

NERA

Economic Consulting

Procurement for Default Service



In Times of Rising Costs

Chantale LaCasse

Senior Vice President

Washington D.C.

202.466.9218

Chantale.LaCasse@nera.com

John F. Kennedy School of Government

Cambridge, Massachusetts

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How Markets WorkSM

What Do Utilities Procure and Why

- **Utilities can be engaged in various types of procurement**
 - New plants
 - Portfolio of power contracts
 - Contract to serve load
- **Utilities in states that have restructured their electricity industry typically procure supply for default service**
 - Utilities divested or transferred generation; regional system operator to ensure full access to transmission system
 - Utilities provide distribution under cost-based regulation
- **Utilities in states that have not restructured typically design and manage a portfolio of resources to supply their customers**
- **The line between these two approaches is not so stark**

What Is Full-Requirements Service?

- **The “product” in restructured states typically is full-requirements**
 - Each supplier provides all necessary services (energy, capacity, ancillary services, etc) for a percentage of the load at a fixed price
- **Full-requirements is not a product that is exclusively the purview of restructured states**
- **Full-requirements puts the price-risk management function and the portfolio management functions in the hands of the competitive market**
 - Suppliers can have different strategies to meet their percentage of load that can adapt and respond to changing market conditions



New Bidding Methods Have Been Developed



New Jersey uses a “clock auction”

■ Multi-Product

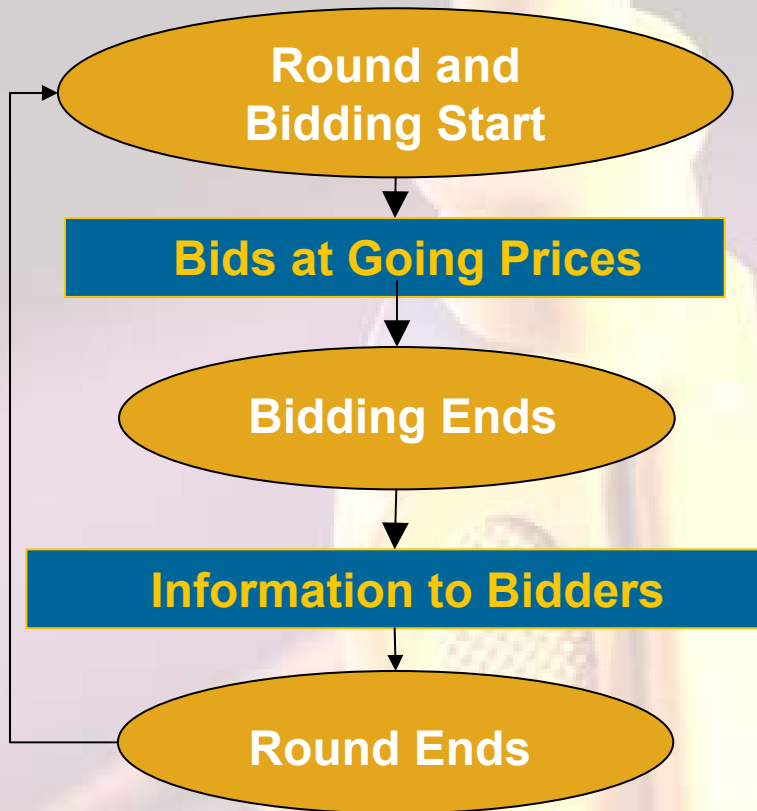
- Tranches from all EDCs are procured at once

■ Multi-Round

- Bidders stated how much they wanted to bid at prices suggested by the Auction Manager
- Prices “tick” down if there are more tranches bid than needed
- Process continues until there is no more excess supply

■ Method also used to procure standard products as part of portfolio

Prices Come Down to Market Levels Through Many Bidding Rounds



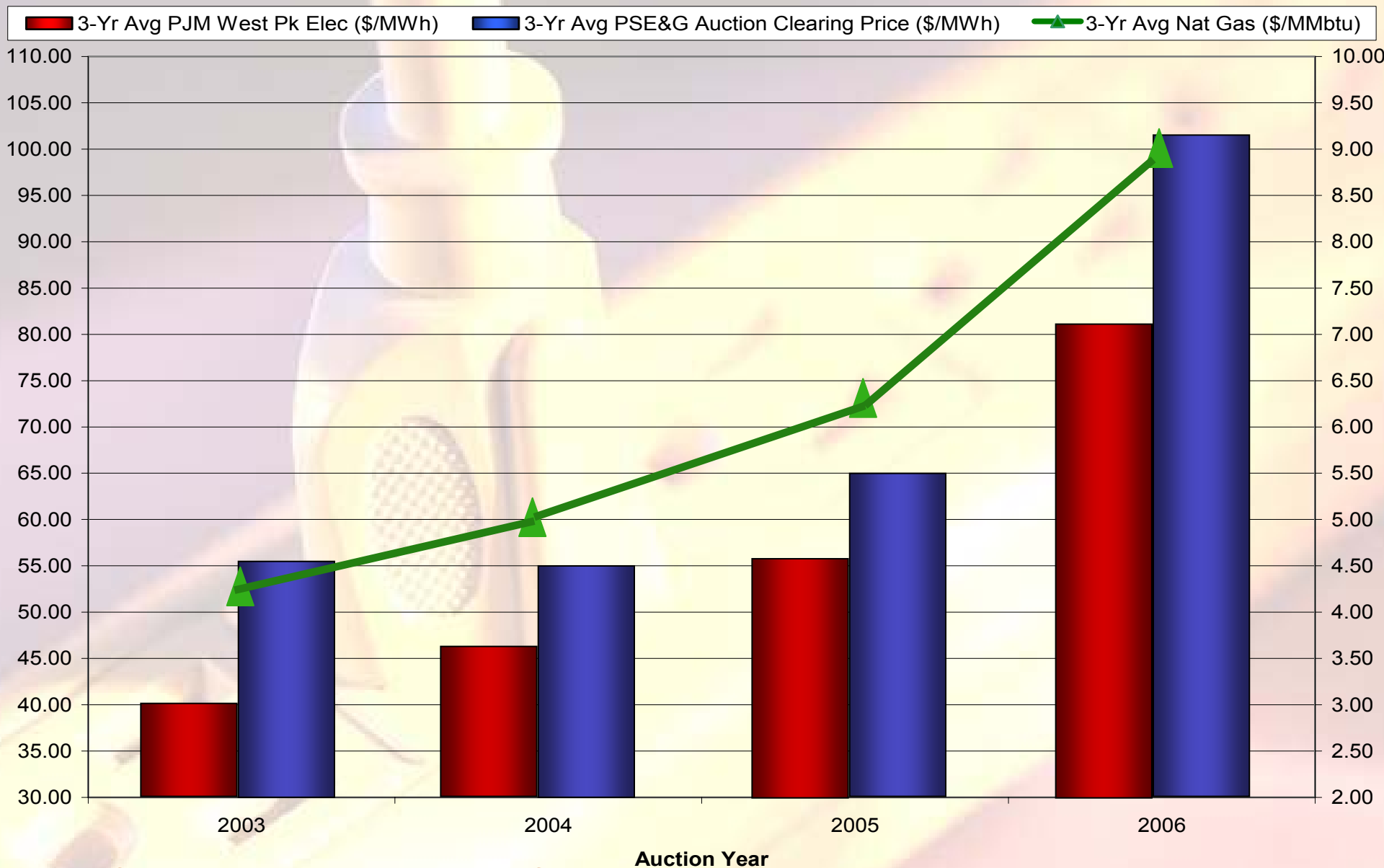
Bids are the number of tranches that bidders are willing to serve at the going price of the round for a particular NJ Utility

Bidders are informed of prices for the next round and prepare their next bids

Price for a NJ Utility “ticks” down if the number of tranches bid is greater than the amount needed

Suppliers bid from their regular place of business. Suppliers submit their bids through the internet each round.

Auction Clearing Prices in New Jersey Have Tracked Regional Power Markets



Local factors have little to no influence

Market Conditions / Procurement Method: Finding the Culprit

MCHUMOR by T. McCracken



"Off hand, I'd say you're suffering from an arrow through your head, but just to play it safe, I'm ordering a bunch of tests."

Rate Freeze Is An Additional Ingredient

- Divorces price of service from its cost
- Impedes development of retail markets
- Dampens demand response

