Lincoln Public Schools

Buckner M. Creel
Administrator for Business and Finance

November 8, 2010

To: School Committee
Mickey Brandmeyer
From: Buckner Creel

Subject: Recommendation for Award – Commodity Electricity Supply

Background. The Lincoln Campus is powered by electricity delivered by the local utility NSTAR. Each bill is composed of two parts: a charge from NSTAR for delivering the electricity and a commodity electricity charge for the electricity itself.

For the past four years we have purchased the commodity electricity through the PowerOptions collaborative from a supplier, Direct Energy, at prices which remain constant over the life of the contract period and do not fluctuate from season to season, as do the commodity electricity prices from NSTAR. The district has benefitted from the resultant budget predictability. The current contract from Direct Energy expires at the first meter read in June 2011, and the district must arrange for the supply of electricity for subsequent periods.

At the time we entered into the current agreement, the Lincoln Water Department and the Lincoln Library joined us by piggybacking on our PowerOptions collaborative membership to provide power for their six and our four accounts. Both the Water Department and the Library have notified us that they wish to continue to purchase commodity electricity through a long-term arrangement, and look to us to find a deal for them. The Town is strongly considering taking its 14 accounts off the NSTAR Basic Service and entering into a long-term arrangement; they also wish to join in this procurement. We will look for the best value for all 24 accounts as the procurement strategy.

Procurement alternatives. Energy contracts are exempt from the bidding provisions of MGL Chapter 30B. Our attorney has verified that we can craft our own procurement process and enter into an agreement for a period up to six years. Nevertheless, we look to acquire goods and services through a competitive process whenever possible. For the past four years we have belonged to the PowerOptions collaborative, sponsored by the Massachusetts Health and Education Financing Authority (MassHEFA). PowerOptions enters into long-term agreements on behalf of the collaborative members, following a competitive process outlined in the attached due-diligence letter. Their current agreement continues the relationship with Direct Energy, and allows for locking in electricity supply rates for up to four years, through October 2015. The PowerOptions contract, negotiated on behalf of the members, provides a "parent-company" guaranty which is singular in the industry, and the PowerOptions staff is available to resolve billing issues and disputes, and to provide advice.

By ourselves, our annual purchase of approximately 900,000 kilowatt hours (kWhr) of electricity is too small to warrant attention from commodity electricity suppliers. Like homeowners, our main alternative would be to purchase from NSTAR at rates that vary seasonally. Nevertheless, in the interest of ensuring that the PowerOptions pricing is in line, even though it results from a competitive process, the efforts of a power broker were sought.

Direct Energy provides daily prices (the "matrix price") for the various meter classes to the PowerOptions staff. These prices are for a one-, two- or three-year period beginning June 2011. Upon request, they will provide pricing for up to four years for a specific collection of accounts (the "discrete price"). The consensus among several energy industry advisors is seek a two-year contract, as near-term fundamentals in the gas market are currently down, but suppliers are tacking on a factor to cover uncertainty in the out years. A two-year term provides budget stability, and we can explore going out an additional two years in the fall of 2011.

Finally, at the suggestion of the PowerOptions staff we requested both matrix pricing and discrete pricing for several scenarios. The initial round showed that our School accounts were not penalized by being lumped in with the Town accounts, so pricing for all 24 accounts for a two-year period beginning with the first meter read in June 2011 became the "apples-to-apples" scenario for price analysis. These rates were all obtained at the same time for decision making purposes; as always, the actual rates obtained would depend upon the current market at the time we locked in a contract price.

Quantitative (price) analysis. A quantitative analysis of alternatives follows.

Non-procurement alternative. The current NSTAR Basic Service rate for the period July 1 through December 31, 2010 for rate class *Small Commercial/Industrial Customers and Lighting* is $0.0853 per kWh, which is expected to climb higher after January 1, 2011. All of the School accounts and all but one of the Town accounts fall into this rate class. This rate provides a point of comparison with the rate offers discussed below, demonstrating that procuring commodity electricity from a third-party supplier continues to yield cost savings for the Schools, and will provide savings going forward for the Town as a whole.

Direct Energy through PowerOptions. Direct Energy has quoted the following "matrix price" rates for the differing types of accounts we have with NSTAR. The cost of our ~900,000 kWh is also shown. Comparison with the Basic Service rate yields no immediate savings.

Direct Energy "Matrix" Offer	$/kWh	Annual Cost to Schools
B1& A9 -- Small Commercial	$0.08356	$ 187
B2 -- Medium Commercial	$0.08392	$75,528
Total		$75,715

Direct Energy has also quoted the following "discrete price" rate that represents a single, blended price that would cover all 24 accounts for both School and Town.

Direct Energy "Discrete" Offer	$/kWh	Annual Cost to Schools
All 24 Town & School Accounts	$0.07759	$69,831

Finally, Direct Energy quoted several "discrete price" rates for various subsets of our 24 accounts: large meter accounts only, School accounts only, etc. None of those rates provided any significant additional value, and most were more expensive. The two-year rate for all 24 accounts is their best offer.

Constellation NewEnergy through an Independent Broker. Acting on our behalf, an independent power broker solicited prices from eight commodity electricity vendors. Most replied that they were uninterested in providing power to 24 accounts with such a small over all annual consumption. Only one vendor, Constellation NewEnergy, provided an offer meeting the essential requirements for all 24 accounts as requested. The quoted rate and resultant cost of our ~900,000 kWh is shown below.

Constellation NewEnergy Offer	$/kWh	Annual Cost to Schools
All 24 Town & School Accounts	$0.07656	$68,904

The Constellation NewEnergy rate is expected to cost $927 less each year than the Direct Energy offer, at our anticipated usage.

Qualitative (value) analysis. Two factors other than price should also be considered in analyzing these alternatives:

1. <u>The PowerOptions contract has better terms</u>.

   - Parent Company Guaranty. The supplier of electricity under the PowerOptions contract is Direct Energy Business, LLC, a subsidiary of Centrica plc. Centrica supplies energy to 20 million customers in the UK and 5 million customers in North America. The PowerOptions contract requires Centrica plc to deliver a financial guaranty in the amount of 150% of the cost exposure for all accounts registered by us with Direct Energy. In the event of Direct Energy contract default, the Centrica guaranty is available to pay the amounts Direct Energy is obligated to pay under the contract terms.

     The supplier of electricity under the Constellation NewEnergy Contract is Constellation New Energy, Inc, a member of the Constellation Energy Group. Constellation NewEnergy supplies energy to 19,000 customers in North America. Our total agreement with the supplier is with Constellation NewEnergy; should they default and refuse to pay the amounts, which would be due under the contract, our recourse is arbitration under the laws of Massachusetts or legal action in the courts.

   - Switching Onto and Off Utility Supply Service. The Constellation NewEnergy contract includes a provision which would allow them to switch our accounts back onto the NSTAR Basic Service; this could occur multiple times during a single year. While we can prohibit them from further switching if we experience any billing problems, this approach to minimize the impacts of market fluctuations on Constellation NewEnergy could cause problems with our accounts payable process and is certainly not the sort of public image the Schools wish to project.

The PowerOptions contract does not permit switching onto and off utility supply service. We view this as gaming the system and contrary to DPU intent and good public policy. Direct Energy is required to hedge the participant's expected requirements in the forward markets once a contract is signed.

- Creditworthiness. The Constellation NewEnergy contract includes the following provision:

> "6. Creditworthiness. You agree to provide us with reasonable information to complete a credit review. If at any time during the term of this Agreement NewEnergy determines that Customer's credit is unsatisfactory, Customer has experienced any adverse change in its financial condition, or the Customer has made two or more late payments, NewEnergy shall have the right to terminate this Agreement upon five business days advance written notice, unless the Parties are able to agree on mutually satisfactory credit arrangements (which may include, without limitation, the Customer agreeing to: (i) make a cash deposit, (ii) post a letter of credit at a financially sound bank or other financial institution, or (iii) make a prepayment to NewEnergy for electricity supplied under this Agreement) to ensure prompt payment by Customer of amounts owed or otherwise payable under this Agreement."

This type of clause has been used by power vendors to terminate contracts which they find to be onerous in any way, including contracts which are unprofitable or require the provision of electricity at below-market rates. Under Constellation NewEnergy's contract, creditworthiness is broadly drawn and may be invoked to their advantage at anytime during the contract period.

The PowerOptions contract contains a provision which is much more narrowly drawn by providing for an initial credit review, within the first five days only, with no additional credit review thereafter.

- Timely Payment. The Constellation NewEnergy contract includes failure to make payment when due as an "Event of Default" which allows them to terminate the contract upon written notice. The PowerOptions contract provides for a late charge for 30 days, then an additional noticed 30-day period, and then possible termination. Additionally, PowerOptions will intervene with Direct Energy on our behalf should we fail to make a timely payment.

2. <u>The PowerOptions contract requires no start-up and less administration.</u>

- As touched on earlier, PowerOptions provides customer service assistance and dispute resolution support with Direct Energy, should either become necessary. With Constellation NewEnergy, we are on our own.

- Switching suppliers costs the Business Office extra effort by adding vendors, making sure bills are correct, etc. We went through this once already, and PowerOptions helped us out. Switching from Direct to a new vendor will run the same problems, without the assistance of PowerOptions available. In effect, the new contract will continue the relationship built up for the current ten accounts over the past four years.

Timing of Decision. Making a decision to lock in prices now for a two-year period beginning November 2011 has the following advantages:

- Budget stability and predictability. We will know the prices for our FY12 budget near the beginning of the FY12 budget process, before the Committee votes on a final budget proposal for Town Meeting.

- Low near-term pricing. Natural gas set a seven-year low price last summer. Since the price of electricity in New England is bound tightly to the price of natural gas, it is hard to imagine a set of circumstances that will drive the price much lower in the future.

- Low out-year pricing. The spread between the 12-month and 36-month pricing is small, making it reasonable to lock in prices for a longer term.

- Price of electricity is likely to increase. Both the US and world economies appear likely to strengthen in the near term, which will increase the demand for natural gas. China, India and Brazil are growing energy users which will put pressure on energy resources and drive up cost.

We could wait until April 2011 in the hopes that some circumstances arise which will result in even lower prices. Success under that strategy seems unlikely, and so there appears to be no advantage in waiting to lock in prices.

Conclusion and recommendation. I believe that the preferential contract terms and ease of contract administration with the Direct Energy contract outweigh the very modest cost savings available through the Constellation NewEnergy offer. I recommend that the School Committee approve the purchase of commodity electricity from Direct Energy through the PowerOptions collaborative, and authorize the administration to lock in prices now, for a two year period at the rates available at the time of lock in.

PowerOptions

To: Members of PowerOptions® Purchasing Consortium

From: Cynthia Arcate, President and CEO

Re: Electricity Supplier Selection Process for the period June 2011 to May 2015

Date: April 30, 2010

To facilitate your internal review and due diligence, the following is a review of the process by which PowerOptions, Inc. selected Direct Energy Business, LLC, as vendor for our new electricity supply contract. This contract is being offered to PowerOptions members for the period June 2011 through May, 2015, or beginning in June 2010 for pricing confirmations entered into during the remainder of the current contract and extending into the new contract period. Below is a detailed summary of the steps in the procurement process including criteria used for selection.

1. Request for Proposals ("RFP") Preparation – During the Fall of 2009, PowerOptions staff and consultant interviewed several electric suppliers to get an understanding of the market trends and issues from their perspectives. It also served and a means of identifying the pool of potential bidders capable of providing the scope and depth of service needed for the PowerOptions membership.

2. Request for Proposals). On October 13, 2009, PowerOptions issued an RFP to obtain electricity supply for it's' members. This RFP was similar to previous RFPs issued by PowerOptions for electric supply and was drafted by our consultant and outside counsel. Proposers were given a compilation of electricity consumption data representative of PowerOptions® members grouped by LDC rate class and zone and were asked to submit indicative pricing. The RFP was advertised in the Boston Globe and posted on our website. Additionally, the RFP was emailed to 11 Massachusetts licensed Competitive Energy Suppliers.

3. Bidder's Conference. A conference call was held on October 19, 2009 for all interested potential respondents to review the terms of the RFP, to answer any questions, and to clarify the steps of the selection process.

4. Review of the RFP. The RFP responses were submitted on November 10, 2009. PowerOptions received four interested responses. PowerOptions appointed a review committee comprised of three PowerOptions staff, two members from the PowerOptions Institutional Advisory Council and two industry experts to review the responses to the RFP, monitor the solicitation process, and to make their recommendation for awarding the new electricity supply contract. The principal elements of the RFP review and those which were used to evaluate the Suppliers included quoted pricing for benchmark usage data, proposed contract terms and assurances, financial qualifications, commercial competence, corporate and staff experience and the range of additional services and terms likely to be offered. Based on this review, two firms were recommended for further consideration and review.

5. Oral Interviews. The review committee met initially with the two selected firms to review their RFP responses, including discussions on the submitted quoted pricing. Subsequent clarifying discussions were conducted with these finalists and both firms were asked to improve upon their initial proposals in light of the clarifications and changes in the energy market. Eventually the two suppliers were asked to submit indicative pricing on the same compilation of data as of two dates.

6. Negotiation and Selection. Submitted pricing was compared and analyzed in detail. Communications were maintained with both finalists throughout the initial negotiation period that extended through April 2010. Based on their lowest submitted pricing and other contract and program terms offered, the evaluation and negotiation team recommended the selection of Direct Energy. Direct Energy's pricing model generated better pricing than all other responding suppliers for all sample loads and accounts across all local distribution companies and all rate classes. Negotiation of the final contract terms was completed with Direct Energy in April 2010.

7. PowerOptions Program Agreement. Under the PowerOptions® program, energy supply contracts are executed between the member institution and the supplier. However, PowerOptions, Inc. enters into Program Agreement with the supplier setting forth, among other things, PowerOptions' ongoing role This role includes monitoring the energy supplier's pricing and performance under the contract, advising members, fostering the continued competitiveness of the supply arrangements and seeking additional opportunities for providing services of value to the members of the PowerOptions consortium. PowerOptions receives a fee from the supplier and a membership fee from its members to recoup the costs of organizing and administering the consortium.