

CABINET - SUBJECTS FOR CONSIDERATION, 13 AUGUST 2007 11:00 AM

1 New Initiatives/Policy Matters

Not Relevant

102 FIN07/003CS

Minister for Finance's Item (Michael Wright)
APPROVED

Not Relevant

102

LOCKED

13/8

BG

CABINET COVER SHEET

1. **TITLE:** ACROSS GOVERNMENT PURCHASE OF ELECTRICITY

2. **MINISTER:** MINISTER FOR FINANCE

3. **PURPOSE** To seek Cabinet approval for:

3.1 The establishment of a new three year contract with Origin Energy for the supply of both conventional and renewable electricity from 1 January 2008.

3.2 Execution of the necessary contract by the State Procurement Board.

3.3 Additional budget impacts resulting from this contract and required additional expenditure authorities.

4. **IDENTIFY THE RELEVANT GOVERNMENT POLICY AND/OR SA's STRATEGIC PLAN TARGET**

4.1 December 1999 Cabinet mandated that the procurement of energy be managed centrally by the Department for Administrative and Information Services. That responsibility has passed to the Department of Treasury and Finance.

4.2 South Australian Renewable Energy target of 20% of total electricity use from 1 January 2008.

5. **ICT COMPONENT**

Does the submission have a material ICT Component?
 Yes No

The Office of the Chief Information Officer agrees with the basis of the assessment of the ICT Component contained in this submission.

6. **RESOURCES REQUIRED FOR IMPLEMENTATION**

Additional expenditure as follows:

2007-08 -\$2.788m

2008-09 -\$5.066m

2009-10 -\$4.545m

2010-11 -\$2.006m

7. **COMMUNITY AND ENVIRONMENTAL IMPACT**

Does the submission have an impact on business?
 Yes No

8. **RISKS** The key risk is that if the government chooses to lock into a 3 year contract it may deny itself any opportunity to review its position if the market changes.
9. **CONSULTATION** Consultation has taken place with the Department of Treasury and Finance and key stakeholders.
10. **COMMUNICATION STRATEGY** Separate advice will be prepared to Agency CEs following Cabinet and State Procurement Board approvals.
11. **URGENCY** Urgent attention required from Cabinet due to short validity of offers.
12. **RECOMMENDATIONS** It is recommended that Cabinet approve:
- 12.1 The establishment of a new three-year contract with Origin Energy for the supply of both conventional and renewable electricity for government sites consuming above 160 MWh per annum.
 - 12.2 The State Procurement Board executing the necessary contract.
 - 12.3 Additional budget impacts resulting from this contract as set out at paragraph 3.11 of this submission.
 - 12.4 Additional expenditure authority to the Administered Items of the Department of Treasury and Finance of \$2.788m in 2007-08, \$5.066m in 2008-09, \$4.545m in 2009-10 and \$2.006m in 2010-11 as a result of this contract.
 - 12.5 Transfers of budgeted expenditure authority for the additional cost of conventional electricity under this contract to individual agencies, as determined by the Treasurer.

I declare that I have no actual or potential conflict of interest in relation to the proposals contained in this submission.


Kevin Foley MP
ADMINISTER FOR FINANCE

24/8/2007

TO: THE PREMIER FOR CABINET

RE: ACROSS GOVERNMENT PURCHASE OF ELECTRICITY

1. PROPOSAL

To seek Cabinet approval of:

- 1.1 The establishment of a new three year contract with Origin Energy for the supply of both conventional and renewable electricity from 1 January 2008.
- 1.2 Execution of the necessary contract by the State Procurement Board.
- 1.3 Additional budget impacts resulting from this contract and required additional expenditure authorities.

2. BACKGROUND

- 2.1 In December 1999, Cabinet mandated the central procurement of government energy requirements by the Department for Administrative and Information Services (DAIS). Since that time Contract Services, Department of Treasury and Finance (formally DAIS) has established a number of energy contracts.
- 2.2 The current government electricity contracts are summarised as follows:
 - Large Market Sites contract (above 160 MWh pa sites),
 - with AGL South Australia Pty Ltd,
 - valued at approximately \$38 million pa (GST inclusive),
 - expires on 31 December 2007;
 - General Sites contract (below 160 MWh pa sites),
 - with Origin Energy Electricity Ltd,
 - valued at approximately \$21 million pa (GST inclusive),
 - includes the purchase of 20% Green Power sourced from 100% wind generation and is valued at an additional \$285,000 pa.
 - expires on 31 December 2009; and
 - Unmetered Lighting contract (Street and Traffic Lights),
 - with AGL South Australia Pty Ltd,
 - valued at approximately \$8.5 million pa (GST inclusive),
 - includes the purchase of 20% Green Power sourced from a blend of wind, solar, bio-mass and hydro generation and is valued at an additional \$120,000 pa.
 - expires on 31 December 2009.
- 2.3 The Premier announced on 14 October 2006 that the State Government was increasing its renewable electricity target to 20% commencing from 1 January 2008.
- 2.4 On 27 November 2006, the State Procurement Board approved a Purchase Recommendation which supported the establishment of new electricity contracts to commence from 1 January 2007.

- 2.5 One contract has been awarded to Origin Energy for a three (3) year term to supply approximately 6,200 sites (consuming below 160 MWh per annum) with 86,000 MWh per annum of electricity. The second contract has been awarded to AGL for a three year term for the supply of 88,900 MWh of electricity per annum to Unmetered Assets (Street and Traffic Lights) managed by State and Local Government bodies.
- 2.6 Both of these contracts include the purchase of up to 20% of the electricity as nationally accredited renewable energy from 1 January 2008 in accordance with government policy.
- 2.7 In November 2006, following the approach to the market, the State Procurement Board also recommended that no contracts be entered into for the supply of electricity to the Government 443 sites consuming greater than 160 MWh per annum, on the basis that:
- Favourable and competitive pricing could not be provided by the respondents;
 - Market offers were not consistent with then existing price expectations and indicators; and
 - Sites in this segment were contracted until 31 December 2007, allowing the government to reapproach the market again in 2007.

3. DISCUSSION

Current Contract Pricing

Clause 7(1)(c) Business Affairs

Market Conditions

- 3.2 Unprecedented price volatility has been experienced in the national and South Australian electricity market over the last 9 months. The following issues have contributed to the higher than normal pricing:
- The impact of the drought (water restrictions impacting on the cooling capabilities of thermal plant and the availability of water to drive the hydro generators);
 - Key eastern seaboard generators restricting generation output due to planned off-season maintenance;
 - The colder than normal winter; and
 - Increasing demand for renewable energy in a constrained market.

Current Procurement Process

- 3.3 On 13 March 2007, DTF issued a Request for Tender (RFT) (Stage 1) to the market calling for the supply of electricity to South Australian Government sites from 1 January 2008. The RFT closed on 11 April 2007.
- 3.4 The Request for Quote (RFQ) (Stage 2) was released to short-listed Respondents on 3 July 2007 and closed on 25 July 2007.

Tender and Negotiation Outcomes

3.5



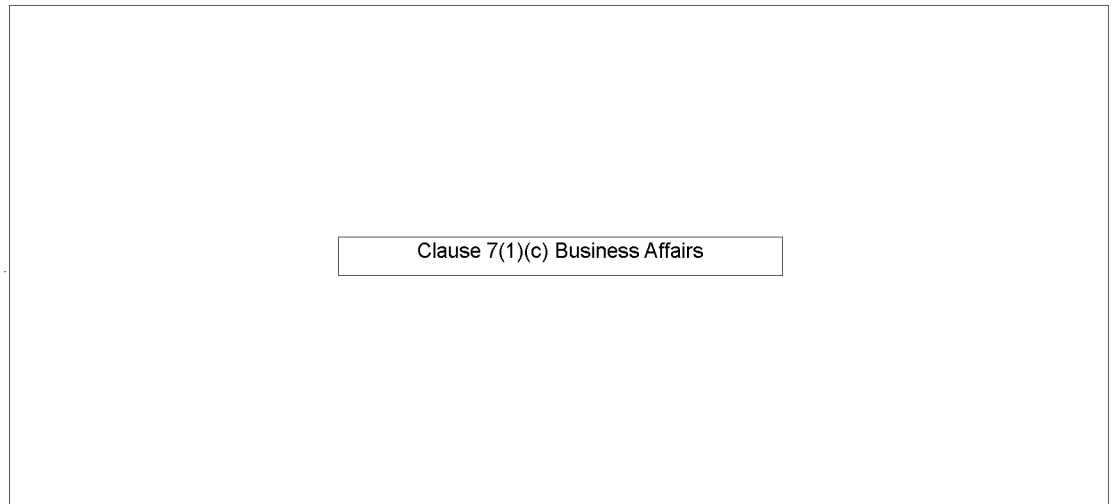
3.6

3.7 The price offers also contained very short "validity" (offer acceptance) periods, whereby price escalation for all years would occur if the offer was not accepted within 7, 14 and 21 days. The rationale for these validity escalation clauses is the need for retailers to gain additional cover (cost) for the electricity load, if a decision is made later rather than sooner. They are standard industry practice.

3.8 Subsequent negotiations with Origin led to a smoothed 3 year option being offered (prices averaged over 2008, 2009 and 2010). The revised Origin Energy offer also included a price reduction of approximately \$200,000 for the renewable energy component over the 3 years. The tight validity periods, however, remained.

3.9 The current offer negotiated with Origin Energy is valid for the first (7 days) validity period until 2:00pm Tuesday, 14 August 2007.

3.10



Contracting Options

3.11 There are three possible options available for the Government in response to the tender outcome.

- Option 1: Enter into a 1 year contract and reapproach the market in early 2008 to establish new arrangements beyond 1 January 2009.

Clause 7(1)(c)

- Option 2: Enter into a 3 year contract for supply.

Clause 7(1)(c)

- Option 3: Award no contract and issue another RFQ in the very near future (say September 2007) when market responses could possibly be more favourable.

Clause 7(1)(c)

3.15 Option 2 locks in prices for 3 years and smooths (averages) the costs for each of 2008, 2009 and 2010. This, in effect, flattens the price spike for 2008. On the downside, this option may (overall) incur a higher cost than option 1 and committing to it forgoes the opportunity to revisit the market in 2008.

3.16 On balance, given uncertainties about market conditions next year and the desire to manage the Government's risk, Option 2 is recommended. Further, whilst Option 2 provides average pricing per annum above that of the existing 18 month contract (July 2006 to December 2007) it is, however, below the initial five year Government contract (July 2001 to June 2006).

- 3.17 Based on the above, it is recommended that negotiations be finalised with the preferred tenderer to secure a three year contract combining renewable and conventional electricity with one retailer.

Economic, Financial And Budgetary Implications

- 3.18 Table 1 following shows the whole of Government budget impact which results from entering into the proposed new three year contract for conventional energy on the basis of the Origin Energy offer.

Current Budget	2007-08	2008-09	2009-10	2010-11
	\$m	\$m	\$m	\$m
Operating Expenses	10.172	20.853	21.374	10.954

Future Contract Cost	2007-08	2008-09	2009-10	2010-11
	\$m	\$m	\$m	\$m
Operating Expenses	12.960	25.919	25.919	12.960

Budget Impact	2007-08	2008-09	2009-10	2010-11
	\$m	\$m	\$m	\$m
Operating Expenses	- 2.788	- 5.066	- 4.545	- 2.006
Operating Revenue	-	-	-	-
Net Operating Balance Impact	- 2.788	- 5.066	- 4.545	- 2.006
Investing Expenditure	-	-	-	-
Less Depreciation	-	-	-	-
Net Lending Impact	- 2.788	- 5.066	- 4.545	- 2.006

- 3.19 To take account of the fact that existing agency budgets include a 2.5% indexation factor, the current budget expenses line in the table above has taken existing contract prices and escalated those by 2.5%. Therefore the net operating balance impacts shown in the above table are net of existing supplementation to agencies of 2.5% (for electricity purchases) across the forward estimates.
- 3.20 Given the significant price increase facing portfolios, it is not proposed to require agencies to absorb the resulting cost increase for conventional energy within existing budgets.
- 3.21 It is proposed that Cabinet approve additional expenditure authority to Treasury and Finance in the first instance, for the budget impact of the new contract. It is further proposed that transfers of expenditure authority to individual agencies be as approved by the Treasurer, following estimation of the additional costs to each agency.

- 3.22 The above costs are exclusive of network charges, taxes and other pass throughs. Price movements in these items have been unremarkable (essentially CPI) and are to be absorbed within agency budgets. The price premium associated with the 20% of renewable energy target is also to be absorbed by agencies, as previously approved by Cabinet (this premium amounts to \$9m over the period of the contract).
- 3.23 The budget impacts presented here do not take account of any increase above the current 20% renewable energy target.
- 3.24 It is not expected that this project will have any staffing impact.
- 3.25 The key risk is that if the government chooses to lock into a 3 year contract it may deny itself any opportunity to review its position if the market changes over that term. However, as discussed above, this must be balanced against the risk that conditions could also worsen over that same period and the clear price smoothing advantages of the 3 year contract.
- 3.26 There has been consultation with the State Procurement Board, DTEI and Treasury and Finance.

4. RECOMMENDATIONS

It is recommended that Cabinet approve:

- 4.1 The establishment of a new three-year contract with Origin Energy Ltd for the supply of both conventional and renewable electricity for government sites consuming above 160 MWh per annum.
- 4.2 The State Procurement Board executing the necessary contract.
- 4.3 Additional budget impacts resulting from this contract as set out at paragraph 3.11 of this submission.
- 4.4 Additional expenditure authority to the Administered Items of the Department of Treasury and Finance of \$2.788m in 2007-08, \$5.066m in 2008-09, \$4.545m in 2009-10 and \$2.006m in 2010-11 as a result of this contract.
- 4.5 Transfers of budgeted expenditure authority for the additional cost of conventional electricity under this contract to individual agencies, as determined by the Treasurer.


Kevin Foley MP
A/MINISTER FOR FINANCE

10/8/2007

In Cabinet

13 AUG 2007

