COMPETITIVE SOLICITATION AS AN INTEGRATED RESOURCE PLANNING MODEL:

Its Competitive Impacts on Small Businesses Serving Low-Income Households

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The purpose of this report is to assess the impacts that a "competitive solicitation" model would have on small businesses, and by extension, on low-income households within a utility Integrated Resource Planning (IRP) context. This evaluation is undertaken because the interests of low-income households and small businesses are often interwoven. Because of the importance attached to ensuring that low-income households are equitably served by whatever type of IRP model is adopted by Arkansas regulators, therefore, it is important, also, to pay particular attention to the impacts of IRP implementation on small businesses.

The context within which small business impacts are considered is Section 111(b) of the Energy Policy Act of 1992 (EPAct), which amended PURPA by adding Section 111(c)(3) requiring state utility commissions to consider, within an IRP framework, the impact that implementation of IRP would have on small businesses engaged in the design, sale, supply, installation or servicing of energy efficiency measures such that utility actions would not provide utilities with unfair competitive advantages over small businesses.

This analysis is presented in four parts. *Part 1* summarizes why it is important for low-income households to be fully and equitably treated by whatever IRP model is adopted. *Part 2* sets forth the proposition that low-income households tend to be primarily served by small businesses and that, therefore, the protection of small business is necessary for the protection of low-income customers. *Part 3* reviews a variety of factors specifically disfavoring small business within a competitive solicitation model. Finally, *Part 4* reviews the track record which the public utility industry has developed to date with regard to addressing the competitiveness of small business. Overall, this analysis concludes that the adoption of a "competitive solicitation" IRP model would have adverse competitive impacts on small businesses, to the particular detriment of low-income households.

PART 1: THE IMPORTANCE OF SERVING LOW-INCOME HOUSEHOLDS

It is extremely important for Arkansas regulators to ensure that low-income Arkansas customers are fully and fairly served by whatever IRP process is adopted by the Commission. A variety of reasons march forward in support of this proposition.

The Distributional Issues: Program Costs

When some households pay all or part of the costs of a DSM measure but, due to the nature of capturing and distributing the benefits, receive none of those benefits, a distributional problem arises. In order to understand this line of reasoning, it is important first to understand the

nature of the distributional questions at issue. A DSM measure is cost-effective if it results in lower total revenue requirements to a utility. The cost which is avoided by implementing the DSM measure is a systemwide benefit and, at least in theory, inures to the benefit of all ratepayers. This is true even though each specific DSM measure is installed in a particular individual's home or in a particular factory, school or commercial business. Despite the individual nature of the placement of the measure, the measure represents a systemwide investment in providing adequate service at least-cost and the savings represent a systemwide savings.

The first distributional question is raised by the mechanism used to capture and distribute these DSM costs and savings. The Table below provides an example of the process. As can be seen in this Table, all ratepayers contributed to the $30 fund. Each was charged a *pro rata* portion of the costs of the efficiency program. On a per kWh basis, the DSM program cost 6.52 cents ($30/4600 kWh). Not all ratepayers, however, shared in the $40 in benefits. In fact, in this example, the savings were allowed to inure solely to the benefit of the ratepayer in whose home the DSM measure was installed. In other words, RP1 saved $40 because the new lights reduced her bill by that amount. She was charged her share of the $30 (600 kWh x $0.0652/kWh = $3.92) but received the entire $40 benefit for a net savings of $36.08. Each of the nine non-participating ratepayers also contributed their *pro rata* share to the $30 for the program (1000 kWh x $0.0652 = $6.52), but received no share of the $40 savings.

These concerns are of particular importance to the low-income community within a competitive solicitation model. To the extent that the small business enterprises specifically serving low-income households are effectively excluded from the process of a utility's bidding process -- whether or not facially excluded-- low-income customers will be forced into a non-participant status for utility-financed DSM programs. Accordingly, even though the savings generated by DSM measures are "system" benefits, and even though the low-income ratepayers are paying "their share" of the costs, they will be systematically excluded from receiving "their share" of the benefits.

The Distributional Issues: Fixed System Costs

A second distributional issue arises due to the impacts of energy efficiency programs on a utility's fixed costs. It seems quite contradictory that while total utility costs will necessarily go down as a result of cost-effective energy efficiency programs, rates (and therefore bills) can at the same time go up. This result arises because of the unique nature of utility ratemaking, with its assignment of costs amongst varying customer classes.

In short, however, rates go up because of the allocation of the fixed costs of the utility system amongst all of the units of energy consumed on that system. The more units of energy consumed, in other words, the less each unit of energy will have to bear of the fixed costs of the system. Some costs on the utility system do not vary as a function of the number of kWh of electricity consumed by customers. These costs must be

paid whether the utility sells 100 kWh or 1.0 million kWh. Taken to the extreme, if the utility sells only 1.0 unit of energy, that single unit would be required to bear the entire fixed cost of the system.

As a matter of simple arithmetic, when a utility sells more units of energy, each unit will bear a smaller portion of the total fixed costs of the system. Conversely, if less energy is consumed, each unit "left" will bear a greater portion of fixed costs. Low-income households will likely be these nonparticipating households, particularly if small business is excluded from a competitive solicitation process. If costs per unit go up, customers experiencing higher bills will be the nonparticipants who can not lower their consumption through the utility DSM program.

Summary

In short, there are serious impacts of failing to provide for full and fair participation of low-income customers in utility-sponsored DSM measures. Because of the anti-competitive impacts of a competitive solicitation process as outlined below, such a process will tend to have significant adverse impacts on the poor.

1.   First, the increased expenses associated with the energy efficiency programs will be disproportionately borne by the nonparticipants. When a utility spends $1.0 million on an energy efficiency program, those costs must be paid by someone. And that "someone" will be the captive nonparticipating customers.

Distributional Problems Rates After Implementation of DSM Measures	
RATEPAYER 1	
Usage	600 kWh
Price for production	$0.10/kWh
Price for DSM measure	$0.0652/kWh*
Total bill	$63.91**
RATEPAYER 2	
Usage	1,000 kWh
Price for production	$0.10/kWh
Price for DSM measure	$0.0652/kWh
Total bill	$106.52***
RATEPAYER 3	
Usage	1,000 kWh
Price for production	$0.10/kWh
Price for DSM measure	$0.0652/kWh
Total bill	$106.52***
RATEPAYER 4	
Usage	1,000 kWh
Price for Production	$0.10/kWh
Price for DSM measure	$0.0652/kWh
Total bill	$106.52***
Ratepayer 5	

Distributional Problems Rates After Implementation of DSM Measures	
Usage	1,000 kWh
Price for production	$0.10/kWh
Price for DSM measure	$0.0652/kWh
Total bill	$106.52***
TOTAL COMPANY REVENUE REQUIREMENT:	$490
TOTAL PRODUCTION:	4,600 kWh
AVERAGE PRICE PER kWh:	10.652

NOTES:

*$30 divided by 4,600 kWh = $0.0652/kWh
**(600 kWh x $0.10/kWh) + (600 kWh x $0.0652/kWh) = $63.91
***(1000 kWh x $0.10/kWh) + (1000 kWh x $0.0652/kWh) = $106.52

2. Second, the fixed costs of the system will be borne by a decreasing consumption base composed of captive, nonparticipating customers. That decreasing base will tend to be residential ratepayers generally and *low-income* customers in particular. Since low-income households tend to be disproportionately nonparticipants, the customers who can least afford to pay these non-cost-based additions to rates will be those most likely called upon to pay them.

3. Finally, the direct benefits of energy efficiency, in reduced bills through reduced consumption, will be denied to residential customers in general and low-income customers in particular. Hence, not even the programs which arise out of payment of the program costs will be available to those customers most likely paying the costs.

A competitive solicitation model that systematically excludes the small businesses which tend to serve low-income customers will adversely affect low-income households and should not be adopted.

PART 2:   LOW-INCOME CUSTOMERS TEND TO BE SERVED BY SMALL BUSINESSES RATHER THAN BY BIG BUSINESS SEEKING TO MAXIMIZE RETURNS.

Having concluded that it is important to fully and fairly serve low-income households within whatever IRP model is adopted by Arkansas regulators, it is thus next important to gain some notion of how the proposed "competitive solicitation" model would affect those low-income customers by affecting small business competitiveness.

In fact, low-income customers tend to be served by small businesses delivering energy efficiency rather than by bigger businesses seeking to maximize returns. Larger projects --*i.e.*, those *not* involving low-income users-- are generally favored by larger businesses for two reasons.

1.   Larger commercial and industrial projects tend to generate a higher return per dollar of investment. Returns are obviously based to a great extent on the aggregate energy savings[1] generated by the provider's energy efficiency program. To the extent that total kWh saved per dollar of investment are increased, the total dollars (representing the utility's avoided costs) paid to the provider will be increased as well.

2.   Larger commercial and industrial projects tend not to face some of the higher transaction costs posed by low-income energy efficiency delivery. Since one way for the provider to increase net returns is to increase the "spread" between the cost of delivered energy efficiency and the avoided costs of the utility, the lower use customers posing higher cost transactions tend to be avoided because of the narrow spread.

The structure of a competitive solicitation model will thus tend to adversely affect the interests of low-income households when they result in a utility's concentration of effort on large scale savings with the highest level of cost-effectiveness. There can be little question, even by low-income service providers, that the greatest savings for the least cost can be obtained from investments in industrial and commercial energy efficiency measures.

To tie returns, therefore, to the extent of savings, or to the extent of the "spread" between the costs of the efficiency measures and the utility's avoided costs, would be to encourage efficiency providers to service large scale energy users while downplaying (or completely ignoring) the residential customers (particularly the *low-income* residential customers) whose savings are smaller while being more expensive to generate at the same time.

In addition, such a structure fails to acknowledge that small businesses serving low-income households tend to work under a number of cost-constraints not facing larger projects:

o   **<u>High transaction costs:</u>** A minimum amount of energy savings is considered necessary in order for the business providing the energy efficiency measures to recoup sufficient cost savings to overcome the fixed costs of program outreach and administration. Experience shows that the costs of program outreach and administration do not vary depending upon the amount of savings generated at a particular dwelling unit. The time devoted to intake is the same, the time devoted to oversight and monitoring is the same, the time

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[1]   In this discussion, "energy savings" is not intended to stand in contrast to "capacity savings." The term is intended to encompass both types of savings. The term "kWh" is intended to include "kW" as well.

devoted to travel is the same.

If anything, transaction costs for low-income households may be somewhat higher than for moderate and upper income households. For example, low-income households tend to be renters. Because of this situation, there exists a "split incentive" regarding energy efficiency measures. While the bill savings will go to the low-income tenant, the utility must approach and gain the consent of the property owner before any work can be done on the dwelling. Since the owner has no incentive for the energy efficiency work to occur, the effort necessary to obtain the necessary consent may be somewhat greater.

These fixed costs are referred to as transaction costs. Given the small energy savings potential for low-income households, utilities often argue that there is insufficient potential for savings to overcome the transactions costs of providing the energy efficiency measures to the low-income household in the first instance.[2] There is no reason to believe that entities providing energy efficiency measures through a competitive solicitation model would argue differently.[3]

o **Non-energy-savings repairs:** A second problem experienced by low-income energy efficiency programs is the frequent need for home repairs to occur before energy savings measures will have any impact. It makes no sense, in other words, to install insulation into a roof when there are holes in the roof with which to begin. Similarly, installing a new or repaired heating system will have no impact if there are structural problems with the house that eliminate the new system's effectiveness.

The problem can be substantial. Philadelphia's Energy Coordinating Agency (ECA), for example, is the non-profit organization that administers the Philadelphia Gas Works (PGW) Conservation Works Program (CWP). ECA reported that in 1992, roughly 40 percent of the low-income households who would otherwise have been eligible for CWP were rejected from the program because of the need for major roof repair or replacement. Similar findings --that low-income housing is plagued with physical problems-- were made in Arkansas.[4]

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[2] R.Colton, *Least-Cost Integrated Resource Planning in Arkansas: The Role of Low-Income Energy Efficiency*, at 65 - 66 (Jan. 1995).

[3] Indeed, given that entities bidding pursuant to a competitive solicitation model presumably would be seeking to place higher priority on measures and endeavors that would increase either total savings or the total spread between savings and costs, there is every reason to believe that such institutions would more likely exclude low-income undertakings for these reasons.

[4] R.Colton, *Least-Cost Integrated Resource Planning in Arkansas: The Role of Low-Income Energy Efficiency*, at 33 - 34 and Tables 19 - 21 (Jan. 1995).

The problem is that while these home repairs may be a necessary precondition to the effective installation of energy savings devices, they do not save energy unto themselves. Every dollar spent on such repairs, therefore, adds a dollar of expense that must be offset by the energy savings generated by the efficiency measures themselves. Given the problem first discussed above --that low-income households frequently present small savings potential with which to begin-- the probability is remote that the cost of home repairs can be added to the utility program and have that program remain cost-effective.

The efficiency provider is thus caught in a classic Catch-22 with low-income households. Without the home repairs, the energy efficiency measures will not be effective, and thus cannot meet the cost-effectiveness tests. However, with the home repairs, the overall cost of the program will likely outstrip the overall savings, again with the program thus failing a cost-effectiveness test.[5]

In sum, a competitive solicitation model will tilt against small businesses serving low-income households for two reasons. On the one hand, the model inherently provides a financial incentive for large firms to serve large customers with large potential savings per dollar of investment. On the other hand, even amongst those firms seeking to serve the low-income market, the competitive solicitation model would tend to favor those larger projects that can be served without the need to address the various non-energy savings transaction problems referenced above.

While it has been shown time and again that it is entirely possible to cost-effectively serve the low-income market with energy efficiency measures, a competitive solicitation model would not allow that cost-effective low-income potential (as generally provided by small business) to surface.

PART 3:   COMPETITIVE BIDDING MODELS POSE SPECIAL OBSTACLES TO PARTICIPATION BY SMALL BUSINESSES.

While the discussion above looked at the competitive impacts on small business due to the nature of the energy efficiency industry, the impacts of competitive solicitations on small businesses are not *unique* to the energy efficiency programs of public utilities. Indeed, regulators can and should take cognizance of the immense work that has been done within the area of anticompetitive factors that affect public sector contracts. The *extensive* research and analysis that has been done in *that* area can help inform utility regulators who consider the small business impacts of any particular IRP process, including a competitive solicitation model.[6]

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[5]   R.Colton, *Least-Cost Integrated Resource Planning in Arkansas: The Role of Low-Income Energy Efficiency*, at 66 (Jan. 1995).

[6]   Indeed, it is the work which FSC has done with regard to anticompetitive effects on small business within the area of public sector contracting that

Innumerable factors have been found to yield anticompetitive impacts relating to small businesses within a competitive solicitation framework. These factors, as described below, will have particular applicability to the types of small businesses that seek to deliver energy efficiency measures to low- and moderate-income households. Consider as follows:

1.   **<u>Type of payment</u>:** The type of payment which inheres in most competitive solicitation models results in anticompetitive impacts on small businesses. Two payment bottlenecks pose particular problems for small businesses: (1) progress payments; and (2) close-out payments.

   "Progress payments" that are long-deferred deny small businesses the working capital necessary to operate. Indeed, one frequent anti-small-business aspect of payments is the requirement that payments be deferred until the *end* of the project. Slow progress payments interfere with the competitiveness of small business due to their lack of ready access to working capital. Small businesses generally do not maintain sufficient cash reserves to meet their own working capital needs, if extensive due to long-deferred payments. Moreover, as discussed in detail elsewhere, small businesses frequently do not have access to affordable commercial credit to help cover working capital needs.

   The problems with slow progress payments are particularly exacerbated when coupled with long "close-out" negotiations. Protracted negotiations force the small business enterprise to continue to carry the costs of the project out of internal capital. Given the undercapitalization experienced by most small businesses with which to begin, this requirement can make participation in projects with protracted close-out negotiations unavailable.

   Certainly, the *combination* of delayed progress payments and protracted close-out negotiations will keep small businesses out of the market.

   Unfortunately, the provision of energy efficiency measures through a competitive solicitation model will likely involve delayed progress payments and protracted close-outs. Payments under such contracts usually depend upon a final determination of actual measured savings attributable to the energy efficiency measures installed. The calculation of such savings depends upon making determinations of the extent to which base case factors which influence consumption have remained the same. Usage normalization for weather, also, must occur, as well as considerations of other causation influences. All of this takes time. The contracts for energy efficiency

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provides much of the basis for this analysis.

measures under a competitive solicitation IRP model do not involve the types of transactions that are likely to be subject to expedited or accelerated payment schedules.

2. **Increments for which bids are taken:** The size of the project for which bids are to be taken generally has anticompetitive impacts to small businesses. Public sector contracts frequently limit acceptable bids to the entire project, with requirements that particular sub-parts of the project be subcontracted to specialists. Moreover, even when not limited to bids on the entire project, such bids are almost universally *favored*. Small businesses, however, rarely --if ever-- have the financial or administrative capacity to bid on an entire project. Moreover, they rarely, --if ever-- have the financial or administrative/managerial capacity to oversee a complex team of prime and subcontractors.

    To the extent that a competitive solicitation model would favor bids on substantial amounts of capacity, to the exclusion of smaller increments, anticompetitive impacts on small businesses will arise. If a utility seeks bids for capacity only in "chunks" of 100, or even 10 mW, small businesses that would be required to package a sufficient number of low-income households together to meet the capacity threshold would be excluded.

3. **Bonding requirements:** Bonding requirements impose a substantial barrier to small business participation in a competitive solicitation model. Several types of bonding requirements exist. Surety bonds guarantee that the contracting party will be compensated for its lost time and additional administrative expense in the event that a contractor reneges on its bid. A bond of 10 percent of the bid is not uncommon.[7] In addition, firms are almost always required to post "payment bonds." Payment bonds ensure that persons supplying labor or materials to the prime contractor or its subcontractors will be paid in the event that the prime contractor does not make good on its obligations. These bonds generally equal from 50 to 100 percent of the contract price. Finally, "performance bonds" are required. These bonds protect the contracting party in the event of contractor nonperformance. These bonds, too, generally must equal from 50 to 100 percent of the contract price.

    It is important to recognize bonding for what it is. Bonding is surety credit and lending principles thus dictate the amount of bonds for which contractors may qualify. One report identified three aspects of bonding requirements that could yield anticompetitive impacts to

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[7] *See generally*, Aileen C. Hernandez Associates, *Between a Rock and a Hard Place: A Study, with Recommendations, of the Impacts on Minority-Owned, Women-Owned and Small Business of Bonding, Insurance, and Other Fee-Related Requirements of Departments and Agencies of the City and County of San Francisco for Businesses Entering into Contracts with Such Agencies*, at 67 (1985).

small business enterprises: (1) the ability to obtain a bond; (2) the bonding capacity; and (3) the affordability of a bond.

The ability to obtain a bond depends upon the type of business that seeks the bond. On the one hand, bonding companies (providing private bonds) tend to serve the best risks. The availability of this type of bonding, however, generally looks to unencumbered corporate assets as a basis for securing the bond. Moreover, performance bonding frequently looks to strong historical performance in the particular arena in which the competitive bid is being solicited. "Strong financial statements, work-in-progress schedules, banking relationships and lines of credit, credit references, and [similar] information are necessary to obtain bonding from the first tier private companies."[8] These requirements tend to make performance bonding unavailable to small businesses. Bonding from the federal Small Business Administration (SBA) is another source. The administrative barriers to this security can be substantial, however. A third source involves private sureties provided through bond agents. While the underwriting standards may be less stringent in these cases, the costs are higher.

Bonding capacity tends to result in a second type of adverse competitive impacts for small business. "Bonding capacity is primarily a function of the amount of working capital in the firm. Small firm bonding capacity is typically 10 times working capital. Larger firms dealing with private surety companies can more effectively leverage their working capital. A large firm might qualify for bonding capacity 20 to 40 times its working capital."[9]

Finally, even where available, performance bonding tends to be unaffordable to small business. Rates for "first tier" private bonds tend to be 2.5 percent of the contract amount for the first $100,000, 1.5 percent for the next $400,000, and 1.0% for any additional amount. Thus,a $1,000,000 bond for a first tier (non-small business) firm would cost roughly $13,000. This same bond would cost $26,000 through the SBA program and $50,000 for the third tier.

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[8]   Harding and Osborne, et al., *Final Report: Denver Disparity Study, Construction and Professional Design Services*, at IX-2 (1990).

[9]   *Id.*, at IX-3.

Payment and Performance Bond Rates (Share of the Contract Amount)[10]			
Type	1st $100,000	Next $400,000	Over $500,000
Standard (1st Tier)	2.5%	1.5%	1.0%
SBA	2.6 - 3.0%	2.6 - 3.0%	2.6 - 3.0%
Non-Standard (3d Tier)	3.5 - 5.0%	3.5 - 5.0%	3.5 - 5.0%
SBA fee is 0.6% on all bonds. Bonding companies may charge up to 2.4%.			

Proponents of a competitive solicitation model for energy efficiency measures would thus have a heavy burden to overcome in order to demonstrate that similar bonding requirements would not be imposed, or that the small business enterprises engaged in the provision of energy efficiency measures have the capacity to obtain and maintain surety, payment and performance bonds in a manner that will not affect their competitive capabilities. Given that there is no reason to believe that the construction and service industry standards for a utility's competitive solicitation for energy efficiency would differ from the competitive solicitation for goods and services by public sector institutions, it is unlikely that a utility could make this showing.

4. **Liability insurance:** Required insurance amounts that are set as a precondition to participation in competitive solicitations often tend to be anticompetitive from a small business perspective. Requirements that bidders maintain $1.0 to $5.0 million in liability insurance, for example, generally bear no relationship to any potential liability of a project that would be proposed by small business bidders. The availability and expense of obtaining and maintaining such insurance often drives small businesses out of the competitive bidding arena.[11] As with bonding, the liability insurance is both difficult to obtain and expensive even when it is available.

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[10] *Id.*, at IX-4.

[11] *See generally*, Margaret C. Simms, ***Government Regulations as an Obstacle to Minority Participation in Government Contracting: Implications for Meeting the Croson Standard***, in, House Committee on the Judiciary, 101st Congress, 1st Session, ***Minority Business Set-Aside Programs: The City***

5.   **Complexity of the bidding process:** The complexity of the bidding process tends frequently to be anticompetitive from a small business perspective. The complexity of the process, in other words, tends to favor those with the resources to respond. In addition, however, it tends to favor larger companies who have the resources to "lose." For example, one commentator pointed out: "in construction, the costs of bidding on a contract are usually in the range of .5 to 2%. That means that to bid on a $10 million contract, a company must be willing to risk $50,000 to $200,000 in preparation costs. Obviously, this is not a game for very small businesses."[12]

Even aside from the capitalization problem, complex bidding means that small businesses work at a competitive disadvantage from the beginning. Small business enterprises generally lack sufficient staff to proceed through a laborious and difficult bidding process.

Particularly in the arena of competitive bidding for energy efficiency improvements, where one need not simply develop the cost of delivering services, but must project and quantify the *results*, and develop a mechanism for monitoring and confirming those results as well, the complexity of the competitive solicitation process will increase. Moreover, dealing with multiple small transactions, each of which makes a small contribution to the total, will be more complex than dealing with a single transaction which is the sole contributor from whom the estimated savings must be monitored and confirmed. This dual impact will thus affect the competitiveness of small business serving low-income households: (a) the fact that the residential transactions will likely be more complex; and (b) the fact that the enterprises seeking to serve that market sector involve small businesses which are most competitively disadvantaged by the complexity of a bidding process.

6.   **Access to financing:** Access to financing tends to drive small businesses out of the competitive solicitation market. Within the context of competitive solicitations for energy efficiency measures, financing is important in two ways: (a) project financing is difficult to obtain, and expensive; and (b) working capital financing is difficult to obtain, and expensive. The problems faced by small businesses in this regard are magnified for the not-for-profit small businesses that would often serve the low-income residential sector.

The availability of commercial financing is probably the primary determinant of the ability of small business enterprises to compete

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of Richmond v. J.A. Croson--A Collection of Articles by Constitutional Scholars and Economists, Serial No. 11, (Comm. Print 1990) at 116, 118.

[12]   George Lanoue, *Standards for the Second Generation of Croson-Inspired Disparity Studies*, 26 **The Urban Lawyer** 485,. 502 (1994), *citing*, Park, **Construction Bidding for Profit**, at 109 (1979).

effectively in bid solicitation processes. Adequate commercial lending is often denied to small business from three perspectives:

o   The *availability* of financing is often denied to small businesses;

o   *Equivalent* financing (meaning financing for an equivalent term of years, and based on similar financial statements)[13] is often unavailable; and

o   Financing on *equivalent terms* (such as equivalent interest rates and security requirements) is often unavailable.

Not only do these financing problems affect the competitiveness of small businesses on any given project, they affect the fundamental formation and survival of small businesses in the first instance. Barriers to start-up and operation, in other words, can be just as inimical to competitiveness as project-specific barriers. As one study by the Federal Financial Institutions Examination Council (FFIEC) concluded as to minority small business in particular: "[95.8%] of the firms turned down for a loan said they had canceled, postponed, or scaled down plans to expand, modernize, or renovate their businesses as a result of the denial of the loan."[14]

Project financing and working capital financing are particularly important factors in achieving any type of competitiveness in the competitive solicitation of energy efficiency bids. As described elsewhere, payments on energy efficiency investments are not generally made simply upon completion of the energy efficiency installations. Instead, payments are dependent on achieving the estimated savings. As a result, initial payments will likely be delayed until adequate time has elapsed to determine whether estimated savings arise. Moreover, continuing payments are likely delayed until a determination is made that recognized savings will persist. Due to the nature of the energy efficiency industry, therefore, the need for financing is substantial. Initial payments will likely be delayed and ultimate payments will be made over time.

7.   **Higher per unit costs of small businesses:** Small businesses tend to have higher per unit of production costs than larger businesses. As a result, a competitive solicitation model will tend to have the effect of systematically excluding small business participation. The higher per unit costs arise for several legitimate reasons. First, small businesses tend to have more "principals" and fewer "associates"

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[13]   For example, loan dollars per dollar of equity are generally less for small business.

[14]   FFIEC, "Where Credit is Due: A Study of Small Business Access to Capital," *Interface*, at 14 (June 1988) (prepared for *Federal Reserve Bulletin*).

than larger businesses. The overall per unit cost, therefore, will not involve the same type of "blended fee structure" that will obtain in a larger commercial organization. Second, small businesses tend to have a higher proportion of permanent, salaried (and benefitted) employees than do larger businesses. Unlike larger organizations, who can and do "out-source" parts of a contract, small businesses will retain a higher proportion in-house, with the accompanying taxes, overhead and benefits associated with maintaining that employment capacity. Third, small businesses tend to face higher costs of production, ranging from the lack of access to wholesale (or bulk) purchasing to the lack of access to less expensive "wholesale" credit.

8.   **Bid solicitation advertising:** Barriers that may seem trifling to a firm the size of a major electric utility in Arkansas on the one hand may be absolutely insurmountable to a small business enterprise on the other. For example, one report in Denver found that that city systematically excluded small businesses from participation by confining the announcements of its bid solicitations to a daily business journal, the cost of which exceeded $400 per year. This cost, the Denver research found, was simply beyond the financial capability of most small businesses to afford. Similarly, Seattle was found to advertise its bid solicitations in the *Daily Journal*, "a relatively high cost (currently $1,080 per year), limited circulation trade paper. . ." Subscription to that publication, research found, was only economically justified by "bigger firms interested in the larger bid opportunities."

In sum, competitive solicitation models, in *any* industry, have commonly recognized anti-competitive impacts on small businesses. To imply, as does one commenter, that no competitive concerns should exist not only flies in the face of available evidence, but ignores the explicit direction of EPAct to consider just such impacts.[15] The dictates of EPAct in this regard become even more important in light of the facts that the competitive barriers faced by small business across-the-board are even more cogent within the arena of bidding on energy efficiency projects.

PART 4:   PUBLIC UTILITIES HAVE A CHECKERED HISTORY REGARDING SMALL AND SMALL DISADVANTAGED SUBCONTRACTORS.

As was shown above, maintaining small business competitiveness within a competitive solicitation framework will not "just happen." Instead, concerted and creative efforts must be taken by the utility industry to overcome the formidable competitive barriers faced by small business

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[15]   Hence, the assertion by one party that adverse impacts on small businesses will not occur because "small DSM providers will have every opportunity to participate in competitive solicitations along with all other interested parties," ignores the substantial array of work that has been undertaken on the structural barriers to participation in "competitive solicitations" for public works projects.

enterprises. Given this need, it is appropriate to inquire into the track record, if any, of the public utility industry as to its ability and willingness to put forth such an effort.

A review of the ability and willingness of public utilities in Arkansas (and elsewhere) to engage in affirmative efforts to promote the competitiveness of small business, in other words, should not ignore the history that has been documented to date. For example, under the Federal Property and Administrative Services Act of 1949, the General Services Administration (GSA) is authorized to enter into contracts with public utility firms for a maximum of ten years for the purchase of utility services for federal agencies.[16] GSA's policy is to obtain service under a formal, written contract if the estimated annual cost of the services will exceed $25,000.

In addition, the Small Business Act, as amended, generally requires that federal contracts exceeding $500,000 that have subcontracting possibilities contain subcontracting plans providing for the maximum practical opportunity for small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals.

Under the statute, failure to comply in good faith with subcontracting plan requirements will be considered a material breach of the contract. Moreover, the statute provides that when a contractor fails to make a good faith effort to comply with a subcontracting plan, the contractor must pay damages to the government. In general, the legislative history of the statute makes clear that the legislative intent for the subcontracting plans was to improve the opportunities for small and small disadvantaged businesses to do business with the federal government.

The U.S. General Accounting Office has issued an opinion that a public utility that sells services under tariff to the federal government but declines to sign a formal contract is nonetheless legally required to comply with the subcontracting plan requirements. GAO said that (1) the statutory requirements are implied in contracts meeting the threshold amounts, whether or not they are expressly included in a written agreement; and (2) the subcontracting plan requirements apply regardless of the utilities' status as regulated monopolies and regardless of whether the utilities had specifically consented to the relevant contract provisions.

As of 1993, roughly 1,000 utilities provide services to GSA, 365 of which meet the threshold of providing services the annual cost of which exceeds $25,000. GSA has signed written contracts with 246 of those 365 utilities. The remaining 119 utilities declined to sign contracts. In a

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[16]   Contracts may be either area wide --providing service for several agencies in a service territory-- or single point --providing service to a single facility.

recent evaluation of utility compliance with the small business statutes, GAO reported:[17]

o   146 of the 1000 utilities are subject to the Small Business Act requirement that businesses with contracts exceeding $500,000 that have subcontracting possibilities submit subcontracting plans setting forth percentage goals for subcontracting with small and small disadvantaged businesses. As of November 1992, 80 of the 146 utilities had submitted current plans, while 66 had not.

o   Although 107 of the utilities that signed contracts and that were required to submit subcontracting plans did so when they initially executed the contracts, 31 have failed to update their plans as required by agency regulations.

o   Of the 119 utilities that declined to sign written contracts, 39 are required to submit subcontracting plans. 35 of those companies, however, had failed to do so by November 1992.

GAO listed the 35 utilities that had refused to sign a contract and had refused to submit the required subcontracting plan to GSA. Amongst those 35 utilities is Arkansas Power and Light Company. Indeed, AP&L is one of 12 companies that had been cited for noncompliance in 1989 as well.

Given this history of lack of effort to pursue legal requirements regarding small and small disadvantaged subcontractors for utilities specifically, state regulators should be skeptical of the observation that the mere existence of a competitive solicitation procedures for energy efficiency procurement would not work to the competitive disadvantage of small firms.

SUMMARY AND CONCLUSIONS

In considering the proposed Integrated Resource Planning (IRP) standard pursuant to PURPA, state regulators are under an explicit statutory directive to take into account the anti-competitive impacts of the standard's implementation on small business. Regulators must consider, in other words, whether utility actions would provide utilities with unfair competitive advantages over small businesses.

Adoption of the proposed competitive solicitation model as set forth in comments to the Arkansas PSC would provide precisely this type of

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[17]   U.S. General Accounting Office, *GSA Procurement: Public Utilities' Plans for Small and Small Disadvantaged Subcontractors* (Jan. 1993).

competitive advantage over small businesses. Not only does a competitive solicitation model inherently favor large firms undertaking large projects, but the model fails to take into account the substantial array of anticompetitive impacts that competitive solicitation procedures in the public sector have been found to have on small business.

The analysis above concludes that a competitive solicitation model will have adverse competitive impacts on small business and, by extension, on the low-income households which tend to be primarily served by such small businesses. The model should not be adopted.

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