Overview of Local Unit Power Supply Bidding Practices

Once deciding to public bid power supply (as opposed to using the BGS-FP tariff) it is a major effort to design and implement a bidding process that attempts to maximize bidder participation and drives down the bid price as low as possible. There are several important elements to accomplishing these goals, these include:

1. Gathering and providing to suppliers accurate, up-to-date and complete information regarding your electric accounts;
2. Understanding and developing an accurate estimate of what your 'price-to-compare' is; i.e. the cost to you of utility-provided power supply;
3. Drafting bid specifications and contract terms that balance basic protections for the contracting unit with the needs and realities of the electric marketplace;
4. Setting up a mechanism that provides for efficient bidding; and,
5. Timely decision-making and contract awards.

1. 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 contracting unit participant provide an accurate and current list of account numbers (ideally form the most recent utility bill).

The next step is to gather complete usage information for each account, including monthly and time-of-use usage data, peak demands, etc. As few contracting units keep a separate database that records all of this information from past bills, this data is best obtained directly from the utility through electronic data transactions. BPU-registered energy agents and energy consultants typically have the capabilities and agreements in-place to effectuate such transactions.

For a procurement involving a relatively small number of accounts, this function can be handled manually by the contracting unit if past bills are available. Accurate and complete usage data for all participating accounts is essential for suppliers to accurately develop a bid price.

2. Developing an accurate estimate of your 'price-to-compare':

In order to evaluate and assess bid prices, it is vital to understand how bid prices should be benchmarked. As described above the utility bill consists of two main categories of charges:

1) Delivery charges; and

2) Power supply charges under the BGS tariff.

For a typical small-to-mid sized contracting unit account, the total average utility price can currently range from about 14 to 18 cents per kwh annual basis. This can break down to anywhere from 3 to 6

cents per kwh for delivery, and 10 to 14 cents for power supply, depending on the utility and on the specific usage profile of the account(s). The power supply component is the only relevant portion of the utility bill for the purpose of evaluating bids, as the utility delivery charge will remain the same regardless of whether you purchase supply from the utility or a third party supplier.

As summarized above, 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.' Further, if the contract will extend beyond 6 to 12 months, getting insights as to how future utility BGS tariff prices may change in the future to appropriately benchmark a longer-term bid price can be a useful activity.

How might tariff pricing change? It's a prediction art that energy consultants can perform. It involves forecasting future BGS prices based upon market knowledge and knowledge of BGS auction that constitutes their business practices. It can be useful because it is not necessarily sufficient to judge a multi-year price offer on first year pricing.

3. 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. As such contracting units must establish the basic terms and conditions of service in the bid specifications and must assure that each bidder is compliant with those published terms and conditions.

Some contracting units conclude that they can treat power supply as any other commodity and use their standard "boilerplate" contracting documents for bidding. This is an unfortunate trap as such generic specifications often do not reflect the unique realities of the electric power market. Many if not most suppliers will not bid if the specifications do not appropriately reflect basic energy market realities and essential terms and conditions. In order to maximize the chance of having a robust competition, it is therefore crucial that contracting units exhibit flexibility in establishing bid specifications and required terms and conditions of service.

These include elements related to commercial terms of the RFP and supply contract. Key issues include: the timing between bid submission and binding award; payment period; provisions that address risk of changes in cost beyond the control of the supplier; material usage change provisions vs. full-requirements pricing; damages calculations; liability limitations, etc.

Finally, bidders and energy consultants are regulated by the BPU and PJM (the regional manager of power supply for our multi-state region) license power suppliers into our system. All bidders and

consultants must have the appropriate registration and licenses approved by BPU and PJM to consult or deliver power into New Jersey.

The important elements of power supply bid specifications fall into several categories.

Account List and Usage Information

It is imperative that the bid specifications contain an accurate and complete list of individual electric accounts included in the bid. Individual accounts can be closed-out, or account numbers can be changed by the utility. Inclusion of current account numbers with accurate digits is vital to avoiding confusion during the bid process or, subsequently, after bid award and during the account enrollment process.

It is also important to provide complete and up-to-date account usage information for each account, ideally providing at least the most recent 12 months' worth of usage information, including at a minimum monthly energy usage (by time of use of hourly if available)and peak demands, as well as capacity and transmission obligations. This information can be gleaned from utility bills, or can be obtained from the utility through electronic medium by registered energy consultants. The existence of accurate and complete load profiles on all accounts gives suppliers a better understanding of the usage patterns for the accounts, thereby enabling suppliers to accurately price the accounts.

Pricing Products and Contract Length

Unlike public utilities, which can only offer one pricing structure under their BPU-regulated power supply tariffs (i.e. the BGS tariff), there are a number of products with different pricing that competitive suppliers can offer. These include fixed price products, floating or 'indexed' pricing products, or various combinations of the two. Depending upon the prevailing energy market conditions, the budget priorities of the contracting units and other factors, different pricing products and contract lengths can make sense. Bid specifications can be established which solicit pricing offers on multiple pricing products or contract lengths.

Contract Terms and Conditions

Under public bidding laws terms and conditions of service *must* be established in advance of the receipt of bids, all bidders *must* have the same information and opportunity to bid and be bidding on the same set of conditions, and contracting units are *not* permitted to negotiate the terms and conditions of service after the submission of bids. It is therefore a vital step to establish and make known to bidders the terms and conditions prior to the receipt of bids. These terms and conditions must provide basic contractual protections to contracting units, while at the same time providing fair terms that are commercially acceptable to bidders and do not impose unacceptable risk on suppliers; otherwise bidders may decline to submit bids or may increase their prices to include hefty risk premiums.

Important terms and conditions that must be developed to balance both parties' interests include, but are not limited to: indemnifications clauses, damages provisions in the event of non-performance and/or early termination; credit requirements, billing and payment terms, provisions addressing the

impact of changes in law of applicable regulations, pricing adjustments in the event of material changes in usage; addressing reductions in usage due to installation of energy efficiency or renewable energy projects. This is where the inclusion on your project team of energy industry procurement and legal experts can be vital.

Procurement Process and Timing

Energy markets are in constant flux, and prices change almost constantly. If suppliers are required to hold bid prices for an extended period of time after the submission of bids, this can impose significant, and at some point unacceptable risk on suppliers. Increased risk can have tone of two consequences: a) suppliers decline to bid, thereby reducing the bidder pool and potentially impacting the competitiveness of the bid; or b) suppliers will include a risk premium in their price. Therefore it is important that a process be established in advance to review bids and issue contract awards in an efficient and timely manner, this process must be established and be made known to bidders in advance of the bid.

4. 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 contracting unit to implement.

There has been much debate about the added merits of online auctions. The platform has worked quite well for the State's electric utilities who have utilized a reverse auction for many years to procure wholesale power. However the wholesale auction has rules that require a minimum level of participation by multiple suppliers also has significant oversight and monitoring by the BPU, there are extensive bidding rules and market share tests, and the system is designed to have multiple winners for each product and maximum market shares for any one winner.

By contrast, however, in the retail supply arena the bid is effectively a winner take all for each product; moreover despite the best efforts to develop bid specifications that attract bidders, in fact in most public bids for power supply there is generally a relatively small turnout of suppliers. Without robust competition and other protections, there is some question whether the price discovery inherent in an online auction can lead to the intended effect of driving prices down to their lowest possible levels. Given the various elements in choosing a bid receipt model, contracting units should give due consideration to the appropriate means for accepting bids.

Using a pilot program that permits online bidding, the Division of Local Government Services has authorized several vendors to use electronic systems for receipt of bids. Two organizations have been approved to conduct reverse online auctions for power supply purchases: Dome-Tech Inc. and Birdsall Services Group. Various vendors have also been approved for online bidding services.

5. 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.

This risk prospect can manifest itself in one of two ways: a) the bid price is increased to include an additional 'risk premium' or; b) a supplier(s) will find the level of risk unacceptable and will decline to bid.

In order to promote a robust competition and push prices down, it is critical that a contracting unit implement a process to rapidly review and award a contract; ideally this window of time is just a few hours. Such an expedited process has been implemented successfully by many contracting units; the key is scheduling special meetings of the governing body to convene shortly after bid submissions, and/or for the governing body(s)to pre-authorize the Lead Agency or responsible personnel to make firm commitments, under certain pre-established guidelines. In either scenario, substantial advance groundwork is essential.

Procuring Power Supply through a Cooperative Purchasing System

Over the last few years many contracting units have turned to energy procurement cooperatives to take advantage of the benefits of aggregating power supply demand. Pooling power supply needs can provide a small user of the potential savings of a large user.

The bidding of power supply requires a good degree of sophistication by customers to maximize the value of aggregated bidding. For example, aggregating government contacting agencies that share pre-existing contracting relationships with known and trusted leadership, and that that have similar load profiles, budgeting priorities, and procurement policies, adds value to cooperative purchasing. For these reasons schools districts, for example, have generally found that it is to their advantage to bid with other school districts for their electrical power.

Pooling demand also allows contracting units to hire a consultant rather than try to write the specifications themselves or pay for a consultant themselves. The formation of large aggregation groups allows each individual contracting unit to spread consulting and legal fees over the usage of the entire group, thereby reducing the per-unit transaction costs by several orders of magnitude. Understanding the energy markets and the attendant legal considerations is a necessity when bidding and contracting for power supply.

Several counties have developed their own power supply cooperative purchasing system and, in some cases, counties have aggregated their needs with other counties in a multi-county power supply

cooperative to increase their usage and drive down the costs of a consultant. These systems have been very successful in the past. Unlike other cooperative procurement systems, however, energy co-op members are required to pledge their demand and use the system's contract for their supply if they join the system.

To join a power supply co-op, the first step is to determine if there is a power cooperative in the vicinity of your local unit of government (see website for a list). If there is, they can be contacted to find out if they can currently handle additional members or if not, when they will be able to bring in new members and what requirements they impose.

If there is no energy co-op in existence in your area you may wish to start one. N.J.A.C. 5:34-7 provides the regulatory basis for cooperative pricing systems, and 5:34-7.13 and 7.19 have specific guidance on regional and cooperative energy cooperatives.

Contracting units that join a co-op will need to obtain account information for all of electricity accounts and participate in decision making as the co-op may require. In addition the bidding process may require the contracting unit to commit virtually immediately once the bids come in to lock in the best prices.