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United States General Accounting Office
Washington, DC 20548

December 17, 2001

Mr. David A. Drabkin
Deputy Associate Administrator
U.S. General Services Administration
Office of Acquisition Policy
1800 F Street, N.W.
Washington, DC 20405

Subject: GSA's Guidance and Oversight Concerning Areawide Utility Contracts

Dear Mr. Drabkin:

In September 2001, we issued a report on the District of Columbia school system's use of a General Services Administration (GSA) areawide utility contract with the Washington Gas Light Company.[1] The school system has used this contract for $43 million worth of general facility improvements and maintenance—work that was outside the scope of the contract. In the report, we raised concerns about GSA's guidance on the use of areawide utility contracts.

The guidance does not adequately indicate that, when the utility is not the only available source, services ordered under areawide contracts must be provided by the utility acting in its capacity as a public utility (i.e., subject to regulatory authority). Otherwise, the government's competitive contracting requirements apply. In addition, we found that GSA lacked oversight of the school system's use of the contract and was unaware of the scope of work ordered under it, largely because neither the school system nor Washington Gas complied with GSA's reporting requirements. This letter discusses these findings in greater detail and recommends actions that GSA can take to improve its oversight of areawide contracts and its guidance on their use.

Background

GSA is authorized by statute to prescribe policies and methods governing the acquisition and supply of utility services for federal agencies.[2] Competition to

[1] See *District of Columbia: D.C. Public Schools Inappropriately Used Gas Utility Contract for Renovations* (GAO-01-963, Sept. 28, 2001).

[2] See section 201 of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. sec. 481).

provide such services is often unavailable within the market established by a utility's regulators. In such cases, GSA and utility service providers enter into areawide contracts to cover the service needs of federal agencies within the utility's franchise territory. The franchise territory is a geographical area that a utility has a right to serve on the basis of a franchise or other legal means. Areawide contracts provide a preestablished contractual vehicle for ordering utility services such as electricity and natural gas.

According to the Federal Acquisition Regulation, areawide contracts generally provide for ordering utility services at rates approved and/or established by a regulatory body (such as a public utility commission) and published in a tariff or rate schedule.[3] Any federal agency having a requirement for utility services within an area covered by an areawide contract is required to acquire the services under that contract unless service is available from more than one supplier. If service is available from more than one supplier, the Federal Acquisition Regulation requires that the service be acquired using competitive acquisition procedures.[4]

The District of Columbia government is authorized by GSA to use available areawide contracts for utility services. The District of Columbia school system started using the GSA areawide contract with Washington Gas in late 1997. To date, the school system has ordered about $43 million worth of general facility improvements and maintenance from Washington Gas as "energy management services" under the contract's ordering procedures. For example, the school system used the GSA contract for a variety of renovation services, including painting, carpeting, plumbing, and electrical work; boiler, air conditioning, and heating repairs; playground upgrades; bathroom renovations; and the refurbishing of flagpoles.

Guidance on Use of Areawide Contracts Is Misleading

GSA's Energy Center of Expertise has published two sets of guidance to familiarize agencies with the use of its areawide utility contracts: the *Utility Areawide Guide* and *Procuring Energy Management Services with the Utility Areawide Contract.* However, this guidance is misleading.

GSA's guidance does not explain that, when the utility is not the only available source, services ordered under areawide contracts must be provided by the utility acting in its capacity as a public utility (i.e. subject to a regulatory authority such as a public utility commission). Instead, the guidance states only that areawide contracts allow agencies to procure from utilities a variety of energy management services—

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[3] See 48 C.F.R. sec. 41.204.

[4] Id.

including energy audits, feasibility studies, and installation of energy conservation projects—and that agencies can define their own energy management projects under the contract.

GSA's use of areawide contracts for energy-efficiency services is based on the National Energy Conservation Policy Act, as amended by the Energy Policy Act of 1992. This law encourages investment in energy efficiency by electric and gas utilities, establishes energy management requirements for federal agencies, and authorizes federal agencies to participate in utility incentive programs. (Appendix II contains more detail on the authorization for agencies to participate in utility incentive programs). Furthermore, Executive Order 13123, *Greening the Government Through Efficient Energy Management*, issued on June 3, 1999 and based on the Energy Policy Act, requires agencies to reduce energy usage and cost through the use of alternative financing and contracting mechanisms.

Areawide contracts may be appropriate vehicles for carrying out the federal energy management goals of the Energy Policy Act and the Executive Order. However, under these authorities, use of these contracts is limited to only those services that are subject to public utility regulatory authority and offered by a utility in its capacity as a public utility.

The Energy Policy Act authorizes agencies to participate in a utility company's energy-efficiency programs that are generally available to the utility's customers. Such utility services are subject to public utility regulatory authority not only because of the regulated nature of the utility industry in general, but also because of the Energy Policy Act's specific requirement that investment by electric and gas utilities in energy efficiency be subject to state regulatory authority.[5] Congress, in requiring under the Energy Policy Act that utilities and public utility commissions consider energy-efficiency programs to reduce energy demand, intended that state laws and regulatory commissions would continue to determine whether utilities actually engage in such activities.[6] Further, Executive Order 13123 defines "utility" as meaning public agencies and privately-owned companies that market, generate, and/or distribute energy or water as commodities for public use and that provide the service under federal, state, or local regulated authority for all authorized customers.[7]

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[5] Sections 111 and 115 of the Energy Policy Act amended the Public Utilities Regulatory Policies Act of 1978 (16 U.S.C. sec. 2621; 15 U.S.C. sec. 3203) to encourage investments in conservation and energy efficiency by electric and gas utilities under state regulatory authority.

[6] H.R. Conf. Rep. No. 102-1018, at 381-82, 383-83, reprinted in 1992 U.S.C.C.A.N. 2472-73, 2474-75.

[7] The principal determinative characteristic of a public utility is that of service to, or readiness to serve, an indefinite public that has a legal right to demand and receive its services or commodities. 64 Am Jur 2d Public Utilities sec. 2 (2001). A public utility holds itself out to the public generally and may not refuse any legitimate demand for service, while a private business independently determines whom it will serve. Id.

Accordingly, the energy-efficiency programs available to federal agencies under the Energy Policy Act—and generally available to the utilities' customers—are subject to public utility regulatory authority. To the extent that the Executive Order authorizes the use by federal agencies of GSA areawide contracts for the procurement of energy-efficiency services from utilities, such services may be provided only in the utility's capacity as a public utility (i.e. subject to regulatory authority). Otherwise, such services would not be properly available to federal agencies through areawide contracts, which are typically entered into by GSA with utilities on a sole-source basis precisely because of utilities' status as public utilities with exclusive franchises. GSA's guidance on the use of areawide contracts fails to make this clear.

Finally, GSA's guidance does not list alternatives to areawide contracts for use in situations where these contracts are inappropriate. For example, the guidance could refer agencies to procedures for using energy savings performance contracts (which are awarded using competitive procedures) or to the Federal Acquisition Regulation procedures for acquiring utility services where more than one source is available. Appendix III contains more detail on energy savings performance contracts. Preexisting government sources, such as GSA's federal supply schedules, may be another option for fulfilling agencies' needs for certain energy management services.

Guidance Does Not Emphasize Competitive Contracting Requirements

In responding to our September 2001 report, GSA takes the position that the acquisition of utilities' energy-efficiency services without competition, through an areawide contract, is an authorized exception to the government's competitive contracting requirements. According to GSA, the Energy Policy Act's authorization for federal agencies' participation in utility incentive programs provides authorization to procure the services from a specified source (the utility), which is one of the statutory exemptions from competition in the Competition in Contracting Act of 1984.[8] However, even if the Energy Policy Act provides such authorization, the exemption from competition is limited to the acquisition of utility services subject to regulatory authority. GSA's guidance does not make clear that, when the utility is not the only available source for the services, the acquisition of the services is otherwise subject to the government's competitive contracting requirements.

GSA enters into areawide contracts without competition due to the regulated nature of utility services, which, because of the legal right granted to a utility to service an exclusive area, typically precludes competition. A service is authorized under a utility incentive program—and thus under an available areawide contract—when it is

[8] 41 U.S.C. sec. 253(c)(5).

subject to public utility regulatory authority.[9] Federal agencies would then be authorized to participate in the program by the Energy Policy Act, notwithstanding the availability of other sources for specific energy-conservation projects. The use of an areawide contract to procure energy-efficiency services that are not subject to regulatory authority is inconsistent with the government's competitive procurement requirements. In a June 20, 1974, bid protest decision, we held that in procuring utility service, GSA is obligated to obtain competition to the extent that it is available (*RCA Alaska Communications, Inc.*, B-178442). We held that GSA's authority to procure utility services under the Federal Property and Administrative Services Act does not justify noncompetitive procurements where competition is available. We recognized that where public utilities are involved, the number of potential sources may be severely limited, or, for that matter, only one source may be available. However, we stated that, in our opinion, "the duty to obtain maximum competition is paramount." We concluded that GSA must assess the availability of competition and act accordingly before entering into public utilities contracts.

Unless utilities provide energy-efficiency services in their capacity as public utilities, we believe the services cannot be procured through a GSA areawide contract without violating the Competition in Contracting Act of 1984. This Act establishes an even higher competition standard—"full and open"—than was applicable in the 1974 GAO bid protest decision. If GSA allows federal agencies to use areawide contracts to procure energy efficiency services that are not subject to public utility regulatory authority, GSA is not providing for full and open competition for potential sources of these services, as required.

The GSA guidance lists a variety of potential energy-efficiency projects, none of which involve work that only a utility could provide. Most of them—general facility improvements and heating, ventilation, and air conditioning equipment upgrades—could be performed by other sources such as a general contractor, licensed plumber or electrician, or heating and air conditioning equipment company. Nonetheless, the guidance states that most types of energy and energy management services are

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[9] For example, a July 29, 1994, GSA Office of General Counsel memorandum approved the use of an existing areawide contract for the acquisition of energy management services. The utility company's proposed energy conservation measures were a tariffed service offered under a program authorized by the state public utilities commission, and participation in the program was generally available to customers of the utility. The public utility would provide GSA a subsidy offsetting the total cost of certain energy conservation measures (including the installation of energy-saving equipment) which would be paid for through a monthly service charge on the agency's electric bill over 14 years. Payment for the services rendered by the utility would be determined in accordance with an equipment services tariff approved by the public utilities commission.

available through areawide utility contracts, and that these contracts have the flexibility to cover "nearly every type of energy, water, and demand-side management project possible." According to the guidance, "if your local utility services provider offers it, your Agency can procure it quickly and easily using the GSA Areawide Contract." However, GSA's guidance does not inform agencies that the procurement of any of the numerous potential energy conservation projects it lists is subject to the availability of those services through regulatory authority over public utilities and thus may not actually be available in each case. The guidance also fails to state that, when the utility is not the only available source, services ordered under areawide contracts are limited to those provided by the utility in its capacity as a public utility.

GSA Lacked Oversight Over School System's Use of Washington Gas Contract

Neither Washington Gas nor the District of Columbia public school system complied with requirements to inform GSA of all orders executed under the areawide contract with Washington Gas. In fact, the GSA contracting officer responsible for the contract was unaware that the school system had improperly used the contract until we informed her in April 2001.

GSA's contract with Washington Gas requires a copy of each order executed under the contract to be transmitted by the ordering agency (in this case, the District of Columbia Public Schools) to GSA. This instruction is also printed on the front of the contract's ordering form. In addition, the contractor is required to provide GSA with an annual report listing all federal customers requiring service under the contract, including the nature, dollar value, and quantity of service. Furthermore, the Federal Acquisition Regulation requires agencies using GSA areawide contracts to provide GSA with a copy of each order issued to the contractor within 30 days after execution.[12]

The contracting officer stated that many ordering agencies and contractors do not comply with the requirement to report on their use of areawide contracts. In this case, neither Washington Gas nor the school system filed copies of any of the orders executed under the contract. The official said GSA administers about 160 areawide contracts nationwide and lacks the resources to adequately monitor contract usage. As a result, GSA relies on ordering agencies to raise questions or concerns. In the case of the school system's use of the Washington Gas contract, however, the school system's contracting officer did not raise questions about the scope of work allowed under the contract. Thus, GSA was unaware that the contract was being improperly used.

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[12] 48 C.F.R. sec. 41.204(e).

Once we notified GSA that the school system was using the Washington Gas contract for work outside the scope of the contract, the GSA contracting officer took prompt action. In May 2001, GSA sent a letter to the schools' contracting officer stating that

- GSA's contract with Washington Gas is not intended to provide general facility improvements and maintenance that are not energy-related and
- the continued use of the contract for services outside its scope and intent would jeopardize the school system's ability to continue using the contract.

The schools' contracting officer responded that the school system would adhere to the intended use of the contract when ordering future services and would follow GSA guidance to ensure that only proper services are ordered. However, we remain concerned that, by following the GSA guidance, the school system may continue to procure services not covered under the areawide contract.

As the scope of our review was limited to the school system's use of the Washington Gas contract, we did not determine whether other GSA areawide utility contracts are being improperly used or whether other contractors and ordering agencies are failing to comply with the requirement to notify GSA of orders executed under the contracts.

Conclusion

Unless GSA's guidance on areawide contracts is revised, the potential for misuse exists. Following current guidance, ordering agencies could inappropriately define an energy-efficiency project to be anything a utility—or its subsidiaries—is willing and able to perform as a private business rather than in its capacity as a public utility. The guidance could be interpreted as permitting agencies to order such energy-efficiency projects on a sole-source basis under an areawide contract, even if the projects are not subject to regulatory authority as required by law. We believe the guidance fails to clearly advise agencies that unless the ordered services are subject to regulatory authority, agencies are required to use competitive acquisition procedures to obtain the services when more than one source exists.

The District of Columbia public school system's misuse of the GSA areawide utility contract with Washington Gas may be a solitary occurrence among the many agencies that use these types of contracts. However, we believe that a contracting agency such as GSA should be responsible for knowing how its contracts are used and that ordering agencies and contractors are responsible for complying with GSA's reporting requirements. Better contract management and oversight by GSA would help ensure that contracts are not used for more than their intended purpose and that contractors provide no services beyond the scope of the contract.

Recommendations for Executive Action

We recommend that you take the following actions:

- Direct a revision of GSA's guidance on areawide utility contracts to emphasize that ordering agencies must use competitive acquisition procedures to procure utility services that are (1) not subject to regulatory authority and (2) available from more than one supplier.
- Conduct an assessment—or request the GSA Inspector General to conduct an assessment—of the extent to which (1) ordering agencies and contractors are reporting the use of the contracts as required and (2) GSA is adequately monitoring the contracts' use. If appropriate monitoring is not taking place, GSA should develop cost-effective controls to ensure that agencies are complying with reporting requirements and properly using the contracts.

Please provide us with a response within 30 days of planned actions to be taken on our recommendations.

Agency Comments

In written comments on a draft of this report, GSA concurred with our recommendations. GSA's agreement with our first recommendation was contingent on an understanding that our interpretation of GSA's authority under the Energy Policy Act is consistent with GSA's. GSA's interpretation of its authority to provide energy management services through areawide contracts is consistent with our position. Specifically, GSA acknowledges in its comments that its authority to negotiate utility contracts is limited to services that are subject to state regulatory authority and to public utilities acting in their capacity as public utilities. GSA agrees with our position that areawide contracts are limited to those utility services subject to public utility regulatory authority or provided under such authority (which is what we mean by the term "regulated"). We have clarified this language in the report.

GSA plans to implement a number of actions to address our recommendations. As part of its efforts to revise its guidance on areawide contracts, GSA will survey state regulatory commissions on the scope of their authorities and request public utilities to certify that their energy management services offered to federal agencies are in compliance with state rules and regulations. Further, because state standards may vary, GSA plans to adopt a revised definition of, and additional guidance on, what constitutes a demand-side energy management service. Once an agency has determined that a project meets the definition, GSA will require the agency to follow the required justification and approval process for using other than full and open competition.

To increase oversight and monitoring of areawide contracts, GSA plans to clarify the language in areawide contracts regarding the energy management services authorized to be ordered; conduct periodic sampling and reviews of contract actions placed against areawide contracts; encourage agencies to compete energy management requirements; and provide clearer guidance to both agencies and utilities on the use of areawide contracts for energy management services. If improper use of the contracts is discovered, GSA will take steps to advise agencies or, if warranted, terminate the portion of the areawide contract pertaining to demand-side energy management services.

GSA also states that it will (1) require utility companies to provide GSA with a copy of any future authorization for energy management services and (2) remind ordering agencies of their responsibilities to inform GSA when they order services under areawide contracts.

GSA's comments appear in appendix I.

We conducted our review from July to October 2001 in accordance with generally accepted government auditing standards. In conducting our review, we met with officials at GSA, the District of Columbia Public Schools, and Washington Gas. We analyzed GSA's areawide contract with Washington Gas and GSA's guidance provided to ordering agencies.

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We are sending copies of this letter to the Honorable Stephen A. Perry, Administrator, GSA; Dr. Paul Vance, Superintendent, District of Columbia Public Schools; Subcommittee on the District of Columbia, House Committee on Appropriations; and other interested congressional committees. This letter will also be available on GAO's home page at http://www.gao.gov. Please contact me at (202) 512-4841 or Sheila Ratzenberger at (202) 512-8244 if you or your staff have any questions. Other major contributors to this report were Adam Vodraska, Michele Mackin, and Charles D. Groves.

Sincerely yours,

David E. Cooper

David E. Cooper, Director
Acquisition and Sourcing Management

Sheila K. Ratzenberger

Sheila K. Ratzenberger
Associate General Counsel

Appendix I

Comments From the General Services Administration

GSA

GSA Office of Governmentwide Policy

December 7, 2001

Mr. David E. Cooper
Director
Acquisition and Sourcing Management
General Accounting Office
Washington, DC 20548

Re: GSA's Guidance and Oversight Concerning Areawide Utility Contracts (GAO-02-56R)

Dear Mr. Cooper:

This letter is in response to your October 12, 2001 request for comments on the above referenced draft correspondence report. The General Accounting Office (GAO) makes two overall recommendations in the draft correspondence report: (A) that the General Services Administration (GSA) revisit guidance on areawide utility contracts to emphasize that ordering agencies must use competitive acquisition procedures to procure services that are (1) not subject to regulatory authority and (2) available from more than one supplier; and (B) that GSA conduct an assessment –or request the GSA Inspector General to conduct an assessment—of the extent to which (1) ordering agencies and contractors are reporting use of the contracts as required and (2) GSA is adequately monitoring contracts' use. If appropriate monitoring is not taking place, GAO recommends that GSA consider devoting sufficient resources to areawide contract administration to ensure that agencies are complying with reporting requirements and properly using the contracts.

With respect to the first recommendation, GSA agrees that its guidance to other agencies should be revised to reflect parameters within which agencies may appropriately order energy management type services from utilities under Section 152 of the Energy Policy Act of 1992. GSA respectfully disagrees, however, with GAO's conclusion, as drafted, that ordering agencies are required to use competitive acquisition procedures to procure such services. GSA generally agrees with GAO's second recommendation that GSA

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should assess the usage of the areawide contracts, and whether GSA is effectively monitoring usage.

Background

Utility provided Demand Side Management (DSM) incentive programs existed prior to the passage of the Energy Policy Act. Most, if not all, of those same DSM programs exist today in various forms. For example, some of the earliest forms of DSM included energy audits and boiler and chiller replacement. While the use of rebates has declined from the late 1980's to present, total annual utility DSM expenditures have actually increased from 1989 to 1999 (from \$0.87 to \$1.42 billion dollars) with peak expenditures of \$2.7 billion in 1994 as reported by the Energy Information Administration. Utility DSM expenditures are once again on the increase as a result of capacity problems in the electric grid. States such as California, New York, Massachusetts, New York, Florida, Illinois, Connecticut, Wisconsin and Washington continue to be the most active in providing utility DSM funding. In general, utility DSM programs have transitioned from providing specific dollar incentives for installing specific pieces of equipment to providing financial incentives for shedding, shaping, or curtailing electric load during specific times and providing financing to accomplish DSM projects. As in 1992, there continues to be significant variation in utility DSM programs from state to state due to the fact that each state creates its own standards and in many cases has little or no standards at all as a recent study by E Source found.

In the context of achieving the Federal government's energy conservation goals and objectives, utility demand side management (DSM) contracting has been a powerful tool for providing the Federal sector access to private capital. Utility DSM services are accessed via three (3) different contracting vehicles, namely the GSA areawide contract, a basic ordering agreement, and a model agreement. According to the Federal Energy Management Program's website, "more than 45 electric and gas utilities have provided financing for energy and water efficiency upgrades at Federal facilities, investing more than \$600 million…since 1995." This significant infusion of private capital has greatly assisted the entire Federal Government in accomplishing energy reduction goals. In addition, utility companies have pledged the investment of an additional \$2 billion in life cycle cost effective facility improvements to achieve 2010 energy reduction goals through a private/public effort conducted with the Edison Electric Institute.

GSA's Areawide Utility Contract program has enabled the Federal government to receive reasonable utility rates and superior service. Furthermore, the Areawide Contracts have enhanced greatly the Federal government's ability to meet and exceed the energy conservation goals established by the President through executive order and by Congress through the Energy Policy Act.

Recommendation One

GAO recommends that GSA clarify, in both its guidance and in its oversight of the use of the areawide contracts, that only regulated energy management programs, or energy

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management programs specially recognized by public utility commissions, or services not available from more than one source, may be acquired through the areawide utility contracts. We agree that GSA should revise its guidance to more clearly articulate standards for usage to ensure that the ordering agencies are using the areawides for their intended purposes. GSA does not believe, however, that GAO's conclusion as drafted is supported by the Energy Policy Act.

While GSA does not believe that its authority to directly negotiate with utilities is limited to regulated and/or tariffed services or services that are not available from other sources, GSA acknowledges that its authority is limited to services that are subject to state regulatory authority. GSA's authority to negotiate utility contracts under the Federal Property and Administrative Services Act and the Energy Policy Act is limited to public utilities acting in their capacity as a utility. The services provided by a public utility are, by definition, subject to the broad regulatory authority administered by state commissions. This is true even if the service provided is not a tariffed service or has not received special approval. As long as services, as described in section 152(c) of the Energy Policy Act, are offered generally to the customers of the franchised utility, Federal agencies are authorized to negotiate directly with the utility for those services. To the extent GSA's interpretation of its authority under the Energy Policy Act is consistent with GAO's interpretation, GSA is in agreement with GAO's first recommendation.

However, to the extent GAO intends its recommendation to limit the scope of GSA's authority under the Energy Policy Act to regulated (i.e. specifically approved or authorized) and/or tariffed energy management services, GSA respectfully disagrees with GAO's recommendation. Congress neither enacted nor intended such a limitation when it authorized federal agencies to negotiate directly with utility companies with respect to incentive programs for energy conservation.

GSA outlines in more detail below those measures that are intended to provide management controls on its contracting program, including surveying state commissions on the scope of their authorities and providing a more specific definition of demand side or energy conservation measures. With these controls in place, GSA is confident that its energy management procurements will be consistent with our contracting authority.

Authority to procure services on a sole source basis

Section 152(c) of the Energy Policy Act, 42 U.S.C. § 8256(c), expressly authorizes agencies to acquire certain services from gas, water, or electric utilities. In particular, section 152 of the Energy Policy Act, 42 U.S.C. § 8256(c), provides that:

(1) Agencies are authorized and encouraged to participate in programs to increase energy efficiency and for water conservation or the management of electricity demand conducted by gas, water, or electric utilities and generally available to customers of such utilities;

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(2) Each agency may accept any financial incentive, goods, or services generally available from any such utility, to increase energy efficiency or to conserve water or manage electricity demand;

(3) Each agency is encouraged to enter into negotiations with electric, water, and gas utilities to design cost-effective demand management and conservation incentive programs to address the unique needs of facilities utilized by such agency; and

(4) If an agency satisfies the criteria which generally apply to other customers of a utility incentive program, such agency may not be denied collection of rebates or other incentives.

GAO interprets "generally available to customers" as requiring that the offered service be regulated services.

GAO's interpretation is not consistent with the Energy Policy Act or actual industry practice. This language at issue originated in the National Defense Authorization Act for 1991. P.L. 101-510, § 2865(b)(3); 10 U.S.C. § 2865(d). In the Defense Authorization Act, the Secretary of Defense was authorized to:

(1) permit and encourage each military department . . . to participate in demand-side management and energy conservation programs conducted by gas or electric utilities;

(2) accept any financial incentive, goods, or services generally available from gas or electric utilities; and

(3) enter into agreements with gas and electric utilities to design and implement cost-effective demand and conservation incentive programs (including energy management services, facilities alterations, and the installation and maintenance of energy saving devices and technologies by the utilities).

Section 152 of the Energy Policy Act similarly authorizes Federal agencies to participate in all energy management programs that are "generally available to customers" of the utility. The Energy Policy Act differs from the language in the Defense Authorization Act in two respects. First, water conservation programs and utilities are included with gas and electric. Second, the language in the third authorization is different in that Federal agencies were authorized to "enter into **negotiations** with electric, water, and gas utilities to design cost-effective demand management and conservation incentive programs to address the unique needs of facilities utilized by such agency." 42 U.S.C. § 8256(c)(3), emphasis added. The Energy Policy Act also includes separate authority for Energy Savings Performance Contracts (ESPC's) between the Federal government and private companies. 42 U.S.C. § 8287. There is no expressly stated limitation in the statutory language that restricts the Government's ability to negotiate directly with utilities to obtain only tariffed or otherwise regulated energy management services, or that defines

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"generally available to customers" as including only regulated or tariffed services. Similarly, there is no indication in the legislative history of this provision that Congress intended anything other than to enable and encourage Federal agencies to take advantage of programs offered by utilities.

The legislative history of the Energy Policy Act makes it clear that Congress was concerned over the level of utility usage by the Federal government. The Act set specific energy reduction goals for each federal agency. In order to assist agencies in attaining these goals, Congress created several layers of incentives. Federal agencies were authorized to negotiate directly with utilities in order to take advantage of utility incentives, specifically including financial incentives. ESPC's are authorized, where the energy savings from the program will actually "pay for" the conservation measures themselves.

Specifically, Congress noted "a critical need for Federal agencies to increase the pace and scope of their investments to improve energy efficiency." House Committee on Government Operations Report, No. 102-474, Part 5, page 34 (May 5, 1992). The Federal agencies' ability to take advantage of utility financing and ESPC contracting was, and is, critical to achieving the goals set out in the Energy Policy Act.

Congress also recognized that, at that time, public utilities were generally reluctant to develop energy conservation and demand management programs since they negatively impacted sales from those utilities. Therefore, Congress also laid out incentives for electric and gas utilities and for public service commissions. Congress authorized grants to State regulatory authorities that agreed to develop a plan to encourage energy efficiency, including integrated resource planning and considering the costs to utilities for these programs in their ratemaking. 15 U.S.C. § 3203. In their oversight of the gas industry, the State regulatory authorities are required to consider the impact of such programs on small businesses and to assure that utilities would not have an unfair competitive advantage over small businesses. However, Congress specifically stated that this provision **"neither precludes, nor mandates, the adoption of competitive bidding for demand-side management services"**, nor is it intended to preclude utilities from engaging in energy conservation measures. House Conference Report, No. 102-1018, Joint Explanatory Statement of the Committee of Conference, Title I, Section 111, page 382 (October 5, 1992) (Emphasis added).

Furthermore, as noted above, those programs offered by utilities have always included measures that could be provided by other sources, such as energy audits and equipment replacement. Congress never included a restriction that would limit the Government's authority to negotiate directly with utilities to those measures that could not be procured from other sources.

From the time this provision was enacted, the executive branch has construed Section 152 as authorizing an exemption from full and open competition in accordance with the fifth statutory exception under the Competition in Contracting Act (CICA), 41 U.S.C. § 253(c)(5). In a memorandum dated July 7, 1994, the Department of Energy (DOE), the

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agency authorized to interpret and implement the Energy Policy Act, stated that Section 152 of the Energy Policy Act granted federal agencies the authority to acquire energy management services from utility companies on a sole source basis. This decision was based, in part, on a previous decision of the Department of Defense, interpreting the similar language in the Defense Authorization Act. DOD also determined that Section 152 of the Energy Policy Act constituted an exception to CICA. GSA's Office of General Counsel, after reviewing the determinations of both DOD and DOE, concluded that the Energy Policy Act provided an exception to CICA. None of these opinions limited the scope of the exception to regulated services.

As recently as June 2001, in a document entitled "Lessons Learned – Utility Energy Services Contracts", DOE stated that "[t]here is no legal requirement to compete for utility incentive services provided by the 'established source' utility company to a Federal facility in the utility's franchised service territory. If such services are available to customers of the utility company, the Energy Policy Act of 1992 states that there should be no restriction on the Federal facilities directly availing themselves of the same service as any other customer." Therefore, DOE has interpreted the phrase "generally available to customers" as including ALL services provided by the franchised utility to its customers, not just the REGULATED services.

In summary, GSA does not believe that GAO's conclusion is consistent with the Energy Policy Act. Nothing in the actual language or the legislative history of the Energy Policy Act suggests that the authority granted was to be so narrowly interpreted. In fact, the Energy Policy Act, in its emphasis on the need for energy conservation and the incentives available from public utilities, suggests that the authority should be interpreted and applied broadly. DOE has specifically reviewed this issue and has concluded that the exception to CICA extends to all energy management services provided to customers of the franchised utility. GSA agrees with this conclusion.

Utility DSM contracting mechanisms, including the areawide contract, are effective energy conservation tools. Such tools are of particular interest to regulated utilities because they are obligated to serve customer loads and building new power plants and/or siting new power lines is a time consuming and uncertain process. DSM in its various forms reduces the need to build new plants. Utilities thus have an incentive to pursue DSM projects with lower profit margins or longer paybacks, incentives that private sector energy companies often do not have. In addition, GSA has often found that utility companies have provided excellent quality as well as a unique knowledge of the incentive programs offered by the state and the utility itself. For these reasons, GSA has concluded that that the use of areawide contracts for the acquisition of energy management services is not only consistent with the authority provided in the Energy Policy Act, but also provides a powerful tool for meeting environmental goals.

Revision of GSA's guidance to ensure proper use of areawide contracts

GSA agrees that it can take additional steps to ensure that the use of the areawide contract and the authority to negotiate directly with utilities is properly administered. In order to

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ensure that the various state DSM standards are complied with by both Federal agencies and public utilities with areawides, GSA will document state DSM rules and regulations by contacting state regulatory bodies where GSA areawide contracts exist. GSA will begin this effort by focusing on those states where GSA believes the bulk of the DSM activity is occurring. As the various state DSM rules and regulations are gathered, GSA will make this information available in our training materials, guidance, and on our web site. GSA will also ask public utilities offering DSM services under areawide contracts to certify that their DSM services offered to Federal agencies are in compliance with state rules and regulations.

Given that GSA cannot rely on state regulatory bodies to provide a consistent DSM standard and the reality that the Energy Policy Act language is broadly written, GSA has developed a more concise definition of what constitutes a DSM measure. GSA plans to use this definition in future training and guidance materials. The key feature of this definition is that it is designed to enable a Federal agency to make reasonable determinations on a case-by-case basis over time as to what is and what is not a DSM measure. GSA proposes to define DSM services as follows:

> A demand side management (DSM) measure is any project that reduces and/or manages energy demand in a facility (Energy Conservation Measure and Energy Management Service are considered equivalent terms.) To be considered a DSM measure, the measure must satisfy all of the following requirements:
>
> 1. The DSM measure must produce measurable reductions in energy consumption or measurable reductions in energy demand;
> 2. The DSM measure must be directly related to the use of energy or directly control the use of energy;
> 3. The preponderance of work covered by the DSM measure (measured in dollars) must be for items 1 and 2 above; and
> 4. The DSM measure must be an improvement to real property.

To better understand how this definition would work for specific kinds of work, we have included DSM Questions and Answers Guidance (Attachment 1). We propose to include guidance in this form in our instructions and training materials.

This more concise definition of DSM will assist agencies in determining what types of projects qualify for the statutory exception to the Competition in Contracting Act authorized by Section 152 of the Energy Policy Act. Once an agency has determined that a project meets the DSM definition, that agency then must follow the justification and approval process of Federal Acquisition Regulation (FAR) 6.303 and 6.304. On an individual basis, the justification would need to address the items in FAR 6.303-2. This justification would then need approval at the appropriate organizational level prior to initiating negotiations for DSM work. The need to follow the formal justification and approval process outlined in FAR 6.303 and 6.304 will be included in our instructional and training materials on the use of DSM provided by utilities.

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The report issued by DOE in June 2001 also stated that, where more than one utility in a service territory (for example, a gas company and an electric company) could provide the same service, the Government should evaluate the services provided by each utility and select the one that provides the best value. The report also strongly recommends that the utility company be required to competitively select technical subcontractors to do the actual work. GSA operates consistently with that guidance. Where there are competition opportunities between franchised utilities, GSA seeks to maximize the value to the Government through such competition. GSA also requires competition of subcontracting work and enforces compliance with the subcontracting requirements.

Recommendation Two

As previously stated, we agree with GAO that many of the services ordered by the District of Columbia under the areawide contract with Washington Gas Light went beyond the scope and authority of the areawide contract. GSA also believes that Washington Gas Light exercised poor judgement in agreeing to perform non-energy related work. To address these circumstances, GSA will:

1. Provide clearer language in the areawide regarding DSM work authorized to be ordered under an areawide contract;
2. Conduct periodic sampling of contract actions placed against areawide contracts for DSM services;
3. Encourage agencies to compete DSM requirements to the maximum extent practicable between utilities when two or more utilities have areawides serving the same geographic area; and
4. Provide clearer guidance to both agencies and utilities on the use of the areawide contract for DSM services in any training, literature, training manuals, correspondence, and conferences.

We are also reviewing the terms of the areawide contracts to ensure that ordering agencies and the public utilities under contract adhere to the terms of the contracts. Specifically, where reports are required, GSA will issue new instructions to participating utility companies, either through a formal contract modification or formal request, to provide GSA with a copy of any future authorization for energy management services. Previously, GSA's areawide put this reporting requirement on the ordering agency, which to date, has not proved effective. It is our expectation that the established source utility will be more likely to respond. GSA will monitor compliance with this new reporting requirement and take action in those cases where the public utility fails to meet its contract obligations. Likewise, GSA intends to remind ordering agencies of their responsibilities to inform GSA when they order services under the areawide contracts. While we remain convinced that abuses in the purchases made by the District are the exception, we recognize that we need to properly oversee the use of the areawide contracts.

In our periodic reviews of utility DSM work under areawides, GSA's review will focus on the appropriateness of the DSM work ordered, the justification and approval, the extent requirements were competed, price reasonableness, and financing terms. In the event GSA discovers improper use of the areawide by ordering agencies for DSM services, GSA will advise agencies on the nature and extent of improper activities and how to correct these errors. Should GSA determine that a utility has grossly abused the areawide contract in the provision of DSM services, GSA may, at its discretion, terminate that portion of the areawide contract pertaining to DSM services.

We hope that these proposed changes to the areawide contract program specifically address the concerns noted in the draft correspondence report. If there are any continued concerns, we look forward to the opportunity to respond to such concerns.

Thank you for the opportunity to comment on the draft report.

David A. Drabkin
Deputy Associate Administrator
Office of Acquisition Policy

Attachment

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Demand Side Management
Questions and Answers Guidance

Background: Due to the varying definitions of what constitutes a demand side management (DSM) measure, GSA has developed a definition of DSM measures that is designed to provide consistency and guidance in determining what is and what is not a DSM measure.

Definition: A demand side management (DSM) measure is any project that reduces and/or manages energy demand in a facility (Energy Conservation Measure (ECM) and Energy Management Service are considered equivalent terms.) To be considered a DSM measure, the measure must satisfy all of the following requirements:

1. The DSM measure must produce measurable energy reductions or measurable amounts of controlled energy use;
2. The DSM measure must be directly related to the use of energy or directly control the use of energy;
3. The preponderance of work covered by the DSM measure (measured in dollars) must be for items 1 and 2 above; and
4. The DSM measure must be an improvement to real property.

Questions and Answers: To guide Federal agencies in the use of this definition and thereby in the use of areawide utility contracts that offer DSM or ECM services, a series of DSM related questions are both asked and answered. By providing these examples, GSA is attempting to assist agencies in the proper use of areawide contracts for DSM projects.

1. Would the installation of energy efficient computers in a building be considered a DSM measure? No. While energy efficient computers would satisfy requirements 1-3, they would not be considered an improvement to real property.

2. Would the installation of behind the meter renewable power technologies be considered a DSM measure? Yes. It would meet all four definition requirements.

3. Would building commissioning services be considered a DSM measure? Yes. To the extent that commissioning has been shown to produce measurable energy reductions, one could argue that it is appropriate provided that the energy reductions are quantified and verified. One could also include building commissioning as an incidental portion of major equipment installation (i.e. boilers, chillers, HVAC system). By definition, commissioning endeavors to ensure that improvements to real property are being operated optimally to reduce energy consumption and to extend useful equipment life.

4. Would services such as energy audits and energy project designs be considered DSM measures?
   Yes. To the extent that energy audits and/or energy project designs are part of a larger DSM project, such services would be appropriately considered DSM as they are necessary for project accomplishment and do not represent a significant portion of total project costs. However, stand alone energy audits and/or energy project designs would not be considered DSM measures.

5. Would painting be considered a DSM measure?
No. If painting is the sole thing being purchased, then it would not qualify and requirement 2 would be difficult to meet in general. However,if painting were included as part of an integrated system, then it would qualify (i.e. insulating roof and painting with reflective, light colored paint or incorporating dark colored paint into a perforated, hollow membrane wall with southern exposure in a northern climate to enhance heating).

6. Would energy consulting services be considered DSM services? No.

7. Would stand alone architect and engineering services be considered DSM services? No.

8. Would advanced electric and/or gas meters qualify as a DSM measure?
If the meter is simply being changed because of meter failure or to enable billing, then requirement 1 would not be met and it would not be DSM. If the meter is being changed to enable the planned control of energy use or to produce energy reductions, then requirements 1-4 would be met and it would be a DSM.

9. Would distributed generation technologies be considered DSM measures? Yes. Distributed generation would meet all four requirements if it was installed to control measurable amounts of energy usage.

10. Would combined heat and power or cogeneration technologies be considered DSM measures? Yes. Cogeneration would meet all four requirements if it was installed to control measurable amounts of energy use.

11. Would interactive energy management software tied to the meter/energy management system be considered a DSM measure? Yes. The software would meet requirements 1-3 even though it may be difficult to quantify the energy reduced and/or controlled. The key question would be whether requirement 4 is met. As long as such software is integrated into the building's metering and/or energy management system, it should be considered an improvement to real property (i.e. it would become part of a building system that would transfer to the building owner).

12. Would items such as drapes and window blinds be considered DSM measures? No. While certain specialized drapes and/or window blinds may produce quantifiable reductions in energy use and would thus meet requirements 1-3, such items would not meet requirement 4 as they would not be improvements to real property.

Appendix II

Utility Incentive Programs

Section 152(f) of the Energy Policy Act of 1992 (P.L. 102-486) amended the National Energy Conservation Policy Act (42 U.S.C. sec. 8256(c)) to provide that

- federal agencies are authorized and encouraged to participate in programs to increase energy efficiency and water conservation or the management of electricity demand conducted by gas, water, or electric utilities and generally available to the customers of such utilities;
- each agency may accept any financial incentive, goods, or services generally available from any such utility to increase energy efficiency or to conserve water or manage electricity demand;
- each agency is encouraged to enter into negotiations with electric, water, and gas utilities to design cost-effective demand management and conservation incentive programs to address the unique needs of facilities utilized by such agency; and
- agencies may not be denied the collection of rebates or other incentives if an agency satisfies the criteria that generally apply to other customers of a utility incentive program.

Appendix III

Energy Savings Performance Contracts

Energy savings performance contracts are authorized by section 155 of the Energy Policy Act of 1992 (P.L. 102-486), 42 U.S.C. sec. 8287. Performance contracting is a tool for implementing energy conservation measures. Under performance contracting, a federal agency enters into a multiyear contract with a qualified energy service company, which then installs improvements in the agency's buildings. The company assumes all the up-front capital costs and, in return, receives a portion of the annual savings attributable to the improvements for the duration of the contract. The company's portion of the energy savings is paid by the agency from funds that the agency would otherwise have used to pay its utility costs. Performance contracting allows the government to reduce its energy costs without appropriating funds and without incurring capital costs for energy-efficient improvements. Unlike areawide utility contracts, an energy savings performance contract is awarded through competitive procedures and is not limited to regulated public utilities. For a more detailed description of energy savings performance contracting, see our report *Energy Conservation: Energy Savings Performance Contracting in Federal Civilian Agencies* (GAO/RCED-96-215, Sept. 16, 1996).

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