

Electricity Procurement



Energy Managers' Guide to Electricity Procurement
Produced by the Energy Manager's Association

Energy Managers' Guide to Electricity Procurement

Introduction

Summary

This guide offers an overview of the energy procurement process and principles for best practice. Energy procurement is a complex process and the outputs of this activity directly influence the cost of energy to the organisation, hence a critical activity that needs to be managed appropriately.

We all want to know what the best procurement strategy is for the organisation, and the focus is usually on energy price, but the truth is that unless one is consistently buying daily spot prices over a period of time, a best price is near impossible to achieve. Energy purchasing is not just about price, but about getting the best fit for the organisation, one that not only delivers value but also fits within and supports the company's strategy and risk management requirements. Negotiating the right contractual terms and knowing how to optimise all the inputs into the procurement process is also key.

For impartial sources of information

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Planning for energy procurement

The planning process should focus on gathering and assessing information to feed into development of a suitable purchasing strategy and to form a concise instruction for energy suppliers. The degree to which planning takes place, is largely relative to company requirements, and likely to increase proportionately to the energy expenditure.

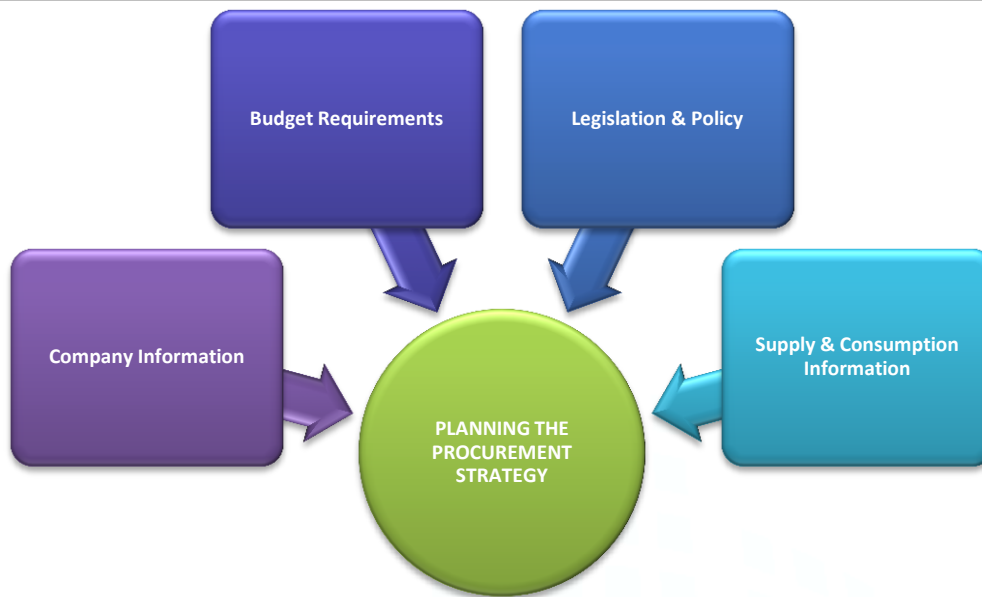
Planning is beneficial because it;

- Helps ensure one is buying at the right time,
- buying in the right way,
- offers clear pricing instruction to suppliers,
- allows time to investigate or negotiate offers,
- and allows time to track the market

The planning process should evaluate any relevant internal company information, the organisations budget requirements, any legislation or policy requirements and supply and consumption information.

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Planning the Procurement Strategy



Company information

A logical place to start is to gather company information internally that may impact on the purchasing strategy.

For example, if the organisation has sustainability policy that dictates a preferred fuel mix for the energy bought, this will need to be included in the contract specification. Although one should be aware of the impact that this choice may have on price depending on the suppliers energy sources.

If there are any existing or planned energy efficiency initiatives or long term strategic plans within the organisation that may impact forecast consumption volumes, one should consider this and the risk of breaching suppliers contractual volume tolerances. One may wish to mitigate this risk by instructing pricing against a reduced contractual period, or perhaps consider negotiating the volume tolerance with the supplier (however one should be aware of the potential cost implications as a supplier effectively accepts this additional risk).

One should also consider to what extent their organisation has the ability to impact their consumption on a day to day basis. For example, if a company were able to reduce a half hourly metered consumption during key DUoS, Triad or other peak periods, then entering into a fully fixed contract with these third party costs bundle up into the rates, would not allow the benefit of these onsite measures to be realised.

The availability of internal resources in the organisation will also dictate the energy strategy. If the organisations energy management is passive, it is likely the organisation will take a systematic and more hands off approach to energy procurement. If the organisations energy management approach is more active, there is likely to be more risk diversification, often more intense energy procurement.

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Planning the Procurement Strategy

Planning should also include engagement with stakeholders within the organisation that may be affected by energy procurement. The finance team for example may wish to specify a preferred payment method and payment period for bill payments or the legal or supply chain team may wish to view the supplier's contractual terms and conditions.

Thought should also be given to the organisation's credit rating. If this rating is poor, a supplier may impose steep deposit requirements. One may be able to mitigate this risk if internal company accounts or statements can be gathered and provided to suppliers with the pricing instruction, or being open to negotiate terms with the supplier that offer them greater protection. Again, the option to reduce the contract obligation period may enable the supplier to take more risks.

Budget requirements

One should also clearly understand the company's budget requirements. If there is a risk framework within the organisation that needs to be adhered to or a minimum hedge position that must be achieved at any one time on exposed budget, then this will drive decisions around length of contract and choices between fixed and flexible energy procurement.

In energy procurement there is a balance that needs to be achieved between savings and budget certainty, both are difficult to maximise at once.

For some organisations the cost at which energy is purchased may directly affect a company's competitiveness. A data centre for example may determine their clients rates based on the price they buy the energy for. They may therefore be more interested in chasing the market for the best price and engage in intensive flexible procurement. Equally the dilemma for them may be how to avoid disgruntling their clients with ever changing rates from multiple volumes of energy purchased.

Equally, a regulated business may have a completely different view on budget and be looking for the highest security. They are likely to be governed by a long term budget (sometimes up to 10 years), and may in fact not be overly concerned about the price of energy as long as it is bought under the set budget, and is fixed for the longest possible period. One may in this scenario be looking for a bespoke supply agreement past the 3 year liquid market, or even wish to enter into power purchase agreements direct with generators to secure the price, despite the higher premiums one can expect for further out pricing.

All organisations will have different budget requirements, and understanding the companies risk profile is also key to determining the best fit. A risk adverse company will be attracted to longer term more secure deals, and a risk seeking organisation will often want to diversify their strategies.

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Planning the Procurement Strategy

If one is seeking to change the companies existing energy purchasing strategy, then additional planning will be needed. One would need to consider time needed for building the business case, and deliberation if needing board approval. Often the organisations past experiences or previous exposure to different strategies will determine the likelihood of stakeholder buy-in to any change. Where perceptions may be formed perhaps from lack of insight or understanding in what is a complex field, then perhaps the challenge for an energy manager is building a business case into a simpler and more understandable story.

Legislation & Policy

One should also consider any internal and external legislative or policy requirements that may affect the company and its procurement activities. The following could be examples of legislative or company policy restrictions;

- Perhaps for community organisations (such as housing associations), there may be social responsibility requirements, and therefore needing to understand what added benefits suppliers can offer with the supply contract that can be passed on to the communities.
- For companies acting as landlords or managing agents, there may be requirements for engagement or consultation with tenants prior to purchasing.
- For public bodies, procurement may need to be undertaken through OJEU processes, and in this case, more intensive planning is necessary to adhere to legislation.
- There may be corporate or reputational company requirements which may also limit dealings with certain supplier that need to be identified in the planning stage.

Supply & Consumption Data

Supply and consumption data is essential for a supplier to be able to price up an energy contract. Ensuring that one's supply details are up to date and accurate will increase accuracy of pricing and success of the tender.

Supply specific information necessary for inclusion into a tender instruction, is often obtained from the company's existing energy supplier or incumbent. This information can however be out of date or incorrect, and particularly on multi-site portfolios, errors can get lost in the noise. A prospective supplier may therefore be using this information as a basis for their offer, and errors can result in the supplier pricing an incorrect rate, making assumptions or refusing to price at all.

When providing the supplier with consumption data, one should provide full and accurate information for the last 12 months consumption, and also include a forecast of future use, if one

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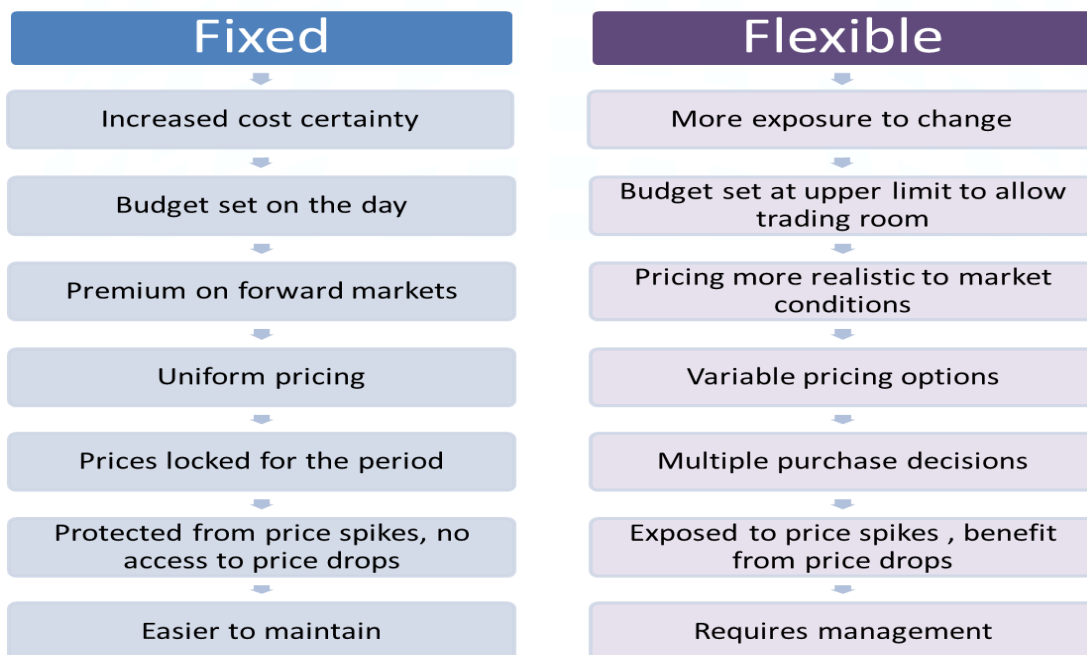
Planning the Procurement Strategy

is expecting a notable deviation from this past usage. It is prudent where possible to also provide as much detail behind forecast calculations as possible, to offer confidence to the supplier and minimise any risk premiums they may build in when forecasting the volume.

Once all information has been gathered from within the organisation, and all the inputs have been assessed, one should have a clearer vision of the preferred contractual arrangements and purchasing strategy. One can then start to formulate a wish list of requirements, that may include for example;

- Preferred principle terms
- Preferred payment methods
- Billing & transparency requirements
- Length of contract
- Fuel mix
- Volume tolerance
- Reporting & account management preferences
- Additional benefits
- Contract type:
 - Fixed or flexible commodity purchasing
 - Fixed, fully assured or pass through non commodity

The choice between fixed and flexible procurement can be a difficult one. There are advantages and disadvantages to each choice. The decision should really be by the type of organisation and their needs. The below offers some comparisons between the two different purchasing routes.

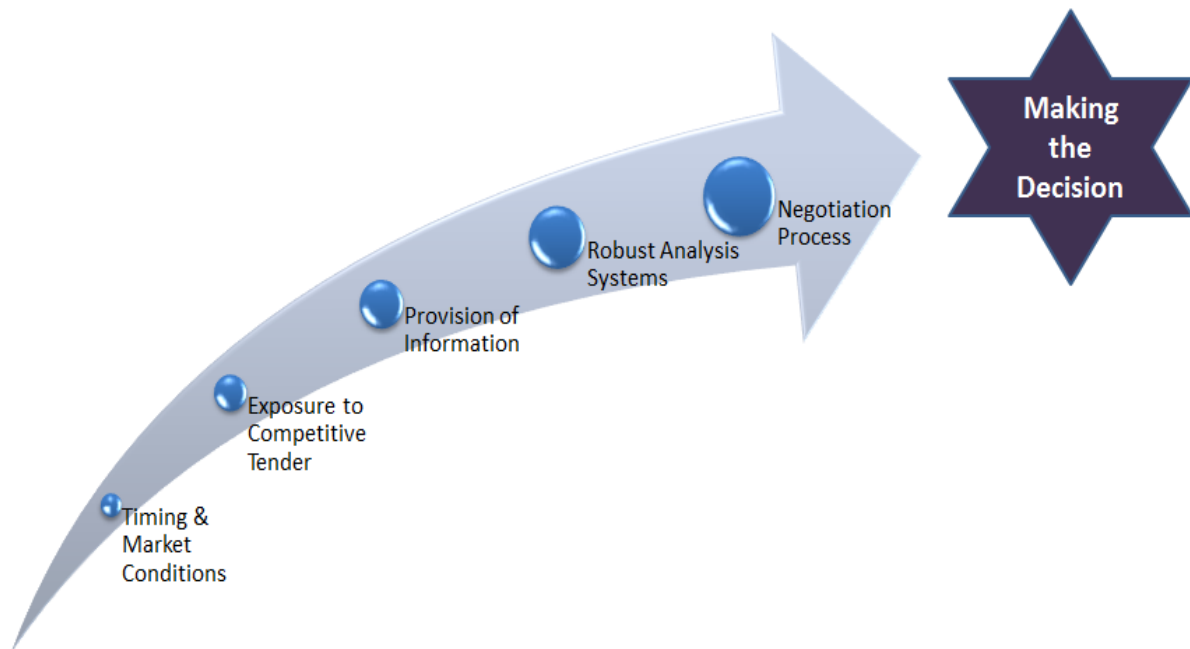


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It is important at this stage to note that even the most intensive and perceivably high risk flexible energy procurement can be low risk, but only if there is a robust risk framework in which activities take place.

GOING TO MARKET

Once the purchasing strategy and all contractual requirements have been finalised, one can then consider going to market to obtain supplier pricing. Key considerations will be timing when going to market, the level of exposure to multiple suppliers prices, the provision of information to supplier/s, the robustness of systems used to analyse those prices and the negotiation process with suppliers.



Timing & Market Conditions

When planning to go to market, the timing should be optimised based on market conditions. It is important to remain informed on what is happening in the gas and electricity market and have an understanding of any macro events, such as political, economic or supply situations affecting price and how long these may affect the market upwards or downwards. It is also sensible to plan around areas of volatility, such as last trading days in a month - for month-ahead volumes, or last trading days in a season - for season-ahead volumes etc. One should also be prepared for sudden change based on external factors such as an unexpected cold weather front, where it may be prudent to reschedule a tender at short notice. One should also factor in time needed for;

- a.) Multiple tender rounds
- b.) The negotiation process
- c.) Review of contractual terms by legal teams and time for amendments
- d.) The transfer process if considering moving to another supplier
- e.) The availability of decision makers and authorised signatories

Energy Managers' Guide to Electricity Procurement Going to Market

Exposure to competitive tender

It is completely the company's choice on whether they wish to tender competitively or only deal with one supplier, but approaching multiple suppliers increases competitiveness and exposes an organisation to a number of different options. One should also consider planning for multiple tenders as this allows for errors in pricing to be ironed out, enables a process to negotiate and engage with suppliers, to ask questions about their terms and contractual jargon and to provide feedback from the last tender that allows them an opportunity to improve on price. So leading up to the final tender one is clear on the different offers, calculators are set up and adjusted to accommodate each offer and there is minimal rushing around.

Provision of Information

Touched upon previously, information provided to a supplier should undergo a robust validation exercise to ensure pricing is accurate as well as avoid suppliers losing interest from continual corrections. The information provided should include supply and consumption information and some critical requirements from the wish list. But it is best to separate out more complex or nonstandard requirements from this list, because overwhelming the first tender instruction may result in incorrect response or even lack of response. Bearing in mind, any deviation from standard pricing within the suppliers pricing team likely requires approvals and bespoke documentation.

Keep information concise, perhaps the other details from the wish list could be those discussed perhaps with the top three best priced suppliers from the first tender, when more intense engagement takes place?

Robust analysis systems

All supplier products are different. There will be differing levels of transparency of individual costs, as well as complicated clauses sometimes leading to misinterpretation of the full cost, and where third party charges are pass through, some costs may not be included in pricing at all, or included at various rates. Robust analysis systems are necessary to enable accurate assessment of these offers, and accurately compare the rates provided with an additional mechanism to also identify and standardise any pass through pricing so that like for like comparison can be achieved. It is also important that analysis systems can identify any missing or hidden charges and ensure these are accounted for so that not one supplier has an unfair advantage.

In addition, despite one's best effort to provide concise and clear instruction, suppliers may still disregard this purposely or through human error. Errors or missing information may not always be obvious, so time is necessary on the day of tender to scrutinise contracts.

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The negotiation process

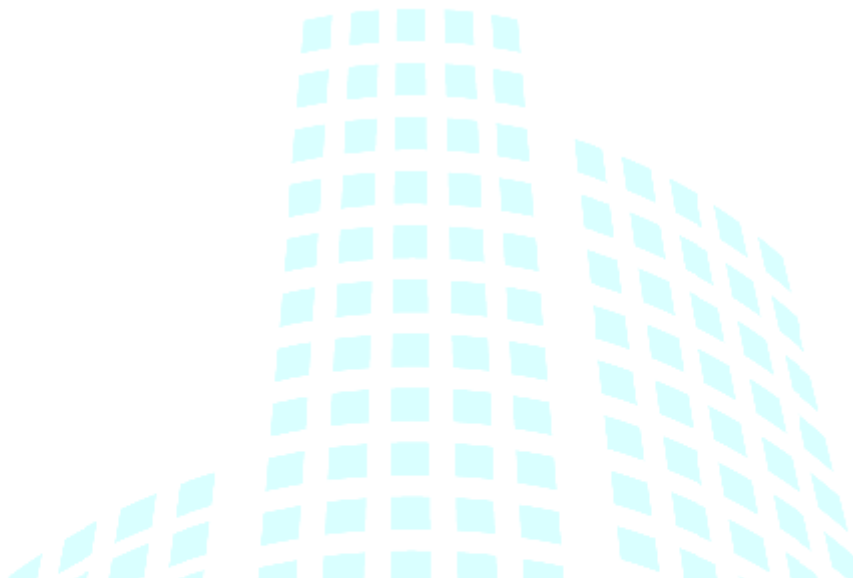
Negotiation is an important and beneficial part of the tender process for those organisations procuring energy not subject to the OJEU public purchasing requirements. Calling or arranging meetings with a supplier to discuss results of their pricing, and encouraging them to improve on their price or offer better terms, can go a long way. Planning for multiple tenders and ensuring feedback is provided to suppliers after each round of tenders, facilitates and improves negotiation, and offers a supplier opportunity to improve on price.

One does however need to be mindful that too many pricing requests with little sign of a firm commitment may cause suppliers to become disinterested over time. Sometimes response to a tender can be poor for other reasons as well despite one's best efforts to provide concise information and suitable notice. Response may be affected by resourcing issues within the supplier's pricing team, or the supplier may be prioritising higher bids on the day. A supplier may also only have an interest in a certain kind of market, such as SME or I&C for example. There may be a number of reasons for a failed tender, however making time to call the supplier to understand the issues and whether there is something that can be done to increase response if useful.

Making the decision

Many are likely to have experienced a panic that can emerge on a tender day with too little time. A supplier will usually offer a limited window to accept a contract; however one needs to also be mindful that a supplier's offer is subject to withdrawal at any time within that price window due to their pricing being against a fluid market. And with time needed to assess a number of prices, compose results into a simplified format, gain approval to proceed and return the approved and signed contract back to the supplier before the time window is up, one needs to be on top of their game and have a robust and streamlined tender process.

Whilst price and terms will largely play a part in decision making it is also prudent to consider less tangible factors such as prior experience with the preferred supplier, their customer service scores and perhaps any other add-on services these may be offering.



DEVELOPING A RISK FRAMEWORK FOR FLEXIBLE ENERGY PURCHASING

Once a tender is complete and a contract has been entered into with a supplier, if this is a fixed energy contract one's activities will be largely complete. However, if one has entered into a flexible contract, then the future activities of purchasing energy within this flexible contract will need to be planned for within a documented risk framework.



The process should include:

- Defining and documenting a trading strategy. This should capture requirements such as the frequency of purchasing, the volumes to be locked or remain exposed, and the hedging approach (market or budget driven).
- Agree a capital risk position. This being the absolute maximum position in which all volumes must be immediately locked if triggered.
- One should also define the trade triggers that will control exposure. Documenting what the monitor or buy triggers will be, communication of the activity around these triggers, the frequency of review of these triggers and contingency planning if an immediate change in the market occurred.
- Documenting approvers and who is authorised to trade on the companies behalf
- Reporting is usually required in two parts, firstly to capture trading activities and market conditions against these trades and then of course financial reporting providing a view of current position against the budget. The frequency of communication and construct of these reports need to be agreed.
- Market intelligence and tracking. Insuring that adequate sources of information are being used to make trading decisions and to track the market.

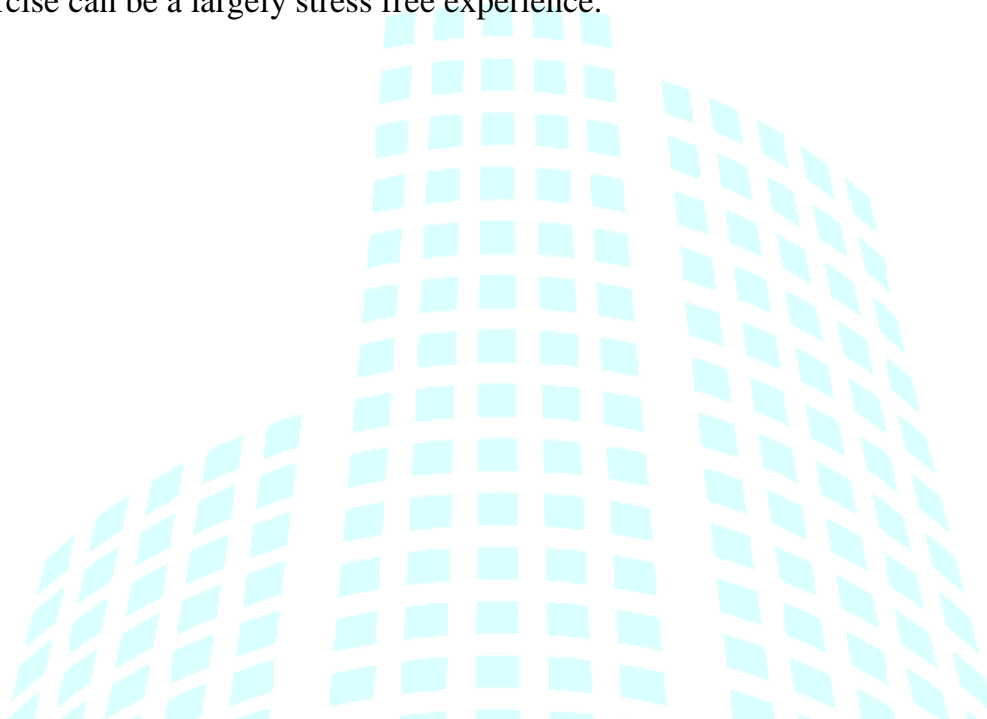
ENGAGING WITH BROKERS

The decision to use a broker is entirely the organisations decision. There are many benefits to using a broker, as they are experienced in dealing with many different energy users and energy suppliers. They are also able to assist in developing one's strategy, can manage the whole planning and tender process, can manage the ongoing portfolio and contract, and have specialist insight and information on the markets.

However in saying this, it is recognised that there are some less reputable organisations in operation that will not always be working in the interests of the client. An organisation therefore should ensure the following pre-requisites are in place;

- There is a written contractual arrangement
- Defined key performance indicators with which the broker can be measured
- There are defined reporting & information sharing requirements
- The appropriate authorities for various activities have been agreed
- There is trust and transparency at all times with all activities they undertake
- There is neutrality, and the broker has no specific allegiances to any suppliers
- The broker has either an internal code of practice governing their activities or are subscribed to an external code of practice body. This is not essential but offer assurances that the broker will be working in the interests of their clients and in an honest and transparent manner.

Energy procurement is a bespoke and complex process, that can sometimes be seen as confusing or intimidating to energy managers. Whilst a level of understanding is required, one does not need to be an expert in the field to complete a successful energy procurement exercise. A supplier or broker can often provide a high level of support and guidance, but it is up to the energy manager to drive those questions. If one fully utilises the resources they have at hand, the exercise can be a largely stress free experience.

A decorative graphic at the bottom of the page consists of three stylized skyscrapers. Each building is represented by a grid of light blue squares, creating a sense of depth and perspective. The buildings are arranged in a row, with the central one being the tallest and the two flanking ones being shorter.

The Energy Managers Association

Aims

Improvement of the stand of the energy management profession and those working within it

Establishment of best practice in energy management

Put energy management at the heart of British business



Objectives

Representing energy managers across industries and protecting their interests

Developing energy management profession

Raising awareness of energy management and promoting energy efficiency opportunities

Promoting the exchange of knowledge, information and best practice



Initiatives to deliver strategy

Training Standards and Programmes:
Low Energy Company (LEC) Initiative; Energy Savings Opportunity Scheme (ESOS) Lead Assessor; Schools' Course; Compliance Course

Utilities Compliance Assurance Body (UCAB): Assurance of Transparency in Utilities' Selling

Energy Efficiency Policy Development:
DECC, BIS, OFWAT, OFGEM, European Commission, Transparence

Membership Engagement:
Members' meetings, Topical Conferences, EMEX, Working Groups

Public Engagement:
Articles, Conferences, Forums

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