

## Taking Advantage of Lower Electric Rates for your Government Agency

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We have all witnessed, in various ways and to varying degrees, the significant drop in energy prices since they peaked in the summer of 2008. Among other impacts of lower market prices for energy, many local government officials have been recently approached by electric power suppliers and brokers offering electric supply contracts, simply by “signing-up” with their firm. This article provides background about the changes in energy markets and offers insights and advice about how to conduct a successful procurement process that can, given individual circumstances, result in energy cost savings.

**About Electric Bills:** Individual public electric utility bills have many elements that fall into one of two general categories: 1) delivery service; and 2) power supply. *Delivery service* constitutes the utility’s cost of building, operating and maintaining its distribution network and maintaining its metering, billing and customer service functions. *Power supply* constitutes the cost of building, operating and maintaining electric power generating plants, including the cost of fuel burned in those power plants, as well as the cost of the high-voltage, interstate transmission grid.

Delivery service is always provided by your local electric utility and is fully regulated by the New Jersey Board of Public Utilities. Power supply is obtained from the electric utility under the BPU Basic Generation Service (BGS) tariffs or, obtained from a competitive third party supplier (TPS) under the State’s “retail choice” program. Retail choice is a program that permits electricity users to contract with a TPS to obtain power supply that is delivered over the utility’s distribution grid.

The vast majority of local government contracting unit electric accounts (municipal buildings, libraries, schools, police headquarters, etc.) receive electric service at voltage levels and power levels that makes them eligible for their utility’s BGS-Fixed Price (FP) tariff. Under the BPU program, the BGS-FP tariff price(s) is set annually, and as part of a policy to minimize spikes, reflects the average of staggered, 3-year wholesale supply contracts. Because the BGS-FP tariff price in any given year is based upon contracts signed from several months to several years prior, the tariff price tends to lag behind market prices.

For most of the decade preceding the summer of 2008, as market prices rose rather steadily, tariff prices for power supply were consistently lower than market prices. This meant that third party suppliers were largely unable to offer contracts that could compete with the utility BGS-FP tariff price.

That has changed with the recession-driven drop in market prices over the past two years. Many third party suppliers are now able to offer contract prices for power supply below the utility's tariff prices. and are aggressively pursuing the small-to-mid-size electric account market, which includes municipalities, boards of education, counties, and local authorities. Unfortunately, some TPS or brokers are not familiar with public procurement laws and may be offering public officials services in ways not permitted under the relevant public contracting laws.

**The Power Supply Question:** So what is a local official to do when approached by third party suppliers with contract offers that promise, and in some cases may be able to deliver eye-popping savings? The answer is to step back and review the things to take into consideration when looking to reduce electric costs.

**How to Procure Electricity:** First, it is important to emphasize that procurement of power supply *must* be consistent with the Local Public Contracts Law (LPCL) or for boards of education, the Public School Contracts Law (PSCL). Bottom line: When the estimated amount of spending for *power supply* is above the contracting unit's bid threshold, power supply must be publicly bid or purchased subject to an exception to the bid law.

Under both the LPCL and PSCL, power purchases from regulated public utilities using their BGS-FP tariff are exempt from bidding. And while there are several other public bidding exemptions on the books applicable to unique electricity scenarios, *none* of these are applicable to purchasing retail supply from a TPS; meaning that procuring power supply from a TPS (directly or through a broker) requires a public bid. Moreover for electric accounts of any size at all that would warrant attention from a third party supplier, the contract value will be above the bid threshold.

There is also the time and cost effort of preparing bid specifications and conducting a bidding process. This can be a time-consuming and possibly labor intensive process. Contracting agency officials should carefully consider all these considerations in determining if they should proceed with a public bid or stick with the BGS-FP tariff.

If the decision is made to publicly bid power supply, the next important matter is to consider whether to go out to bid as a single agency for your accounts, or whether to join together or ‘aggregate’ with fellow agencies or other government contracting units through a cooperative purchasing arrangement.

Aggregating demand for power supply purchasing is a particularly important consideration. When responding to a public bid, a supplier can incur significant administrative and other ‘transaction’ costs in preparing a price offer and contracting to serve government accounts. While electric accounts surely seem to most local officials to take a significant bite out of their budget, in the universe that most electric suppliers operate the typical contracting unit electric account is quite small. It is therefore often helpful to have one or more, large ‘anchor’ accounts, or a large number of small-to-mid sized accounts, to spread-out the suppliers’ relatively high transaction costs and attract as many suppliers as possible that will compete for your business. Under the LPCL and PSCL, this can be accommodated by power supply cooperative purchasing agreements between government contracting units: municipalities, counties, local authorities, and boards of education (N.J.A.C. 5:34-7.1 et seq.).

There are many recent examples of contracting units successfully banding together to form a large aggregation group that offers an attractive and biddable electric load and achieves electricity cost savings for participants. A critical component of a successful aggregation group is to have a strong, well-organized and trusted Lead Agency that will be empowered to make decisions on participants’ behalf.

The key element to a successful procurement is to design and implement a bidding process that attempts to maximize bidder participation and drives down the bid price as low as possible.

As space limitations prevent going into full detail on each bidding element, the authors have prepared a document that explains the relevant challenges and potential process solutions in more detail. That document also reviews other concepts for local government units to explore energy cost reductions such as financing and implementation of energy efficiency measures and renewable energy projects. Our [““Overview of Local Unit Power Supply Bidding Practices””](#) may be found on the Division of Local Government Services’ website.

In summary, these elements are as follows:

***Gathering and Providing Suppliers Accurate Information:*** While seemingly a simple task, in practice this step can be quite challenging, particularly when there is a large number of electric accounts

involved. Accounts can be eliminated, account numbers can be changed by the utility, and transposition errors can be made in re-typing account numbers. It is critical to assure that each agency provide an accurate and current list of account numbers.

***Developing an accurate estimate of the 'price-to-compare':*** In order to evaluate and assess bid prices, it is vital to understand how bid prices should be benchmarked. The power supply component is the only relevant portion of the utility bill for the purpose of evaluating bids, as the delivery charge will remain the same regardless of whether you purchase supply from the utility or a third party supplier. The average power supply price can vary fairly significantly depending upon the usage profile of the account(s). It is therefore important to model your account(s) usage profiles in detail against utility tariff prices in order to develop an accurate 'price-to-compare.'

***Drafting bid specifications and contract terms:*** There are a number of third party suppliers competing in the New Jersey retail market. In private sector supply deals, these suppliers negotiate with customers, and typically use their standard form of supply contract as the basis for negotiations of terms and conditions. These supply contracts have been extensively and carefully vetted through each supplier's legal and risk management departments. In public bidding, the terms and conditions of service cannot be negotiated once bids are received and, moreover, bidders must be bidding on equal footing.

***Timely decision-making:*** Energy markets are inherently volatile, with prices changing constantly throughout the trading day. This makes electric power purchasing relatively unique in the public procurement arena. When suppliers submit a fixed bid price, they are basing that bid price on the latest quotes just prior to the bid submission deadline. The supplier will later lock the price in with their wholesale suppliers, only after a binding notice of award is issued. During the period between the submission of bids and the award of contract the supplier is taking the risk of price volatility. The longer the period of time between bid submission and contract award, the greater the risk to the supplier. In order to promote a robust competition and push prices down, it is critical that the agency implement a process to rapidly review and award a contract; ideally this window of time is just a few hours.

***Efficient Bidding:*** There are generally several forms of bidding that have been implemented for power supply in recent years in New Jersey: the traditional sealed paper bid, sealed electronic bids; and online reverse auctions. Sealed paper and electronic bids generally have little incremental costs to implement;

the use of an online reverse auction platform generally imposes additional costs for the contacting unit to implement but may result in lower prices. Purchasing officials should give careful consideration to the appropriate means for accepting bids.

**What Next?** With all the attention being paid to local budgets, the cost of power should be reviewed by all contacting unit officials as a potential cost saving opportunity. As described above and supplemented with the online resources, due care and consideration must be given to ensure that moving to a TPS will provide the desired results. Agency officials should consult with their procurement professionals and other advisors to assist them to determine if bidding for power supply is the best route or if the traditional BGS-P approach is in their advantage.