National Energy Marketers Association

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Standard Competitive Market Designs

The Supreme Court has recently decided that FERC has all the authority and discretion it needs to implement restructuring at the national level with impacts all the way down to the bundled retail transmission customer. This case will likely have a significant impact on all future FERC rulemakings, particularly proposals to implement a Standard Wholesale Market Design.

Given this significant change in the regulatory landscape, it is now more important than ever that state regulators design retail markets to remove barriers to competition and provide consumers with accurate price signals.

A. Fully Allocated Embedded Cost-Based Unbundled Rates Are The Foundation For A Competitive Retail Market Design

The proper prices to beat for competitive services are the utilities' fully allocated embedded costs. Embedded costs are the basis for rates which consumers currently and historically have been charged by utilities for fully bundled services. Utility revenue requirements are established based on fully allocated embedded costs, and accordingly, such costs have already been determined by state commissions to be "just and reasonable." Implementing unbundled rates or backout credits for competitive products, services, information and technologies based on less than the just and reasonable rates that consumers are currently being charged is inherently unjust and unreasonable.

If unbundled rates are based on the same just and reasonable rates currently paid by consumers, it will help to establish efficient competitive market prices for contestable services. This will be true until the utility no longer offers such services and competition to provide these services at or below current utility prices and permits a truly competitive price for these services to equalize at the point where marginal revenues paid for these services, in fact, equal the marginal costs to produce them by competitive non-regulated, non-subsidized vendors. As a result, marginal utility revenues received by adding a new customer will and should be exactly equal to the marginal utility costs of losing an existing customer.

B. Unbundled Rates Based On Incremental Costs Undermine A Competitive Market Structure

Incremental/marginal/avoided cost methodologies should not form the basis of unbundled rates. Unbundled rates based on incremental costs or decremental savings will not accurately reflect the true prices that consumers actually pay for competitive services currently provided by utilities and will therefore fail to provide consumers with adequate price information to compare utility rates and competitive offers. Furthermore, the implementation of unbundled rates that are less than the bundled rates that consumers are currently paying for competitive services will, by definition, result in unbundled rates that are less than just and less than reasonable. In addition, properly quantifying incremental costs requires extensive speculation about future migration rates, the timing of migration, the "best available technology" in the marketplace, and the competitive cost of capital.

Furthermore, the methodology for unbundling telecommunication network elements is not an appropriate manner to unbundle competitive energy products, services, information and technologies currently bundled in utility network sales that are available elsewhere from competitive vendors.

C. Proper Structuring Of Stranded Cost Recovery Is Essential To Competitive Market Design

"Just and reasonable unbundled utility rates" based on fully embedded costs will allow utilities to both quantify and, if properly mitigated, recover stranded costs within a reasonable time frame without incurring and imposing new costs on departing customers. Stranded costs or revenues lost due to migration should be calculated after unbundled rates or shopping credits based on fully embedded costs have been implemented and actual migration has occurred.

Once a reasonable time has elapsed during which consumers are able to shop for one or more competitive services with embedded cost-based credits, then a calculation of the difference between the revenues that the utility would have received using fully embedded cost-based rates and the revenues actually received by the utility can be made.

Utility recovery should be premised upon a utility showing that: (1) the costs are material; (2) the costs were productively managed and reasonably mitigated; (3) the utility is not earning in excess of its earnings/sharing cap; and (4) the utility's stranded costs or lost revenue was not a result of the utility's POLR obligation or the need to provide fully bundled service. Any costs or lost revenues connected with POLR-related services or fully bundled sales service should be recovered in those rates. Remaining costs that are truly stranded should be recovered in a competitively neutral fashion.

D. Conclusion

The goals of deregulation are to lower costs, improve the quality of service and provide value-added services to consumers. These goals are attainable if the state implements uniform, consistent standards, processes, contract terms, and information protocols that allow competitive suppliers to effectively compete in multiple utility service territories and jurisdictions at the lowest cost to consumers.

NEM urges regulators and legislators to require utilities to exit the merchant function by a date certain and to implement fully allocated embedded cost-based unbundled rates at the earliest possible time. NEM submits that embedded cost-based rates for competitive services previously bundled is just and reasonable, and that consumers deserve no less than just and reasonable unbundled rates.