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Competitive Procurement of Retail Electricity Supply: Recent Trends in State Policies and Utility Practices

There is now considerable experience in designing competitive procurements of all types. However, actual experience with implementing incremental resource procurements is uneven, particularly for procurements undertaken within the regulatory frameworks currently overseen by state commissions.

Susan Tierney and Todd Schatzki

I. Introduction

Unless the economy remains bleak for a longer period than we now anticipate, the coming decade is expected to require a new wave of electric resource additions. While future resource needs will be met in part by actions to reduce and manage demand, fulfilling these needs will likely require substantial supply-side resources, driven by a variety of concerns about enhancing fuel diversity,

maintaining resource adequacy, and addressing climate change. Developing these resources in a manner that is cost-effective and yet manages financial, environmental and physical reliability risks will require careful design of markets, utility procedures, and regulatory policies and oversight to balance appropriately protection of consumers with encouragement of capital investment.

Competitive procurements can be an important tool

available to regulators and utilities as they explore how to obtain future retail electricity supply. By allowing the market to compete for the opportunity to supply power, utilities can obtain electricity supply that has the “best” fit to customers’ needs at the “best” possible financial terms. Competitive procurements can also lower the costs of achieving energy and environmental policy objectives through the discipline created when market participants that bear the financial risks of supplying power are allowed to compete. The greater transparency and structured “market test” provided by competitive procurements can also give regulators greater confidence about the reasonableness of utility resource decisions and their implications for retail electricity consumers. Such confidence may allow regulators to commit to allowing full recovery of the costs associated with new resources, irrespective of whether they arise from purchase power agreements (PPAs) or the utility’s own investment. This, in turn, may provide assurances to financial markets that reduce overall costs of capital, much to the benefit of consumers.

Over the past two decades, electric distribution utilities¹ have increasingly relied on competitive procurements as a means to obtain power supply for their retail customers. In many states, regulators now rely on such procurements as an

important tool to help ensure that utilities provide cost-effective retail services. Today, more than 40 percent of U.S. states (or jurisdictions)² have formal regulations or guidance that requires or encourages utilities to use competitive processes. Although the use of competitive procurements to obtain supply for retail customers is not new, many of the requirements affecting when and how competitive

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procurements are to be used have either been newly enacted or substantively revised in recent years.

With growing attention on the design and use of competitive procurements, the authors were asked by the National Association of Regulatory Utility Commissioners (NARUC), in collaboration with the Federal Energy Regulatory Commission (FERC), to study state and utility policies and practices for competitive procurement of retail electric supply.³ Our assessment reflected the current procurement approaches and practices of those

states that have formally adopted policies or guidelines for competitive procurements. This article describes “lessons learned” from our assessment and – where possible – identifies best practices for designing and implementing competitive procurements in different regulatory contexts and industry settings.

II. Criteria for the Design of Competitive Procurements

Competitive procurements can provide utilities with a means of obtaining electricity supply that best fits their system needs economically, while also accounting for risk, environmental outcomes, and other policy factors. In principle, competitive procurements accomplish this goal by requiring market participants to compete for the opportunity to provide these services. However, for competitive procurements to fulfill their promise, they must be designed and implemented in a manner that fosters competition among market participants, including potentially the regulated utility and its affiliated companies. To achieve robust competition, procurements should aim to meet certain criteria. These criteria may seem obvious, but are nonetheless integral to a successful process:

- ***The procurement process should be fair and objective.*** A fair and objective process can avoid

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