

Retail Procurement: Default Service vs. Monopoly Service Considerations

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Legacy Context of Retail Supply Product Issues:

The Open Invitation for Politicization

- **Legacy of Intellectually Dishonest Sale of Restructuring**
 - Billed as lowering prices, not improving efficiency
 - Christmas presents for all organized interests
- **Legacy of Price Freezes**
 - Barrier to new entrants
 - Arbitrary nature of prices
 - Accrual of deferred costs
- **Legacy of Stranded Cost Recovery**
 - False presumption of competition driving down prices
 - Consumer perception of paying “twice” for same generation
 - Exacerbated when **incumbent wins bid**
- **Legacy of Divergent Costs**
 - Perception of lower prices in non-restructured states

Critical distinctions between competitive and monopoly retail supply models

■ **Monopoly**

- Attractive Retail Supply (including demand side activity) is the objective.

■ **Retail Default Service**

- Attractiveness of the default service is not the objective. The objective is promotion and sustenance of competition. Attractive default service is a barrier to achievement of the objective.

Default supply products in competitive supply markets vs. Supply products in monopoly supply markets: assessing relevant characteristics

Characteristic	Competitive Market	Monopoly Market
Reliability	Desirable	Desirable
Attractive Price	Arguably Undesirable	Very Desirable
Price Signals	Value Limited to Deterring Customer Use	Very Important
Business Judgment on Supply	Customer's	Supplier's
Supplier Fiduciary Obligation to Customer	Limited to Keeping Lights On	Reliability & Economic
Supplier Incentives	Reliability Only	Reliability & Price
Risk/Reward Symmetry	Depends on auction design	Depends on auction design
Scope of Auction	Divisible into Tranches	Divisible into Tranches

Default supply products in competitive supply markets vs. Supply products in monopoly supply markets: assessing relevant characteristics – *cont'd*

Characteristic	Competitive Market	Monopoly Market
Regulatory Oversight	Structure & process only	Prudence review
Regulatory Timing	<i>Ex ante</i>	<i>Ex Ante</i> Rules/ <i>Ex Post</i> Review
Management Judgment	Limited	Essential
Demand Side Incentives	Inconsequential for supplier	Necessary
Resource selection	Largely irrelevant	Can be important
Politicization Potential	Significant, primarily where choice is illusory or incumbent wins	Always a possibility

Auction mechanism for default service in retail competition regimes

- Meets minimal needs noted above when customers truly have choice
- Removes incentives for vertical integration
- Removes dispatch biases in non-RTO regions
- Complete separation of wires and supply functions
- Transparent mechanism when well administered and overseen

Auction mechanism for monopoly supply regimes

- Removes incentives for vertical integration
- Removes dispatch biases in non-RTO regions
- Transparent mechanism when well administered and overseen
- Puts regulators in charge of supply procurement
- Could strengthen capacity market while reducing reliance on energy market
- Limits nuanced supply management judgments/imposes a level of rigidity
- Socialization of risks and rewards
- Potentially higher transaction costs in overall supply procurement and management (e.g. power purchasing, load balancing, ancillary services, FTR's)

Non-auction mechanisms for retail supply

Mechanism	Competitive Market	Monopoly Market
Utility Self Builds	Vertical re-aggregation	Business as usual
	Reduce wholesale competition?	Reduce wholesale competition?
	Skill sets may have left	Skill sets may remain
	Conflicting Incentives (ROR varies depending on option selected)	Competitive bid test or pass through of prudently incurred costs (including ROR)
		Disincentive for demand side activities

Non-auction mechanisms for retail supply

<u>Mechanism</u>	<u>Competitive Market</u>	<u>Monopoly Market</u>
Utility Buys	Contracts or flow through wholesale energy prices	Who determines and takes risks for power purchase strategy?
	Recovery mechanisms may no longer exist	Buy or build incentives are unbalanced
	Demand Side Services by utility antithetical to customer choice	More level footing for demand side activities
	Same as default service	

Conclusion

- Auction Mechanisms are sensible for Default Service in Retail Choice Model
- Non-auction models are more sensible in Retail Monopoly Model but incentives need improvement