



THE SCOTTISH OFFICE

NHS
MEL(1993)83

National Health Service in Scotland
Management Executive

St. Andrew's House
Edinburgh EH1 3DG

Dear Colleague

**PRIVATE FINANCE: CONTRACT ENERGY
MANAGEMENT**

Summary

1. This letter introduces Guidelines for Contract Energy Management (CEM).
2. The Guidelines have been compiled by the Treasury and the Energy Efficiency Office of the Department of the Environment and outline how the procedures to be followed for employing CEM in the public sector have been simplified. They also explain how investment, which the private sector undertakes, no longer leads to possible offsets for spending allocations.
3. Annex A of the Guidelines gives examples of CEM. There is no single form of CEM contract and the options for CEM are open to interpretation as long as the financing and management of the investment meets the criteria laid down in the Guidelines.

Action

4. Chief Executives and others with responsibility for the efficient management of the Estate and the achievement of the national energy targets as set out in EPM(92)2, and the Management Executive's Management Plan, are invited to re-examine the scope for contracting out energy management, through taking advantage of private finance in accordance with the Guidelines.

Background

5. Changes to the approval criteria for the use of private finance (formerly known as unconventional finance) were announced by the Government on 12 November 1992 and details were issued to the Service in MEL(1993)26, issued on 4 March 1993. That letter provided details on how the new policy was to be developed and implemented in the NHS in Scotland.

17 June 1993

Addressees

For action:
General Managers,
Health Boards

General Manager,
Common Services Agency

General Manager
State Hospital

Chief Executives,
NHS Trusts

Unit General Managers

For information:
Director of Finance:
Health Boards, Units,
CSA, State Hospital,
NHS Trusts

General Manager
Health Education Board
for Scotland

Enquiries to:

Mr J C McLuckie
NHS in Scotland
Management Executive
Room 370
St Andrew's House
EDINBURGH EH1 3DG

Tel: 031-244 2080
Fax: 031-244 2323

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6. For the sake of clarity the Guidelines for CEM as published are attached in their entirety. However, in Scotland the contact referred to in paragraph 8 is:-

Mr J Robertson
Regional Energy Efficiency Office in Scotland
Room 6/48
New St Andrew's House
Edinburgh
EH1 3TG

Telephone No: 031-244 4665
Fax No: 031-244 4785

7. Paragraph 11 of the CEM Guidelines provides a contact point for Public Sector Bodies in England. In Scotland all enquiries should be made to Mr McLuckie.

8. Finally, you will wish to note that the Management Executive may from time to time make enquiries on the usefulness of the Guidelines and the impact they have had on energy management and the efficient use of resources.

Yours sincerely



H R McCALLUM
Director of Estates

Guidelines for Contract Energy Management in the Public Sector

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Energy Efficiency Office
DEPARTMENT OF THE ENVIRONMENT



FOREWORD

The procedures to be followed before employing Contract Energy Management (CEM) in the public sector have been simplified. In particular, the investment which the private sector undertakes should no longer lead to possible offsets from spending allocations. The need to consult the Treasury will be reduced accordingly. The changes result from the moves to enable the public and private sectors to work together more effectively which the Chancellor of the Exchequer announced in his Autumn Statement on 12 November 1992.

This paper sets out the revised guidelines and we are pleased to have this opportunity to welcome them. Contract Energy Management has an important part to play in enabling the public sector to meet its energy saving targets and to contribute to the UK's national programme for limiting emissions of greenhouse gases.

We hope these new simplified guidelines will encourage Departments to re-examine the scope for contracting out their energy management.

A handwritten signature in black ink, appearing to read 'Stephen Dorrell'.

Stephen Dorrell MP
Financial Secretary
to the Treasury

A handwritten signature in black ink, appearing to read 'The Lord Strathclyde'.

The Lord Strathclyde
Parliamentary Under Secretary of
State for the Environment

CONTRACT ENERGY MANAGEMENT IN GOVERNMENT DEPARTMENTS

Note by the Department of the Environment and the Treasury

1. Energy efficiency in Government Departments remains a key objective in the wider effort to promote energy efficiency in the public sector. Departments should continue to re-examine their arrangements for managing the use of energy, including the scope for increasing the rate of take-up of cost-effective measures through contracting out. Contract Energy Management (CEM) was identified by the Chancellor of the Exchequer as one of the areas to benefit under the private finance initiative announced in his Autumn Statement of 12 November 1992. This note provides guidance to Departments on the use of contractors for energy management, and supersedes all previous guidance on the subject.

Options for Energy Management

2. Effective campaigns to improve energy management within a Department will normally require a combination of improved management and good housekeeping, together with investment in new equipment. There are three main approaches to financing and managing such investment:

i) the investment is financed directly by the Department, and new equipment is operated by their own staff;

ii) the investment is financed directly by the Department, but the operation and management of new equipment (and sometimes its specification and installation) is contracted out to private consultants;

iii) some or all of the investment and its operation are financed by outside contractors; for example, under shared savings contracts whereby the outside contractor undertakes an energy survey, finances, installs and maintains the necessary equipment. The outside contractor recoups the cost through a share in the subsequent savings in the Department's energy bill.

Both (ii) and (iii) above are examples of contracted out energy management; (iii) is often referred to as Contract Energy Management (CEM). The term CEM is used in the rest of this paper to refer to all contracts involving some investment in equipment by the contractor.

3. To be confident that it is obtaining best value for money, before committing itself to a particular course a Department should explore a range of valid alternatives, comparing these to the base case for what is expected to happen to the Department's energy use and expenditure on present trends and plans. Departments should consider contracting out to the private sector wherever it is cost effective to do so and where this represents sound management. In any examination of alternatives, Departments should ensure that CEM options are treated on equal terms to other options. In particular, account should be taken of the effect on the net present value of alternative options of timing differences as a result of capital availability. The potential advantages and disadvantages of taking the CEM route are described in Annex A.

4. The options should be compared using standard investment appraisal techniques as described in the Treasury's investment appraisal guidance ("Economic Appraisal in Central Government: A Technical Guide for Government Departments, April 1991, ISBN 0 11 560034 5"). Comparisons should be made with publicly financed provision if this is a realistic alternative on a similar timescale, excluding, for example, cases which would in practice be impossible owing to limited availability of specialised personnel. Proper account must be taken of the risks of cost or time overruns, or performance shortfalls, and of whether these risks are borne by the Department or the contractors. In many cases the speed of energy efficiency improvement will vary between the options.

5. When considering contracting out options, including CEM, Departments should seek more than one tender (see the Central Unit on Purchasing Guidance Note No. 34 "Market Testing and Buying In" and "Public Purchasing Policy: Consolidated Guidelines"; help is also available from Departments' internal purchasing and supply specialists). Multiple tenderers may be unwilling to incur heavy pre-tender expenditure, since they know that only one of them can win the contract. In such cases it may be necessary for the Department to consider reducing the amount of unremunerated work which tenderers need to undertake.

Public Expenditure Treatment

6. The choice between options should be based on considerations of value for money established through investment appraisal. Adjustments to Departmental spending allocations will no longer need to be considered in respect of the capital cost of equipment installed, provided the great majority of the risk stays with the private sector.

This will be the case, for example, when the outside supplier recoups costs through a share in subsequent savings. The new arrangements have been introduced following the private finance initiative announced by the Chancellor of the Exchequer in the 1992 Autumn Statement. Departments may wish to refer to the interim guidance on the initiative published by the Treasury on 9 December 1992.

Monitoring and Approval of CEM Schemes

7. The Treasury will seek information from Departments from time to time on progress on Contract Energy Management as part of its monitoring of the private sector finance initiative. Formal approval for projects will only be required where the cost is expected to exceed a Department's relevant delegated authority.

Role of the Energy Efficiency Office (EEO)

8. The examination and appraisal of options to improve value for money through energy efficiency is the responsibility of individual Departments. However, to assist Departments, the EEO within the Department of the Environment stands ready to offer further help and guidance. It :

(i) can act as a channel through which the experiences of lead departments are disseminated to others; it would therefore be helpful if Departments informed the EEO of CEM arrangements that are entered into;

(ii) can take up with the CEM industry generic issues, affecting more than one Department, where some form of co-ordinated agreement or guidance would be helpful.

9. Departments should also refer to the EEO-sponsored comprehensive Applications Manual on CEM (AM6), published by the Chartered Institution of Building Services Engineers (CIBSE), and available from the Institution at Delta House, 222 Balham High Road, London SW12 9BS. This provides clear guidance to all considering CEM for their organisation.

Other Public Sector Bodies

10. Departments will also wish to promote a similar approach to energy efficiency in other parts of the public sector (for example, the National Health Service, NDPBs, Nationalised Industries) for which they are responsible.

11. Any queries should be directed to Colin Main (EEO, Tel: 071-238 3569) or to your usual expenditure contact in the Treasury on public expenditure aspects.

February 1993

ADVANTAGES AND DISADVANTAGES OF CONTRACT ENERGY MANAGEMENT

1. There is no single form of CEM contract. However, one common type of contract is structured so that the contractor guarantees an immediate saving of say 2-3% on the client's base year energy bill. Savings beyond this up to a given percentage then go to the contractor to cover the capital cost of new equipment, operating costs and a return on his investment. Any further savings are then split in an agreed proportion between the client and the contractor. At the end of the contract the hardware generally becomes the property of the client who then benefits from all further savings. Staffing arrangements vary: often the CEM company is involved in monitoring the equipment and in motivating the staff in the client organisation who will then be equipped to operate the new system at the end of the contract. This sort of contract will usually only be viable for premises or sites with energy bill of around £150,000 per annum or greater.

2. An alternative is where the contractor tenders for the maintenance of plant and/or buildings combined with provision of specified energy services (eg, to meet heat and electrical loads spelt out in the contract) for an annual fee, which is typically fixed below the level of the client's current and projected expenditure on fuel and maintenance. How the contractor achieves the necessary improvement in efficiency to enable him to supply this service profitably, including the contribution to be made from investment in new plant, is then a matter for him. (Energy Inclusive Maintenance Contracts).

3. There are therefore a number of advantages in using CEM:

- (i) Risks of cost or time overruns, or performance shortfalls, are borne by the contractor. It is important to ensure, when drawing up the CEM contract, that there is no lack of clarity over the extent to which these risks are in fact transferred. The weight to be attached to this factor will be influenced by the extent to which the public sector body has the necessary technical expertise and by any experience of cost or time overruns and performance shortfalls on similar projects undertaken in the past.
- (ii) The public sector client makes guaranteed savings right from the start.
- (iii) The structure of the contract ensures that both sides have clear incentives to work towards improving energy efficiency and achieving further savings throughout the life of the contract.

4. On the other hand:

- (i) the work could perhaps be done more cost-effectively in-house with all the savings, rather than just a proportion, going to the public sector body;
- (ii) the type of equipment installed and procedures implemented will be those giving the best commercial return on investment over the contract period; where it would be appropriate to adopt a longer term view equivalent or greater savings may be achieved by ensuring that the public sector client retains ownership of the equipment and

investment, but contracts out maintenance and operation with a contract designed to achieve more efficient operation than at present.