

# **Pennsylvania Public Utility Commission**

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## **Provider of Last Resort (POLR) Roundtable**

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## **Introduction**

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Pennsylvania has played a leading role in retail deregulation, and will be one of the first states to replace its transitional program with a permanently restructured market.

We would like to offer observations on three issues:

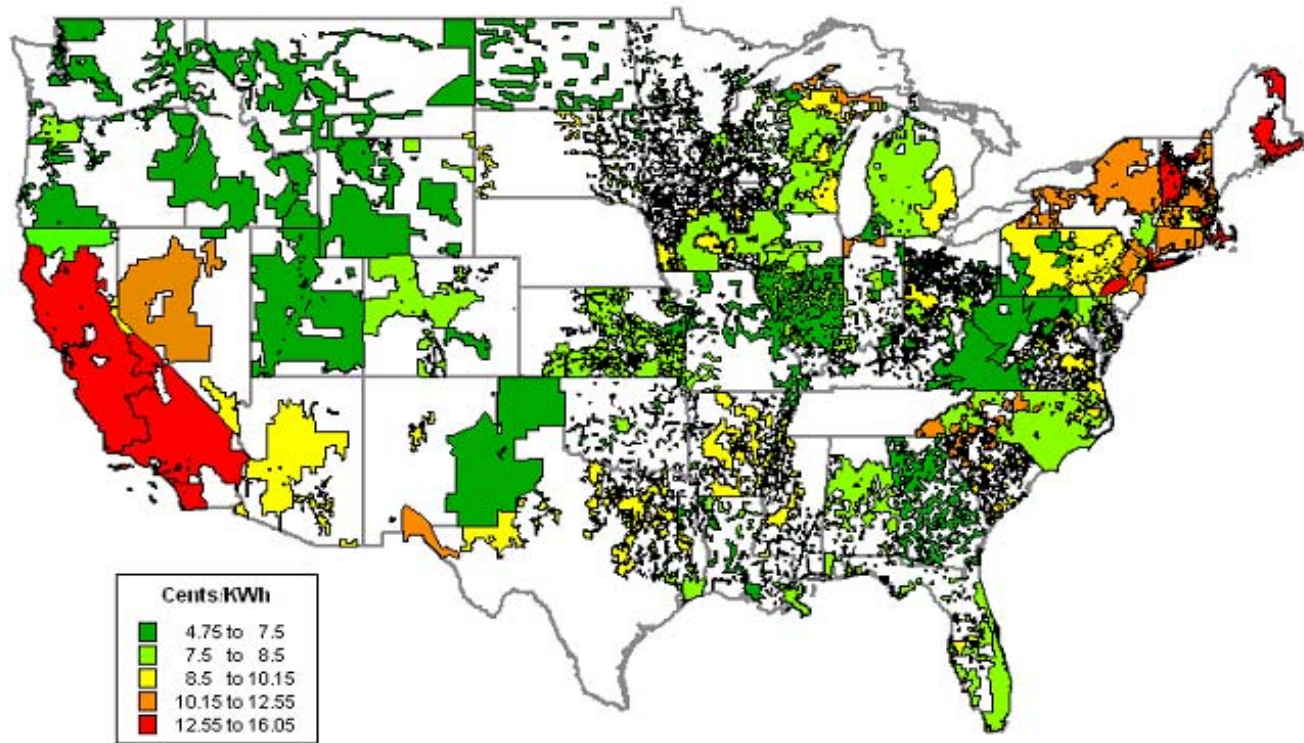
- POLR situations elsewhere and the potential for rate shock
- Cyclicity of deregulated wholesale power markets
- Option value of right to return to POLR service

# California and Rate Shock Potential

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- The essentials of the California disaster are well known:
  - POLR generation divested
  - Substantial POLR reliance on the short-term market
  - POLR vulnerability to gas price escalation (and manipulation)
- Retail deregulation programs vary throughout the US, but almost all retail programs involve generation divestment and capped transitional pricing provisions
- California and other state programs share the common issue that fuel price volatility and capacity cyclicalities have exceeded expectations
- A new issue is the creditworthiness of participants: their ability to perform existing contracts, and eventually to support new construction

# Residential Rates for IOUs



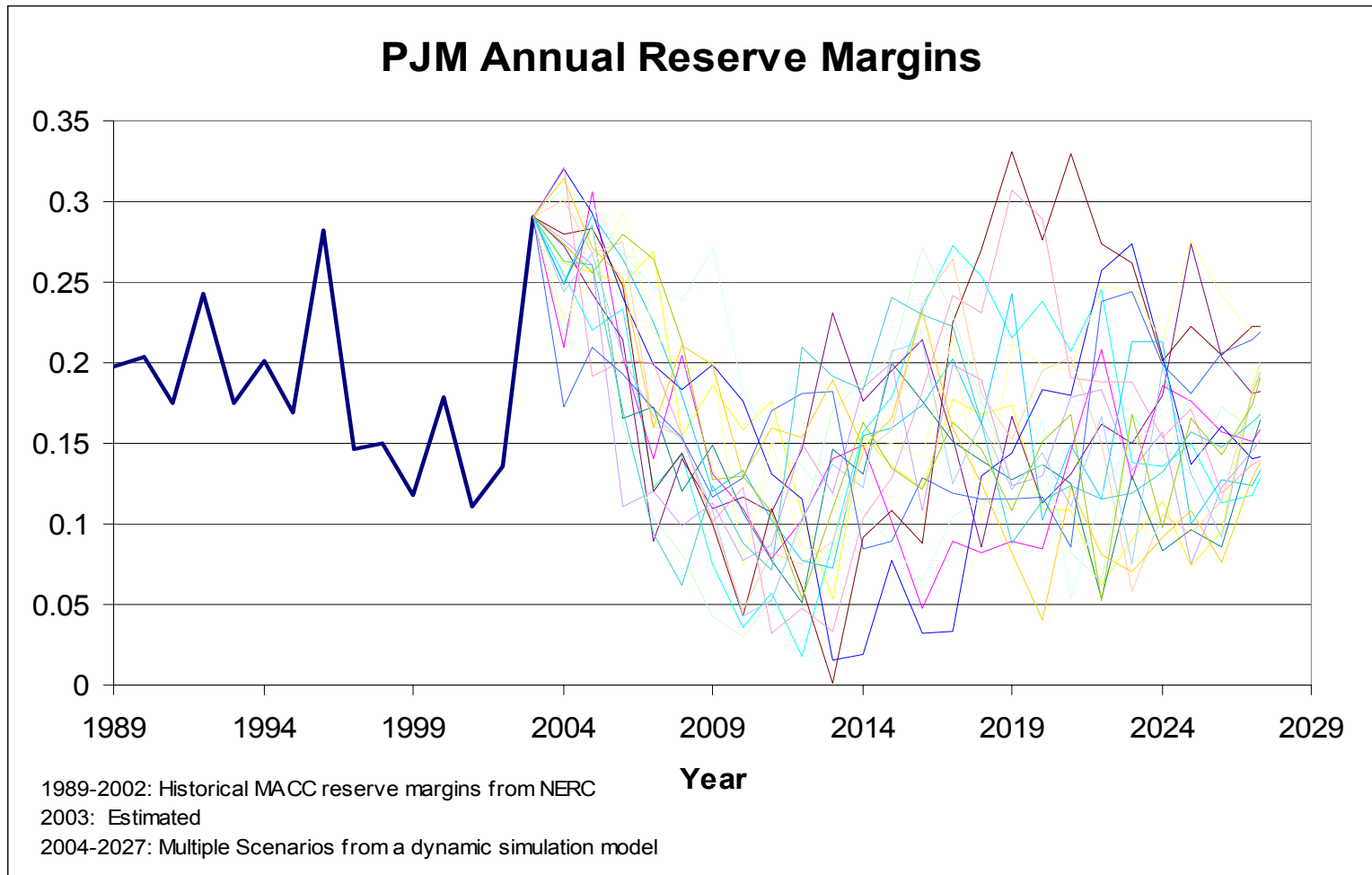
Source: EEI Winter 2003

# Power Market Cycles

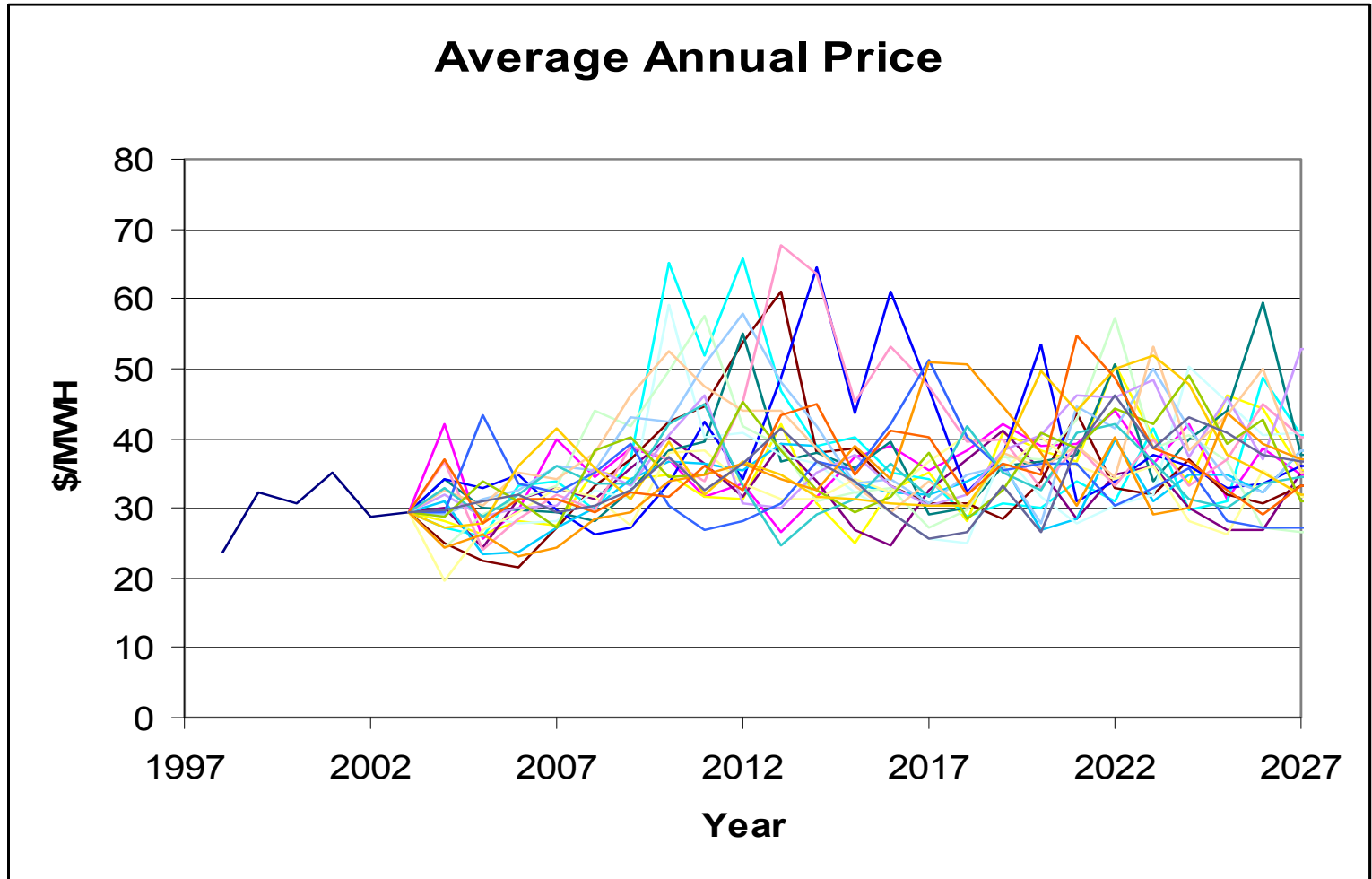
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- Electric wholesale supply and demand has always been cyclical, though former regulatory rules and processes substantially reduced the amplitude of the cycle
- New capacity planning, permitting and construction take time: measured in years, not months
- Wholesale deregulation has accentuated power market amplitude by decentralizing decision-making and increasing its reliance on current power prices
- Full market cycle appears to be approximately 12-14 years with significant phases of oversupply (as at present) and undersupply

# PA Consulting Dynamic Simulation Model



# Possible Price Scenarios



## Return to POLR Service

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- Within the longer-term power market cycle, customers can be expected to migrate between competitive and POLR service as prices fluctuate
- The POLR may lose or regain customers at any time and must plan accordingly; the uncertainty of loss or return complicates the ability of the POLR to hedge its obligations
- A customer's right to return to POLR service is in some sense a financial benefit to the shopping customer and a potential burden on the POLR (and its remaining customers)



## Suggestions

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- The terms and pricing for POLR service should be able to respond flexibly to market conditions
- The Commission should consider the use of mathematical modeling to understand and anticipate the impact of the structure of POLR service on the retail market and the finances of potential POLR providers
- The cost and value of the right to return to POLR service should be taken into account when designing and pricing POLR service offerings