintain effective, efficient and economic arrangements for the purchase and supply of energy and utilities at the request of and to the satisfaction of the Member Authorities and to other bodies which may be approved by the Joint Committee. The day to day running of the business and the implementation of any strategy agreed by the Joint Committee is delegated to the WME Director.
19. The Committee has strategic oversight of the business of WME, including the approval of the Annual Budget and Business Plan and the Purchasing Strategy. The four Member Authorities purchase all of their energy through WME, currently representing 13.4% of the WME portfolio. This Council has the largest of this share with 5% of the overall portfolio. Each of the partners receives an annual dividend in October, on the basis as set out in the Joint Committee agreement. Essentially, each Member Authority receives a dividend based on the agreed distributable surplus split by each Member Authority's contribution to the gross profit and a quarter share from external business (non-Member Authority).
20. WME has an annual turnover of £70m and is currently trading approximately 1.15 billion kWh of gas and electricity annually. The portfolio is now at 11,000 supply points with a 98% customer retention rate.
21. The initial Joint Committee Agreement ran for a fixed term until 2016, following which agreement was reached to move from this fixed-term life (extendable by agreement) to an ongoing commitment in perpetuity, with a restricted ability for a constituent authority to terminate their participation and withdraw from WME.
22. WME is not a legal entity in its own right, the legal arrangement is similar to a partnership between the 4 Member Authorities. WME has no shareholding, no property assets and the liabilities are shared equally between the 4 Member Authorities.
23. Shropshire Council administers the Joint Committee on behalf of the Member Authorities and WME has a Director and a small team of staff to run its operation. External Energy Consultants are also employed on a 3-year contract to assist in gauging and monitoring the markets.
24. Under the Joint Committee arrangement, the Council is not obliged to purchase its energy through WME, but as a member authority, it has always demonstrated its commitment by doing so.

Governance and the Council's Representation

25. The Council is represented in the WME governance structure as follows:

- (i) West Mercia Joint Committee
There are two Cabinet Members on the WME Joint Committee who are elected for a four-year term. The Committee meets twice a year, in February to approve the Annual Business Plan and September where the financial statements for the previous financial year are presented. Currently, the representatives of the Council are the Deputy Leader (who is also CMR for Adult Social Care) and the CMR for Health and Well-being.
- (ii) Chief Executive of Member Authorities
The Annual Business Plan is recommended to the Joint Committee by the Chief Executives (delegated to the S151 Officer) of the Member Authorities. The Chief Executives of the Member Authorities may recommend any material variations to the Annual Business Plan to the Joint Committee, including the acquisition of new customer markets not already referred to therein.
- (iii) The Flexible Energy Advisory Panel
The Flexible Energy Advisory Panel is made up of officers from WME as well as an officer from each of the Member Authorities. The Panel meets every 6-8 weeks and acts in an advisory capacity to the Director of WME in areas such as pricing, strategic policy formation and trading. Currently, Worcestershire is represented by the Deputy S151 Officer, the other Member Authorities representatives include procurement and energy officers.

26. The Responsibility for the Council's overall procurement functions lies within the portfolio of the CMR for Transformation and Commissioning. The Strategic Director for Commercial and Change carries out the executive role in this regard.

The Council's Current Energy Contracts

27. The Council currently has contracts for the supply of gas and electricity which were arranged through the WME third party supplier and run until March 2022 and March 2024 respectively.
28. It also has a contract for fixed price unmetered supply (UMS) for the Council's street lighting which runs until March 2022. At the request of the Council, WME used a dynamic purchasing arrangement for the first time to arrange this contract and by opting for this arrangement, considerable savings have been achieved for the Council.

Energy Markets and Trading

29. Energy purchasing is operated through a hedging strategy, with trading blocks being created through a flexible trading model. Energy prices are renowned for being volatile and unpredictable, so successfully managing energy requires close monitoring of market prices and drivers. WME has an in-house Energy Analyst who has responsibility on a daily basis to decide whether to trade or not on the energy market based on daily reports, forecasts and prices etc. in addition to a discussion with WME's Energy Consultants. The option to unset options is crucial to this process and spreads the risk, as if the market was seen to be softening, a position could be unset, and the energy re-procured.

30. The commodity element of this flexible model is traded from the start of the supply contract through to delivery. In February each year non-commodity charges (NCC) are finalised and validated by WME. The prices at which energy and services are sold are at the discretion of the Director of WME as advised by the Flexible Energy Advisory Panel. Once the capped prices are set for the year, they are later reviewed in August and December to see whether any discounts off the cap could be given.
31. There has been a significant change in focus towards green energy and supporting the zero-carbon agenda over the past year, with an increased number of customers selecting to include green electricity as part of their contract. WME has been proactive to support this move, for instance, by securing very competitive rates for REGO (Renewable Energy Guarantees of Origin scheme) backed electricity and by supporting councils by offsetting their own generation against demand. There is potential for Power Purchase Agreements to be set up with local means of generation, but this requires a long-term commitment from the customer.
32. WME anticipated a greater focus going forward for customers to seek to reduce carbon levels which, although this brings additional costs, may be increasingly viewed as acceptable and justifiable in a desire to address climate change issues. This would be driven by customers and particularly which route they choose for this journey. A recent green questionnaire issued to WME customers will help to shape the service in the future.

Business Development

33. WME has a short to medium term planning approach with a 3-year projection contained in the Business Plan. The Task Group was informed that whilst historically WME had used fixed price purchasing of energy, the volatility in the markets in recent years had meant a more flexible approach has been adopted. The vast majority of WME customers are now on variable contracts for all their energy needs, although a small number have opted for fixed deals. The arrangements in place for each of the WME customers and the agreed rates charged for their energy, are dependent on when they joined WME and the level of service they required.
34. WME offered two options for flexible procurement to enable customers to balance their desire for risk. Customers could 'trade within period (TWP)' or 'trade in advance (TIA)'. The majority of current WME customers have opted for the 'TWP' strategy. The TWP option has opened the buying window and budget certainty has been provided through a capped price. This arrangement has provided customers with budget certainty whilst also providing discounts, if the market conditions allow.
35. Recent developments have seen a new 'procurement only' service option (POSO) being started as well as trading basket options for customers. A new fixed price, fixed term Dynamic Purchasing system arrangement has also been introduced to accommodate the needs of this Council. This option is now available to other authorities to make use of.
36. The breakdown of the WME portfolio is split with roughly three-quarters on a fully managed basis (including owning Member authorities, large external customers, such as County and City Councils, and others, including Police and Fire Authorities, NHS Trusts as well as Schools and Colleges) and just under a quarter represented by large external customers on a procurement only basis.

37. The Joint Committee has supported a controlled growth of the WME portfolio. In the early years of the business, growth was achieved by a combination of direct marketing and recommendation from customers. In 2016 WME appointed a dedicated Business Development Manager to support customer retention and the acquisition of new business. The vast majority of customers have renewed their contracts once the initial contract expired.

Risk

38. WME has a cautious attitude towards risk, which is closely managed on a daily basis. Trading risk is managed through comprehensive and robust risk management policies and controls. The trading approach is essentially to seek to remove the market risk whilst at same time trying to beat the market. The Task Group received assurance that WME is only able to purchase energy if a customer is already in place for that energy, therefore significantly reducing the trading risk.

39. Once the annual capped sales price is set, the maximum level of risk that WME will take is 10% and the Director provided assurance that this could be covered by capital and the Capital Risk Fund (5%). He explained that the Capital Risk fund is in place specifically to retain a proportion of profits to cover any potential losses. Large local authorities also built up a fund in the first few years of their contract which is available for their use as required.

40. As a Member Authority, the Council continues to benefit from an annual dividend. It is noted that the dividend levels fell between 2017 and 2019 due to an agreed margin reduction programme. The dividend level for 2020 increased as a result of trading gains. The annual dividend figures received by Worcestershire County Council for the last four years are shown below:

Oct 2017	Oct 2018	Oct 2019	Oct 2020
£344,941	£249,825	£206,459	£308,268

41. The Council needs to take a view as to what intervention might be required should dividend levels reach a certain low point, taking into account the capped rate charged to service budgets.

Best Practice

42. The Government has encouraged Local Authorities to enter contracts for energy procurement with compliant buying organisations. By doing this, they can join and secure their energy needs without having to run compliance procedures.

43. Crown Commercial Services is the largest public procurement organisation in the UK. Some of the other energy procurement providers are geographically based, for instance LASER Energy in the south-east of England.

44. Customers choose different options for their energy purchasing depending on their needs at the time and the level of effort that they wish to put in. One of the key issues is whether they want flexibility to achieve best value in the short or long term or the certainty of an assured price. Some organisations employ super brokers to procure and manage competitive energy contracts on their behalf, to meet their needs.

45. The Task Group learned that it is difficult to measure how other energy procurement organisations compared or performed against WME because specific information details are not readily available as to all the conditions and requirements that are relevant on the day a contract is entered into. Only with such specific information would a fair comparison be able to be made.

Conclusion

46. Understanding the County Council's energy purchasing arrangements has been a steep learning curve for Members of the Task Group. The Council's position as a member authority within a joint committee that purchases energy, is unusual and complex. However, through the work of this Task Group, Members have increased their knowledge and understanding of the Council's commitment to the West Mercia Joint Committee Agreement.
47. Although, it wasn't possible accurately to compare market positions to establish whether these arrangements provide the lowest price for the Council, Members were reassured by the Cabinet Member with Responsibility that she was confident that the energy purchasing arrangements through WME are fit for purpose, offer value for money and are legally compliant.
48. Despite this reassurance, some concerns have remained, including the lack of knowledge and understanding of the Council's energy purchasing arrangements outside of those directly involved in the West Mercia Energy Joint Committee; the lack of scrutiny, the reliance on key individuals and the lack of succession planning and long-term vision. The Group's recommendations try to address this as well as fostering better communications and relationships.
49. It is also worth noting that, if at any point the Council decides to withdraw as a member of the Joint Committee Agreement (which is a key decision for Cabinet), in addition to the 12 months' notice required, there is an inability to withdraw whilst any 'key contract', which was negotiated whilst the Council was a member, is still live.
50. The Task Group hopes that their recommendations will help to ensure that the Council's position is safeguarded and that risks are known, understood and kept at an acceptable level.

Appendix 1 - Schedule of Activity

Date	Activity
21 August 2020	Background to the setting up of the Task Group discussed and information needs. Discussion with Strategic Director of Commercial and Change, Chief Accountant and a Senior Solicitor.
27 August 2020	Discussion with Strategic Director of Commercial and Change and the Procurement Team.
15 October 2020	Discussion with the Council's Representatives on the West Mercia Energy Joint Committee.
28 October 2020	Discussion with the Director of West Mercia Energy.
6 November 2020	Discussion with Strategic Director of Commercial and Change.
25 November 2020	Discussion of the Emerging themes with the Cabinet Member with Responsibility for Transformation and Commissioning and the Strategic Director of Commercial and Change.
15 December 2020	Task Group Meeting to discuss the draft Report.

Appendix 2 – Background Documents

- Worcestershire County Council - Cabinet reports and minutes – 27 September 2012, 21 July 2016 and 26 March 2020
- West Mercia Energy Joint Agreement – dated 20th day of June 2013
Clean conformed copy incorporating changes pursuant to the Deeds of variation of contract dated 13 February 2015, 24 July 2015, 3 January 2017 and 6 September 2018
- West Mercia Energy Business Plan and Budget 2020-21 (exempt due to commercial sensitivity)
- Economy and Environment Overview and Scrutiny Panel reports and minutes – 9 November 2019
- Corporate and Communities Overview and Scrutiny Panel reports and minutes - 10 December 2019

[All agendas and minutes are available on the Council's website here.](#)