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## Take Some of the Guessing Out of Your Energy Buy

Initiating the RFP process and requiring suppliers to bid for your business is a good step in managing your energy costs.

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**By**

To know the nuances affecting energy prices is to know how to manage the seemingly unmanageable. Energy is one of the most volatile commodities in the world and as prices go up and down and back up again, procurement professionals may hesitate when they should buy or lock in prices when rates are predicted to fall. Purchasing energy at the most opportunistic time can be a complex and sophisticated decision relying on many influences outside the market. But understanding what drives energy prices can help you make the procurement process less of a guessing game and more of a strategic energy plan.

Energy prices move not only because of the market, but also because of factors such as fuel charges, transportation costs and capacity rates. Knowing the value of these underlying components can help you estimate supplier margins and provide negotiating leverage. Look at the price of energy in the same way you would look at buying a car -- know the wholesale price before making a purchase. Fortunately, finding energy wholesale price points is as simple as looking at the NYMEX Web site or a subscription service like Bloomberg.

Initiating the RFP process and requiring suppliers to bid for your business is a good step in managing your energy costs, but it will not guarantee that the bids from competing suppliers are "realistic." However, awareness of the wholesale value of a single energy commodity can help you determine which suppliers' "competitive" bids are truly competitive. Armed with the market knowledge of a baseline price, you then have the upper hand when it comes time to negotiate, although you'll also have to consider the additional charges it takes to move that commodity to your site(s).

Another factor that affects the cost of energy is geography. Energy markets have unique drivers, nuances and even negotiating techniques, depending on their region. Understanding these regional dynamics can put you in a stronger negotiating position with potential suppliers. For example, a large food manufacturer has more than 20 sites just within Illinois. The price of energy for a Chicago site is significantly lower than the price of energy across the Mississippi River from St. Louis. Factors such as regional generation, transmission and/or renewable portfolio standards can have significant impact on the delivered price -- and these factors vary widely across the United States.

Without knowledge of these regional market nuances, end users can face negative consequences. A few years ago, a major provider of power to end users in the Northeast implemented a new market, costing customers millions of dollars. A global pharmaceutical company felt the effects at its

New Jersey site, where there was a \$500,000 cost increase without warning. Though you cannot negotiate the cost of power after such a change has occurred and you have been billed, you can negotiate supplier pricing and contract terms up front to protect yourself from major tariff changes as was experienced in this case. Understand the type of market where you are operating, and look closely at the contract language you are signing. End users should protect themselves as much as possible through diligent contract negotiations and understand what is included in all costs of their energy. By knowing what is included in your cost, you are more informed of what can and can't be adjusted in your energy invoice.

Factors inside a company's facility can also affect the price of energy. Significant leverage can be gained when you have a firm handle on your site's usage level. Many companies require site managers to forecast the projected usage for their sites. If there is uncertainty in this forecast, a swing tolerance is built into the contract that allows the site to use more energy than predicted (up to a certain amount) at an additional fee. Some companies have up to 100% swing tolerances built into their contracts. Yet those that have a greater handle on their usage have zero swing tolerances and, as such, do not pay additional fees. When you know how much energy your site consumes, you are in a stronger position to negotiate the removal of additional fees like those associated with swing tolerances.

Overall, negotiation with any business partner takes diligence, knowledge and, often times, patience. You can increase your odds for a successful negotiation by seeking solutions that provide mutual benefit to you and your energy provider. Building and maintaining strong relationships with your utilities and suppliers can go a long way when you find yourselves on opposite sides of the table. A large communications company learned the benefits of such a relationship when a Northeast supplier was faced with robust regional competition. When the communications company went out to bid and the RFP results were in, the supplier not only returned the lowest price, but was more than flexible to negotiate amiable contract language. The supplier also worked with the client to set up a specific type of utility bill payment that the supplier did not previously provide to other customers.

While you can successfully manage the factors influencing your energy price, you cannot fully control them. However, your organization's overall corporate goals are one factor in which you are in complete control. When you, your facility personnel and your finance team are on the same page, you have more leverage at the negotiating table because you know your strategy and purchasing boundaries. Clearly knowing what your company wants to achieve and establishing it as a goal in the procurement process is the first step in having a successful procurement experience.

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