





## ENERGY EXPLANATIONS

### Variable-price contract management products

- Trackers – market tracking products following feed market fluctuations.
- Caps and collars – these financial instruments are usually referred to in a different context as maximum and minimum levels – set by the client – at which a client chooses to buy energy. Within the financial context, these levels are priced with a premium that ensures that a client will pay no more (cap), or less (collar) than the agreed levels.
- Block purchases – separation of base (constant demand) and peak (peak demand) within supply profile, thereby spreading risk.
- Financial products – hedges and index-linked arrangements.



style contract. The contract term generally varies according to the forward market price as rising prices is likely to cause customers to purchase far ahead.

With these styles of products, the principal risk remains with the supplier. Fixed contracts are therefore attractive to companies that need a measure of cost predictability for budgetary purposes. Companies considering a fixed contract need to use tools that can quickly analyse

quotations and provide feedback to suppliers. Typically, this would be provided through e-sourcing functionality, such as a reverse auction process.

However, in today's volatile climate, some customers may wish to opt for variable-priced contracts, rather than obtaining a fixed price for the entire year (see box).

One of the advantages of this is that a variable-price contract management offers greater flexibility, but it carries a

corresponding level of risk. As a consequence, variable contracts are suitable only really for larger companies that have more experience, as well as the necessary time and support to deal with the extra work involved.

### Wholesale buying

Trading on the wholesale market is one option, but for this to be workable, companies need to consume a sufficient volume of energy annually – generally more than 120GWh. Alternatively, customers can be bundled together to create the required volume size and shape. Small customers willing to “aggregate” their volumes could have them purchased at the same time by an energy broker and all get the same price.

Usually these customers will show similar criteria in, for example, volume, load factors, risk aversion and credit rating. The bundled group will execute purchasing decisions as a single entity under a “memorandum of understanding”.

Where customers choose flexible products, various factors play a significant part in the end result. These include their dependency on a strategy, access to daily market prices, an energy price model, and knowledge of the energy markets.

If their strategy requires many buying decisions throughout the year, much of their time will be absorbed in evaluating the price, with or without support from a consultancy.

The current energy market presents buyers with opportunity and choice. In their evaluation, they need to assess risk and their ability to manage this risk.

All stakeholders need to work together. And a strategic review that defines the current situation, aims and objectives, together with any internal limitations, is indispensable in easing the decision-making process, and getting the best deal.

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Oil traders at the London Petroleum Exchange. Rising oil prices are making energy buying a complex task