



White Paper

Energy Procurement Best Practices

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INTRODUCTION

The goal of your energy procurement process should be to secure reliable energy supplies at the lowest available cost. Price is just one component of total cost. The reliability and competence of your supplier can greatly affect your final cost as well. By following best practices for energy sourcing, you can optimize your results.

Energy sourcing is a complex process that requires a high level of expertise and experience. While there are many steps involved in a Request for Proposal (RFP) and a multitude of factors to be considered, these three are critical:

- Counterparty
- Timing
- Pricing Structure

COUNTERPARTY

Myth: “Energy is Energy.” Energy is not a homogeneous commodity. There are quality differences in vendors, transportation options, storage availability, contract terms, and pricing structure. The selection of a counterparty is one of the most important decisions in the procurement process, so it pays to research the suppliers in your area early in the process. Knowledge of past vendor performance can be the deciding factor between two bids with prices that are comparable.

- **Financial Stability.** You need to be comfortable that your supplier will be around tomorrow to deliver your energy.
- **Assets.** The more assets a supplier owns, the more reliable and competitively priced the energy should be. Some important assets are natural gas storage, pipelines or pipeline capacity, and electric generation.



- **Regional Experience.** Does the supplier fully understand the rules and regulations of your local pipelines, RTOs and utilities? How do they handle imbalances? How successful have they been during curtailments?
- **Customer Service.** Suppliers need to be responsive and flexible when you need to make unexpected changes. A marketer who fails to return a phone call promptly can cost your company money in balancing charges or cash outs. During a curtailment, they could cost you thousands in penalties.



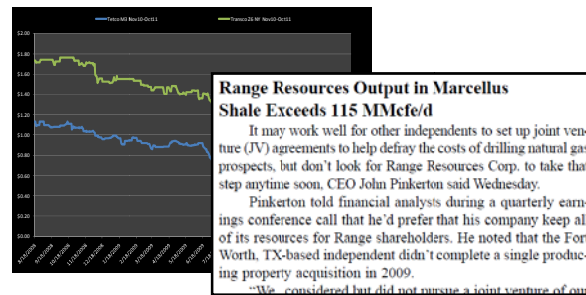


TIMING

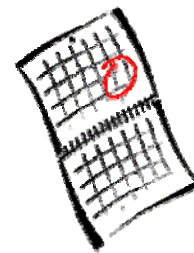
The timing of energy procurement is critical to securing the lowest cost supplies. Make sure you understand how the timing of your energy purchases affects your procurement program and results. Energy users can schedule their energy procurement process around a variety of factors:

- **Market Conditions.** The best procurement outcomes result from a process that is market-based, not calendar-based. Watching market prices on a regular basis can help identify when market conditions are favorable. Decisions should incorporate a variety of information sources and an understanding of how key market factors affect pricing in your area.

- Futures pricing
- Historical averages
- Regional production changes
- Infrastructure expansions
- Basis trends



- **Budget-Driven Sourcing.** Some energy buyers purchase their energy supplies in conjunction with budgetary guidelines to achieve corporate earnings targets.
- **Risk Management Policies.** Companies that use financial instruments to hedge their energy supply prices often require physical volume commitments to be in place prior to hedging for accounting purposes.
- **Contract End Dates.** Purchasing strictly by contract end date limits the ability to take advantage of market opportunities. Timing energy RFPs based upon the rollover or expiration of existing contract terms is not recommended. Existing contract expiration should only be used as a “drop dead” date.



PRICING STRUCTURE

Choose a product that fits your objectives and is in line with your organization’s operations and load profile. There are a variety of mechanisms that can be used to price your energy supplies. Deciding which one is right for you is key:

- **Natural Gas.**
 - NYMEX + Basis
 - Index + Basis
 - Fixed Price



- Spot (Floating)
- Cost Plus
- Blended
- Long-Term / Short-Term

- **Electricity.**
 - Real-Time / LMP Pricing
 - Load Following / Fixed Price
 - Block Power
 - Heat Rate
 - Combination / Split Load (On/Off Peak)
 - Long Term / Short Term



CONCLUSION

The total cost of your energy is determined by more than just price. Following best practices in your next energy procurement effort, you can optimize your results by:

- 1) Ensuring that you are buying from a reliable counterparty that you are comfortable with
- 2) Taking advantage of opportunities in market pricing by monitoring the market and understand the factors that influence the price of your commodity
- 3) Using a pricing structure that suits your operational needs and corporate policies

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