

When is the best time to

evaluate

my energy contract?



Constellation®

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As an energy buyer in a competitive retail market, you have the luxury of choice. You can choose from retail supply contracts that span a variety of timeframes and incorporate an array of purchasing structures.

But what if the energy contract you selected a few months or years ago no longer serves your current business needs? With the knowledge that energy prices typically fluctuate over time, should you simply aim to lock in a new contract when prices are low?

Ultimately, when is the best time to **evaluate and make changes to your energy contract?**

There are many factors to consider, so this guide may help you **navigate the process and determine when and how to create the most effective energy management strategy for your business.**

Why not try to time the market?

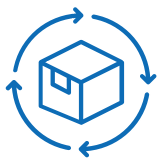
Energy prices behave similarly to what you see in the stock market: Prices go up and down based on a variety of factors, including weather, the economy, and supply and demand.



► **Weather:** Extreme weather has a significant impact on energy supply and demand. When natural disasters hinder energy production, supply goes down and prices tend to rise. Extreme weather, such as hurricanes, blizzards and winter storms can also damage the infrastructure used to generate energy, which can further drive prices up.



► **Economy:** Energy prices generally reflect the state of the economy. When the economy is strong and growing, energy prices typically increase. However, during economic slowdowns, like the 2009 recession, there can be steep price drop-offs.



► **Supply and demand:** Energy prices can also fluctuate based on trends in supply and demand. For example, the 2020 coronavirus crisis has led to declines in energy demand in the commercial and industrial sector, as many companies' operations were reduced or halted, and many employees transitioned to working from home.

With knowledge of these factors, some companies decide that the best course of action is to watch the market and try to lock in a fixed price contract when prices seem reasonably low. However, market volatility and unpredictability make it next to impossible to make the correct purchasing calls 100 percent of the time. You may, for instance, lock in an energy contract when you think prices are low —only to see prices dip even lower in a few weeks. However, because you're already locked into a contract at that point, you are unable to take advantage of those rates.

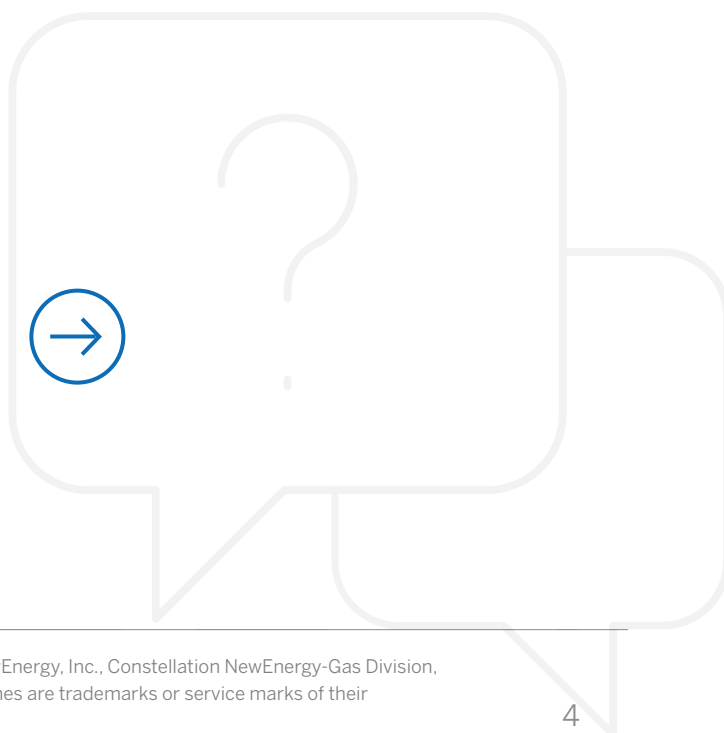
Plus, while a fixed price contract can lock in a low price for the short term, you also have to consider the long term. Prices may be higher when it's time to renew, forcing you to pay more.

Constantly adjusting your strategy to what is currently happening in the market (a reactive approach) can leave you exposed to risk and unexpected volatility.

Energy purchasers are left facing several questions:

- ▶ How can I take advantage of market dips without exposing my company to more risk than we prefer?
- ▶ If I'm not only evaluating market prices, what other factors should I consider when making decisions about my energy contract?
- ▶ What other costs may impact my energy bill?
- ▶ If not based on market timing, when should I evaluate my energy contract to make changes?

We explore the answers to these questions
on the following pages.



4 decision-making components to consider when purchasing energy

1 Budget certainty and risk tolerance

Every company has a different level of risk tolerance. However, businesses often prefer to minimize risk for more accuracy in forecasting and budgeting. They want to have a clear picture of what they will pay on a monthly basis, so they aren't surprised by unexpectedly high bills.

However, while taking the most conservative purchasing route (a 100 percent fixed price contract) provides budget certainty, it doesn't account for market fluctuations that could benefit your bottom line. In fact, Constellation evaluated [73 different purchasing strategies over a 13-year time period](#)—which encompassed a range of different economic and market conditions—and found that a 100 percent fixed strategy resulted in the overall *highest* price outcome.

On the other side of the spectrum, the 100 percent index strategy (in which the energy price “floated” at an index to take advantage of market fluctuations) **resulted in the lowest prices over that 13-year period, but also possessed the highest risk.**

Regardless of how you purchase energy, there will be some level of risk. However, there are methods of energy purchasing that give you the fluidity to minimize risk while still taking advantage of market variations. In our evaluation of purchasing strategies, **the flexible purchasing strategy effectively reduced both budget risk and price** over the 13-year time period, regardless of market conditions. By adopting a flexible, managed power purchasing strategy, you can positively impact your energy costs.

2 Transmission and capacity rates

In addition to supply costs, energy prices can include several other components, such as transmission and capacity costs.

- ▶ **Transmission** is the bulk transfer of electrical energy from generating power plants to electrical substations located near demand centers. Interconnected transmission lines become power grids, and this infrastructure may be owned, operated and maintained by electric utilities or independent transmission owners. These owners set their own transmission rates, which can be fixed or based on a forward-looking formula.

How transmission rates are incorporated into electricity bills varies based on electric distribution company, supplier and the electricity product. These costs can be structured as fixed costs or “pass through” costs, based on your budget and risk tolerance.

- ▶ **Capacity** costs are charged to energy buyers to ensure that there is enough electricity supply available on the grid at all times to meet potential demand. Energy suppliers charge their customers based on an approved capacity rate. This charge may be in a separate line item on the bill or incorporated into a line item with other charges. The supplier then pays the **Independent System Operator (ISO)** or **Regional Transmission Organization (RTO)** for the capacity required to cover the megawatts they are contracted to serve and the ISO/RTO in turn pays the participating generators and demand response suppliers.

Since annual capacity and transmission rates are based on consumption during a company's peak hours, many businesses aim to reduce their demand during this timeframe to see cost reductions.

When you evaluate your energy contract, you should be aware of how these costs are incorporated into your contract and bill. However, your supplier may also offer programs to help manage these costs. For example, with [Constellation's Peak Load Management](#), end users are notified on a day-ahead and day-of basis of expected peak setting hours. Customers who choose to reduce their consumption during those peak setting hours can reduce capacity and transmission costs during the following year.

Implementing energy conservation measures, like [energy efficiency upgrades](#), can also help lower peak load contribution and, ultimately, capacity and transmission costs.

3 Usage patterns

As you consider different components of your energy strategy and contract terms, you may want to think about how your business uses energy. For example, does your business use more energy in the summer or the winter? Does your business use a consistent amount of energy throughout each day (i.e., you operate 24 hours a day, 7 days a week), or is it concentrated within business hours?

Understanding your usage patterns and goals can help you plan your purchasing strategy by identifying ways to appropriately take on risk and plan for budget certainty. Constellation's digital platform can help you monitor and find patterns in your energy usage and is available at no charge to customers.

4 Time you can allocate to the process

Finally, amid other priorities, how much time can you dedicate to monitoring the market? Rather than worrying about whether you're making the right purchasing decision at the right time, you can automate some or all of your energy purchasing. An automated, algorithmic approach can help you achieve a more consistent price over time.

For example, [**Constellation's Minimize Volatile Pricing \(MVPe\)**](#) solution leverages an algorithm to buy smaller percentages of load at regularly scheduled intervals over a longer time horizon. Over time, this approach manages to the mean, mitigating energy market and timing risk.

For natural gas buyers, [**Constellation's SmartPortfolio**](#) solution offers varying degrees of volatility protection to ensure the right level of budget certainty, volatility protection and risk tolerance.

So, when should you evaluate your energy contract?

While there is no one-size-fits-all answer to this question, your company should first take the time to make some internal evaluations, including:

- ▶ What is our tolerance for risk? What is our preference for budget certainty?
Are we willing to take on more risk to take advantage of typical market fluctuations?
- ▶ Do we understand the costs incorporated into our current energy bill, including capacity and transmission? Does our current energy supplier do anything to help us manage or reduce those costs?
- ▶ Based on the way our company uses energy, are there any steps we can take to become more efficient or take our usage patterns into account when purchasing energy?

- ▶ Are we willing to monitor the market, or would we prefer to automate some or all of our energy purchasing, so we can focus on other business priorities?
- ▶ Overall, is our current energy strategy helping us meet our business goals?

Once your leadership and/or energy procurement team has an answer to these questions, you will be in a better position to determine if and when to evaluate your current energy contract.

For example, if your business is ready to take steps toward energy efficiency, but you don't have the capital available upfront to pay for necessary upgrades, it may be an ideal time to look into contracts that build the costs of those upgrades into your monthly energy bill. Constellation's **Efficiency Made Easy (EME) program**, for example, makes it easy to identify and implement efficiency measures that can help your business better manage energy usage and costs.

Or, if you determine that your energy usage typically spikes in the winter, you may want to evaluate your energy contract and purchasing strategy during the summer before the cold weather arrives. Pursuing a new or revised contract and strategy—one that considers your preferences for risk, budget certainty, usage patterns, and automation, and uses market fluctuations to your advantage—can equip your company to meet your energy and financial goals.

Constellation offers the **tools and expertise** you need to assess your current contract and make an informed decision about your power purchasing strategy.

To learn more about evaluating your current contract and optimizing your strategy, [contact us](#).