Mitigating electricity price shocks

Power purchasing is no longer a set-and-forget exercise. It requires a proactive execution of a risk management strategy endorsed at C-suite level.

As energy prices and market volatility surge to unprecedented levels, Australian corporates are tackling this energy commodity risk exposure by rethinking how they buy electricity.

The war in Ukraine is putting pressure on our internationally linked domestic gas market. The net zero agenda is conducive to less investment in fossil fuel power generation. Investment in new renewable energy generation capacity, power transmission infrastructure and energy storage is not keeping pace to support a smooth clean energy transition. All these elements are pushing up prices, says Gilles Walgenwitz, general manager Energy and Carbon Markets at climate risk and energy consultancy Energetics. “This is not a one-summer or one-winter issue. It’s a decade-long issue.”

Companies have several available strategies to protect themselves against electricity price risk. Energy users with large portfolios can diversify risk by staggering their power supply contracts with retailers to ensure they don’t all end at the same time, which could mean having to renegotiate their entire supply when market prices are potentially high.

Another strategy is to mix long-term power purchase agreements — for example with a renewable generator — with progressive purchasing of short-term forward contracts. This provides a partial hedge against future price rises, while also allowing the company to benefit if the price falls by following the market on the shorter-term contracts.

Companies can also produce their own power, for example by installing solar power generation systems to get cheaper electricity and save on growing transmission and distribution costs.

Finally, there is demand response. Companies with batch processes can turn off production at a time when spot power prices are high, reduce or defer production until prices fall and be paid for contributing to the adjustment of demand to supply. Alternatively, if they can be flexible with their power demand, they can negotiate a contract for a flat electricity load from their retailer — rather than one that caters to demand spikes that attract a higher retail risk premium. With a flat load, they can secure lower retail prices and manage residual spot market exposure by responding to high prices. Flexible demand will increasingly be valued in volatile spot markets.

All these strategies require energy markets expertise and a much more active risk management capability than many Australian companies have applied to electricity purchasing previously.

“You need to actively monitor the market, adjust portfolio positions and understand your risk limits,” says Walgenwitz. “Five years ago, I was talking to procurement teams. Now I’m talking to CEOs, CFOs and executive teams because energy commodities can seriously affect their business P&L.”