Unbundling Rates for Competition

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Unbundling Rates for Competition

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Background

- **Historically only Electric utilities produced/purchased commodity and provided delivery service to all customers so there was no choice.**
- **A single rate was charged including both commodity and delivery costs which was a “Bundled Rate”.**

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Background (continued)

- **In the late 1990's the NYPSC restructured the Electric industry to create competitive services where possible**
- **Regulation is a proxy for competition but a competitive market is presumed to be more efficient**
- **Competition offers choice and savings from innovation and value-added services**
- **NYPSC believed that the provision of commodity and retail sale to customer could be a competitive activity**
- **Delivery (due to infrastructure requirements) not considered ripe for competition**

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Restructuring markets for competition:

- Electric market restructuring
  - Utilities sold generation to private parties
  - Regional Independent System Operators were established to:
    - Operate competitive markets for the sale of electricity between generators and Load Serving Entities (utilities and Energy Service Companies {ESCO})
    - Control bulk and interstate transmission systems of utilities which are still largely regulated operations
  - ESCO's were created by private enterprises and were intended to compete with, and eventually replace, utilities in resale of electricity to customers

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Goal of Unbundling

- **To separate bundled Electric Utility rates into commodity and delivery service related portions.**
- **WHY?**
  - **For customers to compare ESCO and utility commodity service rates the utility must offer a comparable commodity rate**
  - **Customers who take commodity service from an ESCO should not pay commodity related costs of utility which are included in bundled rates**

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Unbundling Process

- **Utility Delivery and Commodity service <u>costs</u> must be separately identified to design unbundled <u>rates</u>**
- **Delivery and Commodity service costs are each composed of subcategories:**
  - **Commodity costs (purchase price of KWH's) is easy to quantify as coming from contracts or purchased on the wholesale market**
  - **Retailing costs in selling services are not easy to quantify since they are performed by the utility for both commodity and delivery services using common facilities and labor**

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Unbundling Process (continued):

Commodity Costs

- **Utilities purchase commodity for its customers in regional ISO market or bilateral contracts with generators**
- **Utilities use flow through commodity tariffs to recover commodity costs from its customers - no profit is included**
- **NOTE: any stranded costs/benefits from restructuring are reflected in non by-passable Delivery rates and also flowed through to customers' bills**

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Unbundling Process (continued)

Retailing Costs:

- **Focus is on identifying utility retailing functions and related costs**
- **Retailing costs must then be allocated between the utility's commodity and delivery service to be able to design unbundled rates**

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Unbundling Process (continued)

- **NYPSC required utilities to perform <u>cost of service studies</u> to identify retailing function costs and their allocation between provision of commodity and delivery service**
- **Embedded cost of service studies using historic costs were used as surrogate for costs utility would avoid in the long run <u>if retailing functions were no longer performed by utility for commodity service</u>**

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Unbundling Process (continued)

- **NOTE: Utilities are required to be ready to provide commodity service to all customers including those who may have previously been customers of an ESCO (Provider of Last Resort or POLR)**
- **Due to POLR requirement utilities can’t avoid all commodity retailing costs in unbundled rates since they can’t fully exit the commodity business**
- **Difference between utility actual avoided cost and amounts reflected in unbundled commodity service rates is known as “lost revenues”**

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Unbundling Process (continued)

Example of Lost Revenues

- **Utility commodity related unbundled retailing rate is 4¢ per KWH**
- **Due to POLR requirement utility can only avoid 1¢ per KWH**
- **100 KWH customer transferred to ESCO commodity service**
- **Utility revenues reduced by $4 but only $1 of costs reduced= $3 of lost revenues**

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Unbundling Process (continued)

- **Utilities provided recovery of lost revenues**
- **Lost revenues are a measure of system duplicated costs resulting from the transition to competition:**
  - **ESCO is incurring commodity related retailing costs serving transferred customer**
  - **Utility is incurring residual commodity related retailing costs due to POLR requirement**

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Retailing functions and their costs reflected in unbundled rates are:

- Meter ownership, service and data handling (for electric only)
- Billing & Payment Processing
- Commodity Supply (Procurement)

Note : Indirect costs reflected in each function

- Customer Care (for example call centers)
- Credit & Collections
- Uncollectibles

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Example of Unbundled Rates:

Unbundled rates for Con Ed Electric Residential Customer:

- **Commodity (Procurement) $0.18/KWH**
- **Retailing Functions:**
  - **Billing & Payment Processing $0.94/mo.**
  - **Meter (own, service & data) $4.22/mo.**
  - **Commodity Supply $0.0037/KWH**

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Unbundled Rates and Bill