

CRONIN AWARD SUBMISSION

NEW YORK STATE OFFICE OF GENERAL SERVICES Procurement Services Group

**Natural Gas
AWARD # 21411**

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Procurement Services Group

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CRONIN AWARD RECOMMENDATION

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Natural Gas

Group # 05900 • Award # 21411

<http://www.ogs.state.ny.us/purchase/spg/awards/0590021411CAN.HTM>

Summary

The Office of General Services (OGS), Procurement Services Group (PSG) routinely contracts for the purchase of natural gas based on requirements filed by over 230 New York State facilities. OGS bids three types of supply for natural gas.

- **fixed/firm – fixed price, firm supply**

fixed price - the combined price of the commodity (gas) and the bidder's operating cost for the contract period

firm supply - service that anticipates no interruptions of gas service by the utility;

- **Indexed/firm – indexed price firm supply**

indexed price - combined price of a "bidder's operating costs" plus a monthly indexed commodity price using fluctuations in the New York Mercantile Exchange (NYMEX);and

- **indexed/interruptible – indexed price, interruptible supply**

interruptible supply - gas service which may be interrupted by the marketer (contractor) or the transporter for a period of time due to interstate pipeline or Local Distribution Company (LDC) curtailment.

The contracts for natural gas are awarded by location and by supply type. They cover 62 counties and 8 LDCs. Contracts for all users including both state and non-state facilities are valued at \$80,000,000 annually, based on the current market price for gas.

This initiative details the use of an Invitation for Bids with a pricing methodology that solicited offers for both firm and interruptible gas supply for two large New York State dual fuel (gas and oil) facilities. The method of award provided that the state award to the bidder offering either firm or interruptible gas supply, based on the state's analysis as to which offer was in the state's best interest. This determination was made using statistical and market analysis of the natural gas and oil markets. It considered the higher price for firm supply relative to the cost avoidance of using oil during interrupted gas service.

We recommend this solution as a Cronin Award recommendation and as a viable option to those states that could benefit from considering the alternate pricing variables to further reduce energy costs at times when budgets are most constrained.

Innovation

OGS Utilities manages two buildings with a combined estimated gas usage at almost 2,000,000 dekatherms over a 12 month period, enough gas to satisfy the operational needs of the entire Empire State Plaza Complex, consisting of 10 large office buildings and underground facilities equal in length to a half mile distance and the New York State Office Campus, an even larger account of many state agency buildings housed on a campus and serviced through one account. These facilities are extremely sizable accounts and burn either gas or oil fuels (known as dual burning facilities). Both buildings have interruptible transportation gas delivery, (specifically, service classification rate SC-6 as listed with the local utility company National Grid) which means that their gas supply can be interrupted and the facilities would have to use oil until the gas curtailment is lifted. The buildings historically receive their gas through a contract marketer using indexed priced interruptible supply. Because these facilities have a service classification that allows for interruption by the utility, the OGS has always contracted with a supplier to provide interruptible pipeline delivery of natural gas. Contracting for an interruptible supply has historically proved beneficial when the price differential between natural gas and oil were insignificant, and the OGS could switch to burning oil with limited financial impact during an interruption. However, as the price differentials increased between the two fuels, it has become increasingly more costly to burn oil during periods of gas interruptions. The facilities have historically had their natural gas supply interrupted by the supplier for approximately 45 days during the winter season, causing the facilities to burn the more costly fuel alternative, oil. The financial impact of these interruptions has burdened the State with an incremental cost of over \$61,000 per occurrence (generally a day). With the possibility of numerous interruptions and the recent unprecedented oil prices, staff at the OGS brainstormed to “think outside the box,” to determine alternative methods for procuring the less expensive fuel alternatives given the market fluctuations.

Staff canvassed approved marketers in the National Grid (local utility) Area, researched capacity issues with the applicable pipelines and the LDC and was able to establish a feasibility plan. We received conceptual approval from the State Controller and aligned procurement and energy specialists to review bids on the bid opening day.

The OGS established a method of award that allowed for accepting bids for both, indexed price/ interruptible supply and indexed price / firm supply but awarding the option pricing that best suited the state’s financial needs. This involved, choosing the best price methodology on the bid opening day given the prices received and the fuel market trends. Energy staff and procurement specialists analyzed the bids and made a determination, based on current fuel trends and the bids offered to award on the indexed price / firm supply bid. Having firm gas to the city gate reduces the occurrence of interruptions by almost 96%; thereby eliminating the need to burn the more costly fuel, oil. At the bid opening, calculations were performed based on bids submitted to make a determination if the interruptible or firm supply offers would be in the best interests of the state. After crunching numbers, a determination was made to award on the indexed price / firm supply option with an estimated saving of \$6 million.

For the first time, this contract also offered a unique option to those contract users who utilize interruptible gas supply. In the event that contract gas service is interrupted, this contract provides for alternate pricing for natural gas that can be considered in lieu of switching to oil. It enables the contractor to offer a price (potentially higher than contract price) for replacement gas available from another source. Such sources may include, but are not limited to, supplies on alternate pipelines serving the affected LDC, requests to other marketers, and requests to the affected LDCs of the availability of excess system supply gas (“excess city gas supply”). This “non-contract” pricing tends to be higher than contract pricing, but may be less than the cost of burning oil.

If the facility is considering this option, the marketer must provide written documentation to the facility and then confirm the transaction by submitting a Transaction Confirmation. The marketer is allowed to charge a per dekatherm fee for this option.

Transferability

This contract can be used as a model for other states for procuring Natural Gas particularly for large volume dual fuel facilities. It created a large cost savings to the state to prevent burning oil at a time when oil prices escalated.

Service Improvement

The availability of firm gas supply to the city gate dramatically reduces the interruption of the facility's natural gas service which eliminates the need to switch to oil, currently, a more costly heating method. The centralized contract for natural gas yields better pricing based on significant volume aggregation for facilities that cover fuel needs for massive state complexes. It also further enables increased cost savings due to fewer service requirements and avoided maintenance costs for burning oil. It allows for better budget forecasting as well due to the unpredictability of gas supply interruptions.

The decision to change the procurement methodology was based on in-depth discussion with utility, energy, procurement, finance and facility maintenance specialists who brainstormed to arrive at this cost savings option.

Cost Reduction

On August 12, 2008, OGS awarded a two (2) year contract to a natural gas supplier that guarantees uninterrupted supply of natural gas to the city gate for consumption at Empire State Plaza Complex/Campus facilities. This contracting strategy is expected to provide avoided cost savings of \$6.1 million over the contract; or \$60,000 per day in the first year and \$76,000 per day in the second year based on assumed interruptions of gas for 45 days/year. The avoided cost is based on forecasted market conditions at the time of award and the differential of cost between natural gas and heating oil.