

Pool Power:

Bringing Big-business Electricity Choices to Small and Mid-size Businesses

Executive Summary

Aggregation is an increasingly popular option for small and mid-size businesses seeking greater control of their electricity costs, particularly in today's volatile energy market. This white paper serves as a primer for businesses considering joining an aggregation or electricity buying pool. We outline the basic concepts behind the pricing for pool members, explain the characteristics of success and offer practical advice for selecting a pool program.

Introduction

Health insurance. Wholesale clubs. Retirement plans. Small and mid-size businesses have long understood the power of banding together, gaining strength in numbers to address the basic costs of doing business. The ability to save money on operational essentials can directly affect your opportunities to survive and grow.

Similar to other programs that leverage a group's collective purchasing power, electricity aggregation pools provide an opportunity to trim energy costs by working in partnership. Working with an aggregation partner, the aggregation pool takes its collective electricity load to the wholesale market with the intent of securing better pricing for each member in the pool.

Aggregation: The Basics

Aggregation is the term used to describe the process by which individual electricity users form an alliance for energy-buying leverage. In an aggregation pool, companies band together to combine each of their smaller energy purchase demands — or *loads* — into a single larger load. The most competitive electricity rates are available through a purchase on the wholesale market. Because wholesale electricity is sold in large blocks, businesses with large electricity loads can enter the market with stronger bargaining power.

To gain the benefits of procurement on the wholesale market, a business or multi-facility enterprise must have peak demand of 1MW or greater. Because most institutions and commercial or small manufacturing businesses typically use less than 300 kilowatts per month, the opportunity to make wholesale market purchases is a challenge — if not an impossibility. However, by forming an aggregation pool, smaller businesses can unlock access to the core promise of the deregulated electricity market: the ability to shop around for a more competitive rate.

To strengthen buying power — and gain access to the more competitive pricing that typically follows — most aggregation pools will include a group of 30-200 customers. An aggregation may include companies from a mix of industries or a single industry. These pools are created and managed by an aggregator that creates the energy-buying alliance, seeks out competitive pricing, executes the electricity buy on the wholesale market and secures the rate contracts for all pool participants.

How Wholesale Market Contracts and Buys Are Structured

Unlike the rate structures that a small or mid-size business may receive as an individual consumer, the rates and contract terms for aggregation pools are structured to purchase the required load through a supplier that is licensed to buy on the wholesale electricity market. As part of a pool, a smaller customer can access a wider variety of electricity supply strategies, including some that are typically available only to large energy consumers such as industrial businesses. This wholesale market approach to energy procurement offers greater flexibility — and expanded opportunity — in the pursuit of competitive pricing.

Like the stock market, the electricity market changes constantly. Factors such as weather, supply and demand, political or industry events and regulatory change can affect pricing from hour to hour. Retail suppliers working in the wholesale market closely monitor market conditions and identify opportunities to buy when pricing and terms are most advantageous.

Many institutions and commercial businesses are accustomed to securing electricity service from a traditional utility. The utility company establishes rates based on its costs, desired profit margins and regulatory requirements or allowances, and it may change those rates periodically in accordance with regulations that govern their service area. As such, organizations purchasing their electricity supply are charged for usage at the utility's pre-established rate, with no opportunity to negotiate or take advantage of pricing dips on the wholesale market.

Conversely, businesses working with aggregators in deregulated markets may have access to choices in *products*, the industry term that describes the contract structure and purchasing processes for securing the customer's required load. Depending on the product selected, aggregation pool members may have opportunities to take advantage of rate dips.

An aggregation pool can purchase its entire load with a *fixed-price product*. In this scenario, the aggregator's objective is to secure the pool's entire load at a rate lower than that which is available to each pool member as an individual consumer. The electricity service rate charged to each member is fixed for a prescribed time. Business owners choosing a purely fixed-price product may do so because they prefer the predictability of their electricity rate. Because they are more comfortable with predictability rather than risk, they are willing to give up the opportunity to secure lower rates that may become available over time on the wholesale market.

Some aggregators may also offer options for *market- or index-based products*. These products are best suited for a pool that is comfortable with taking on more risk, with the objective of achieving lower energy costs. Initially, no portion of the aggregation pool's load is secured with a fixed-price, and the aggregator's objective is to secure portions of the pool's load at points in time when market conditions and rates appear to be most favorable. Like a stock market broker, the aggregator closely monitors the market and purchases electricity loads based on anticipated market behavior, with an eye on getting the best value in given market conditions.

Aggregators may also offer a *portfolio-style product* that balances fixed-price certainty with market-priced opportunity. Based on the collective needs of the pool, the aggregator recommends a portfolio-type structure for the load purchasing plan. The portfolio product locks in a portion of the required energy supply at a fixed price at the beginning of the contract term. However, a portion of the total load requirement is not purchased, which allows the supplier to search for opportunistic buys on the market. Throughout the contract duration, the supplier watches the market for fluctuations, to identify opportunities and purchase power loads at rates that meet the pool's supply and budget needs. When the supplier identifies a favorable rate that meets the pool's objectives, the supplier is able to purchase another block, creating a layered effect that positions the pool for competitive pricing with the assurance of seamless electricity service.

For successful implementation, market-based or portfolio-style products must be driven by an aggregator committed to high-quality customer service. The aggregator is charged to act as the aggregation pool's advisor on product selection decisions and as an informed buyer on the wholesale market. With electricity representing a major portion of overhead costs, the pool members need to feel highly confident in entrusting the aggregator with their electricity supply management activities.

Businesses considering an aggregation pool can benefit by understanding the aggregator's available products, services and recommended purchasing strategies. Armed with this knowledge, the business owner can determine if an aggregation pool will work in support of his/her individual business needs.

Cooperative Action: An Essential for Aggregation Success

Aggregation is an option available in many deregulated electricity markets. Most often, aggregation pools are formed around an existing organization, such as school district coalitions, chambers of commerce, trade organizations or other regional business consortiums. In other cases, the businesses may have no pre-existing relationship but share the same geographic location. A consultant or other third party may recruit businesses within this service area for pool participation with a focus on achieving a mix that yields a competitive load shape.

Electricity aggregation pools begin with a group and a commitment to a goal of controlling electricity costs. As described below, the group's commitment to cooperative action can make the difference between success and shortcomings.

Similar to group insurance or retirement plans, the aggregator and partnering organization will establish an open enrollment period for 30 to 60 days. During this time, prospective pool members should have the opportunity to learn about the aggregator, their purchasing choices and contract terms as well as information about regulations, choices and rate trends in their service area.

During this time, the aggregator also will gather recent copies of electricity bills from each participant. This billing data will give the aggregator an understanding of the collective load profile and average rates per member. The aggregator may also conduct credit checks of each business to protect the viability of the entire pool. At a pre-determined date, the enrollment period closes, and the aggregator should communicate the target rate or "price-to-beat" to the pool members. Collectively, the aggregator and pool members will reach an agreement on goals for the pool contract.

The cooperative actions of the aggregator and prospective pool participants during this phase are critical to the success of the pool. The aggregator will enter the purchasing period with assumptions based on the entire load requirements. If prospective pool members abandon their commitment, pricing for the entire pool can be adversely affected.

Using the target rate as a guide, the aggregator will require a span of time to identify competitive pricing on the market. Based on purchasing opportunities, the aggregator will supply the pool participants with a proposed contract structure.

Because market conditions change so rapidly, the aggregator and pool members should be positioned to work in concert to efficiently secure and execute the terms proposed in the contract. As described above, the contract rates and terms are made possible by the collective load shape. To successfully secure the proposed rates, each pool member must support the group's cooperative efforts in contract processing. The pool's proposed rates are not secure until all contracts are executed, and a failure to execute each contract in a timely manner can result in a missed opportunity — and the need to restart the purchasing process.

Evaluating an Aggregator

When joining an aggregation pool, you're also exercising your right to choose your energy supplier. As with any significant business investment, it's well worth the time to research your options, understand the qualifications of the aggregator and make your purchasing decision with confidence.

The following questions can help you and your pool members evaluate qualifications.

What is the aggregator's level of experience?

The pool's ability to save money and control costs is largely based on the strategic decisions of the aggregator. The aggregator's strategy should be based on an understanding of the regulations that apply to your service area and knowledge of the wholesale market, with experience in direct purchasing. Your evaluation questions may include:

- *How long have you been in business?*
- *How long has management and purchasing for aggregation pools been a core service of your business?*
- *How many aggregation pools are you managing in our service area?*
- *How many businesses are participating in these pools?*
- *Who is responsible for purchases on the wholesale market, and what is their experience level?*
- *Is the aggregator registered with the utility commission?*

What products are available?

As described on page 3, aggregation should give smaller businesses access to products that unlock more competitive pricing. Your evaluation questions should give you an understanding of the available range of products. Aggregators offering only a fixed-price product may provide fewer alternatives for cost savings, with little variation from your current electricity service provider.

What is the process for distributing and managing contracts?

This paper describes the time-sensitive nature of processing contracts. The commitment of pool participants is essential to success, and their commitment must be matched by the aggregator's ability to process the group's contracts efficiently. The following evaluation questions can guide you to an understanding of an aggregator's ability to manage this phase efficiently.

- *How will you distribute contracts to our members?*
- *Who will answer any member questions throughout the contract signing process?*
- *Who is responsible for notifying us of contract renewal opportunities, and how much time will we have to consider our renewal options?*

How will my account be serviced?

High-quality customer service should be part of your aggregation package, both before and after you sign a contract. These evaluation questions can help you understand the level of service you can expect to receive.

- *Where will I direct questions or concerns about my contract structure or monthly bill?*
- *As a customer, what other services can I expect throughout the term of my account?*
- *What is the renewal rate of the aggregation pools managed by your firm?*
- *Will you communicate changes in market or regulatory conditions, energy trends or other information that may affect my electricity rates? If so, how and how frequently will that information be communicated?*
- *Can we speak to references?*

Conclusion

In today's business climate, small and mid-size businesses are challenged to control the basic costs of doing business. Aggregation pools offer a big-business electricity supply solution to smaller energy consumers. With the knowledge of electricity purchasing choices, a qualified aggregation partner and a shared commitment to success, small and mid-size businesses can work cooperatively with an aggregator to tap into the true benefit of the deregulated electricity market: pricing choices.

Presented by Direct Energy Business

Transparent pricing, experienced guidance and unequalled service. Direct Energy Business is dedicated to serving our customers with innovative energy management solutions. As your energy partner, we can help you gain greater control of your energy costs and streamline your procurement process. With more than 20 years of industry experience, we are dedicated to helping companies make cost-effective choices for their electricity and natural gas requirements. Contact us to talk about your energy demands, and we'll help you navigate the procurement options available in your service area. To learn more about our company and other energy strategies for commercial and industrial enterprises, visit www.directenergybusiness.com or call 800.830.5923.