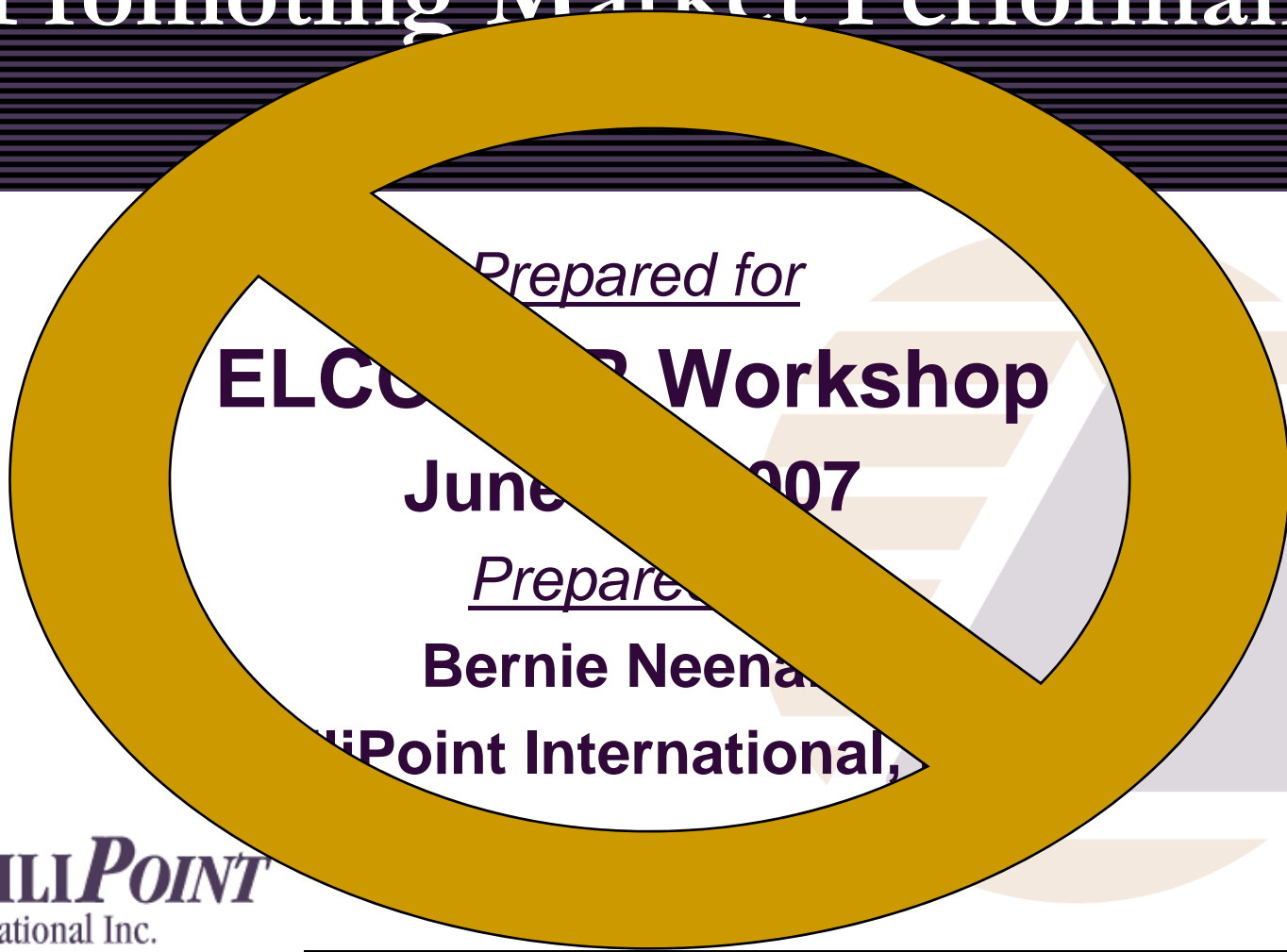


The Role of Basic (Default) Service in Promoting Market Performance



Prepared for

ELCCO Workshop

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Prepared by

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Confessions of

An economist masquerading as an electric utility rate Czar transformed into a competitive market advocate and therefore apologist for unfulfilled expectations and patron saint of lost causes like efficient pricing (and devoted wine sampler)

Industrial Customer Clout on the Pricing of Electricity

	Historic	Day 1	ISO/RTO
Volume	++	++	
Load Factor	++		
Load Profile		+++	++
Curtailability	+		+++
Contestability	+		
L-T Commitment	+++	--	
Political Clout	+		
Local Econ Impact	++		
Board Room	+++		
Regulator	++		

National Dialogue on Demand Response

- **Old perspective; Sell the product (energy)**
- **New Outlook: Apple pie, mother, demand management, demand response (not necessarily in that order)**
- **Raging issues concerning demand response**
 - ▲ Is it a privilege or obligation?
 - ▲ Is there a level playing field for DR?
 - ▲ Value of AMI
 - ▲ How much is enough?
 - ▲ A one man-one vote principle?
 - ▲ Fair distribution of benefits
 - ▲ Measuring what might have been, but was not

Trends in fostering demand and price response in competitive markets

ISOs- reluctant but effective leadership

- ▲ **Insightful integration of DR into capacity markets**
- ▲ **Discovering role for DR as an operating reserve**
- ▲ **Efforts to induce PR through DA bidding, RT price-taking have had mixed results**
 - **Low participation at ISO-NE & NYISO; High at PJM**
 - **Double payment may preclude competitive alternatives**
 - **Negative welfare criticisms**
- ***Going forward***
 - ▲ **What role will ISOs play in fostering price response?**

Trends in fostering demand and price response in competitive markets

Competitive retailers – some smoke, little heat

- ▲ Growing portfolio of underappreciated and little utilized pricing plans
- ▲ Exploring the option value of price response
- ▲ Desirous of product standardization, but not sure how to achieve it
- *Going forward*
 - ▲ First-mover dilemma – it's not clear if a firm can recapture the high cost of educating customers and providing the required metering technology
 - ▲ Will capacity program DR predominate at the expense to PR initiatives?

Trends in fostering demand and price response in competitive markets

State legislators – fear of failure

- ▲ *High aversion to G-Day syndrome (policies that are a day late and several million votes short)*

State regulators – single-minded priority

- ▲ *“He that dies with the highest shopping rate wins”*
- *Going forward*
 - ▲ *Accept that Basic Service will serve a substantial number of customers in the foreseeable future*
 - ▲ *Fostering price response begins at home, through efficient Basic Service pricing*

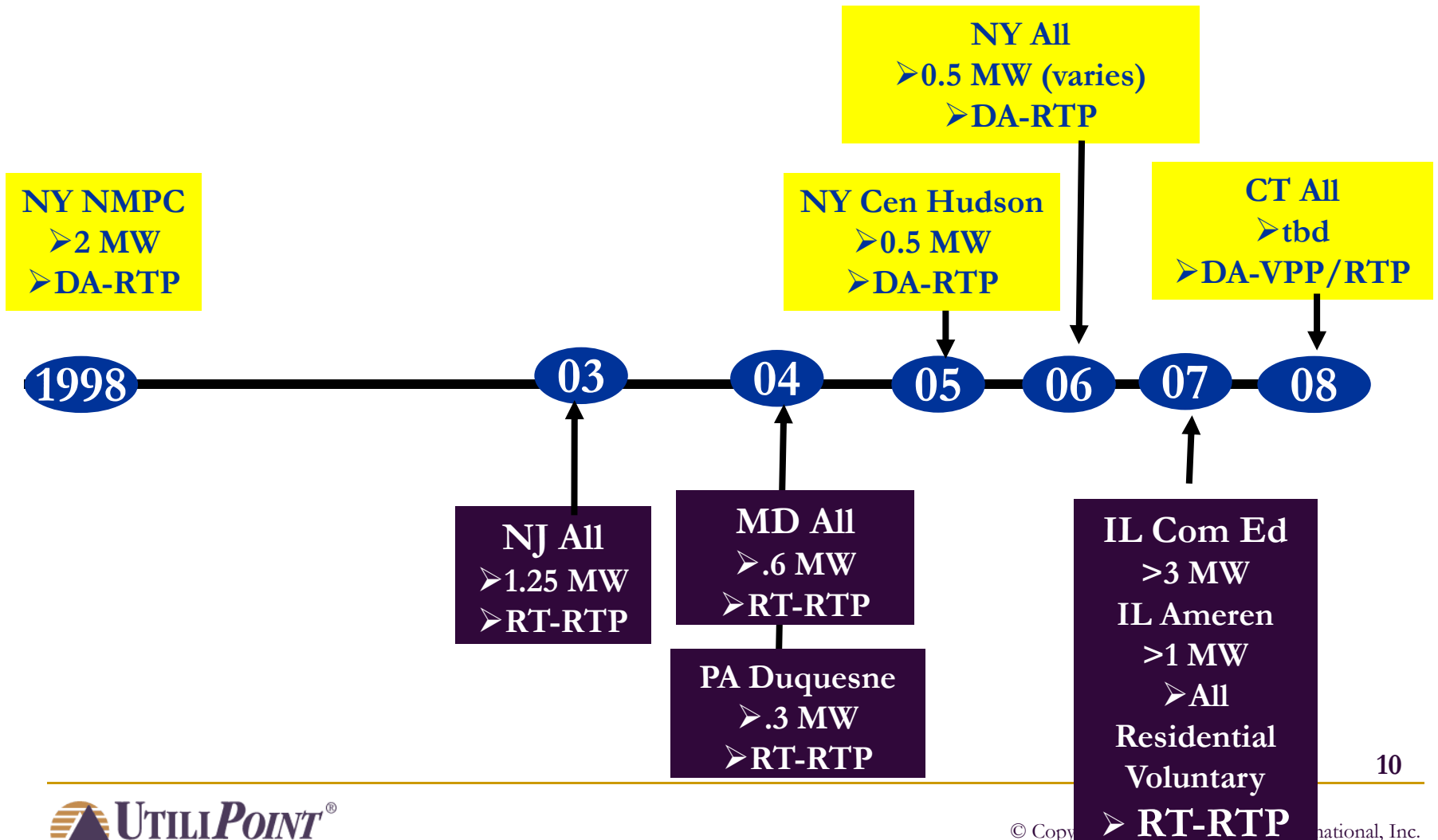
Polar views on the role of Basic Service

School	Break their plate	Safe harbor
Philosophy	Markets are smarter than market administrators	Markets are too unsafe for many customers to navigate
Approach to Basic Service Design	Force customers to choose for themselves how much to hedge	Shelter customers from the potentially adverse consequences of their choices
Pricing	High impact (hourly) energy prices linked directly to LMPs	Low impact (flat) rates with gradual adjustments to trends in LMPs

A new vision for basic service

- **Goal is to foster the efficient use of electricity**
 - ▲ At least some degree of price risk (e.g., TOU as the minimum)
 - ▲ Larger the customer, the greater the price risk
- **Stable designs and price-setting processes should be adopted**
 - ▲ Promote, not preclude, switching to competitive alternatives
 - ▲ Reduce investment risks in behavioral changes and enabling technology
 - ▲ Establish the basis for complete alternatives
- **Design should contribute to least cost procurement**
- **It should accommodate energy efficiency and demand response program participation**

History of RTP-type Basic Service



Exposure to LMPs – 2005 LBNL Study

	Eligibility		Exposure to LMPs		
	Threshold (MW)	% System Peak	Full Hedged	Basic Service RTP	Com. Retailer RTP
	<i>% Customer load eligible for Basic Service</i>				
NY/NGrid	2	9%	33%	33%	33%
NJ	1.25	16%	50%	20%	30%
MD	0.5	18%	80%	15%	5%

What About Regulated Vertically Integrated Utilities

- **Renewed interest in efficient pricing**
 - ▲ **California Energy Commission - condition of service perspective**
 - ▲ **Kentucky, other states following up in EPACT 2005 charter**
 - ▲ **Midwest –improved retail pricing seem by some a condition for maintaining existing market structure**
- **The AMR/AMI freight train**
 - ▲ **AMI seen as necessary condition for DR**
 - ▲ **DR may be a sufficient condition for the AMI investment**

Questions that need to be answered

- **Design**
 - ▲ How much LMP exposure?
 - ▲ Collection of non-commodity costs?
- **Will customers with limited competitive recourse be adversely harmed?**
- **What are the costs associated with**
 - ▲ Metering and meter data management services?
 - ▲ Billing and related accounting costs?
 - ▲ Communicating prices?
 - ▲ Fostering price-response behaviors?
- **Basic Service procurement**
 - ▲ Competitive-compatible mechanisms

How to get from here to there

- **First priority - establish a framework for evaluating and valuing alternative pricing plans**
 - ▲ **Level and distribution of benefits**
 - ▲ **Cost to implement**
- **Next, devise an orderly and purposeful implementation**
 - ▲ **Begin with larger customers**
 - ▲ **Allow for early adopters in all segments**
 - ▲ **Take advantage of, but do not be enslaved by technological advances**
 - ▲ **Coordinate and cooperate with competitive retailers**
- **Summon the collective will to stick to the plan**

Comments and suggestions are
welcomed

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