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Preserving the Benefits of Competition through Effective Competitive Bidding Rules for Utility Resource Procurement

Policymakers and regulators continue to face the question of how to optimize benefits to retail consumers through the procurement and resource planning process. In absence of robust retail markets, such optimization will best occur when the utility's duty to serve is viewed in the context of the utility as portfolio manager.

Alexandre B. Makler and Steven S. Schleimer

I. Introduction

The purpose of competition in the electricity sector is to provide retail consumers lower cost, greater reliability, and more environmentally responsible electric power service than they would have in the absence of such competition. While the economics of power generation will differ in different regions around the country, competitive markets tend to select the efficient supplier, and the supplier that is able to bring new state-of-the-art

generation resources to the market "cheaper, faster, better" will create significant reductions in the costs, risks, and environmental impacts of generation as these new facilities displace or replace older, less efficient, and environmentally costly units.

Indeed, over the last five years competitive generators such as Calpine have developed and constructed the majority of new generation capacity throughout North America, representing a multi-billion-dollar investment. In many areas of the country these

are the only new generating facilities to come on-line in decades. Such investment was, and continues to be, made without a single penny of utility ratepayer money being at risk. In contrast, these assets were developed at the risk of private debt and equity investors.

Due to a variety of events during the last few years—including the California energy crisis, the Enron bankruptcy, the tightening of capital and credit markets, and other factors—many are questioning whether to continue to move towards a more competitive market in the electricity sector. Indeed, some stakeholders have argued for a return, or continuation in some regions, to the “good old days” of cost-of-service rate regulation, where a captive load is served by a vertically integrated monopoly utility. However, there has been little discussion recently about the costs and risks to ratepayers of monopoly-led central planning. To optimize the provision of electric service to retail ratepayers, utilities must be accountable not only to consistent and appropriate regulatory oversight, but also to the discipline of competitive wholesale electric markets.

In most parts of the country, retail electric consumers do not have any meaningful choice regarding their service provider, nor do they have a meaningful say regarding how their utility provides such service. Their options regarding procurement and other forms of resource planning continue to be made by the vertically integrated regulated utilities. In

other words, in contrast to many other products or services, individual electric customers have very little input regarding attributes such as price, risk, and the environmental impact of the service that they take.

This raises the oft-discussed question of how such procurement and resource planning activities should be conducted. *Specifically, how does the process ensure that the decisions of the*

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vertically integrated monopoly utility result in the optimal balance of risk, cost, and environmental benefit to the retail consumer?

In many regions, utilities are, in a real sense, managing a portfolio of generation resources on their customer’s behalf. As a result, the utility resource planning process—including resource procurement—thus becomes the single most important avenue for the utility customers to optimize the overall costs and benefits associated with electricity supply. As a fundamental component to this determination, the resource procurement process must be transparent, free of conflict, and

appropriately designed to permit a complete evaluation of not only direct costs, but also take into account indirect costs, such as environmental impacts.

Absent the development of fully open and competitive wholesale and retail markets, a central question is whether utilities should revert to building capacity to meet their own needs, as some have proposed, or whether state regulators should require utilities to use competitive bidding to procure new generating resources. Unfortunately, some jurisdictions provide no guidance on this issue at all, and few states have specific rules and regulations in place to determine how the utilities should go about the process of competitive procurement in today’s market.

Some states have already recognized the significance of these issues and are currently revisiting the resource planning and procurement processes or have already done so. Among these are Arizona, California, Florida, Louisiana, New York, Oregon, and Washington.

II. Overview

This article attempts to present key elements of what would constitute a set of “best practices” for utility-centered procurement and resource planning, based on our experience with procurement processes throughout the country. We believe that, in the absence of direct retail consumer choice, consumers are best served when

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