Motion 502: Regulated Rate Option Regulation

Technical Briefing

Executive Summary

Since 2001, Albertans have been able to choose to receive their electricity either from a retailer that is regulated by the Alberta Utilities Commission (AUC), or from a competitive retailer. In which case, they would sign a contract for a set price structure for electricity.

The Regulated Rate Option was established to provide a “default option” for consumers who decide not to choose a competitive retail product. But, in 2006, the RRO Regulation was changed to encourage customers to switch to competitive retail products, and, thereby, develop a new competitive energy market.

The price that consumers pay under the RRO is determined using what is called the “forward pricing.” In a forward market, power plant owners (electricity producers) announce the amount of power they will produce **120 days prior to the month of consumption**, and power companies (electricity retailers) bid, like an auction, on how much they are willing to pay for that power. They then charge consumers based on how much they paid in the forward market.

Since the price is determined several months in advance, what consumers pay for their electricity is often higher than if they had bought it directly from the power plant (wholesale price). Historical pricing data has shown that consumers had been overcharged for their electricity since the Regulated Rate Option Regulation was changed in 2006. Motion 502 aims to address this issue. It proposes that the RRO be calculated based on the monthly wholesale price of power.

The Proposal

The Regulated Rate Option (RRO) calculation can be changed to benefit consumers by using the actual weighted average Pool price each month instead of forward market prices. This change will benefit RRO customers by substantially reducing the monthly cost of electricity.

Current Regulated Rate Option Regulation

Calculation of new RRO rate
11(1) Each new RRO rate

(a) must be based on

(i) regulated rate customer load forecasts made during a relevant price setting period described in subsection (2), and

(ii) monthly forward market electricity prices established in a relevant price setting period,

and

(b) must not be based on prices established before or after a relevant price setting period.

(2) The price setting period for a calendar month is a period beginning on a day that is not more than 120 days preceding the month and ending on the 5th business day preceding the month.

AR 262/2005 s11;11/2013

Motion 502

"Be it resolved that the Legislative Assembly urge the Government to amend the Regulated Rate Option Regulation, Alta. Reg. 262/2005, by replacing the Regulated Rate Option with a new default rate for electricity that is to be calculated using a weighted average of the wholesale price of electricity."

Motion 502's Policy Goals

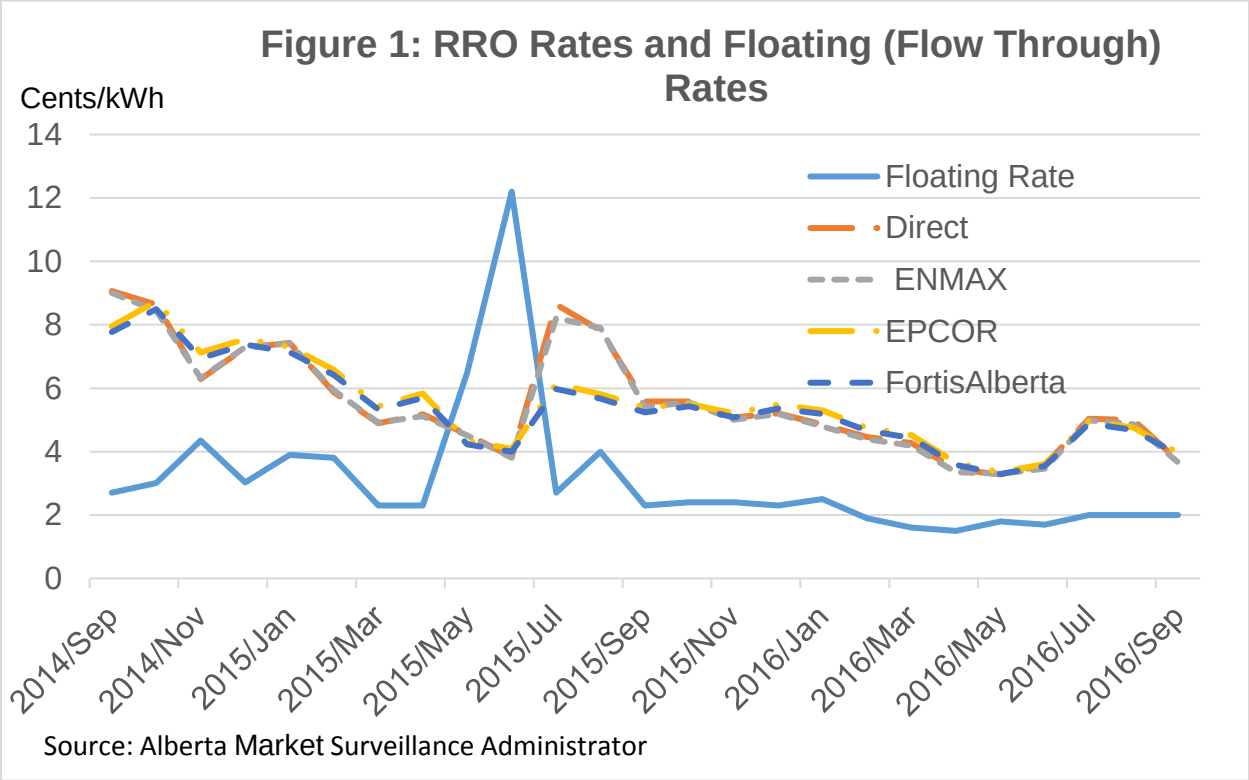
- *To ensure that electricity customers obtain their energy supply at the lowest possible cost, consistent with reasonable levels of reliability and service.*
- The motion's goal is similar to the stated goal of the Utilities Consumer Advocate, an Alberta government agency and part of Service Alberta.
- To ensure customer choice for those consumers who want to make energy choices based on preference.
- To provide a "default product" for those consumers who are indifferent to choice and simply want price certainty, stability and reliability.
- To implement an energy pricing policy based on the actual cost of electricity rather, which is determined by competitive forces rather than an artificial or ideologically motivated price.
- To reflect the actual cost of electricity so that consumers have a "price signal" they can use to correctly value the cost of energy alternatives.

Benefits of Motion 502

- The price paid by RRO consumers is the actual cost of power.
- The new default rate would provide RRO consumers with significant savings.
- It allows consumers to continue to make energy decisions that best meet their preferences.
- It preserves the integrity of the competitive retail market and, in fact, has the potential to make it more competitive.
- It assumes an equitable balance of risk and reward amongst energy suppliers, retailers and consumers.
- Consumers may not have understood that there is a significant cost premium built into the RRO rate. The new default rate will increase consumer awareness about the true cost of electricity in Alberta.
- Strategically, it is a very good time to implement a change in the RRO due to the current low level of Pool prices relative to historical levels. These low pricing levels are expected to continue for the next 3 to 4 years.
- It establishes a “price reference point” based on the actual weighted average monthly cost of electric energy that consumers can then use as a basis for evaluating the cost/benefit of competitive retail options.
- It standardizes the default cost of electricity across the province and facilitates comparability of non-energy costs such as distribution, administration and return margins amongst different regulated retailers.
- It achieves a significant reduction in the complexity and cost of the regulatory process related to approving RRO rates by the Alberta Utilities Commission.
- The negative impacts (price volatility) on energy producers, retailers and vulnerable consumers can be readily offset through fixed price contracts, subsidizes or rebates.

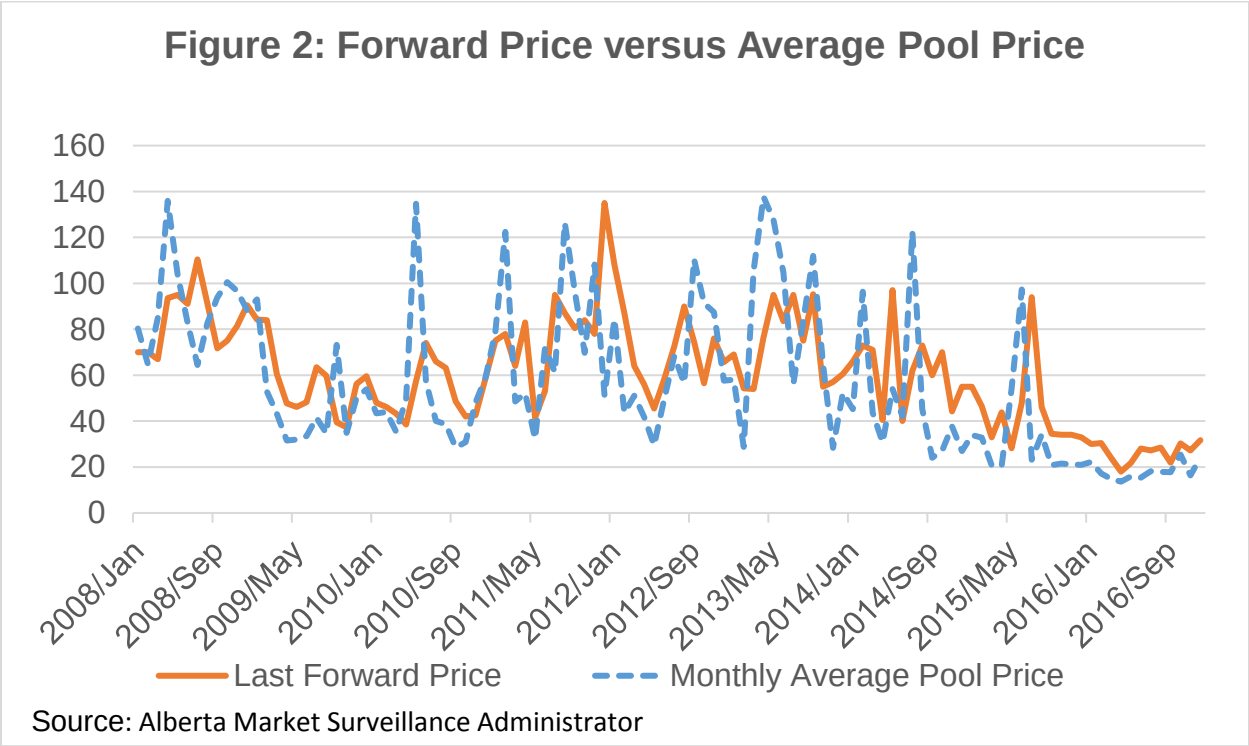
Figures

Figure 1 compares RRO rates and the flow through or floating rate for each of the major RRO retailers for the period September 2014 to September 2016. The figure clearly indicates a significant cost savings for all months except June 2015.[1]



[1] The spike in Pool price in June 2015 was related to factors such as temperature and outages at generating plants. The frequency, duration and magnitude of these types of factors can greatly affect the volatility of Pool prices.

Figure 2 shows that the forward price is frequently above the Pool price. During the January 2008 to September 2016 time period, the Pool price was lower than the forward price about 70 per cent of the time.[2]



Source: Alberta Market Surveillance Administrator

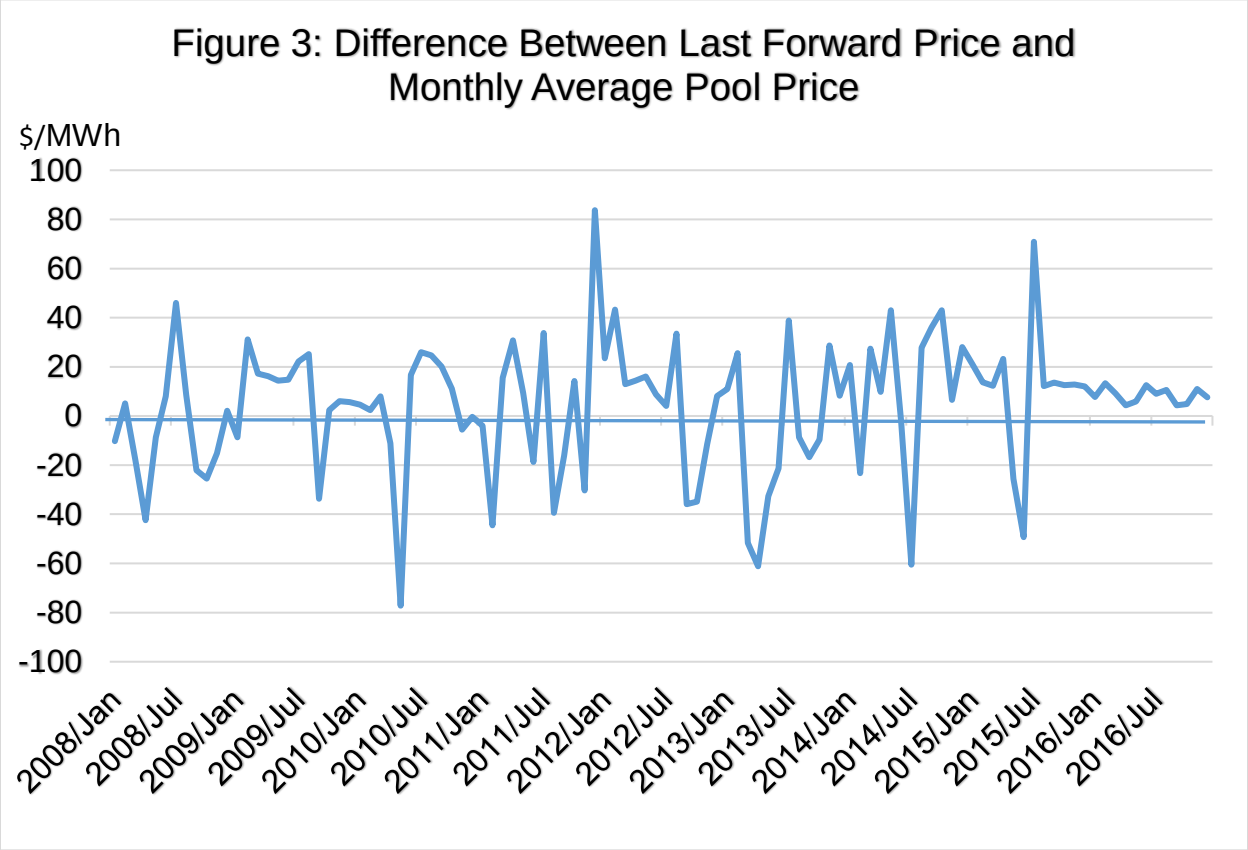
[2] We found a similar number looking at the RRO price compared to the Pool price.

Figure 3 examines the difference between the monthly average Pool price and the forward price on the last day of trading. Positive numbers indicate when the forward price is higher than the Pool price and negative numbers when it is lower.

In theory, the forward price should converge to the pool price by the last day of trading. If this were true in Alberta, the differential would be much closer to zero each month and there would really be no point in amending the RRO Regulation.

However, because the prices do not converge there is a strong likelihood that there will be a cost differential in favour of consumers.

The failure to converge is also demonstrated by a low statistical correlation between the Pool price and the forward price at around 60%.



Note: The above analysis demonstrates that there is a high certainty that there will be a cost saving associated with Motion's proposal.

Tables

Table 1 summarizes the additional cost to RRO customers over the 2006 to 2016 time period as a result of using forward prices rather than the actual weighted average wholesale price.

Table 1: Summary of Additional RRO Costs Due to Forward Pricing (July 1, 2006 to June 30, 2016)

	Energy Cost ($Million)	Risk, Credit and Other Costs ($Million)	Total ($Million)
EPCOR	262	327	589
ENMAX	82	124	206
DIRECT	108	119	227
Total	452	570	1,022

Source: N. Jansen and R. Spragins

Table 2 summarizes the average monthly RRO over-charges by major retailer for the first two Energy Price Setting Plans.

Table 2: Average Monthly RRO Over-Charges

	First EPSP: July 1, 2006 to June 30, 2011 ($/Month)	Second EPSP: July 1, 2011 to June 30, 2016 ($/Month)
EPCOR	4.05	9.18
ENMAX	4.24	8.54
DIRECT	7.05	11.31
Total	4.56	9.40

Source: N. Jansen and R.Spragins

Table 3 summarizes estimated future savings for consumers if RRO pricing is changed from forward pricing to the actual weighted average wholesale Pool price.

Table 3: Estimated Future Savings if RRO Priced Using Actual Average Wholesale Price

	Potential Savings Range	
	Low	High
Average Annual Savings/Customer	$150	$180
Average Monthly Savings/Customer	$12	$15
Estimated Savings to RROR Expiry (April 30, 2020)	$500	$600

Source: R. Spragins

Notes:

(1) The estimates in the table assume that the costs and return margin in the current and future Energy Price Setting Plans (EPSP) are lower than the costs and return margins in the first two EPSPs.

(2) For the purpose of this table, we assumed the savings periods would correspond to the expiry of the RRO Regulation.