ARGYLL AND BUTE COUNCIL   **POLICY & RESOURCES COMMITTEE**

CUSTOMER SERVICES   **19 OCTOBER 2017**

MICROSOFT LICENSING COSTS

1   EXECUTIVE SUMMARY

1.1   The Council uses Microsoft software extensively across all services and departments. This report focuses on changes to the corporate Enterprise Agreement (EA) only, excluding Education which has much more favourable licensing terms. Expert licensing advisors, Insight, were engaged to recommend the best way given recent significant price increases. They recommended not renewing the EA at the end of May 2017 and instead continuing to use the licences currently owned. The plan, based on the Microsoft release roadmap, is to buy new licences in line with expected upgrades from 2020 onwards. The report makes recommendations on how we could afford to buy new licences in future years through building up savings over the next 3 years as earmarked reserves. This would have the advantage of avoiding a future cost pressure in 2021/22 through 2022/23. It also retains flexibility should there be significant further pricing changes or alternative new products brought to market.

1.2   The recommendations are:

- Policy & Resources Committee is asked to note that the Council's corporate body no longer operates an Enterprise Agreement with Microsoft with effect from 1 June 2017 and that savings of £208k are anticipated for 2017-18, £222k in 2018-19 and £264k in 2019-20 as a result. The Committee note that these savings will be required in future years in order to fund upgrades to the latest versions of software from 2020 onwards.

- Policy & Resources Committee approves the retention of the savings in 2017-18, 2018-19 and 2019-20 as earmarked reserves to be used to fund the expected additional costs of Microsoft software in 2020-21 to 2022-23 as this will smooth the annual budgetary requirement.

- Policy & Resources Committee notes that the ICT Service will keep the plan for Microsoft software licensing under annual review.

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2.   INTRODUCTION

2.1   The Council uses Microsoft software extensively across all services and departments and is licensed to do so under the terms of our corporate and education Microsoft Enterprise Agreements (EA). This report focuses on changes to the corporate EA only – there are no corresponding changes to the Education agreement. The latest corporate agreement expired on 31st May 2017 and was not renewed at that date because it was no longer affordable.

2.2   Until now the EA has been renewed every three years and this has allowed the Council to continually upgrade the software it owns and take advantage of the latest Microsoft technologies such as Lync/Skype for Business, SharePoint and Windows 10.

2.3   Prior to the end of the latest agreement, Microsoft announced significant changes to their licensing model and the pricing for their software. They recently removed UK Government discounts from their pricing strategy and applied a separate 22% increase to UK and EU pricing to reflect the recent fall in value of the pound and euro against the dollar. The Microsoft strategy is to direct customers away from perpetual licensing where customers pay for a software asset over the course of a three year EA, towards a subscription based software rental agreement where customers are locked into paying continual monthly or annual fees.

2.4   The net effect of all of the changes is that the traditional method of purchasing Microsoft software assets over a three year term and owning them outright is no longer affordable.

2.5   The ICT Service engaged with Insight, the world's largest Microsoft reseller, to carry out an independent Licensing Consultancy Service (LCS) and to advise the Council on how best to licence our Microsoft estate over the next seven years. The Council also consulted with Gartner analysts to better understand Microsoft's future pricing strategy and Gartner say MS are being driven by investors who are applying pressure to the business to provide growth on revenues. Such growth is more easily repeated and maintained for Cloud based subscription services rather than via sales of perpetual licences.

2.6 This report looks at the outputs from the LCS, the implications of Microsoft's pricing strategy, and the purchasing arrangements available to the Council, and recommends the most affordable and practical way forward to allow us to continue to afford to use Microsoft Software to help conduct our business with minimum or no disruption to services.

3.0 RECOMMENDATIONS

3.1 Policy & Resources Committee is asked to note that the Council's corporate body no longer operates an Enterprise Agreement with Microsoft with effect from 1 June 2017 and that savings of £208k are anticipated for 2017-18, and £222k in 2018-19 and £264k in 2019-20 as a result. The Committee notes that these savings will be required in future years in order to fund upgrades to the latest versions of software from 2020 onwards.

3.2 Policy & Resources Committee approves the retention of the savings in 2017-18, 2018-19 and 2019-20 as earmarked reserves to be used to fund the expected additional costs of Microsoft software in 2020-21 to 2022-23 as this will smooth the annual budgetary requirement.

3.3 Policy & Resources Committee notes that the ICT Service will keep the plan for Microsoft software licensing under annual review.

3.0 DETAIL

3.1 The Council's Microsoft Enterprise Agreement has traditionally been based around "on premise" solutions where a range of Microsoft systems such as Skype for Business, Exchange and Office were purchased and owned by the Council using perpetual licences and were hosted and operated from the Council's IT Centres and desktop PCs. The Council paid Microsoft for each licence and software assurance over a three year period which allowed us to maintain and update software then own the current versions of each EA included product at the end of the agreement. As an example, our latest EA started in June 2014 and ended in May 2017. The EA included 1741 Office Professional licences and client access licences (cals) for core systems which were paid for over the three years. As well as allowing the Council to maintain regular security fixes and patches for the current estate, this meant we owned and were entitled to use the latest 2016 version of Office and other systems by the end of the EA term. The fee per desktop averaged £342 over the three year EA term (£114 per annum) against an undiscounted non EA standard price for Office, Windows 10 and the core cals of £740.

3.2 At the conclusion of each EA the Council has retained the right to decide to stick with current versions of the software we use or contract for a further three years and benefit from the new releases available during that period. Customers could also withdraw from the EA environment (take an EA holiday) until such times as they were ready to move to the next versions – this option has not been favoured previously because it resulted in the loss of the CCS discounts when customers eventually signed up to a new agreement. The Council's preference, until now, has been to subscribe to a new agreement and sign-up to use the very latest "on premise" versions of Microsoft's software released during the new EA term. The Council retained the right to decide which option suited it best because it owned

the software outright at the conclusion of each EA. As services migrated and upgraded to numerous new versions of Microsoft software over the past years (Windows, Office, Lync/Skype for Business, Exchange and SharePoint), this meant they could use whichever version suited the Council and its departmental application suppliers at any particular time rather than be tied to a Cloud based subscription service using only the very latest version of Microsoft's products. In the main all Argyll and Bute users are dependent on Microsoft Office technologies and there is a lot of interdependency with required 3rd party applications. Many of these applications are only compatible with certain versions of Microsoft software.

3.3 Microsoft are encouraging customers to move away from "on-premise" solutions and perpetual licences in order to maximise revenue streams through continual subscriptions – i.e. they don't want customers to take an "EA holiday" and stop paying for their software. Their strategy over recent years has been to concentrate development on Cloud based solutions which carry an ongoing subscription i.e. the customer will never own the software but will continue to pay a monthly or annual subscription to use it. This is a major change for those organisations who have traditionally paid to own assets at the end of each agreement. Gartner say this is being driven by investors who are putting pressure on Microsoft to provide growth on revenues for Cloud services. The Cloud subscription model delivers much benefit to Microsoft as it locks users in and the cost of moving to another platform becomes cost prohibitive. This means that users have less leverage in negotiating prices and there is less pressure on Microsoft to offer discounts.

3.4 Our last EA was purchased under the Crown Commercial Service (CCS) purchasing framework which allowed all UK public sector organisations to buy Microsoft software at heavily discounted rates. This framework has been replaced with a much more expensive Cloud Transition Agreement (CTA) and UK Public Sector EA subscribers are offered lesser discounts to move from "on-premise" based agreements to the Cloud based services over a three to five year period. CCS handle pricing negotiations with Microsoft on behalf of the public sector. Their leverage in negotiation is dependent on more of the UK public sector using Microsoft's competitor products such as Google or open source platforms but very few have followed these routes. As more businesses grow to depend even more on Microsoft products it follows that they maximise the potential for "lock in". The global price list for Microsoft Office has not increased at all for the last 7 years. However, the perpetual licence discounts negotiated by CCS reduced significantly in 2012 and 2016 and, along with currency movements, has resulted in significant price increases for the UK public sector. Price increases for core Office licences may go up again as Microsoft try to drive more customers to the Cloud, but this is likely to be aligned to the release of new products – e.g. the next major release of Skype for Business is expected in late 2018.

3.5 Office 365 is Microsoft's Cloud based version of Office. It has had two global price reductions in 2012/13 – reducing by c 35% - in order to encourage take-up. Uptake started to increase really from April 2014 but the rate of uptake has been slower than expected in the UK. The last price increase was in August 2014. Increases since then have been limited to currency rate changes. Other price changes have been related to re-bundling the different licence packages available. According to Gartner, the trend appears to be for Microsoft to attempt to buy market share by offering relatively low prices, gain dominance, and then push prices up. European organisations have been slower to move to the Cloud than US organisations and this

is partly because they are more discerning and open to considering alternatives. Therefore Microsoft has lowered the price differential between US and European prices and Microsoft has been incentivising European organisations more strongly to move to the Cloud. At some point this differential will be removed and so European prices are expected to increase faster than US prices for Cloud services in the future.

3.6 In the UK Microsoft has bought into UK data centres in the last 12 months in order to drive UK uptake faster. A lot of users with perpetual Enterprise Agreement licences shifted to subscription licences from 2012 onwards – these are still "on premise" licences rather than cloud licences. Such users are more readily shifted to the Cloud where all licences are subscription based as the costs will be comparable.

3.7 The CTA and associated offers from Microsoft have been considered as part of an independent Licensing Consultancy Service from software reseller Insight Ltd., which concluded with a report and recommendation that the Council does not fully subscribe to the new CTA service. The previous annual commitment to the EA for 1741 users cost the Council £200k. This was expected to rise due to an increased dependency on Microsoft SQL databases and an increase in the number of corporate desktops since our last declaration to Microsoft. This was reflected in the £127k net cost pressure previously agreed by the Council and an annual budget of £327k is now available. However the LCS analysis showed the cost under the CTA to renew the EA with perpetual licences after factoring in a future deployment of Office 365, would increase significantly to £2.3m over the 3 years from 2017/18. Adding in years 4-7 would increase the Council's commitment by a further £2.5m and a total of £4.8m over the 7 year term.

3.8 Against a revised 7 year budget of £2.289m (£327k per annum) this became the unaffordable "Control Option" and the Insight LCS has considered all of the alternative options available to the Council to minimise the impact of these significant price rises.

3.9 Having established that the Control Option was too expensive, the Insight LCS looked at the overall costs to the Council, application software and network dependencies, and Microsoft's release roadmap over the next seven years to try to determine the maximum time available to the Council for an EA holiday before it would be necessary to subscribe to the next EA. The objective was to find the most cost effective solution, maximise the use of existing licences, and re-establish an EA at a time when the major releases are expected to benefit the Council.

3.10 With Microsoft perpetual licences for most systems already in place there is no immediate technical need to migrate on premise systems to the Cloud. The Council maintains excellent data centre facilities and operates a data network where all traffic is routed back to those data centres. For the next few years, at least, the Council is well placed to continue primarily with on premise Microsoft services. The Microsoft roadmap shows a significant upgrade is expected to Skype For Business in 2018 but the next major upgrade to Office is not expected until 2020. On this basis the LCS concluded that it is in the Council's best interests to take an EA holiday for the next three years and plan to buy back in and gradually transition to the latest version of Office from 2020 onwards.

3.11 At the conclusion of the EA in May 2017 ICT Management took a decision to purchase 250 Office 365 subscriptions which is the minimum level available from

the CTA . This increased the Council's total licence count and helped to meet the shortfall in licences currently in use. It also locked in CTA prices for future purchases. Further work has now been completed with Insight to find a suitable affordable option and the costs of this option can be contained within current budget levels. Full details of the costs are contained within Appendix 1 but a summary of the revised financial position is reflected in the table below:

Microsoft Software Costs	Years 1-3 2017-2019	Years 4-7 2020-2023	Years 1-7 Total
Current Budget	£0.981m	£1.308m	£2.289m
Control Option	£2.308m	£2.501m	£4.809m
Preferred Option	£0.287m	£1.957m	£2.244m

3.12 In essence the Council will take an EA holiday but maintain a commitment with Microsoft for SQL server licences, Exchange, and 250 x Office 365 licences for the next three years. This will cost a total of £0.287m between 2017 and 2019. In 2020 the Council will subscribe again to an EA covering the core cals and the latest Skype for Business platform. By 2021 we will add further licences for Office 2020 to be paid over the following three years. The total cost over the 7 year term is £2.244m against a revised budget of £2.289m. All additional devices above the current licensed estate will require the full undiscounted suite of Microsoft software at a one-off cost of £740 per device and departments will be asked to meet these costs directly. In order to pay for the variable costs for the current estate over the 7 year period the budget not required from 2017-18, 18-19 and 19-20 should be retained as earmarked reserves to meet the significant increases from 2020-21 onwards. At this stage the advice from Insight and Gartner is that we may be able to repeat the process from 2024 onwards but they are not prepared to speculate about market conditions beyond the next 7 years.

3.13 Although the cost of Microsoft software has increased significantly recently, the recommended option maintains costs within existing budget levels. The approach provides flexibility, and if numbers of staff reduce, we are able to reduce the number of licences and associated costs commensurately before buying back in. Insight have guided the Council through a very complex licensing environment. The Council will need to keep this plan under annual review. In addition Insight recommend another LCS foundation service is utilised towards the end of the 7 year term to help determine the best approach at that time.

4.0 IMPLICATIONS

4.1 Policy: The Council has exited the corporate Microsoft Enterprise Agreement. Software will be maintained at 2016 release levels over the next three years.

4.2 Financial: Within existing budgeted resources.

4.3 Legal: Aims to ensure compliance with all relevant legislation.

4.4 HR: None.

4.5 Equalities: None.

4.6   Risk: Manages ICT security risks by ensuring software
                             assurance is available on main applications

4.7   Customer Service: The Council will upgrade and maintain user software
                             at 2016 release levels

Appendices

1   Costs for Recommended Option for Microsoft Software 2017-2023

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16 August 2017

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Appendix 1: Microsoft Enterprise Agreement: Pricing of recommended option 2017 to 2023

Item	Price	2016/17 Units	£	2017/18 Units	£	2018/19 Units	£	2019/20 Units	£	2020/21 Units	£	2021/22 Units	£	2022/23 Units	£	2023/2024 Units	£
EA Desktop																	
Windows Enterprise Device L&SA	32.32			84	2,714.88												
CoreCAL User L&SA	90.32									1698	153,363.36	1698	153,363.36	1698	153,363.36		
SkypePlusCAL User L&SA	45.12									1698	76,613.76	1698	76,613.76	1698	76,613.76		
Office Professional Plus Device L&SA	126.09			84	10,591.56												
EA Server																	
Exchange Enterprise CAL L&SA	29.28									1698	49,717.44	1698	49,717.44	1698	49,717.44		
Skype for Business Enterprise CAL L&SA	52.96									1698	89,926.08	1698	89,926.08	1698	89,926.08		
MPSA																	
Exchange Server Standard Server L&SA	765.98	6	4,595.88														
Exchange Server Standard Server SA	109.44							6	656.64	6	656.64	6	656.64	6	656.64	6	656.64
Exchange Server Enterprise Server L&SA	4,384.08	4	17,536.32														
Exchange Server Enterprise Server SA	626.28							4	2,505.12	4	2,505.12	4	2,505.12	4	2,505.12	4	2,505.12
Visio Standard Device L&SA	298.12			2	198.75	2	198.75	2	198.75								
Skype for Business server Server L&SA	2,254.68									6	13,528.08						
Office Professional Plus Device L only	314.28											550	172,854.00	550	172,854.00	598	187,939.44
SQL Server Enterprise Core L&SA	14,880.48	16	79,362.56	16	79,362.56	16	79,362.56										
SQL Server Enterprise Core SA	2,125.80							16	34,012.80	16	34,012.80	16	34,012.80	16	34,012.80	16	34,012.80
Office 365																	
Office 365 E3 CTA User Subs	103.08			250	25,770.00	250	25,770.00	250	25,770.00								
Office 365 E3 Govt User Subs	152.52									250	38,130.00	250	38,130.00	250	38,130.00	250	38,130.00
TOTALS			101,494.76		118,637.75		105,331.31		63,143.31		458,453.28		617,779.20		617,779.20		263,244.00
Base Budget					327,000.00		327,000.00		327,000.00		327,000.00		327,000.00		327,000.00		327,000.00
To/from earmarking					208,362.25		221,668.69		263,856.69	-	131,453.28	-	290,779.20	-	290,779.20		63,756.00
Projected balance in earmarked reserves					208,362.25		430,030.95		693,887.64		562,434.36		271,655.16	-	19,124.04		44,631.96
				Total costs for 2017/20				287,112.36		Total costs for 2020/24						1,957,255.68
										Grand total 2017/24						2,244,368.04

Notes:

Assumes we buy a new EA for a 3 year period from 2020/21 to 2022/23 and then take a holiday again - based on new Skype software being released in 2018

Assumes we buy 1950 new Office Professional Plus licences on a phased basis over 3 years from 2021/22 based on new Office software being released in 2020

A number of MPSA items were purchased in March 2017 and these costs were accommodated within 2016/17 budgets.