

# More Than 10 Ways To Sweeten A Retail Power Contract

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## ABSTRACT

Securing good results from a retail power contract is more than merely receiving a good price. Depending on a customer's leverage and his awareness of the purchasing process, a variety of other options may be pursued that could improve the bottom line.

Ways to do so are reviewed, including some with immediate financial benefit and others that could provide future value were a contract to be renewed or extended. Among the items covered are: use of the customer's name, renewal bonus, size/duration of contract, "swing" allowance and penalties, share of available incentives, account "splitting" and/or triage, and use of interval data.

Issues that could impact a customer's price and term leverage are also reviewed, including credit, metering, acceptance of price volatility, load factor/profile, energy services "hunting license," cross-marketing potential, load curtailability, use of reverse auctions, and prior experience with the vendor.

Many of the items covered are taken from the author's online power procurement training course, "Power Techniques for Power Procurement" (for details, go to: [www.aeecenter.org/realtime/Power-Purchasing](http://www.aeecenter.org/realtime/Power-Purchasing)) and come from his first-hand experience serving large retail power customers in both the U.S. and Canada.

## INTRODUCTION

When setting up a retail power contract, securing a good price is only part of the battle. Exploiting a customer's leverage, and working the procurement process, may further improve the bottom line. Readers

are encouraged to use their imagination by applying the lessons found herein in other ways.

To best understand these issues, let's look at a fictitious facility that we'll call Always Bigger University, or ABU for short. ABU is a growing private educational facility with a peak load of 10 megawatts (MW) and annual consumption of about 50 million kilowatt-hours (i.e., 50,000 MWhr). The campus has two dozen electrical accounts, and a variety of facility types that include a central chilled water plant, classrooms, offices, labs, dorms, library, garage, field house, athletic fields, and a computer center. Several of the accounts have peak demands exceeding 2 MW, and most accounts are on a time-of-use (TOU) electric rate. ABU employs 2,000 people and has 20,000 students. Its annual electric bill (without delivery) exceeds \$4 million, and its power contract runs out next December (it is presently early September). For budgetary reasons, ABU prefers a fixed energy price.

#### WHAT DO WE MEAN BY "SWEETENING" A CONTRACT?

Requesting an acceptable price and a contract with clear terms and conditions (T&C) is the minimum one should expect when purchasing energy. Various ways exist to improve both pricing and T&C in small ways that may add up to significantly improved value. Let's look at some of the ways ABU might seek greater value from the competitive purchasing process.

#### TAKE ADVANTAGE OF DATA

As retail power markets mature, suppliers seek more information about a customer's usage profile to both offer better pricing and to assess volume risk (i.e., wide swings in usage that could make the account more expensive and/or problematic to serve). If the only usage data available to suppliers are monthly kWh and peak kW for the last year or two, the supplier will have to apply standard utility load profiles developed for the rate class in which an account has been placed by the utility (e.g., large commercial).

If, however, a customer is served under a utility time-of-use (TOU) electric rate, he should have access to interval data collected by the

utility to separate on and off-peak usage and charge them at different rates. Interval data are typically the kWh consumed in a 15-, 30-, or 60-minute period. When divided by the length of the interval, utilities derive peak demands that are also separately charged. Many utilities now routinely offer online access to such data (though not necessarily in real time) through web sites and online software, either free or via a nominally-priced subscription.

Providing suppliers with a year of interval data (or access to it) for each TOU account may yield better power pricing if they support a claim that one's load profile is better than that used by a utility to develop pricing for his rate class. In the case of ABU, its central chilled water plant was gas-fired, resulting in a much flatter summer load profile than the typical commercial facility using an electric chiller. While monthly data might hint at such a difference across a year, interval data detail such usage across a day, allowing a supplier to "sharpen his pencil" when it comes to power pricing.

#### SYNCHRONIZE WITH YOUR MARKET

ABU's present power contract ends in December which, for its locale, is often when power prices are high due to heavy use of natural gas at that time for both space heating and power generation. If buying under a 12-month contract, a better time for ABU would be between mid-March and the end of April, when minimal gas is being used for space heating or power to serve electric air conditioning loads (such timing will vary among markets). In some areas, another low price point is reached in early fall, when little or no air conditioning or space heating is needed by most buildings.

To have its contract end at a more opportune pricing point, ABU could seek an extension of its present contract (from December to April) and then bid out its load for a longer contract term (e.g., 12 months) when forward pricing is generally better.

#### CONSIDER AN ONLINE AUCTION

Most electricity bids are obtained through quotes by suppliers responding to calls and/or requests for proposals (RFPs). A growing

number, however, are being obtained through online reverse auctions in which suppliers compete in real time through a secure web site (imagine an eBay for power).

Such auctions are an excellent way to drive down pricing, often realizing greater savings than standard procurement methods, but they may have value even when not pursued. Suppose ABU secures a price from its present supplier during a period of low volatility so that day-to-day variations are small. ABU then says that it may instead decide to hold an online auction in which the present supplier must compete with others, thus creating the possibility that the supplier may lose ABU as a customer. ABU asks how much lower the supplier will go to *avoid* taking that risk. If the number is significant (e.g., on the order of several mills or more, where 1 mill = .1 cent), ABU may have improved its price without the labor and hassles involved in pursuing an online auction.

While several online auctioneers specialize in handling retail energy transactions, they generally charge a significant fee to do so. For ABU, that fee could (for a 12-month contract) be as high as \$50,000. For significantly less, ABU could buy auction software, mount it on its server, and run its own auction, saving money before even seeing the results of an auction. Such software is available from several vendors, including Ariba ([www.ariba.com](http://www.ariba.com)) and IonWave Technology ([www.ionwave.net](http://www.ionwave.net)). The purchasing departments of many large commercial firms already use such online auction software when buying items not related to energy.

#### USE "HIDDEN" ASSETS

Many organizations have more assets than they realize. ABU has, in its locale, a well-recognized name. Most supplier contracts include a clause that allows use of a customer's name in the supplier's future advertising. ABU states in its RFP that no permission is granted for name use. Many suppliers quote their pricing without looking closely at such "boilerplate" RFP text. Once the price is provided, ABU pointed out that it would be happy to allow its name to be used by the supplier, in exchange for a one-time fee, or a reduction in its quoted power price. To grow their business, some suppliers will accept that offer by dropping their price a bit. If provided as a one-time check at contract

signing, a nice photo op has been created.

If name use in advertising is not acceptable, consider one of the following ways to achieve the same end through a donation (which, in the case of non-profits, may also be tax-deductible by the supplier).

- In exchange for a one-time donation from the supplier, rename an athletic field or building with the supplier's name for the term of the contract. With thousands of people seeing the name on a regular basis, it acts like a free billboard.
- Endow a chair (in effect, sponsoring a professor) or contribute toward a new wing or room bearing the supplier's name during the term of the contract.
- Donate energy-efficient equipment (e.g., LCD monitors) bearing the supplier's name on a label.

With many employees and students regularly receiving written communications (e.g. weekly paychecks, academic materials), ABU could allow a supplier seeking residential power customers to co-market to such people via flyers accompanying those other communications, in exchange for a one-time fee or reduction in its power price.

#### EXPLOIT A NEAR TIE

In a competitive market, retail power suppliers often provide pricing within a very narrow range. When confronted by a near tie, smart customers offer novel ways to help one supplier provide more value. It should be noted that some suppliers lack imagination, and may appreciate such guidance to win a customer. Following are several options that ABU used to break a tie.

- Ask for a bonus for a quick signature, instead of the often days-long process that may entail several re-pricings before someone from upper management finally signs the contract.
- Alternatively, hold the present price during a multi-day signing process if the wholesale price does not rise more than X percent.

- Seek a bonus for a longer contract term at essentially the same price.
- If one of the suppliers tied for price is the present supplier, ask for a bonus to remain his customer.
- Seek a lower penalty for exceeding the allowable variance (i.e., “swing”).
- Alternatively, seek a wider swing before an overusage penalty occurs.
- If the wholesale price drops by more than X percent for more than Y weeks, allow pricing of the remainder of the contract to be renegotiated to secure some of those savings, not necessarily through a contract extension.
- Build into the contract a bonus if you renew or extend the contract without bidding it out.
- If new loads are added (especially if they have higher load factors than the others), add an option to re-open pricing for the whole block instead of simply increasing the contract volume (i.e., annual kWh) at the same or an incremental market price.
- If a negotiable mandated discount (typical during early stages of deregulation) is available, seek a larger share of it (some suppliers try to keep half or all of it).

#### SPLIT THE ACCOUNTS BETWEEN COMPETING SUPPLIERS

Experience shows that suppliers, regardless of pricing sophistication, may make mistakes, or use pricing models that vary significantly from supplier to supplier. When multiple accounts are bid out at the same time, many customers seek only an aggregated price for them. Doing so misses out on significant opportunities that may appear if individual account pricing is secured at the same time.

When ABU bid out its two dozen accounts, the *aggregate* pric-

ing among suppliers didn't vary much, but noticeable spreads existed among pricing for individual accounts. ABU segregated its accounts between two possible suppliers (we'll call them X and Y), each of which offered the best pricing for different accounts. ABU then asked supplier X to drop his price for the rest of his accounts to match that of supplier Y. If he refused, ABU could simply cut two contracts, each for a subgroup of the total campus and get the best overall pricing. In the end, supplier X instead dropped his pricing on the other accounts to match that of supplier Y. Doing so increased savings by 20 percent over the best aggregated pricing.

**TRIAGE THE BAD ACCOUNTS**

Load factor (LF) is the ratio between average demand and peak demand. When use is continuous (yielding a flat load profile), load factor = 1.0. Due to high peak demands from electric air conditioning, many commercial buildings have  $LF < .4$  (some are as low as .25). Facilities with high night usage (e.g., industrial, hospital, data center) and/or gas-fired air conditioning may have  $LF > .6$  with some over .8. Within a range of about .25 to .65, commodity price (i.e., energy only, exclusive of delivery and regulated charges) may be inversely proportional to LF (see Chart 1).

Utilities aggregate many accounts by peak demand irrespective of LF. The energy price for that aggregated group may then be based

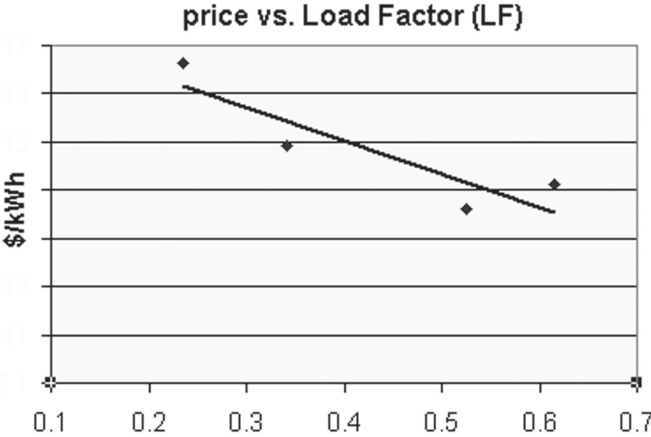


Chart 1

on a higher LF than some of the worst (i.e. lowest LF) accounts. Leaving such accounts with the utility may result in a lower cost, since the service class rate for those accounts may end up subsidizing them.

To determine if this applies to any of ABU accounts, the utility was treated as just another supplier and its expected utility energy price developed for each account (using its tariff and recent other charges) so it could be compared to those offered by competitive suppliers. Where the utility rate was lower, ABU dropped those accounts from its bidding list and left them with the utility to be subsidized by other ratepayers in that rate class who were still buying power from the utility. Remember the goal: lowest total cost for electricity, not minimum paperwork for the accounting department.

#### FOLD IN SOME PERKS

But wait, there's more. To close the sale with ABU, some suppliers were willing to offer a few freebies that cost them little but provided significant value to the customer. Once again, these options work best when two suppliers have very similar pricing. If, however, a threat to buy from "the other guy" is not real, future credibility with the supplier will be damaged and he may simply choose not to bid next time.

Depending on the supplier (some simply do not offer anything beyond energy), all the following items may be open to discussion. They could be included as incentives for signing or to be paid through a small adder to the negotiated \$/kWh price.

- Interval metering or submetering may help both the customer and supplier better track loads and find ways to improve LF, or otherwise shape the load more economically. ABU could use submeters to bill some departments internally (e.g., athletic, fraternity houses, that cyclotron in the physics building). Such internal billing often helps reduce or control overall consumption.
- In some areas where the margin between peak supply and peak demand is tight, distributed generation (or an upgrade to existing generation) at a customer's site may open the door to lucrative capacity bidding through the supplier. In those same areas, addition (or upgrade) of an existing energy management system or improving the efficiency of major loads (e.g., lighting, motors) may allow



demand curtailment bidding through the supplier. ABU requested that capacity and/or demand management pricing terms be added to the contract that give it at least half the resulting benefits.

- ABU could greatly benefit by acquiring and implementing professional energy accounting software (e.g., EnergyCAP) or services to help track loads, usage, etc. better than is presently done by its accounts payable or facilities management departments.
- The same may be true for facilities that have never had a professional energy audit performed at their site(s).
- If the price of power is indexed, e.g., to *Megawatt Daily*, the supplier could include a free subscription to that professional daily newsletter (worth almost \$2K) to help ABU verify contract compliance.
- If the facility could benefit from energy efficiency upgrades (even if they don't reduce peak demand), include into the power price the financing of such options. Be sure, however, that those relating to electricity supply will not create a problem with the allowable variance state in the contract. If so, allow an adjustment to the variance based on projected usage reductions.
- In some areas, ownership of the distribution transformer feeding a facility is an option. If the utility tariff for power distribution shows a significant difference between secondary service (i.e., taking power on the low voltage side of that transformer) and primary service (taking power at the high voltage side), then acquiring that transformer (or installing a customer-owned unit and requesting primary power service) could cut the regulated *distribution* charge. Often called a "voltage upgrade," some suppliers have financed such acquisitions through adders to multi-year power supply contracts. Once again, remember the goal: lowest total cost for electricity, regardless of where the savings originate.

#### REDUCE CREDIT-RELATED AND BILLING COSTS

Once a contract is in place, some customers are surprised to find various additional charges that they either did not understand were built into an agreement or did not realize their facility could incur

due to its financial and/or operational behavior. The time to avoid or minimize such “surprises” is during contract development, not after the first invoice arrives.

- If monthly electricity usage is not predictable within definable limits (e.g., due to poor HVAC control), balancing or excess usage charges may occur for not remaining within a contract’s allowable variance (also called “swing”). In such situations, seek a wider swing (e.g.,  $\pm 20$  percent instead of  $\pm 10$  percent) or request “full requirements” power that has no such variance limitation. It will cost more, but avoiding balancing (possibly at spot market prices) or contractual penalties may be desirable. If possible, fix the problem(s) that causes excessive swing.
- A variation on the above is to eliminate or cap balancing charges/penalties if the variance in a given month is beyond a defined range. For example, if the allowable swing is  $\pm 10$  percent and the customer instead used 20 percent more kWh than nominated in his contract, the first 7 percent of the excess would be penalized at whatever rate was stated in the contract plus the incremental market cost of that 7 percent (if the spot market price was higher than the contract price). The remaining 3 percent would be based only on its incremental market cost; no additional penalty would be charged. In essence, this is like a second tier swing level.
- If the customer’s credit is not good, a supplier may demand a one-month deposit or a letter of credit (LoC) so that he does not run into late payment problems. A month’s deposit could amount to a hefty down payment for a cash-strapped institution (such customers are also more likely to have credit problems). An LoC is, in effect, an agreement with a customer’s bank to provide one or two months of cash via a revolving loan guaranteed by the customer’s bank accounts. If the customer cannot pay his electric bill on time, the bank will do so for him, up to the limit of the LoC. The customer then repays the bank when able to do so, at whatever interest rate he has negotiated with his bank. An LoC is not free, however, and may cost 5 percent or more of its face value (think of it as a bank fee for a mortgage). If paying that fee will be difficult for a customer, a supplier may be willing to pay the LoC fee and later recoup that money in his power

price. Doing so avoids cash flow problems for the supplier, and the usual 1 to 1.5 percent per month (i.e., 12 to 18 percent per year) late fee that he would otherwise charge the customer.

- To blunt the impact of a possible late fee, negotiate a lower interest rate (in this case, .7 percent per month instead of 1 percent per month).
- To avoid charging a late fee, many suppliers now require payment within 15 or 20 days instead of the usual utility payment period of 30 days. Negotiate a longer time to pay bills before a penalty is incurred.
- The flip side of that option is to seek a slightly lower price by accepting an even shorter payment time (e.g., 7 business days). Before suggesting it, however, be sure that's acceptable and viable with the accounts payable department.
- That option may be further "sweetened" if the payment is made by electronic fund transfer (EFT) directly into the supplier's bank account. Some suppliers have offered a discount of 1 mill or more (i.e., one tenth of a cent) when payment is quickly received directly into their account. If inflation occurs, the value of that "float" to the supplier will increase, making it a more desirable option.
- If the contract is being renewed while there are outstanding late fees, build forgiveness of all or part of those fees into the renewed contract.
- If the contract includes many accounts at different locations, seek a lower price (or other benefit) in exchange for agreement to channel all communications about contractual or billing problems through one person on the customer's side. Doing so reduces the supplier's time to service a customer, and allows (for example) overcharges to multiple accounts to be handled with one person on the customer side, instead of a separate person for each account problem.
- Allow a "mulligan" for the first late payment (i.e., let it go by without a penalty or late fee).

- Even an early termination offers opportunities. Some supplier contracts (especially where retail markets have not fully matured) include egregious termination clauses. To get out of a contract, ABU could, for example, be asked to pay the value of two average monthly electric bills, regardless of whether that caused any financial loss for the supplier. Here are two better termination options:
- The supplier is reimbursed only for losses he can prove from reselling the customer's reserved power into the spot market; no other penalty would be charged.
- If the market price was higher than the contract price, the supplier would split the profit with the customer at a defined fraction (e.g., 75 percent supplier, 25 percent customer).

## SUMMARY/CONCLUSIONS

Unless you're in a hurry, or a contract is very kind to you, always look for ways to improve the standard wording of an energy contract.

Contract provisions and wording are constantly changing. A few of these options may be outmoded in some markets or novel in others. Use your imagination to find and negotiate any aspect of a deal that may have value, either financial or otherwise.

## Bibliography

Many of the items covered are taken from Audin's online retail power procurement training course, "Power Techniques for Power Procurement" and come from his first-hand experience serving large power customers in major markets in both the U.S. and Canada. For further details, go to [www.aeecenter.org/realtime/PowerPurchasing/](http://www.aeecenter.org/realtime/PowerPurchasing/). See also [www.energybuyer.org](http://www.energybuyer.org) for articles covering several of the techniques discussed above.

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## ABOUT THE AUTHOR

**Lindsay Audin** is the president of Energywiz, Inc., an energy consulting firm serving commercial/industrial facilities, government agencies, energy suppliers, and other consultants, both in the U.S. and

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His 28 years of experience in the energy services industry include 8 years as energy manager for Columbia University and 12 years with private engineering and energy consulting firms in New York City prior to founding Energywiz in 1996.

Audin has been named Energy Manager of the Year by three different national or regional US organizations. In 1993, the Association of Energy Engineers named him their International Energy Manager of the Year, and in 1996 inducted him into its Energy Manager's Hall of Fame. In 1992, he founded the New York Energy Buyers Forum, a non-profit organization of large energy users that focuses on regulatory and technical ways to cut energy costs. He also holds certifications in energy management and energy procurement.

His work has won many other national and regional awards, and has been featured in videos, case studies, and magazine articles. Over a thousand people have attended his seminars on energy procurement and energy analysis. Audin sits on several professional boards related to energy services, maintains a column on energy issues in *Engineered Systems* magazine, and is a contributing editor to *Building Operating Management* magazine.