Re-Verticalizing Electricity

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Re-Verticalizing Electricity

- Is it happening?
- Is it a problem?
- What are appropriate policy responses?
Residual Obligations

- Electric utilities have residual service obligations post restructuring (e.g. POLR).

- Originally intended as transition services, but now appear to be perpetual.

- Meeting residual service obligations is complicated by customer switching rights.
  - All of the traditional load risks (e.g. weather)
  - Plus asymmetric risk of customer switching
The Procurement Problem

- Utilities no longer own generation, so must purchase power to meet service obligations.
- Power markets are volatile.
- There are many feasible procurement plans.
- In many cases regulators have not established clear procurement criteria.
Challenges

- Utilities have a high degree of exposure to regulatory risk. (Can always identify a lower cost procurement plan after the fact.)
- Credit quality diminished by sale of generation and loss of exclusive service franchise.
- Many participants anxious about long-term performance/reliability of wholesale market.
Procurement Models

- **Portfolio Model**: acquire/manage a portfolio of contracts to meet residual obligations, supplemented by balancing in “spot” market.
- **Transfer Model**: bid out residual service obligations to third-party suppliers.
- **Ownership Model**: retain/acquire generation assets to back residual service obligations.
Motivation for Re-Integration

- Ownership of generation assets appears to be attractive as a risk management strategy.
  - Hedge long-term price risk
  - Enhance credit quality
  - Mitigate regulatory risk
  - Assure long-term reliability
Policy Responses

- Establish competitive, transparent, and standardized procurement processes.
- Define basis for exceptions to the rule that utility does not own generation.
- Anything to promote well functioning wholesale markets.