Negotiating Energy Contracts

This article will discuss some of key things to consider when tendering out for energy supply including some of the hidden costs to beware of.

Since deregulation of the electricity market in Victoria in 2002, retail competition has grown significantly and Victoria is now one of the most competitive retail markets in the world with annual churn rates of over 30%.

Prior to 2007, energy rates had been relatively static and tendering out was a simple matter of comparing offers and locking in the best price for 3 to 5 years. Generally, the bigger the load you had to offer the retailer, the sharper the pricing so aggregating contracts across several buildings often proved beneficial.

With the effects of long term drought, the market place changed significantly at the beginning of 2007 with the price of energy skyrocketing 2 – 3 times higher than historical levels. Retailers that had inadequately hedged suffered badly with some suffering big losses and others closing shop altogether. The most recent example was AGL who posted a $23M half year loss blamed on increased hedge costs.

In line with higher pricing, there has been a significant change in retail sentiment. Volume is no longer the key driver in obtaining cheaper pricing. Instead retailers are interested in the load profile of your building. That is, what does your daily peak and off peak consumption look like over the year. The more consistent the consumption, the better the retailer can hedge future supply and therefore reduce risk. Lower risk for the retailer leads to lower pricing for the consumer.

In light of the above, it is important to supply consumption data over the past 12 – 24 months in any tender submitted to retailers. You can obtain this data by asking your current retailer to provide "interval" data as recorded by your energy meter. This data shows the energy consumed every 15 mins and is also highly useful when evaluating the energy efficiency of a building in an effort to reduce maximum demand.

One thing you may not be aware of with energy contracts is that you don't need to tender just prior to your current energy contract expiring. You may sign a new contract for supply now that doesn't start until some time well into the future (eg. next year for example). You would do this because you believe contract prices are likely to be higher next year and it is therefore better to lock in lower pricing today for future supply. This is known as "forward contracting" and becoming more and more popular.

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Similarly if you are coming out of contract and prices are high, you should consider a short term contract (6 – 12 months say) and look to go longer at a later date when forward pricing is likely to be lower. In this regard, the length of a contract can often be just as important as the timing of its purchase.

Other tendering strategies to consider during times of high energy prices may include asking for smoothed pricing instead of tiered. That is requesting a single rate over the term of contract rather than obtaining specific pricing for each year. In this way, your energy costs will be consistent making budgeting easier rather than having dramatic costs swings year to year.

Other hidden caveats to be aware of are CPI increases. It's important to read the fine print with any contract as retailers are getting tricky by including CPI increases on pricing offers. Once again, don't just take offered prices on face value. The lowest offer may often include an annual CPI increase which by year 3 could make it the most expensive offer.

Other things to consider when negotiating new energy contracts include Renewable Energy Certificates (RECs). These are not all the same and will vary subtly between retailers so you should factor these into your overall price evaluation. Metering costs will vary widely depending on which Meter Provider the retailer uses so need to be included in your analysis. Some retailers also charge annual "Service Fees" which will need to be considered.

Termination fees is another area that can be overlooked and given not all contracts are created equal, may be highly relevant. Especially if market pricing drops so dramatically it becomes worthwhile looking at terminating your existing contract to extract savings under a new one with lower pricing. Whilst not applicable in the past due to relatively static pricing, this has become more relevant in recent times.

In summary, there are many important factors to consider when purchasing energy contracts. Energy costs for buildings often range into the tens if not hundreds of thousands of dollars and every percentage point saved can be worth a lot of money. Building and Facility Managers do not always fully understand the tender process or intricacies of the energy market. In such cases, they should consider engaging a suitably experienced professional to assist with this process. The costs of engaging an energy consultant is far outweighed by the savings that will be made.

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