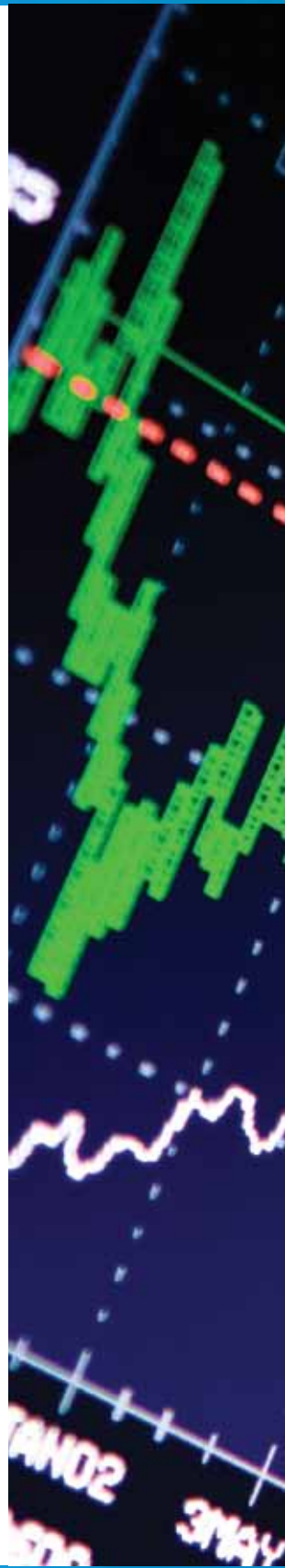


# How “Fixed” is the Fixed Price Product

You Are Purchasing From  
Your Electricity Supplier?






# Electricity Supply Agreements

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**EXECUTIVE SUMMARY** Over the past year or two, it has become increasingly common for electricity suppliers to sell a fixed price product to customers and later pass through additional costs. In other words, fixed prices have become less and less fixed. The electricity equivalents of baggage fees and fuel assessments have started showing up on more and more customer bills.

In some cases this has been done cooperatively with a customer to meet a specific objective or transfer a risk to the customer that he or she was willing to take. In other cases, this has been done to create the appearance of a lower price in order to induce a customer to sign a contract, leaving unpleasant, budget-busting surprises down the road. Product innovation will ultimately benefit customers, and bad actors will eventually be identified and eliminated by an educated marketplace. In the meantime, **customers and their advisers will be challenged to determine if Offer A is really better than Offer B.**

### **Why are some suppliers passing through costs on a fixed price product?**

**Competitive pressures have encouraged some suppliers to search for ways to lower the customer's perception of the price being offered for electricity.** Thus, suppliers have removed unknown, uncertain or unrealized cost components from their quoted prices, even those components that are certain or highly likely to be adjusted in the future. Suppliers subsequently pass through such costs when the change in cost takes effect.

**Competitive pressures on consultants have encouraged some consultants to focus their efforts on securing new customers, and to trust suppliers to add in all of the components that the consultant is asking for.** As a result, less focus may be placed on the exact language in the supplier's contract, or how the supplier has applied that language in the past, which may pose potential problems for customers down the road.

**There has been a period of sustained lower energy prices and lower cost volatility for many energy cost components.** Non-energy cost components (e.g. capacity, transmission, ancillary services) make up an increasingly large portion of the total cost of electricity. It may be within some customers' intended risk tolerance to not fix the future cost of some components, thereby avoiding the "risk premium" that occurs when a supplier fixes this future cost.

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### Under what circumstances are some suppliers passing through costs?

1. An unknown or unforeseeable future change in a law or regulation that will change the cost to supply electricity to the customer. For example, the timing and level of Reliability Must Run (RMR) charges in all ISOs can be highly unpredictable and volatile, and most suppliers pass through RMR charges that occur during the term of the contract.
2. An anticipated future change, for which the precise timing and/or calculation impact is not yet fully known. In PJM, for example, transmission (i.e., NITs) charges are charged to the electricity supplier. Over the last few years, most utilities in the Northeast and mid-Atlantic have been expanding or strengthening their transmission systems. While the exact timing and level of these cost increases is difficult to predict, the general trend towards large annual transmission cost increases has been very predictable.
3. An anticipated future change for which the precise timing is known (e.g., June 1), but the cost of the change is not yet fully known. The new Lower Hudson Valley (LHV) capacity zone in NYISO is one such example. While there is knowledge that the new capacity zone will go into effect around May 2014 and that it will result in cost increases for customers in southeastern New York State, the exact level of the increase is still the subject of debate. Many suppliers are not pricing in any impact for this known cost increase, choosing rather to pass through the full effect to customers later when the charges become effective.
4. An anticipated future change for which both the timing AND the cost of the future change are both reasonably known (e.g., \$1.38/MWH beginning June 1). For example, for the second half of 2013, the New Jersey State Legislature increased the Solar RPS (Renewable Portfolio Standard) standards. While both the timing and the level of this increase was known when the new standards were passed last year, many suppliers chose to ignore adding these additional known future charges to their fixed price offers, even for contracts priced after the Legislation had passed. By not including these known future cost increases, these suppliers were able to show a lower initial fixed price offer than competing suppliers that factored these charges into their quotes.

### What contract mechanisms do some suppliers use to pass through costs?

#### Material Adverse Change and Regulatory Change Clauses

By far, the most prevalent way in which some suppliers have changed their prices is by invoking the language contained in the “material adverse change (MAC)” or “regulatory change” clauses in their contracts. In the past, most suppliers limited this language to cover items described in Category 1 above, i.e., “an unknown or unforeseeable future change in a law or regulation that changes the cost to supply electricity to the customer.” However, many suppliers have broadened their language to cover items covered in Categories 2-4. Paraphrased below are a number of circumstances which certain suppliers have utilized in their “fixed” price products so as to pass through costs to customers.

- Broadly, any change in governing laws, regulatory changes, ISO rules and protocols, market rules, load profiles, or how a utility or ISO may calculate usage, or a change in interpretation or application of certain rules.
- Any utility change to a customer’s monthly capacity or transmission obligations.
- For any particular utility zone, the contract price may be changed once per year to reflect a change in the NITs charges that occurs after the date the contract with the customer was entered into.
- Change in fees or costs imposed by an ISO or government authority, or a change in application or interpretation of these changes.
- Any change by a utility, including a change in tariff, rate class, procedure or other process or change, that alters the supplier’s cost to perform or economic returns expected, including changes in capacity and transmission charges based on adjustments to a customer’s peak load contribution.
- Any change in usage that affects costs (which potentially changes the capacity obligations that then lead to a cost adjustment).

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Customers and consultants should consider the following when reviewing regulatory change and material adverse change language:

- What circumstances does the supplier consider as justification for triggering a price increase? The broader the language, the less fixed the price tends to be.
- Does the customer get the benefit if a change in law decreases a cost component?
- What right does a customer have to disagree with a pass-through cost and what are the consequences if he/she refuses to accept the change?
- What is the past practice of a supplier in invoking a regulatory change provision? Two suppliers may have more or less identical language, but may have vastly different positions in terms of their practice of invoking the language. Ask your potential suppliers to submit in writing each of the circumstances for which they have invoked a price change.

### Price Adjust Concept:

- Increasingly prevalent is the use of the “price adjust” concept, in which a supplier includes a cost component estimated at either its current level or a stipulated level (sometimes stipulated below even current costs). If the cost incurred for that component is higher than the stipulated or current level, the supplier passes the difference through to the customer. This concept is often used when a future cost increase is scheduled. It is especially important to be aware of this clause because it can cause confusion. For example, when asked if that cost component is included, a supplier can say yes, even though it is only included up to a certain level. A fixed price contract in which a supplier is not going to increase the price when a known transmission increase occurs, is dramatically different than a fixed price that will be adjusted upward when an increase takes place.
- The price adjust concept can be used effectively by customers and consultants when there is uncertainty around the timing or the exact future cost of a component. In that circumstance, the concept allows for a known transfer of risk and the avoidance of a premium that may work out in the customer’s favor. However, when the concept is used in a less transparent way, it can create confusion and invalid price comparisons.

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## What components are most likely to be passed through?

The table below highlights some of the specific cost components that suppliers have passed through to customers through the clauses described above. Such items are described and quantified, to the extent possible, on an ISO by ISO basis. To date, the PJM market by far has had the most widespread use of pass-through charges, with the costs transferred to customers in many instances becoming material. A more detailed discussion is included in the attached appendix (page 8).

Market	Cost component	Type of change	When the change occurs	What causes the change?	How is the impact of the change calculated?	What is the impact of the change on cost?
PJM	Transmission or NITS	Price Adjust	Yearly--June 1 or January 1	Transmission upgrades; Rate cases	Difference between cost in effect at time of contracting and time of change is passed through	\$1-12/MWH
All	Capacity obligation	Regulatory Change/MAC/Forecast Adjustment	PJM/ISO NE-June 1; NYISO: May 1 or November 1	Change in capacity obligation of customer	Difference between higher and lower capacity obligation passed through	\$0.25-\$5/MWH depending on load factor and market
NY	Capacity load zone	Regulatory Change/MAC/Price Adjust	May 1 2014	New capacity zone implemented in NY (Lower Hudson Valley)	In case of regulatory change invocation, entire increase may be passed through	\$1-14/MWH depending on load factor and zone
All	RMR	Regulatory Change/Price Adjust	Ad Hoc	Regulatory approval of cost recovery for keeping a plant out of retirement in order to maintain system reliability	Anything more than current level will be passed through	Typically \$1-3/MWH
NE, PJM	RPS	Regulatory Change/MAC/Legislative Change	Ad Hoc	Change in regulation or law	Could be market based or based on an alternative compliance payment	Past increases have caused \$1-2/MWH increases

**To date, the PJM market by far has had the most widespread use of pass-through charges.**



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### What products and tools is ConEdison Solutions making available to its customers and partners to improve clarity on fixed price products and pass-through costs?

ConEdison Solutions will provide information and product clarity to its customers and partners so as to support smart buying decisions. We will provide such information in various formats and venues, including white papers, webcasts, breakfast meetings, tradeshow presentations, and consultation between customers and our energy experts. Additionally, we have continued to innovate our product suites. A list of some of our fixed energy products and their descriptions are below.

- **All-inclusive fixed price:** ConEdison Solutions will continue to offer its market leading all-inclusive fixed price product. Our intent when we price, offer, and contract on this product is to include any cost that can be anticipated, even those where the costs are not wholly known. Until recently, despite numerous opportunities to do so, we had never invoked our regulatory change clause. A regulation requiring us to purchase a higher percentage of renewable power for customers in New Jersey has prompted us to pass that cost on to customers who signed contracts before that regulation went into effect. We believe that the circumstance of this new legislation meets the appropriate definition of the regulatory change clause in our contract.
- **Fixed price with price adjust options for capacity, NITs, and RMR:** Customers have the option to receive a reduction on their fixed price by taking the risk on ancillary costs such as NITs and RMR or increase in capacity obligation.
- **Fixed price with price adjust for LHV capacity zone in NY:** Customers have the option to include the current ROS (Rest-of-State) cost and pass through any cost increases or decreases once the capacity zone is approved and set for May 2014.
- **Fixed price with peak shaving:** For larger customers who have the ability to manage down their system peak, but still want the budget stability of a fixed price, we can add a rider to a longer term agreement to allow those customers to benefit in the event they are able to lower their capacity and/or transmission obligation.

As markets continue to evolve, we will continue to seek new products that meet the needs of our customers and the overall market. As always, we will strive to do so with the expertise and transparency that ConEdison Solutions has been known for since 1997.

#### ConEdison Solutions provides:

- All-inclusive fixed price
- Fixed price with price adjust options for capacity, NITs, and RMR
- Fixed price with price adjust for LHV capacity zone in NY
- Fixed price with peak shaving



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**PJM:  
Network Integration Transmission Charges (NITs)**

NITs have ramped up in recent years due to the ambitious Regional Transmission Expansion Plan (RTEP) enacted in PJM. The 2012 revised RTEP calls for \$24 billion worth of transmission expansion and improvement in the PJM region. This includes \$6.6 billion for projects already in service, \$2.3 billion for those under construction, and the bulk of the cost - \$15.1 billion - for projects planned but not yet under construction. Transmission projects typically have long construction time frames and can encounter numerous unplanned delays making an accurate forecast of completion dates difficult. Most PJM utilities recover their RTEP costs via Transmission Enhancement Charges (TECs) approved by their state regulatory commissions. However, some utilities recover their RTEP costs via NITs through a rate filed with the FERC, thus bypassing the state regulatory approval process. The construction costs are recovered over 25 to 35 years, so transmission costs will continue their upward trajectory for some time. To make matters even more complicated, certain projects are initially financed by one LDC, but if the projects benefit other LDCs, such other LDCs have to reimburse the financing LDC.

Of all the pass-through charges, NITs have become the most dangerous for suppliers and customers alike, since there is no way to predict or quantify the risks. NITs costs in the PSEG market are now more than one penny per kWh, compared to a cost that was negligible in PJM just a few years ago (and remains so in many markets). The NITs costs in PJM range from \$3 to \$12 per MWh. The utilities update the NITs costs once per year, usually at the beginning of a calendar or fiscal year, but those costs cannot be accurately predicted. In addition, many suppliers pass through the increases, but not the decreases, when the NITs costs are adjusted. Other suppliers pass through the entire cost of NITs without even a current baseline. As noted above, this is the most dangerous cost provision in PJM contracts at this time and ConEdison *Solutions* strongly recommends that customers ask their existing or potential suppliers to specifically address the NITs issue in their contract.

A customer should either: (i) request that its supplier take the risk with no ability to pass through cost increases (which ConEdison *Solutions* and some other suppliers currently do) or (ii) receive a reduction on their fixed price and have the customer take the risk, agreeing to pay utility-posted rates, provided, however, that the contract provides that decreases, as well as increases, in NITs get passed through to the customer. At present, we do not see any information suggesting that NITs will reverse their upward trend

over the next several years and expect most utilities to post increased NITs costs, some of which will be significant. If a customer has not specifically addressed NITs in a PJM contract, it is likely that a supplier has drafted this provision in a manner that permits the supplier to adjust the price. This does not hold true for all suppliers and is not the case for ConEdison *Solutions*, but the majority of suppliers now pursue such a strategy and more will do so as these costs continue to increase.

**Reliability Must Run (RMR)**

Another ancillary cost that is unpredictable and unhedgeable for suppliers is RMR. As the name suggests, this is also a cost associated with maintaining system reliability.

As generating plants, especially coal plants in PJM, become uneconomical, the plants' owners request permission to retire the plants. However, if the ISO deems the plants critical for reliability, the request for plant retirement is denied. The plants are required to remain open, but are made whole on the price differential between their actual costs and the ISO clearing price (LMP). There have been a number of such denials in PJM, especially in the PSEG market in New Jersey in the last six months, with many more plants likely to be reviewed over the next several years. RMR charges are being passed through by many suppliers in express contractual provisions or through Change in Law or Material Change clauses. Such charges can range from \$0.50 to \$3 per MWh in the PJM market and are a cause for concern for both customers and suppliers.

Similar to NITs, customers should be very clear with their supplier as to which party (i.e., supplier or customer) bears the RMR risks. If the supplier is to be responsible, the customer needs to make sure that the contract is clear that such costs will not be passed through.

**Renewable Portfolio Standards (RPS)**

RPS costs are increasing in most markets throughout the country, a trend ConEdison *Solutions* anticipates will continue. Since these costs are not always certain far into the future, they are often estimated when suppliers lock customers into agreements extending beyond 12 months. Additionally, changes in renewable portfolio standards are susceptible to political and environmental pressures, so the laws and regulations related to these components may change more often than other components.

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## Capacity and Transmission Tag Changes

While the capacity tag change issue exists in all markets other than ERCOT, transmission tag changes are currently an issue in retail electricity supply deals in PJM only. When a customer's capacity tag changes, the supplier's settlement obligation with the ISO also changes. When capacity tags go up, some suppliers pass through the associated costs. When tags decrease however, some suppliers may not automatically pass the savings through to the customer.

On our standard fixed price contract, ConEdison *Solutions* has always taken the risk/reward on capacity and transmission tag changes, but we have now also added options to allow customers to assume more responsibility and control for that cost if they choose. With our demand response customers, we are willing to lower our contract price to reflect capacity tag reductions due to participation in demand response programs. If a customer has reason to believe its usage will increase, ConEdison *Solutions* recommends passing through capacity and transmission costs since unitizing those costs in a fixed supply price will cost the customer money. We also recommend passing through such costs if a customer is anticipating a capacity tag reduction as a result of participation in a demand response program or another reason. Swings in capacity and transmission tags can be significant and often are known well in advance of when such tags change based on the summer peak load. Customers should be aware of what their tag is and have a view of what it is likely to be in the future in order to make the best decision regarding the product they contract for.

### **NYISO:**

The capacity tag issue is significant in New York. Since capacity costs are high, utility tags can often be inconsistent with a customer's peak demand, and capacity charges are more market-based than in PJM or ISO-NE. The information in the discussion of capacity tags in PJM (above) applies in New York, but since capacity costs in NYISO can vary widely from year-to-year and are not set multiple years in advance, customers need to be aware that many suppliers are passing through increases to capacity costs.

## New Capacity Zone

A significant New York-specific issue is the new capacity zone for the Lower Hudson Valley. On the energy side, there have been multiple zones in the Rest-of-State (ROS) New York market, but those zones were all pooled together in ROS with respect to capacity. However, that is scheduled to change effective May 2014, but with the additional costs resulting from such change still an unknown. Many suppliers will be passing through either increases in current capacity costs or the entire capacity cost. This will affect non-NYC customers outside of Zone J in a very significant way, but will affect NYC customers as well, since nearly one-third of NYC customers' capacity requirement has been able to be secured with ROS capacity. As a result, this will be an issue for customers to watch very closely for the remainder of 2013 or until such time as the new zone is set and liquidly traded. For now, customers should make sure they know who is bearing the risks, and likely cost increases, with respect to this new zone.

ConEdison *Solutions* has two ways to handle this issue for our New York customers: (i) include projections for the capacity cost in our fixed price and take the risk on any potential changes (full requirements, no pass-through) or (ii) include the current ROS cost and pass through any cost increases (or decreases) to the customer once the capacity zone is approved and costs are set. While a customer may select either option, we believe that it is in the customer's best interest to make sure the contract with their supplier is clear on this point for contracts extending beyond May 2014. While the impact on customers remains uncertain at this time, we estimate that NYC customers may see a \$3 per MWh increase and \$15 for ROS customers. Some customers in the north and west of the state may see a lower capacity cost, but that is not a given at this point.

### **Miscellaneous:**

Recent storms in 2011 and 2012 have resulted in the widespread development of plans to "strengthen" utility T&D systems, which when realized are likely to result in a material increase to T&D costs in all utilities in the Northeast and mid-Atlantic. Such plans should not impact supply contracts, but may impact the ability of customers to meet their energy budgets in future years.

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ConEdison Solutions is a leading energy services company that provides competitive power supply, renewable energy, sustainability services, cost-effective energy efficiency solutions, and performance contracting services for commercial, industrial, residential and government customers, including universities, public school districts, and hospitals nationwide. Offering innovative products, financial stability, and a commitment to customer service, the company is based in Valhalla, New York, with offices in Burlington, Massachusetts; Cherry Hill, New Jersey; Chicago, Illinois; Falls Church, Virginia; Houston, Texas; Tampa, Florida; and Overland Park, Kansas. The firm's dedicated team of energy professionals delivers a broad range of energy solutions. ConEdison Solutions offers programs and services designed to help customers achieve their individual energy objectives and is accredited as an Energy Services Provider (ESP) by the National Association of Energy Service Companies (NAESCO).

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## VP of Commodity Services

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