

# Electricity Options:

## Understanding the Basics of the Electricity Market and Product Choices in the Illinois Market

### Introduction

Deregulated electricity markets offer electricity procurement choices. These product choices are designed to help business owners and energy managers take advantage of the opportunities created by the volatility of the wholesale electricity market.

A variety of choices (commonly referred to as electricity products) are available through retail suppliers. Become familiar with the choices available to you. Then, consider how the products fit with your unique business objectives, factoring in tolerance to risk, financial objectives, and business goals.

### What Moves the Market?

Just like in the financial market place, electricity is driven by basic supply and demand principles. However, because electricity can't be easily stored, the market can't even out fluctuations by drawing down reserves, resulting in more frequent and dramatic price changes.

#### ■ **Electricity generally follows a seasonal cycle**

Demand for electricity and ensuing prices rise during peak heating (winter) and cooling (summer) seasons and drop during transitional seasons (spring and autumn).

The market is affected by a broad variety of factors. Changes in one of the following can intensify volatility and lead to dramatic price changes.

■ **Source Fuels:** Because source fuels like coal, natural gas, and petroleum account for 71.5% of electricity generated in the U.S.<sup>1</sup> as well as heating and cooling, dramatic movement in source fuels also impacts the electricity market.

■ **Weather:** Weather is one of the most influential variables on the market place because it directly affects energy consumption (demand). Extreme weather such as hurricanes, floods, and blizzards also create periods of extreme price volatility, especially if they interrupt natural gas production facilities that provide source fuel for electricity generation (limiting supply) or damage electricity transmission and distribution infrastructure (reducing supply and limiting the flow of electricity).

■ **Geopolitical Events:** Political unrest, war, hostage crisis or other events in regions that export natural resources can affect the energy market. The events typically impact the market immediately,

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<sup>1</sup> "Existing Generation by Fuel Type", Energy Information Administration 2009

which can affect short-term prices. Prolonged unrest will produce prolonged uncertainty, which can lead to wholesale market increases over the long-term.

The factors affecting the electricity market can be overwhelming. However, shifting conditions are also sources of opportunity for electricity shoppers. The cornerstones to developing a successful energy strategy are understanding the energy options available and your selection of a reliable energy consultant who can offer you good advice.

## Electricity Procurement Choices

The goal is to select an electricity product based on external factors (market conditions) and the needs of your business (such as long-term profitability goals, monthly budgets, and risk tolerance). The next section provides an overview of typical product choices available in a competitive electricity market. Not all suppliers offer the same products, and not all products with similar names will be identical to those described below. Your decision should include discussion with your energy consultant and careful review of the terms and conditions of your supply agreement.

## Common Product Types

### FIXED PRICE PRODUCT

**Description:** A fixed rate product provides a secure rate per kilowatt hour (kWh) for the generation portion of your electricity bill. Your monthly bill will vary based on usage, but the rate you pay for the electricity generation will remain constant no matter what happens in the market. Transmission and distribution charges will continue to be billed by ComEd and may be included in a single bill by the retail supplier.

Options for length of the contract may vary based on the retail supplier, but fixed-price products are often available in terms as short as 6 months or as long as 60 months.

**Benefits:** A fixed rate is often preferred by businesses with low risk tolerance and/or very little budget flexibility. It offers a level of budget certainty, which can help you control operational costs. Cost control should not be confused with immediate cost savings; although a well-timed purchase can produce cost savings immediately and over time.

A fixed price product is also a very low maintenance choice. Once you have locked in your fixed rate, you do not have to manage your electricity procurement until your contract is nearing expiration.

**Points to consider:** Though a fixed rate offers you protection against price spikes, it also does not allow you to take advantage of price dips. Timing is important. You want to lock in when the market is low and flat. You must weigh the value of waiting to see if the price dips further versus the risk of waiting too long before the prices rise. Long-term price certainty may come with a price premium compared to the index price.

## **INDEX PRICED**

**Description:** Index priced products (also referred to as market-based products) provided supply at a rate that is linked to a transparent, published index (day-ahead or real-time, hourly pricing).

**Benefits:** An index priced product may provide greater flexibility to take advantage of short-term market opportunities until the timing and market conditions are more advantageous to lock in on a long-term contract with a fixed price product.

**Points to consider:** If budget certainty is your top priority, an index priced product is not typically recommended as a long-term strategy because of the risk of price volatility. However, it can be a good alternative bridge position to wait out a period of high or rising market conditions. Index priced products are generally used by businesses that want to ride the market for some period of time to assess future market conditions or opportunities.