

## Electricity Contracting – Keeping Costs Down

Purchasing electricity may not be the most complex task, but for most large energy users the purchase of energy, and especially electricity, is not far from the top spot. It is a relatively new requirement, relatively complex and relatively time consuming.

A few years ago electricity purchasing was a mundane task that required no more than a few minutes attention. The local government owned retailer supplied your electricity under the terms of a highly regulated tariff regime. There was no choice of retailer and little or no room to negotiate either price or contract conditions. Conversely, the local retailer was obliged to provide this electricity at the ‘most appropriate applicable tariff,’ i.e. the cheapest tariff and provide advice on how costs could be reduced and energy saved.

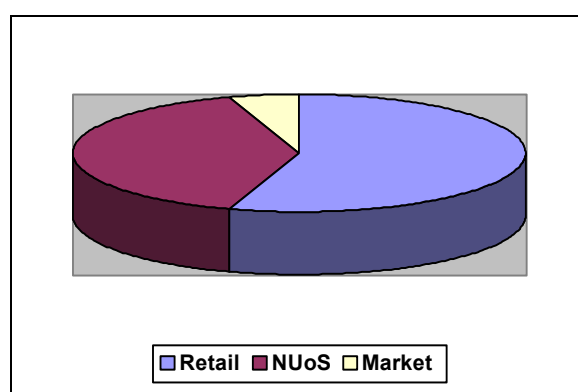
In the main, the government energy retailers performed well, implemented some large energy saving programs and responded to government policy while trying to keep energy prices within acceptable limits.

However, over the last few years all this has changed. For those of us in South Australia, Victoria, New South Wales, The ACT and Queensland the deregulation process has now rolled out. Competing retailers are vying for your business, prices are negotiable, commercial terms are negotiable and some background work needs to be done if you are to achieve the best possible outcome.

So where do we begin? The best starting point is to understand our electricity invoice and our current position.

Electricity invoices for contestable customers, i.e. those customers who have negotiated an electricity supply arrangement with the retailer of choice are loosely divided into three sections, as per figure 1.

Figure 1  
Typical Electricity Invoice



**Market participation fees** are paid to the market managers and include a menagerie of relatively small costs that are largely unavoidable. In the main, market participation fees are non-negotiable and by far the smallest component of the electricity account.

***NUoS fees.*** These are the *Network Use of System* fees that are paid to your local franchise network provider i.e. the person who own the poles and wires. They are location dependent and voltage dependent. All things being equal, a high voltage customer in a metropolitan area can expect to pay considerably lower NUoS fees than a low voltage customer in a rural area. NUoS fees are regulated in so far as the appropriate regulatory authorities set maximum tariffs in return for regulated service levels. You are free to negotiate lower NUoS fees if you are so able. Conversely, you are free to negotiate higher NUoS in return for higher service levels.

In practice, you would be negotiating with a monopoly service provider, i.e. the sole network service provider for your geographic area and negotiating any variation to the published NUoS fees is most unusual. The most probable source of savings is by checking your tariffs. All of the network service providers offer a range of tariffs and there is normally more than one tariff that is applicable for every operation. The savings that can be realised by simply changing tariffs or by nominating a more suitable ‘contract demand’ pleasantly surprises many consumers.

Your network provider always operates independently from your retailer, even if the same company owns them. The network provider is responsible for the operation of the local electricity distribution network and thus, is largely responsible for power quality and reliability. They are the people who normally deal with power failures, not your retailer. This ‘decoupling’ of the physical delivery of electricity from the financial settlement for the electricity ‘commodity’ means that you can safely negotiate with retailers who are physically removed from your network.

Many of our clients have built happy and profitable retailers who are interstate based.

***Retail Fees.*** These are the fees that are negotiated with your electricity retailer. In their simplest form they will be rates for the supply of energy, typically broken into peak, off peak, and for those of us in NSW, shoulder periods. The retail fees should also include the cost of meeting your renewable energy obligations under the National ‘MRET or Mandatory Renewable Electricity Target’ legislation and for most of us they should also include the cost of metering.

Negotiation of the retail fees will occupy most of your effort. But before looking at how these fees should be negotiated, let's look at some of the market risks. Under the old regulated regime the electricity supplier carried most, if not all of the risk. In part, we can assume that this risk was offset by a small price premium. More significantly, the regulated regime was inherently less risky and many of the risks that are now in the market place simply did not exist.

In the new market place we have the option of accepting increased risk for decreased prices. These risks are not for the faint hearted and should only be taken on by sophisticated users that have suitable risk management procedures. The real trap is for those of us who are unaware of any risks that may be embedded in our electricity contract.

Some of the more common risks include:

- **Price Firmness**

Most of us are probably paying somewhere between \$30 and \$50/MWh for the retail component of our electricity. Underpinning this 'retail' price is a wholesale electricity pool. The price of electricity on the pool can vary from zero to \$10,000/MWh. At the top end, electricity pool prices can be two hundred times more than our retail price.

Electricity retailers purchase all of their electricity from the pool and use a series of hedge contracts to manage their 'wholesale' risk i.e. the risk of wholesale spot market prices being higher than their retail sale price. Naturally, they can provide consumers with a lower up front price if the consumers take on part of this risk.

- **Usage Penalties**

In order to help manage their wholesale risk the electricity retailers like to know exactly how much electricity will be sold. To facilitate this process, many contracts have tightly defined usage bands, for example +/- 15%.

Usage in excess of the upper band normally attracts a price premium. Conversely, the consumer is obliged to 'take or pay' for electricity up to the lower usage band.

This can present the consumer with some unacceptable risks. For example, the obligation to pay for 'unused' electricity for a site that is no longer required or for a plant that is experiencing significantly reduced business activity

- **Contract Expiry – Roll Over**

Most electricity contracts specify a price path for electricity that is supplied beyond the termination of the nominal contract period. On one hand, this has the advantage of ensuring that consumers are not left without an electricity contract. On the other hand, it may specify an unpalatable price path and unpalatable commercial conditions. For example, the price for electricity supplied over this period may be expressed as the wholesale pool price plus a management fee. This leaves consumers exposed to the wholesale market risk and the threat of very high prices. The contract may also specify a minimum termination period that is to apply if the contract runs beyond the nominal contract period.

- **Rate Shock**

Under the old regulated regime we could be reasonably sure that next years electricity price would be this years electricity price plus a small allowance for CPI. We could also be reasonable sure that electricity prices for ‘similar industries’ across the Eastern Seaboard would be comparable.

All of this has now changed. Over the last few years the retail price for peak electricity across the Eastern Seaboard has varied from over \$100/MWh to under \$20/MWh. This is more than a five-fold increase, which was in part due to timing and in part due to the performance of the various state based electricity markets.

Now some tips for negotiating a competitive electricity contract. Once you have a strong understanding of your needs and your current position there are a few steps you can take to help ensure that you get the best possible outcome.

**Timing:** This is probably the most important aspect of negotiating a good electricity contract. Too many consumers negotiate their new contracts several weeks before the expiry of their existing contracts. Not only does it leaves them negotiating against a deadline, it does not allow them to take advantage of the seasonal nature of the electricity market. Electricity prices are currently lower than they have been for several years and a number of our clients are negotiating forward start contracts so that they can take advantage of this opportunity.

**Involve all the retailers:** Given the fickle nature of the electricity industry it is hard to predict which retailers are likely to be competitive at any given time. Our advice is to always involve all the retailers, including interstate retailers. We have seen instances where retailers have ‘bought long’ and then been able to offer some very good prices to our clients.

**Listen:** Many of the retailers are able to provide you with good advice. By critically listening to what they have to offer and carefully considering what they have to offer you may end up with a ‘win-win’ outcome.

**Understand:** It is important to understand your requirements, your likely future requirements and the deals that are being offered by the retailers. If a retailer cannot demonstrate an appreciation of your requirements and clearly explain how they can meet these requirements then find another retailer. Always make sure that you understand all aspects of the deal that is being offered and don’t waste time with account managers who are unable or unwilling to fully explain their position.

**Energy savings:** As the negotiation process unwinds it is not uncommon to get to a situation where there is only a very small price difference between several competing retailers. At this stage it is time to start focusing on ‘non price’ issues and especially energy saving issues. There may be opportunities for a good retailer to help you more effectively manage your energy consumption and thus realise savings that will swamp any small savings associated with a further drop in energy rated.

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Finally, become proactive. Take an active role in managing energy costs, checking energy accounts and checking tariffs. It is surprising how many incorrect electricity accounts come across our desk and how many sites we see that are on the wrong tariff.

Good luck, and lets make those electricity retailers work for our business.