



Citizens Utility Board

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Comments on the Procurement of Full Requirements Products

On June 17, 2014, the Illinois Power Agency (“IPA”) issued a request for comments in response to a June 5, 2014 workshop concerning the inclusion of full requirements products in IPA’s procurement strategy. IPA requested that stakeholders submit their comments no later than June 2, 2014. The Citizens Utility Board (“CUB”) welcomes the opportunity to provide feedback on several of the relevant prompting questions.

CUB maintains that although full requirements products may provide a level of price stability, the risk premium customers must pay to achieve this benefit is not worth the cost. This is particularly true given that energy efficiency, demand response, and distributed generation provide a similar benefit with minimal negative rate impacts. CUB believes that any full requirements product—whether it be energy-only or a bundled energy, capacity, and ancillary services product—is not in the best interest of ratepayers. Here in Illinois, the IPA exists in part precisely because of problems associated with full requirements contracts; managing the risk associated with supply prices and load size is the reason a third-party agency like the IPA was created.

3. Bids for full requirements contracts include compensation for various costs and risks borne by the product supplier (i.e., “residual compensation” as described in the ICEA presentation). Please comment on what factors influence the level of this cost and how it should be estimated. Other discussions of full requirements procurement (e.g., the IPA’s 2014 Procurement Plan) discuss the concept of a “risk premium.” Please also comment on the differences in definition between “residual compensation” and “risk premium” and how the two concepts should be differently understood.

The term “residual compensation” as used by ICEA during the June 5, 2014 workshop is simply a reframing of the “risk premium” descriptor used in the IPA’s 2014 Procurement Plan. Both terms refer to the amount customers pay to suppliers in exchange for the supplier assuming greater wholesale market risk. CUB asserts this amount—whether described as a “risk premium” for customers or as “residual compensation” for suppliers—is not justified since it ultimately translates to higher rates for customers that could achieve the same end result (i.e. price stability) through other, less expensive means.

The premium customers pay under full requirements contracts is meant to be comparable to the value that consumers would perceive they obtain by eliminating the uncertainty around the price. Estimating this premium is a difficult task as it involves calculating unexpressed consumer value preferences. From suppliers’ perspective, the full requirements price premium accounts for increased costs and risks such as customer migration as well as usage and price

uncertainty.¹ If the IPA pursues the use of full requirements in the future, the agency should closely compare the full requirements price with the counterfactual price that would occur under the current block procurement strategy or if alternative means were used to achieve price stability.

7. To what degree, and how, could the potential benefits of procuring full requirements products (as compared to a block procurement approach) be quantified rather than qualitatively described? What are some of the relevant risk metrics that should be included in such an analysis, and how should they be compared to known procurement costs? Additionally, what are some of the inputs and variables that must be appropriately captured in order to quantitatively assess potential benefits? Are there benefits of the block procurement approach (as compared to a full requirements approach) that could also be assessed and quantified?

While CUB does not support the use of full requirements products at this time, there are three broad components of the full requirements approach that should be analyzed quantitatively if the strategy is adopted:

- (1) **The Price Premium.** Capturing the difference in price between a full requirements approach and the counterfactual block approach reveals the price premium paid by customers. This is essential for determining the value of full requirements over the current block purchasing approach.
- (2) **Customer Value for Stability.** Capturing the monetary value customers place on price certainty and the ability to mitigate unexpected price spikes also indicates whether or not the price premium is “worth it” for customers. While capturing this metric may be difficult, it is an essential factor. It is important to note that customer value on price stability should be weighed against cheaper alternatives to full requirements products.
- (3) **The Cost/Benefit of Alternatives.** Capturing the costs/benefits of alternative approaches will allow the IPA to determine if there are other strategies that achieve the same goal as full requirements (i.e. price stability) at a lower cost to customers.

8. The IPA’s traditional procurement approach hedges in the forward market a percentage of expected load taking into account market conditions. In the 2014 Procurement Plan, the IPA hedged 106% of average load for the summer months to mitigate shaping risk, and for the first time, the IPA is planning a fall procurement for ComEd to adjust the balance of the current delivery year supply to balance an updated summer load forecast. The goal of this second procurement is to reduce load risk. Given the legislative mandate of the Agency to “develop electricity procurement plans to ensure adequate, reliable, affordable, efficient, and environmentally sustainable electric service at the lowest total cost over time, taking

¹ Illinois Competitive Energy Association (ICEA) IPA Workshop on Full Requirements power point (June 5, 2014), p 7.

into account any benefits of price stability,” are there strategies other than full requirements procurement and the IPA’s current approach that the IPA could consider for managing risks?

CUB agrees that price stability holds value for some customers. Since a statutory goal of the IPA is to account for price stability, the question becomes the best means to do so while meeting the other statutory goals of the IPA to provide reliable, affordable, efficient, and environmentally sustainable energy. The price premium that customers are required to pay if price stability is achieved using full requirements products is unjustifiable given cheaper alternative approaches. For a full requirements supply hedge, the IPA’s own analysis shows that the risk premium as seen in other state jurisdictions is too expensive compared to other management tools, such as energy efficiency and demand response, identified by the IPA.²

In addition to traditional energy efficiency and demand response products that help customers achieve price stability at a fraction of the cost when compared to full requirements products, the IPA is also currently holding workshops regarding the potential procurement of distributed generation and energy efficiency as a supply side resource for its 2015 Procurement Plan.³ Distributed generation will allow customers to produce their own energy, mitigating price increases. , Procuring energy efficiency or demand response as a supply resource will allow the IPA to target energy and cost savings during peak demand when electricity is most expensive. CUB supports the IPA’s efforts to investigate these alternative resources for providing lower and more stable energy prices.

9. During the workshop the idea was raised that there may be ways to achieve rate stability other than utilizing a full requirements supply strategy. How could the utilities provide firm prices for a defined period through a tariff mechanism? Could the utilities adjust the PEA on an annual basis, as opposed to a monthly basis? Would a “rate stabilization account” approach add unnecessary costs? Are there ways to achieve additional utility price/rate certainty while utilizing the IPA’s current competitively-bid block procurement strategy?

Price stability should not come at the expense of affordability for customers. Any effort to achieve a more stable price should do so at the lowest possible cost. Including energy efficiency (both incremental and as a supply side resource), demand response, and/or distributed generation in the IPA’s procurement strategy all help achieve price/rate stability and deliver these benefits at much lower cost than many alternatives including full requirements. Another advantage of such products is that they provide long-term protection against price volatility, which is a missing component of alternative approaches that may freeze rates in the short term but leave customers open to future price shocks as policy and markets change. These elements can also utilize IPA’s current block procurement strategy, which simplifies their adoption and implementation.

CUB holds no objection to adjusting the PEA on an annual basis, as opposed to a monthly basis, as Commonwealth Edison has begun doing. CUB is also open to making other

² ICC Docket No. 13-0546, IPA 2014 Procurement Plan, pp 71-73.

³ DG workshop was held June 12, 2014; EE as a supply resource workshop was held June 18, 2014. See <http://www2.illinois.gov/> for additional information and meeting materials.

adjustments if there are concerns that it is difficult for customers to compare the real cost of electricity across supplier offers.

10. Please provide examples of studies or other evidence that assesses or quantifies the interest of Illinois residential (and/or small commercial) customers in firm rates. To the extent available, please correlate those examples to evidence of customer choice and switching. Please also provide examples from other retail markets

It is difficult to accurately quantify customer preference for price stability. Such estimation must account for a variety of factors that vary widely among individual customers and customer classes. However, many studies have been conducted that show customer demand elasticity in response to price. Studies indicate that, in the presence of price transparency and technology that allows for responding to high prices, customers reduce consumption. Such findings indicate that low prices—not necessarily price *stability*—is of primary concern to customers. This is true throughout the country as well as in Illinois where ComEd and Ameren’s experimentation with dynamic rates show that educated and enabled customers are willing to shift their usage when rates more accurately reflect fluctuating wholesale prices. The following studies highlight consumer’s value for low prices:

- A widely-cited study entitled *Impact Evaluation of the California Statewide Pricing Pilot* involved 2,500 residential customers and dynamic rates (combined time-of-use and critical peak pricing). The study showed customers reduced demand by an average of 13.7% on critical peak days when events were called.⁴
- Pepco conducted its PowerCentsDC Pilot Program in Washington, DC with 1,300 customers in an effort to test three dynamic pricing schemes: Critical Peak Pricing (CPP), Critical Peak Rebate (CPR), and Hourly Pricing (HP). CPP and CPR customers reduced average consumption by 34% and 13% respectively in response to peaking prices. The ability to respond to wholesale price fluctuations incentivized HP customers to reduce by 39% on average.⁵
- In 2008, Connecticut Light & Power conducted its Plan-it Wise Energy a pilot with 1,251 customers in order to three dynamic rates: Time of Use (TOU), Peak Time Pricing (PTP), and Peak Time Rebate (PTR). The study showed that providing customers with price information and enabling technology resulted in the following average peak savings: 29% for PTP, 22% for PTR, and 4% for TOU.⁶

⁴ *Impact Evaluation of the California Statewide Pricing Pilot* (Charles River Associates International, March 2005), 11–7,

https://www.smartgrid.gov/document/impact_evaluation_california_statewide_pricing_pilot.

⁵ eMeter Strategic Consulting, *PowerCentsDC Program: Final Report*, September 2010, 32.

⁶ Faruqui, Ahmad and Sanem Sergici, *Impact Evaluation of NU’s Plan-It Wise Energy Program: Final Results*, November 2, 2009.