KNOWLEDGE IS POWER: WHAT MAKES A GOOD ENERGY CONSULTANT?

Businesses buy things all the time—from pencils and pens to multi-million dollar pieces of equipment. However, one of the more challenging purchases made by end users involves strategic energy sourcing (procurement) in areas of the country with deregulated energy markets. Procuring energy and managing related risks, presents businesses with unique challenges unlike any other goods or services they purchase. Energy commodity prices can be extremely volatile and are governed by a complex set of rules and inter-relationships. Therefore, many businesses and governmental entities opt to utilize the services of an energy risk management consulting firm to aid them in making this purchase. This has led to a proliferation of firms claiming to have energy market expertise. Amidst all the noise, it is important for businesses to evaluate energy consultants to find a partner who can help manage the risks involved in strategic energy sourcing for their business.

This whitepaper suggests several criterion that should be used to determine if a company claiming to assist, has the breadth and depth to really deliver what it promises. These criteria include, but are not limited to:

- Understanding energy market dynamics
  - Proficient in market fundamentals and technical analysis
- Effectively communicate complicated concepts in the energy market
  - Expertise in Product Structuring, Derivative Products and Risk Management
- Effective retail and wholesale supplier relationships
- Completion of service after selection of energy provider
  - Insure that business receives benefit of any consummated energy contract

Understanding Energy Market Dynamics

Any time a business seeks outside expertise, be it in the form of an attorney, an accountant, or an energy management consultant, the first and arguably the most important criteria, is whether the company proclaiming to provide expert advice can actually deliver on this promise. This is especially true in the energy sector, where an intricate web of interrelated factors can create confusion and lead to bad energy risk management decisions.

To evaluate whether an energy consultant understands the market dynamics of any particular area of the country, the consultant should be able to explain and act on the following at a minimum:

1. **Spot market and forward price dynamics**—this is at the heart of understanding how to manage energy procurement risk and is a basic requirement for any energy management consultant. Without this basic knowledge, the person claiming to be an expert energy consultant cannot offer effective energy risk management advice. Access to historic market data and live price feeds is also critical.
2. **The impact of fuel costs on power costs**—while knowing the breakdown of various fuel sources used to power generation plants is important, this is only part of the story. In energy markets, the power price is set by the “marginal” unit. Understanding which units are typically on the margin will help the consultant and the client understand what is driving the real time and forward energy markets, helping in the development of an appropriate risk management strategy.

3. **The details of the basic market structure**—while this may sound obvious, it is one area where most energy risk consultants can fall short. Understanding the numerous bundled components that are included in the supply proposal for each deregulated market is key to managing energy risks. This knowledge is critical to evaluate and determine which supplier is offering the best proposal to a client. Although most consultants will understand the market structure at a high level, such as knowing what a forward capacity market is, the devil is in the details. For instance, how are prices determined in the capacity market? How often are capacity prices set? What can end users do to reduce their exposure to capacity market prices? While these appear to be relatively simple questions, the answers can be highly complex and difficult to fully understand and appreciate the risk that capacity markets entail for those not familiar with the energy markets.

4. **The regulatory environment**—although the underlying fundamentals of supply and demand impact the costs for energy, an often overlooked, yet critical component of an effective energy consulting strategy involves understanding the regulatory environment. One reason this topic can be especially challenging is that there are multiple levels of regulatory involvement, ranging from the FERC, to the state public utility commission, the independent system operation, such as PJM and the state legislature. These differing bodies impact different aspects of the energy market and understanding the interplay between the two is critical to implementing a solid energy risk management strategy.

5. **Drafting and managing RFPs**—RFPs come in all shapes and sizes, so it is worth your time to delve into the consultant’s capabilities of covering all your requirements and needs in such an RFP. Likewise, it is essential to develop an RFP that provides transparency in responses from suppliers.

Understanding these five fundamental concepts at a minimum is an important first step in determining the efficacy of an energy management consultant.

**Communicating complex concepts**

Understanding complex market concepts entails a base level of knowledge and competency, but this alone is insufficient. A good energy consultant will have the ability to communicate complex concepts to clients in a manner that they can understand and that takes into account the client’s unique business needs.

While most energy consultants have the gift of gab, the litmus test for communication ability lies in whether the client understands the concepts articulated by the energy consultant. From the end user’s
perspective, after meeting with an energy consultant, the client should be able to answer several basic questions, including:

- **What experience does the energy consultant possess?** In other words, what are the consultant’s core competencies? Are they a good fit for your organization’s business model based on their client base and approach? It is critical to evaluate a consultant’s track record. What sets them apart from their competitors and what are their key differentiators. If this is a first time experience for an energy consultant, answers to these simple questions will separate successful consultants from the rest.

- **Does the energy consultant understand you?** Exceptional energy management consultants will not only talk and try to impress a client with fancy charts and slick presentations. Instead, they will spend significant time learning about the client’s needs and facilities. A solid understanding of your business is needed to develop a tailored energy risk management strategy that evaluates all energy saving options, not just procurement.

- **Does the consultant have expertise in Product Structuring?** The best firms that specialize in this arena have employees which have worked in Retail and Wholesale trading organizations. Not only does this help a consulting firm develop strong relationships with Retail and Wholesale suppliers, but also it enables consultants to customize products and draft contracts that accommodate the successful implementation of a strategy.

- **Is the energy consultant actually consulting or just selling?** This is maybe the toughest question for a client to answer as all consultants, regardless of industry, are selling their time and thus there is always a sales element to any meeting. However, one of the key distinctions between someone who is just selling and someone who is truly consulting with a client to manage energy risk, is the ability of the consultant to adapt. A consultant’s initial offer may not be the best fit for their potential client. The willingness and ability to adapt that initial offer in response to the needs of the client based on information, gathered indicates true consulting.

- **Does the consultant have the ability to communicate across your organization?** Besides being able to communicate with facilities managers and procurement managers, it is critical that a consultant has the ability to articulate recommendations to C-level executives in financial terms they can appreciate. Conveying the risk/reward profile of a strategy in a simple, clear and concise fashion is key to communicating the message to all levels within an organization.

When evaluating an energy consultant, it is important to consider the consultant’s ability to communicate complex concepts. The energy market is a potential quagmire. Highly professional energy management consultants are able to navigate clients around the potential pitfalls in a manner that the client understands. Thus mutual understanding and value added allows for a true partnership between the consultant and the client.

*Service after the selection of a supplier to ensure the benefit of the bargain*
Simply understanding the risks inherent in energy markets and being able to communicate these to a client is only a portion of the value proposition of a worthy energy management consultant. The third piece of importance is the energy consultant’s attention to detail. The consultant is to insure that the energy risk management strategy devised provides the envisioned value as follows:

- **Optimizing product selection**—remembering that energy procurement is a risk management exercise, the valuable consultant will try to optimize the product selection to mitigate the exposure of the client to adverse market outcomes. This can be accomplished through a variety of approaches. Constant vigilance as related to energy market conditions is vital to capitalize on favorable market conditions as well as avoiding negative economic outcomes in the event that the consultant and client agreed upon a product with risk exposure. Tracking price moves, providing price alerts and reporting the impact to P&L is key in successfully executing a strategy. An energy management consultant who cannot or does not advise clients concerning market conditions and how they impact the risk/reward calculus of the initial product selection is failing the client and typically serves more as a broker with a “one and done” approach.

- **Contractual language**—proactive energy risk management will not focus on just the price of the commodity, but will also look at and evaluate the risks inherent in the contract signed by the end user. For instance, in a straight-forward Fixed Price product: does the contract include language around bandwidth (changes in usage)? How does the contract define and treat a change in the market rules? Does the contract provide the client with the ability to add or remove meters without significant administrative work or cost? How is early termination treated? These are some of the details that a valuable energy consultant will evaluate from a risk perspective and advise the client on when entering into a retail energy contract.

- **Ensuring compliance with contract terms**—just because an energy risk management contract has been agreed upon by the consumer and the supplier, this does not mean that a good energy consultant’s work is complete. Rather, a good energy partner will remain vigilant throughout the contract term and make sure that both parties are receiving the benefit of the deal that was negotiated. A good energy management consultant will monitor the adherence to the contract by both parties.

- **Customer Care**—it is critical for a consultant to have strong customer service capabilities. The ability to review invoices, reconcile billing with market prices, facilitate add/deletes, facilitate meter switching, etc. is vital. Customized consultant portals also provide clients with relevant information, including but not limited to facilities, contracts, market intelligence and pricing.

Simply defining the desired energy risk management strategy is only the beginning of the job of an effective energy procurement consultant. Working in a partnership with the client and supplier, a professional energy risk management consultant will have determined the energy product providing the best risk/reward balance, negotiated any specific contractual language which provides benefits for the
client with an acceptable level of cost and risk premiums and insure that both parties are adhering to the terms of the negotiated contract.

Conclusion

Energy expenditures tends to be a top 3 line item for most businesses. In those areas of the country where the end user has the ability to negotiate an energy contract; businesses have an unprecedented ability to mitigate their energy price risk. However, with this opportunity comes increased risk and complexity. As a result, many companies choose to outsource this additional critical business function to an energy management consultant. Given the number of consultants claiming to be experts, end users need to understand what they are to be looking for in energy consultant and how to determine what constitutes a good energy risk management partner. By now it should be clear that a professional energy consultant provides services that are well beyond those of an energy broker whose sole function is to act as a middle-man assisting clients in procuring energy without adding more value.

To evaluate energy consultants, a client must consider the consultant’s experience and market knowledge, as this is critical for the client to evaluate the correct risk/reward balance. While market knowledge is important, the ability to effectively communicate this information and to turn it into actionable data requires exceptional communication skills. A consultant who has a great understanding of market rules and dynamics but cannot articulate this information to the client, is going to deliver less value than one who can explain these complicated inter-relationships and the impact they will have on any energy risk management strategy. The third metric for evaluating the efficacy of an energy management consultant revolves around service post contract signing. This includes optimizing the product selection, negotiating contract terms that mitigate risk to the end user without incurring significant premiums and insuring that all parties adhere to the terms of any negotiated contract.

Finally, a customer must select a consultant who is an unbiased third party and acts on the best interest of their client.

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