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## Managing Electricity Costs In An Extreme Power Market - Part 2

WRITTEN BY CATHERINE LUTHIN

Last month Catherine Luthin, president of Luthin Associates, an energy management consulting firm, gave us tips on how to save on electricity costs.

This month she concludes her article with more information on how to make our energy consumption more cost efficient. In case you missed [last months article](#) its available [here](#).

The simplest and most common purchasing method for facility operators is the Fixed Price contract. In this type of deal, the customer agrees to a fixed price per KWh for an agreed period of time, typically one to two years. This product serves an organization with a small tolerance for risk by placing most of the risk on the supplier. It also satisfies an organization's need to have budget certainty. There are two variables that impact the cost of electricity, market pricing and weather.

Since weather cannot be managed at this level, some institutions may find it desirable to manage the other variable, the price. The Fixed Price will protect your company from upward price swings but it will also keep you from fully participating in a downward trend in pricing. The benefit of downward price trends can be partially realized for Fixed Price contracts through the "Blend and Extend" process. Blend and Extend describes a service that most suppliers will provide to their clients. If the market turns downward after you have begun to receive power under your new agreement, the supplier will agree to extend your contract out another year or two to take advantage of the lower prices and blend the cheaper future rates with your current rate for a new overall contract that reflects an overall lower price.

In recent months, we have seen some of our clients entering into Blend and Extend agreements every three months since signing contracts during the summer. This enables them to take advantage of a continuing trend of lower prices. As previously mentioned, since the Fixed Price contract places most of the risk on the energy provider, you will pay a small premium for this protection. The Index Price agreement is a contract that ties your cost of power to some index. The energy supplier will provide you with a discount on a pricing mechanism such as that provided by your local Regional Transmission Organization (RTO).

RTOs such as the New York Independent System Operator (NYISO) or the Electric Reliability Council of Texas (ERCOT) manage electric generation and transportation in a region and they set the market prices. Typical market price structures such as those in New York are the Day Ahead, Hour Ahead and Real Time Market. As its name implies the Day Ahead Market will tell you on Monday what the electric prices will be for any given hour on Tuesday. The discount in the Index Price may be applied to a utility rate as well. One of the advantages of the Index product is that it allows you to float with the current market until a decision about a long term trend becomes apparent. These deals if structured correctly, should allow you to move into a Fixed Price contract if the market price starts to decline. It is important that you negotiate into your supply contract the ability to change to a fixed price deal. The Index has more risk for the customer than the Fixed Price deal because if market conditions start to trend upwards, your price increases. The flexibility of getting out of an upward cycle by locking in a fixed price can control this risk.

The third option is a Hybrid Product. This structure provides some of the components of both the Fixed and Index contracts. Customers and their energy providers or consultants will identify some level of a base load that can be fixed in the market. The base load is a block of electric power that will always be used by your facility during a given time period. The amount of the load varies by the time of day and is based on normal occupancy and operations.

An example of a base load is the lowest level of energy usage on any given day. If your facility's load profiles shows that the lowest demand period during the last twelve months is 50 kilowatts, the energy supplier will look at this as a block of power that can always be predicted to be exactly 50 kilowatts. This block can be purchased at a fixed cost with very little risk premium (or insurance). The balance of the load that is not included in the base load would float in the market place and be tied to a market based RTO index. This would allow an organization to take advantage of downward price trends for that portion of their load that is not on the fixed price.

The customer should also be able to convert this type of structure to a fully fixed deal (Blend and Extend) if the market price increases. Because the energy supplier's risk is reduced while your risk increases, the supplier will charge a lower risk premium for the floating block of power as well. The volume subject to the

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fixed price can be determined by an analysis of your load profile that your consultant can provide. This analysis would apply your historical, hourly profile to the historical prices of the index you will be tracking.

The Hybrid Product has additional advantages for facilities that can exercise load control. Where utilities allow their customers to shave their peak load with electric generation, the higher prices of an index like the Day Ahead Market can be avoided by turning on a generator. This process can also be implemented in facilities that have second and third shifts. In these cases, it may be more beneficial to pay labor premiums and avoid higher daytime energy costs.

Determining which product to select can be both confusing and costly. Most facility or energy managers do not have the time, tools or skills to make informed decisions related to the structure of their energy contract. Most contracts offered by competitive suppliers have underlying terms and conditions that could cause you to pay a lot more than what you bargained for.

Luthin Associates recommends that large energy users like commercial laundries and the hospitals, hotels and other institutions that house them, retain a consultant to help navigate this process and ensure that your purchasing options will be competitively negotiated with your interests in mind. A recent trend in the business is to use a reverse auction managed by a web based platform to obtain prices from the suppliers.

It has been our experience that this process provides extremely competitive pricing while ensuring transparency and compliance with procurement requirements. In future articles, we will provide guidance to assist companies in deciding how to hire an energy consultant.

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Catherine Luthin has over 25 years of financial and energy management experience within the corporate, non-profit and regulatory environments. She is the President of Luthin Associates, an energy management consulting firm that proactively identifies and resolves energy cost issues by delivering cost savings based upon innovative thinking and process improvements for the educational, health care and real estate industries.

She chairs and manages Consumer Power Advocates (CPA), an association of large, non-profit institutions whose primary goal is to decrease the cost of energy by focusing on regulatory decisions and programs which impact energy consumers in New York City. Catherine is a member of Mayor Bloomberg's New York City Energy Policy Task Force and presently co-chairs the NYC Steam Business Development Task Force that is presently implementing a Steam Business Development Plan for the Consolidated Edison System.

In 2002 she was named "Energy Service Professional of the Year" for the State of New York and in 2004 she was named National "Energy Service Professional of the Year" by the Association of Energy Engineers. Catherine has also been a guest lecturer at Columbia University's Environmental and Energy Policy Department. She is a results-focused and effectual leader with proven ability to develop and implement energy management initiatives within major New York institutions.



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