

*From Failure to Failure with
Great Enthusiasm:
A presentation on default policy*



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Advancement of
Energy Markets

Success is
moving from
failure to
failure with
great
enthusiasm



Center for the Advancement of Energy Markets

Discovering consumer,
business, and environmental
advantage in energy markets
transformed by technology and
competition

Center for the Advancement of Energy Markets

CAEM

- Five Years Ago
- Restructuring was Problematic
- Something Missing
- Think Tank on Energy Restructuring

➤ Mission=AID

- **A**nalyze Key Issues
- **I**nform Policymakers
- **D**efend Real Competition

Character

- Independent
- Market-Oriented
- Non-Profit-501(c)(3)
- Change Agency, Think Tank
- Not a lobbying group, trade association, or consulting firm

➤ Canadian Affiliate

- October 2001



Personal Introduction

- Law Professor—late 1970s specializing in Economic Regulation
- FERC—Gas Competition Issues
- Illinois Commerce Commission—General Counsel and Deputy Executive Director
- US Department of Energy
 - Wellhead Decontrol
 - Gas Recommendations in EPACT
 - Order 636
 - Oil Pipeline Deregulation
 - DOE/NARUC Conferences on gas and electric competition
- CAEM Founder
 - RED Index
 - Disco of the Future
 - Default Forum

Default Policy: The Silver Bullet

- I assume a commitment to competitive markets
- What do you do with the customer who does nothing?
- 15 Models: Indication of confusion
- Lynchpin: Key issue in competition scheme
 - Get it right—you win; Get it wrong—you lose
 - RED Index initially underestimated importance
 - Readjusted weights
- CAEM Default Forum
 - 50+ organizations
 - Three plenary meetings
 - Draft final report
- Workshop Yesterday

Two Ways to Organize Models

➤ Success: Best to Worst

➤ Key Attribute:

➤ Pricing

➤ Bifurcation

➤ Assignment

➤ Will use Key Attribute for Today

Models Organized by Key Characteristic

I. Pricing Models (ranked by popularity)

1. Passthrough of Competitive Wholesale Price
2. Rate Discounts
3. Regulated Rate based on Cost of Service
4. Price Caps on Marketers
5. Deregulated Rate
6. Real-time Loaded Rate
7. Non-Market Pricing Incentives to Switch
8. Wholesale/Retail Asymmetry

Models Organized by Key Characteristic

II. Bifurcation Models

- 9. Bifurcation of Consumers
- 10. Virtual Choice

III. Assignment Models

- 11. Aggregation
- 12. Wholesale Bidding
- 13. Retail Bidding
- 14. Monopoly Assignment
- 15. Competitive Assignment

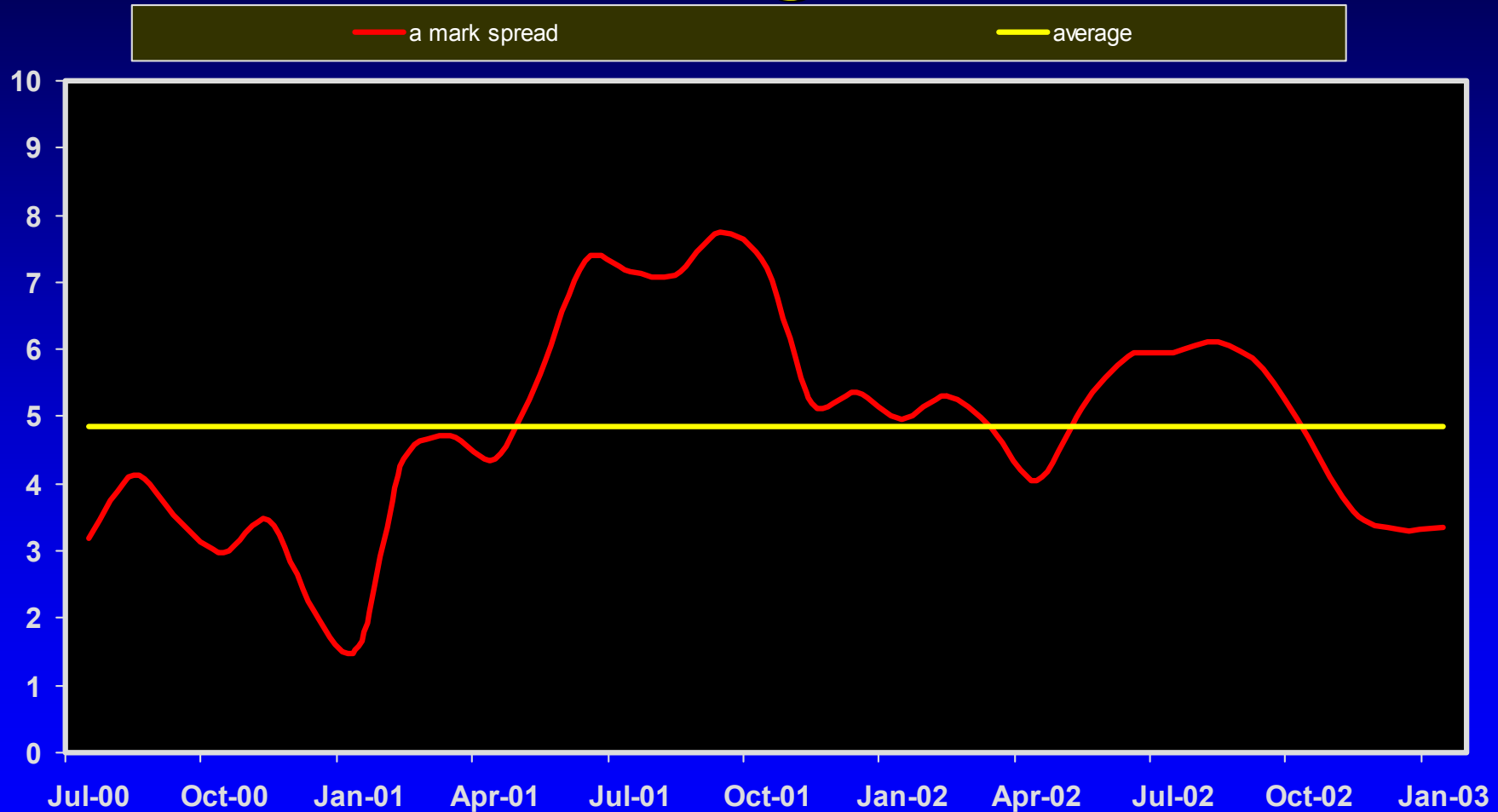
Georgia Model

- Date certain for customers to choose
- Assigned to marketers based on success
- Rush of marketers: over 20
- Got consumers attention: 80% switched
- Black eye because of marketer billing and AGL rate increase
- Pricing Roller Coaster
- Legislature passed legislation allowing price caps on marketers
- Legislature put a safety net default in place for low income and credit challenged
- Full Disclosure: CAEM worked with PUC on Rule to implement legislation

Evaluation of Georgia

- 5 years experience with 100%
- No Consumer Education Program
- Multiple marketers
- Some concentration—top 4 have 80% market
- First two years of implementation were horrendous
- Billing and Bankruptcy
- Last three years much better operationally
- Complaints down
- Whole sale gas prices
- First Wave of price increases—blamed on competition
- Price Cap Rule
- Second Wave of Price Increases
- Consumers now understand that GA prices will be affected by wholesale prices

Spread between Wholesale and Retail in Georgia Gas Market



Spread between Wholesale and Retail in Georgia Gas Market



Spread between Wholesale and Retail in Georgia Gas Market



Draft Principles

1. Goal should be to create competitive retail markets, not merely give consumers a choice in economically dysfunctional markets.
2. Goal should be for all customers eventually to be served by a competitive supplier.
3. Competitive retail markets require many customers (scale) and low barriers to entry for suppliers.
4. Marketers have a right to compete on a level playing field. Allowing the utility to participate by providing commodities that compete with independent marketers distorts the playing field.
5. The needs of low-income customers are a legitimate concern that should be addressed by a State's policies relating to default service.

Disco as Merchant

- What is society's policy on the owner of a bottleneck network asset being able to sell commodities that use the network?
- Far and away, general policy is to prohibit
- Energy is very rare exception
 - Hepburn Act 1906—Railroads can't own grain
 - Supreme Court 1948—Major Movie Producers can't own movie theatres
 - Microsoft original decision—owner of operating system with market power can distort market for applications
 - Airlines don't run air traffic controllers
 - Parent of pitcher for one team shouldn't be the umpire
- Testimony in first antitrust case against a network facility accused of discrimination against independent marketer
- Significantly complicates regulatory function; makes marketers skeptical; confuses consumers; significant potential for anticompetitive conduct

Draft Recommendations

1. A state's should base its default policy on the quantity of energy consumed by a consumer. The state should treat big consumers differently from small consumers.
2. A big gas consumer should be defined as 750 mcf of peak demand and above.
3. A big electric consumer should be defined as 500 KW annual peak demand and above.

4. Big consumers should be required to have meters that allow consumption to be measured in real-time.
5. The state should give big gas and electric consumers only one default option.
6. For commodity costs, the disco serving that consumer should pass through the real-time wholesale spot price to big consumers.
7. In addition to the real-time commodity cost, the disco should be required to charge big consumers an adder that reflects an approximation of the marketing and service costs experienced by marketers in operating in a competitive market.

8. Any revenue over the cost to the disco for providing commodity service to these consumers would be credited back to the wires charges.
9. Big consumers who switched to a competitive supplier may return to the default service for any reason.

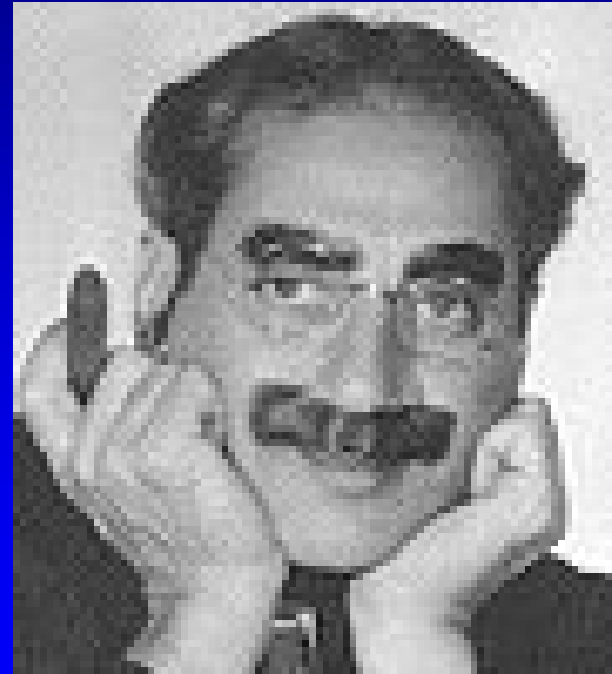
10. The Default Forum should continue to study the options for small consumers in another phase.

1. Leave small consumers alone until markets mature;
2. Give small consumers several virtual choice options (virtual choice requires that the *disco* offer several different options to small consumers: green options, weather hedged options, fixed priced options, real-time price options etc);
3. Expose small consumers to some form of competitive commodity prices; and
4. Adopt aggressive policies such as the Georgia Gas Model that would require an eventual transition of all small consumers to service supplied by competitive retailers.

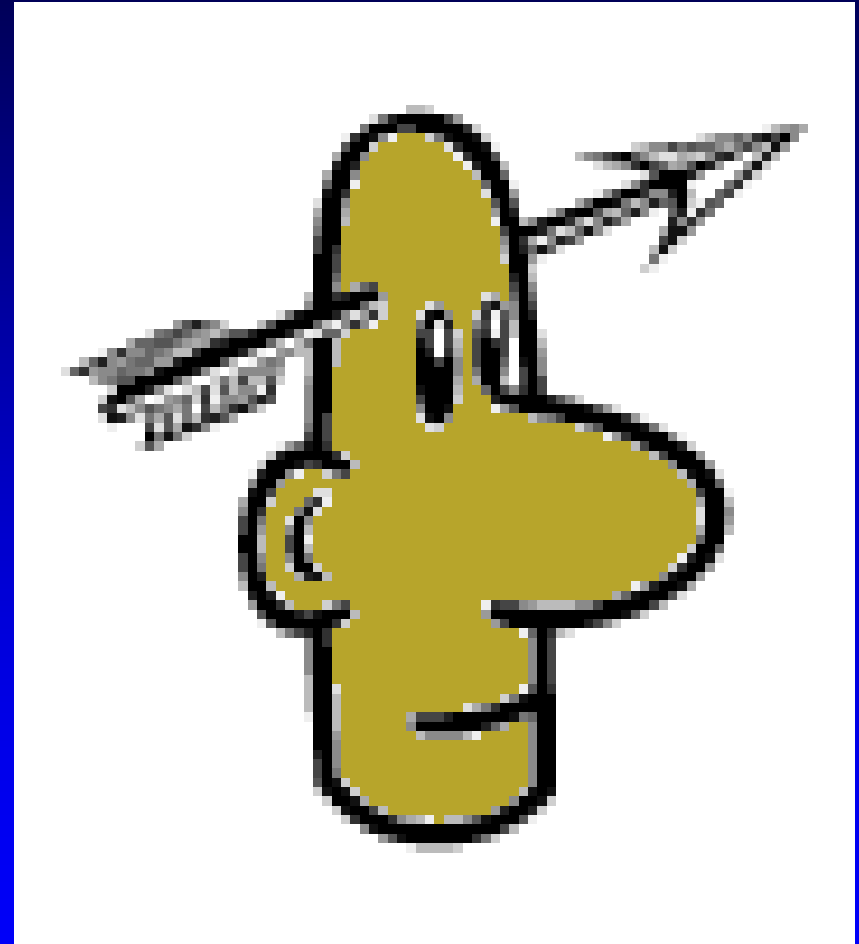
Perspectives on Change

**Politics is the art
of looking for
trouble, finding it
everywhere,
diagnosing it
incorrectly, and
applying the
wrong remedies.**

Marx

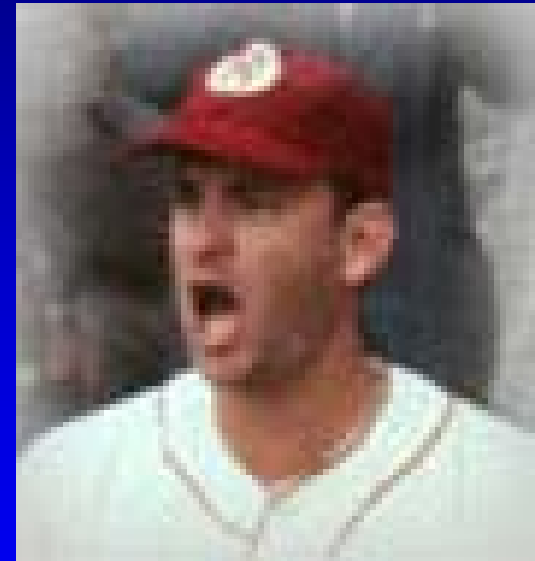


**Pioneers
get all the
arrows,
but we get
the best
campsites.**



It's supposed to be
hard, if it wasn't hard
everyone would do it,
*the hard is what makes
it great.*

Jimmy Dugan (Tom
Hanks)
A League of Their Own



A successful
person is one
who can lay a
firm foundation
with the bricks
that others throw
at him or her.
David Brinkley



Do, or do
not. There
is no try.



Thank You