

The Purpose and Structure of Standard Offer Service in Competitive Electricity Markets – U.S. Experience

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POWERING MAINE INDUSTRIES

Definition

Referred to by different names in the different States that have undergone restructuring

- ◆ Standard Offer Service (SOS)
- ◆ Transition Service
- ◆ Price-to-Beat (PTB)
- ◆ Default Service
- ◆ Provider of Last Resort (POLR)

Purpose – de jure

Described by Intent of the Service

- ◆ “Transition” to a competitive market
- ◆ A “default” option for those who cannot obtain service in the competitive market – a “provider of last resort”
- ◆ A “standard” price or a “price-to-beat” standard against which consumers can measure competitive options available to them

Purpose – de facto

This service has been “morphed” by regulatory commissions into a “preferred” service that is offered at an attractive price and on attractive terms and conditions to some or all consumers.

Dynamic Tension

Promotion of Competitive Market vs. Protection of Captive Customers

This has been the most significant barrier to the successful development of a competitive market in every State that has undertaken to restructure its electric utilities.



Standard Offer Rates

In setting rates for Standard Offer Service, a commission must balance two competing objectives:

- ◆ Fostering an environment of customer choice through a competitive market
- ◆ Protecting captive customers by offering service at the lowest possible price

Tension → Bifurcation

- ◆ Rates for Large Commercial & Industrial (C&I) customers are designed to move these customers to the market
- ◆ Rates for Captive customers are designed to be as low as possible while providing price stability and certainty

Terms and Conditions

The Terms and Conditions for Standard Offer Service will affect the price of that service, and this, in turn, will determine how rapidly and completely a competitive retail market for electricity develops

Terms and Conditions ... 2

Key Components:

- ◆ Entry and exit limitations
- ◆ Treatment of customer credit
- ◆ The provisioning process – e.g., competitive bidding, provision through utility unregulated affiliate, utility sourcing, etc.
- ◆ Pricing structure – e.g., fixed, indexed
- ◆ Term of service – e.g., monthly (New York), six months (Massachusetts), 1 to 3 years (Maine), at discretion of provider (Texas)

C&I Customers

Suggested Structure:

- ◆ Competitively bid
- ◆ Supplier bears full customer migration and market risk
- ◆ Supplier bears customer credit risk
- ◆ Pricing structure – fixed
- ◆ Term of service – short term, e.g., 3-6 mo
- ◆ No artificial bid adders

C&I Customers ... 2

Consequences:

- ◆ Volatility/risk – catalyst for market development
- ◆ Not a premium or preferred service
- ◆ Price uncertainty puts customer at risk
- ◆ Credit risk is placed on customer since Supplier is 100% at risk for performance and for receivables
- ◆ Service will become a last resort option
- ◆ Competitive suppliers will be able to establish a customer base and get market exposure

Captive Customers

Suggested Structure:

- ◆ Price linked to embedded cost of generation if no divestiture – otherwise competitively bid
- ◆ Customer credit risk is socialized
- ◆ Pricing structure – fixed
- ◆ Term of service – longer term, up to 3 yr
- ◆ No artificial bid adders

Captive Customers ... 2

Consequences:

- ◆ Customer is protected at a time of greatest market volatility
- ◆ Market attains more stability through bilateral contracts needed to support supplier of Standard Offer Service
- ◆ Price will be stable at reasonable levels given market conditions
- ◆ Customer migration will not strain the capability of billing systems



Captive Customers ... 3

Potential Concerns:

- ◆ Bilateral contracts may result in substantial exposure to Supplier (AU) if market prices fall.
- ◆ Customer migration can be accelerated through municipal aggregation or other “tight” affinity groups
- ◆ If market prices rise, there will be no choice, and thus no clear means to begin a transition to competitive markets.

Captive Customers ... 4

As market options develop:

- ◆ Competitively bid
- ◆ Supplier bears full customer migration and market risk
- ◆ Customer credit risk remains socialized
- ◆ Pricing structure – fixed
- ◆ Term of service – shorter term, 1 yr
- ◆ Credit for customers in market in lieu of Cost Adders

Retail Market Structure

Wholesale Power Supply



- Assumes full supply risk
- Provides all energy products
- Assumes regulatory risks
- Service to meter – includes losses

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• Losses	3.0
• Ancillary	1.0
• Shaping	3.0
• Margin	
TOTAL	7.0

37

Retail Provider



- EDI capability
- Customer Billing
- Customer Credit Risk
- Financial security

• Credit	0.5
• Billing	0.7
• Bonding	1.0
• Other	0.1
• EDI	2.7
• Margin	2.0
TOTAL	7.0

44

Provider/Broker



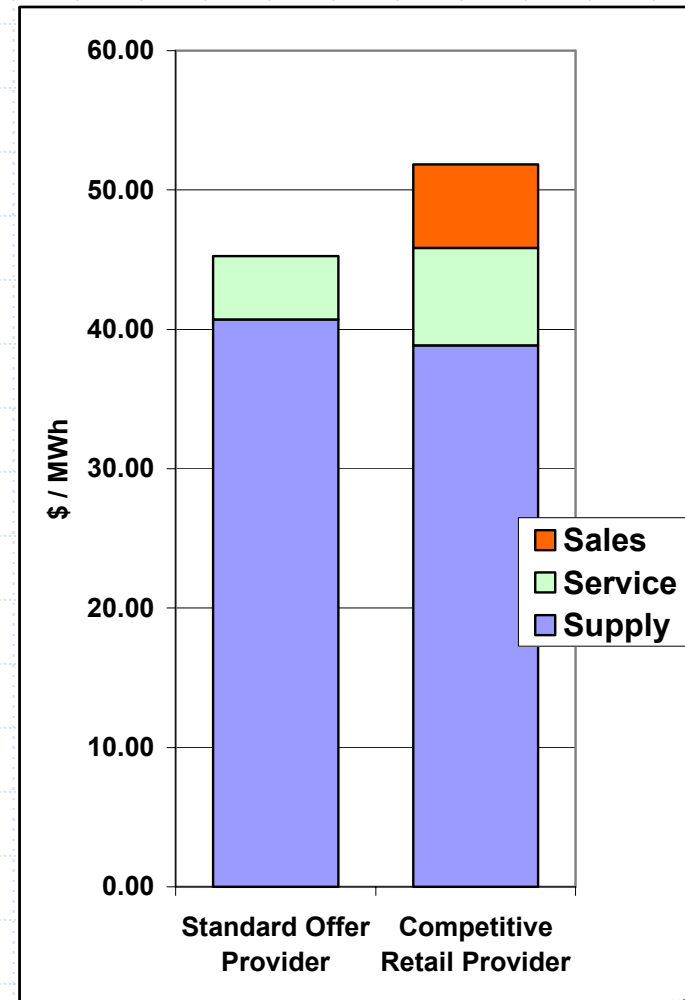
- Marketing costs
- Regulatory conformity
- Customer Service
- Customer Management

• Marketing	2.5
• Sales	1.5
• Margin	2.0
TOTAL	6.0

50

Cost Comparisons

Expenditure Category	Standard Offer Provider	Competitive Retail Provider
Strips	30.00	30.00
Losses	3.00	3.00
Ancillary	1.00	1.00
Shaping	3.00	3.00
Migration (10% / 5%)	3.70	1.85
Subtotal - Supply	40.70	38.85
Credit	0.25	0.50
Billing	0.70	0.70
Bonding	1.00	1.00
Other Fees	0.10	0.10
EDI	0.50	2.70
Margin	2.00	2.00
Subtotal - Service	4.55	7.00
Marketing		2.50
Sales		1.50
Margin		2.00
Subtotal - Sales	0.00	6.00
TOTAL	45.25	51.85



Figures – USD \$ per MWh

Need - Not Going Away

There will always be a need for some type of Standard Offer Service for all customers:

- ◆ Transient or temporary consumers
- ◆ Discontinued service from a supplier
- ◆ Customers with poor credit

Many of these customers may obtain competitive supply with more expanded, market oriented solutions.



Scope of Standard Offer

Are there actions that can be taken that will reduce the need for Standard Offer Service and/or the role such service plays in the development of a competitive market?

I believe the answer is "YES"



Steps to Transition

- ◆ Manage wholesale markets to reduce the premium customers must pay for contract certainty.

The U.S. experience demonstrates one important lesson – the most important ingredient for a successful retail market is a competitive wholesale market.

Steps to Transition ... 2

- ◆ Structure Standard Offer as a true default or provider of last resort service. Structuring the service as a “preferred” service becomes a self-fulfilling prophecy

There is no middle ground over the long-term – either markets are going to develop or utilities will re-emerge

Steps to Transition ... 3

- ◆ Impose the same cost obligations on Standard Offer Providers as are imposed on competitive providers – e.g., EDI enrollments, account by account settlement.

This forces flexibility into the design of utility enrollment and billing systems that will enhance competitive markets, especially for small customers.

Steps to Transition ... 4

- ◆ Provide the same opportunities to competitive providers as are provided to Standard Offer Providers – e.g., credit guarantees

Must manage politics as well as the marketplace and ensure that all customers have the ability to purchase electricity through the competitive market

Steps to Transition ... 5

- ◆ Provide clear policy direction to suppliers so that they can commit to the investments necessary to serve customers with a high degree of certainty that a competitive market will develop

The U.S. experience has been and continues to be poor – with California held up as the poster child for competition