

FOCUS

The Power Players

Should businesses switch electricity providers now or wait?



By **DAVID BRAUN**
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With the expiration of rate caps in Pennsylvania, commercial and industrial customers are confronted with issues that range from what to ask prospective providers to understanding the “fine print” in contracts. But one of the most important considerations they face is this:

Now that customers can choose suppliers in a competitive marketplace, is it better to make a change now — or to wait until the dust of deregulation settles?

The answer to the question depends on a number of factors. But in making the decision, it is essential to know how electric prices are set, how the commodity market for electricity works, and what level of risk you are willing to accept.

Basically, the price of electricity can be consolidated into two broad cost categories: delivery and energy.

Delivery accounts for an average of about 25 percent of the total bill, and represents the cost of getting energy from the generator to the meter. Delivery rates are driven more by regulatory bodies and independent system operators than by the market, as a result there is minimal price volatility.

The energy component, on the other hand, is very different. Energy represents

the cost of the electricity itself, and makes up the remaining 75 percent of what you pay. Before rate caps were lifted, these prices were frozen at 1997 levels. In the deregulated environment, they rise and fall with the wholesale price of electricity on the commodity market.

But be aware that the lowest prices quoted may not add up to the best deal; there are often hidden costs, so ask providers to explain every detail in the contract. The full cost of power from a supplier includes some of the delivery costs like capacity, transmission (separate from the distribution charges from the utility), ancillary services, and line losses. It is critical to understand if each of these costs is included or will be an extra line charge on the bill from your supplier.

Like most commodities, electricity is bought and sold around the clock, every day. Unlike most commodities, however, it cannot be stored once it has been generated. So when demand increases, suppliers have to generate the power and get it onto the grid. When demand decreases, it has to be sold off — typically at lower prices.

Also, when demand is low — such as during the night — the load can be supplied from the least expensive generators. Typically these are nuclear and coal units, but more recently they also consist of wind, which unfortunately blows hardest at night and in the winter. During higher-demand times, like the afternoon of a hot summer day, all power plants are needed, including the most expensive ones that

burn natural gas and oil, and therefore the power supply costs more.

The upshot of this is that prices can be volatile. Large commercial and industrial customers in the deregulated PJM markets who buy from their local utility now will receive prices that fluctuate every hour with the spot wholesale market.

On a month-in, month-out basis, this fluctuation can be significant. For example, in 2009 wholesale day-ahead prices on the PJM West grid ranged from \$95 per MWh on Jan. 16 to \$29 on Sept. 1, according to the U.S. Energy Information Administration. Through mid-February 2010, they had swung between \$44.25 and \$87. And prices are highest during the peak day time hours when businesses are in full operation. However, competitive suppliers can provide a variety of types of electricity contracts that include providing customers the ability to lock in their prices and avoid volatility.

Of course, your willingness to tolerate the risks associated with a volatile market — and the degree to which price certainty is important — play a role in the decision-making process.

If mitigating risk is an issue, it makes sense to find the best deal and then lock it in for an appropriate time frame. This is sometimes a viable approach for entities whose budgets are fixed and cannot pass through any upward price adjustments to third parties.

At the same time, some providers offer contract flexibility in which prices for a

portion of your usage are fixed and those for the remainder float with the market. But again, while this may have value to certain kinds of businesses — such as those who can pass increases through to customers — it is still largely dependent on how willing you are to take the risk that the market will move in your favor.

Given this volatility, there is a clear advantage to shopping around and contracting for the best price and associated products that meet your needs. Current prices are at or near historic lows compared to the past several years. This is due to economic factors such as the recession, which caused a decline in business activity and therefore power demand. Also, recent increases in natural gas reserves and conservation measures all add up to decreased demand and lower energy costs worldwide.

In the end, the decision of when to change providers is a matter of what's best for you. For all the uncertainty in the current market, however, one thing is sure: If you don't change, you'll continue to be at the mercy of the utilities. But by shopping around — and by understanding pricing, volatility, and risk tolerance — you'll at least know your options. With that knowledge, you can gain control to pursue the energy strategy that best aligns with your business and budget strategy.

David Braun is regional vice president, PJM, of GDF SUEZ Energy Resources NA. The URL of the company's web site is www.rediscoverenergy.com