

# CIPS Guide to Purchasing Energy



This purchasing energy guide has been developed with the CIPS Energy specialist knowledge group.



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**The Purchasing Energy Guide has been developed for CIPS members with the CIPS Energy specialist knowledge group and covers the following areas:**

1. What Energy means for buyers
2. What are the risks and how can it affect your company
3. What are the options and how do they compare
4. Information and help available
5. Forecasting usage
6. How to conduct a tender
7. Understanding costs and how do they break down
8. Green energy
9. International Contracts
10. Suppliers of energy and the differences
11. What does the future hold

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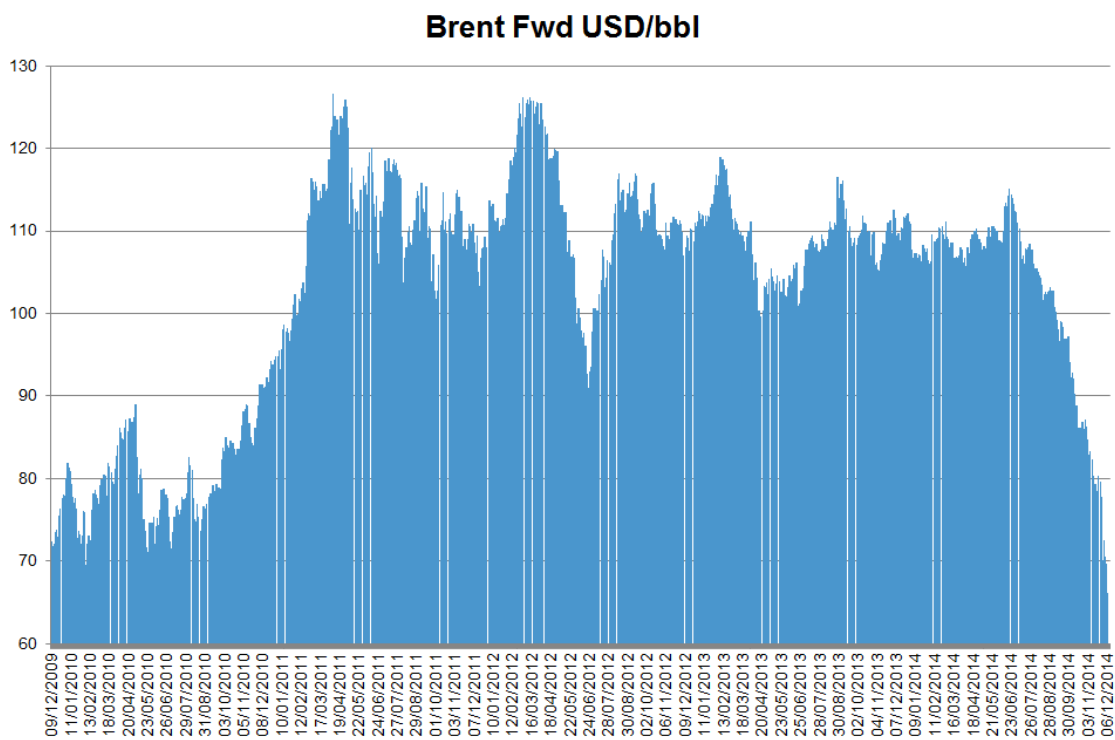
## 1. What Energy means for buyers

As far as buyers are concerned Energy includes Electricity and Gas and to a lesser extent Water, which often falls to the buyer of energy.

The Gas and Electricity markets are totally deregulated in the UK and also across most of Europe. This makes it easier to get better contracts that suit your companies' needs and strategy.

## 2. What are the risks and how can it affect your company?

The main reason for risk is the volatility because the prices fluctuate dramatically. These changes can then have a considerable impact on your budgeted prices and also compared to your competitors.



*Source: Thomson Reuters*

Prices, in addition, are influenced by energy trader sentiment, geo-political tensions, supply and demand.

If energy is a small spend then such risks are not too serious, but it still makes sense to have some control.

The belief is that, as we deplete the natural resources that create our supply of energy e.g. gas, coal, oil etc. then the prices will rise.

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### 3. What are the options and how do they compare?

**A Fixed Price Contract** where you fix for a year or 2 ahead at an agreed price, which should be relevant to the market prices at the time of fixing (reports are available to give you some guidance on these). This method gives you budget certainty and is a one off decision so takes little time. The downside is that if prices drop after you have fixed you will not benefit from that fall while others including your competitors may. Also tender validity is usually limited to a few hours, so the ability to make decisions quickly is important.

**A Floating Price Contract** where you pay the market price every day/week or month. This provides no certainty and so is extremely risky. However recent history has shown that you would have obtained the best prices if you had such a contract as prices have dropped recently.

**A Flexible Contract** which partially combines the first 2, but as the name suggests it is flexible and allows you to fix and unfix forecasted amounts, so that you can control the price within the market confines. There are a number of types of such contracts and these are now the most popular contracts particularly when the volumes are a reasonable amount.

### 4. Information and help available

There are a number of sources of information and help available including CIPS, consultants (TPI's), other buyers, free seminars and supplier reports.

- **CIPS has the Energy Special Knowledge Group (SKG)** which is available to give guidance and a monthly 'Energy Market Review'. Details, resources and useful links can be found via the following link: [Energy Special Knowledge Group](#)
- Most **suppliers** send out a daily or weekly update on market movements and even if you do not use them they are willing to put you on the mailing list. Supplier's such as Total, EDF, Eon etc. CIPS has a knowledge partnership with Total hosting their '[Weekly Market Commentary](#).'
- There are numerous **Consultants** offering varying services, but you need to understand where you need assistance and work with one that provides those particular areas.
- **Other Energy Buyers** are often happy to pass on their experiences and so maintaining a network is helpful.
- Many groups/consultants/suppliers/media provide **free seminars** to give updates on markets and the way markets are moving. Details of some of these will be shown on the CIPS website: [Energy Special Knowledge Group](#)
- **Third Party Intermediates (TPI's)** also send out regular information on markets and elements that impact the prices/supplies etc. Again they are often willing to send you some of this information even if you are not their customer. Such as Schneider Electric, NUS, Inenco etc.  
See [CIPS Guide on Questions to ask and things to do before hiring an energy broker](#).

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## 5. Forecasting usage

Be aware of Take or Pay clauses in contracts – it is good practice to forecast usage as accurately as possible. It is recommended that no contracts should have such clauses now.

It is also important to get as accurate a forecast as possible as it gives you a more transparent price picture and enables suppliers to price more accurately.

Often the easy way to get a forecast is to look at previous year's usage which should be available from your supplier. But do take account of expected changes in production/usage in the contract years.

## 6. How to conduct a tender

You have to decide what type of contract you want. The table below gives a guide based on the spend on commodity only (not all taxes, distribution, grid etc) but this is only a guide and it does depend on your company's attitude to risk, also can your company pass on energy price increases.

<b>Spend on Commodity only in 1 country</b>	<b>Suggested type of contract</b>
Under £100k	1 year fixed
Between £101k - £500k	1 or 2 year fixed
Between £501k - £1m	2 year flexible
Over £1m	2/3 year flexible

Once you have decided what type of contract, you can ask the present supplier (but we would always suggest asking at least 2 suppliers). Or you can do a tender, either with the assistance of a consultant or by yourself.

There is certain information you need for a tender such as Meter Numbers, Monthly forecast usage, Site addresses and contact details at your sites.

If you use a consultant then ensure you negotiate a fixed price for the tender i.e. clearly identify the consultant costs associated with any supply tendering activities.

Generally the margin that the supplier makes on contracts is small and so maybe not the most important element to focus on. You should ensure the contract suits your need particularly in a flexible one e.g. the tolerance levels often 120 – 80% of forecast, the ability to re-forecast, the payment terms, the size of the tranches you can fix/unfix, the costs relating to each trade, the termination arrangements, support during contract and invoice checking.

If you go for a flexible contract then you will probably require the consultant to guide you on when to fix and unfix as they have up to date market information and movements. This means you will need to negotiate a monthly/yearly cost for covering this. Sometimes the suppliers will offer such a service, but it may be sensible to have an independent body involved.

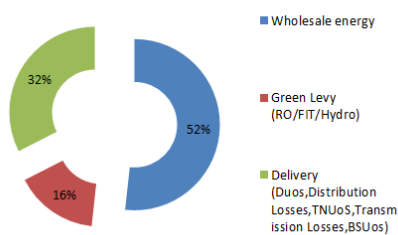
Whatever contract you decide on, you should get it checked by a legal representative before signing.

## 7. Understanding costs and how do they break down

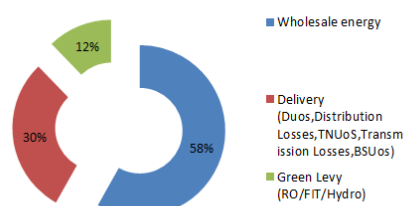
For Electricity there are many other elements apart from just the commodity (which at its simplest is split into Day and Night) on the bill e.g. Energy Tax, Distribution cost (Duos for the local company delivering from grid supply to your premises), Standing charge, Transmission charges (for moving electricity from Power station to nearest high voltage grid supply), Feed in Tariff, Climate Change Levy, Renewable Obligation charge. These other elements can make up 50% or more of the final invoice.

### Cost Components of Electricity Invoice 2012/13

NHH Electricity Supply Charges

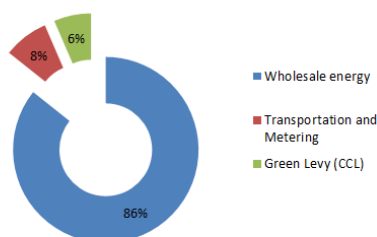


HH Electricity Supply Charges

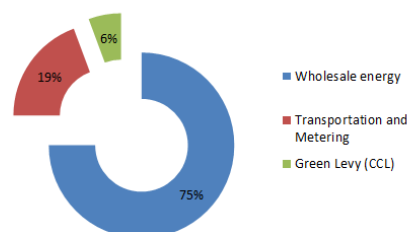


### Cost Components of Gas Invoice 2012/13

Gas DM Supply Charges



Gas NDM Supply Charges





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For Gas the commodity element is more than 80% of the total invoice.

For these other elements you have little control over them in that they are regulated by government type bodies. Depending on your usage and industry you may be able to get exemptions from some renewable costs and this is certainly worth investigating for Electricity. The charges are generally passed through to the customer by the energy supplier at cost (i.e. with no mark-up). It is important to ensure these are correct as this is an area where errors and increased costs occur.

Of course the best way to avoid the costs is to use less energy and if your company is a major user then you should have a strategic programme in place to consider all ways to reduce usage.

## 8. Green energy

Most energy suppliers can offer to supply green electricity, also known as renewable electricity. This electricity has been generated from sustainable sources, such as wind, or biomass. There has been a significant increase on the amount of green electricity being generated, particularly from onshore and offshore wind farms.

Electricity generators have an obligation to produce a certain – and increasing – percentage of their electricity from sustainable sources. When buying electricity, the supplier should be able to provide a typical profile of how much electricity that they supply comes from sustainable sources, or from gas or coal generation.

They will also try to sell this at a premium to their normal tariff to end consumers.

If your company is looking to buy green electricity, you should be able to negotiate this premium to minimise its impact on your costs. However buying green electricity is no substitute for energy efficiency and it is suggested that you look at ways of reducing usage before paying a premium for your electricity supply.

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## 9. International Contracts

If you are an energy user in other countries then you should consider having the same Procurement Strategy across all countries. This will make it easier to manage and top management will have a clearer picture.

The UK market is closely linked to the European and World market and tends to move in the same direction and at similar levels.

Most European markets are fully de-regulated and can offer similar transparency and flexibility as the UK, however some are still slow to offer full de-regulation e.g. Italy, Spain, Portugal, and Eastern European countries.

## 10. Suppliers of energy and the differences

There is a large number of suppliers to choose from, although not all of them have any interest in supplying you for a number of reasons so you need to check their interest first.

There are a number of multi-national suppliers e.g. Total, RWE, Eon, Shell, Wingas. However they often look at countries at an individual level and so there is limited benefit in having one supplier who covers all your countries.

There are a number of local suppliers that compete in only the UK market e.g. SSE, British Gas.

## 11. What does the future hold

If history (recent and further back) is anything to go by then volatility will continue.

There will continue to be a move to more renewable generated energy for two main reasons - Climate change concerns if we keep using fossil fuels, Maintain supply as we deplete natural resources. Because of this prices over the medium/long term are likely to rise.

In the shorter term the Demand/Supply elements tend to dictate the price

The US move to shale production of gas and oil has had a huge impact on the prices of products that they used before shale, in that now there is more supply than demand, so prices have reduced. If the world's growth continues to slow then prices will remain depressed.

However all companies should be looking to reduce their usage where possible to avoid the costs that will inevitably increase over time.



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To find out more about Chartered Institute of Procurement & Supply visit  
<http://www.cips.org/> or call +44 (0)1780 756777 or email [info@cips.org](mailto:info@cips.org)  
Easton House, Church Street, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ.

**CIPS Group** Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom  
T +44 (0)1780 756777 F +44 (0)1780 751610 E [info@cips.org](mailto:info@cips.org)

**CIPS Africa** Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa  
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E [infos@cps.org.za](mailto:infos@cps.org.za)

**CIPS Australasia** Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia  
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E [info@cipsa.com.au](mailto:info@cipsa.com.au)

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**CIPS Middle East & North Africa** Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates  
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E [mena.enquiries@cips.org](mailto:mena.enquiries@cips.org)



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