INSTITUTE FOR CLIMATE AND SUSTAINABLE CITIES

STATEMENT

SC decision portends lower rates for electricity ratepayers

10 May 2019 -- The cloud of uncertainty that hovered over stakeholders in the power sector was lifted by the Supreme Court (SC) decision on the competitive procurement of power supply by distribution utilities, mainly for residential ratepayers, last May 3. The aims and expected results of that decision are to be lauded. If the Department of Energy (DOE) and the Energy Regulatory Commission (ERC) hew to the spirit of the court's decision well, ratepayers can expect lower rates than will otherwise be, and would have been, the case. But there are implementation challenges that have to be addressed.

Prior to the regulations enacted by the DOE and supposed to have taken effect in June 2015, the distribution utilities (DUs) could procure power supply for ratepayers even from affiliated entities, as long as the power supply agreement (PSA) passed muster before the ERC. The DOE regulations tried to make the process more competitive, but only in a limited way. That's because the subsequent ERC process would still have guaranteed independent power producers (IPPs) returns on their capital.

The SC decision castigated the abuse of power by the ERC in extending the deadline for negotiated PSAs between the DUs and IPPs by 10 months. In effect, the SC ruled, the Commission effectively postponed more stringent competition by as much as 20 years, the effective period of most contracts. Simply unacceptable, the court said.

As the case was pending in the SC, the DOE and ERC tried to fine-tune the competitive process further. Noteworthy is the fact that the current ERC has proposed, in its current draft rules, the abolition of guaranteed returns to IPPs by abolishing automatic fuel-cost adjustments, and limiting contract terms to 10 years. The two provisions, taken separately and together, pose theoretical and practical challenges.

Effective competition requires that independent power producers compete not just on managerial, technical, and operational efficiency, but more importantly, on their desired returns to capital, given the attendant risks. In the past regulatory process, the utilities would embark on a pro forma competitive process, with the ERC still regulating, and thus guaranteeing, a rate of return. That guarantee, in turn, has been enforced by the so-called automatic fuel-cost adjustment, a mechanism that passes on the risks of fuel price volatility onto captive ratepayers.

Captive ratepayers are those that have no choice but pay for whatever electricity generation supply is procured by the distribution utility, regardless of whether that supply was the best deal to be had from the market. The responsibility for ensuring that captive

ratepayers get the best deal falls squarely on the shoulders of the DOE and the ERC. The procedure for liberation from captivity was spelled out in the electric power reforms act by way of declining thresholds of average annual peak demand of ratepayers, and many industrial and commercial customers have qualified to be 'contestable' under the first threshold of one (1) megawatt set by the ERC.

However, the process of reducing the threshold, and thus expanding the contestable market, has been suspended because of a case lodged by certain interests. That case is still pending before the Supreme Court. The DOE has reduced the threshold to 500 kilowatts, on a voluntary basis, but there is as yet no showing how effective this has been.

What the Department of Energy and ERC will do in the coming days will be crucial if the spirit of the court decision is to be upheld. The implementation guidelines will have to ensure supply adequacy by minimizing any delays in the 'revised' procurement process, and assure investors a stable environment from where they can get a fair or reasonable return. Otherwise, reforms will be blamed for any shortage that ensues, as the case of the current water crisis highlights.

One way of expediting the revised process is to resort to the Swiss challenge methodology with all its imperfections. This means subjecting the original proposal with its associated technical parameters to a price challenge by other potential suppliers. This procedure gives original proponents a fair result, given the new rules, and newcomers, sufficient time to challenge the incumbents.

We realize that the rapidly changing costs in the power sector, especially of variable and firm renewable energy technologies, pose a challenge to policymakers and regulators in coming out with stable rules. Our institute is committed to participate in this process. But we urge the regulators to be more transparent, especially with respect to making information available to all stakeholders.

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