PROTECT YOUR CITY REVENUES BY WATCHING OUT FOR ELECTRICITY CONTRACT GOTCHAS

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Contracting for municipal electricity is complex. It can be very challenging to find the true lowest price. Apply a standard request for proposal (RFP) to a power acquisition and your city risks hidden charges due to complicated contract language. Recommend to council what appears at first to be the low bid and then find yourself later explaining why the promoted rate may not be the *actual* rate. Cities face few recurring monthly expenses greater than the expenses they incur for electricity. But electricity is not just a price. It is a service too. And both need consideration in the procurement process.

Back in a 2018 edition of *Texas Town & City* we enumerated several leadership tips for energy procurement. This month, with our eye on the "revenue" part of the "revenue and economic development" theme, we describe contract "add-ons" that can undermine an otherwise solid energy contract. A failure to account for these add-ons can increase your budget.

It's important, though, to first review a few basics about the Texas electricity market, commercial energy, and the process of procuring it. Understanding these basics will help you avoid mistakes down the line.

The Basics

Your city's energy bill is comprised of two components: 1) Transmission and Distribution (T&D) utility charges and 2) energy charges. The Texas Public Utility Commission (PUc) regulates the first; the market sets prices for the second. Always keep in mind that since T&D rates are approved and set by the Texas PUC, these charges are non-negotiable. When dealing with procurement, it should be the second part of your bill – the energy component – that should command your attention.

When contracting for electricity, you can sign up for a single fixed-price deal, a variable-price deal, or some combination of both. Although variable-price deals may result in lower average prices over the long run, they also are subject to the most month-to-month volatility and can spike to budget-busting amounts if you are not paying attention to the contract and the market.

In an earlier issue of *Texas Town & City*, we described a number of different useful RFP strategies for power purchases. We won't go through those again except to note that when it comes to using RFPs to procure electricity that pitfalls always remain if you are not aware of them. Also, keep in mind that electric price quote commitments typically remain valid for 24 hours or less.

Some cities seek professional assistance for power procurement. Typically, this means signing your city up with the services of an energy broker or energy aggregator. Brokers can help your city in the acquisition process, but they are not philanthropists. Some brokers, for instance, might present options only from its partnered suppliers and exclude potentially favorable options from alternative suppliers. Some may fail to include detailed analyses of the bids or contracts they present, and this will complicate any effort to make apples-to-apples comparisons between them. A broker may not necessarily attempt to identify and negotiate more favorable contract terms for the end user.

Aggregators, in contrast to brokers, combine the load of those in their aggregation group and then shop that load into the market. Some coalitions of political subdivisions themselves can serve in the aggregator role, and, as such, they will operate on a non-profit basis. Such aggregators likewise enjoy other advantages unique to groupings of governmental entities. But beware: some brokers use the word aggregator or aggregation in their company name, while in reality they obtain quotes for your load only and so don't achieve the true benefits of aggregation. If your city elects to go the aggregator route, you may want to know whether the aggregator operates on a for-profit or non-profit basis, how much it charges as an aggregation fee, and inquire about any additional services the aggregator offers.

Now, with that bit of background dispensed with, let's move on to a discussion of some of those contracting pitfalls. For this edition, we're focusing specifically on price add-ons and related contract provisions. These add-ons come in different forms – ceilings, meter charges, congestion costs – and all can lead to cost overruns if your city fails to account for them properly. Below we list some of the most common add-ons … so be sure to look for them in the fine print. If you don't see these included in your contract, ask your retail electric provider, broker, or aggregator how they plan on handling these charges.

Common Add-On Charges

Bandwidth Charges: Bandwidth refers to a range of electricity usage your city expects to use over the term of the contract. Usage outside of the bandwidth range may result in imposition of a market price instead of a contract price – hence, bandwidth charges. Bandwidths vary by contract, and the price is usually higher for wider bandwidths.

Some contracts impose bandwidth on a total-use basis and some base them on consumption at individual meters. Some contracts allow the electricity seller the right to decide if they want to impose bandwidth provisions or not.

Congestion Costs: Congestion costs are costs incurred to relieve congestion on the ERCOT transmission grid. Congestion costs vary by ERCOT zone and can be significant. Because congestion costs are market based, your supplier can never predict them with certainty. "Fixing" these costs in an energy contract is similar to buying price insurance, but often that insurance ends up costing more than the actual cost of relieving the congestion.

Retail supply contracts treat congestion costs in many different ways. Some include it in the energy price and others treat it as an additional charge. Different suppliers define congestion costs in different ways and use different terms to address congestion costs.

Ancillary Services Costs: Ancillary Services are various costs incurred by ERCOT to maintain system reliability. Similar to congestion costs, ancillary services costs change hourly. The energy seller typically will include Ancillary Services costs in the quoted energy price, but because those actual costs are unknown at the time of contracting, such inclusion again is similar to buying price insurance. As with congestion costs, this means your city may end up paying more than the actual Ancillary Services costs incurred by its retail electric provider.

Most contracts will include Ancillary Services as part of the fixed costs of energy. Some contracts stipulate that the seller can adjust the energy price upward if these costs are higher than anticipated.

Change in Law or Material Changes: A Change in Law (or Material Changes) provision typically allows the electricity seller to adjust the price or some other contract provision should the seller find itself confronting additional costs due to developments outside of its control. These can include costs for congestion, costs for ancillary services, costs resulting from changes in market rules, or costs due to revised laws or regulations.

Most or all retail supply contracts will include some form of a Material Change provision and so look it over before you sign. Typical language creates a unilateral right for the energy seller to adjust the price upward if some action by ERCOT, the Texas PUC or the Texas legislature causes its underlying costs to go up. However, we have seen very few instances in which the buyer can exercise this clause to *lower the energy price* because of a *decrease* in underlying costs.

Broker Fees and Aggregation Fees: Brokers, as noted above, are individuals or companies that solicit and present energy offers to your city obtained from multiple sources. An aggregator, by contrast, combines load of all members in the aggregation group and shops that load to the market. Brokers and aggregators typically receive payment via usage-based fees. Ask what the fee is and what services are included in the fee. Many contracts will have an a la carte menu for additional services which could run into the thousands when you thought the service was included.

The Bottom Line

Understand that each of these complex add-on charges represent potential pitfalls for a successful energy procurement. Contracts will include or exclude a variety of them so ask your energy supplier how it accounts for them and make your expectations clear. What sort of energy-related services will your city expect from the retail electric provider? Will your retail electric supplier charge extra for these services? What happens if Congestion or Ancillary Services charges are greater than anticipated? Asking the right questions now will help protect your city revenues in the future. ★

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