

RETAIL COMPETITION IN ELECTRICITY

FROM WHERE DID IT COME?

WHERE IS IT GOING?

E Source Telephone Conference

June 2, 2000

Ashley Brown
Executive Director
Harvard Electricity Policy Group
John F. Kennedy School of Government
Harvard University

Of Counsel, LeBoeuf, Lamb, Greene, and MacRae

Derivation of Retail Competition

Theoretical

- . Follows Trends From Other Industries (e.g . telecom, transport, natural gas)
- . Inefficient Pricing and Consumption

Practical

- . Unenforceable Monopoly for Large Customers (Demand Really is Elastic)
- . Unhappiness Over Risk Allocations (Prudence and Cost Overruns)
- . Rate Disparities Across Country

Political

- . Demand for Lower Prices
- . Sex Appeal of “Choice”

Combustible Mix of The Theoretical, The Practical, and The Political

- . False Assumption: Newton Visits Economics: Prices Can Only Go Down
- . Newtonian Assumption Contradicts Reality of Markets
- . Reason for Assumption: Customers Want Low Prices / How To Get Them is Irrelevant (e.g political tariff rigging in California, Massachusetts, etc.)
- .Handing Out the Goodies
 - . Stranded Costs for Utilities
 - . Stranded benefits for the Poor and the Greens
 - . Market Design for the Marketers
 - . Lower or Frozen Prices for Consumers (short term only – deferral of recovery)

The Results of Mixing the Combustibles

- . Price Floors and Caps
- . Barriers to New Entry (Low Standard Offers. Low Default Rates)
 - . Some Barriers Inherent (eg. Start Up Costs, Marketing and Back Office)
 - . Some Barriers Flow From Market Design
- . De-linking Wholesale and Retail Prices (e.g. all states with exception of ME & TX)
- . Insufficient Investment in Metering
- . Uncertain Access to Customers and Customer Information
- . Utility as Default Provider (Ohio debate)

Diverse Approaches to Initiating Retail Competition

- . California: Flow Through Wholesale Price (killed by legislature)
- . Pennsylvania: Shopping Credits (too much subsidy to get new entrants?)
- . Maine: Utilities in Wire Business Only
- . Texas: Mandatory Utility Unbundling of Wires and Supply Business
- . Massachusetts and Ohio: Encourage Municipal Aggregation
- . Ohio: Incentive to Lose Load

Objectives and Reality In Future Choices

- . Assured Low Prices or Competition (i.e. Can Caps Be Lifted?)
 - .Are Volatile Electricity Prices Politically and Socially Acceptable?
 - .Are Politics and Electricity Inextricably Linked?
 - .Can Social/Political Desires be Aligned With Investor Expectations?

What Price Differential is Necessary to Catch Consumer Attention?

- . How Much Time Will Joe Six Pack Spend to Save 30 Cents per Month?
- . What is the Value of Price Stability

Can Bifurcated Markets (i.e. Large and Small Consumers) Work?

- . Will Large Customers Lean on System When Prices Are High?

. Relationship Between Wholesale and Retail Markets

- . Can There Be Retail Competition Without Viable Wholesale Markets?

- . Do Viable Wholesale Market Require Retail Competition?

. Virtual Competition

- . Utility Choices (e.g. Time of Day, Interruptible Rates, Demand Side)

- . Hedge Products