Finding a Black Cat in a Coal Cellar

Ohio State University Study of Ohio's Retail Electricity Markets Finds Majority of Retail Electric Supply Offers Have Not Been Cost Saving, Cost Saving Offers Difficult to Find

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Scope of the Problem:

Many Ohioans are familiar with those companies that try to sell retail electricity, known as Competitive Retail Electric Service (CRES) suppliers. Most Ohioans have had these companies sell them, or try to sell them, retail electric or gas service through telemarketing, social media advertisements, mass market mailing, in-person sales in their community or at their home, or other means.

RETAIL CHOICE:

These markets are commonly referred to as "retail choice" markets.

Retail choice means that residential customers can either "shop" from among competing marketers to supply their electricity on a contractual basis, or remain with the regional distribution utility on the Standard Service Offer (SSO).

The "marketplace" for the sale of unregulated retail electricity began with the passage of landmark legislation such as SB 3 (1999) and HB 221 (2008). With that legislation, Ohio followed in the footsteps of several other states in restructuring (or 'deregulating') its electricity markets. Today, Ohio is one of 14 US states that have "competitive" retail sales of electricity through CRES markets. Through this restructuring, consumers can switch to a CRES supplier for their generation service, while the transmission and distribution components of electricity service remain set by a regulatory commission and provided by a regional distribution utility.

The original stated intent of electricity reform legislation was to create a competitive market that would drive down costs to households and businesses, and shift market risk onto suppliers and away from consumers. Basic economic theory would suggest that competition would push retail prices close to wholesale prices, and that above-market supply offers would quickly disappear because they would not sell.

In reality however, consumers across Ohio have seen CRES suppliers persistently sell above-market generation supply offers. In recent years, several of these supply companies have been investigated, censured, fined, or penalized for market manipulation, fraud or abuse by after-the-fact investigations.[1] Some of the intended benefits of competition have not materialized for Ohio's households and businesses.

The Ohio State University Study

A new peer-reviewed study from the Energy Markets and Policy Group at The Ohio State University, in collaboration with researchers at Lehigh University and external partners, took a deep dive into the electric CRES marketplace in Ohio. Every day between approximately 90 and 150 different supply offers are filed with the Public Utilities Commission of Ohio (PUCO) by about 45 different CRES suppliers, in each of the six major electric utility service territories of Ohio. The researchers built and analyzed a database of the millions of offers filed over the past decade.

Funded by the Alfred P. Sloan Foundation, the team combines experts in economics, public policy, engineering, business, data science, computer science, and anthropology.

Study Findings

The study evaluated every daily residential electric CRES offer filed with the PUCO between 2014 and 2023. The study has four core findings:

1. **The majority of CRES electric supply offers have been more costly than the utility's default service.**

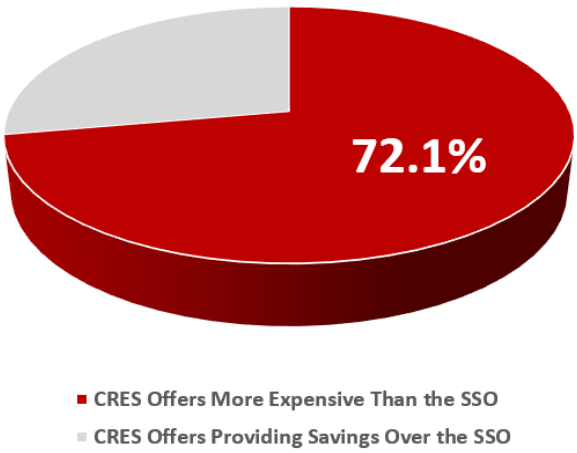

Figure 1. Proportion of CRES Offers Exceeding the Utility's Default SSO

[1] These include investigations regarding SFE Energy, PALMCo, Ambit, Direct Energy, Xoom Energy, Smart Energy Holdings LLC, and RPA Energy. See PUCO Case #s: 19-2153-GE-COI; 20-1216-GE-COI; 22-0128-EL-UNC; 22-0583-GE-UNC; 22-0267-GE-COI; 23-0601-EL-UNC; 22-441-GE-COI.

Each electric distribution utility in Ohio is required to offer a default service to customers who cannot, or will not, switch service to a CRES supplier directly or through municipal aggregation. The cost of this service, referred to as the standard service offer (SSO), is set by each utility blending the results of a series of longer-term procurement auctions.

The study found that the lion's share of CRES supply offers have historically been more expensive (in terms of the rate in cents per KWh) than the default SSO rate at the time the offer was filed for a given service territory. Excluding even the variable rate offers that are oftentimes more expensive for residential customers, the study showed that 72.1% of 12-month fixed-rate CRES offers were more expensive than the SSO. And, it showed that 68.4% of all fixed-rate CRES offers were more expensive than the SSO.

STANDARD SERVICE OFFER (SSO):

The SSO is the default price for generation (excluding the price of transmission or distribution) provided by an electric distribution utility for customers who do not, or cannot, obtain service from a CRES supplier. SSO service is sometimes referred to as Provider of Last Resort (POLR) service.

2. Savings have been about 300% smaller than costs.

Some of the CRES supply offers in the database showed savings as compared to the utility default supply rates. The study evaluated the relative magnitude of those potential price savings as compared to the costs of taking CRES service at rates above the utility's SSO. This allowed the researchers to see if cost-saving offers were at least as big as cost-incurring offers.

The study found that cost-incurring CRES offers have historically been about 25 to 30% more expensive than the SSO, while cost-saving offers have historically been about 5 to 10% below the SSO. Figure 2 compares the percentage rate difference between historic SSO and CRES offers by electric distribution utility.[2] It separates CRES offers above (grey) and below (red) the SSO. In other words, in instances when the CRES marketplace has offered savings, those savings have been considerably smaller than when the CRES marketplace has offered higher price rates.

[2] American Electric Power Columbus Southern Power region (AEPCSP), American Electric Power Ohio Power region (AEPOP), Dayton Power and Light (DPL), Duke Energy (DUKE), First Energy Cleveland Electric Illuminating Company (FECEI), First Energy Ohio Edison (FEOE), and First Energy Toledo Edison (FETE).

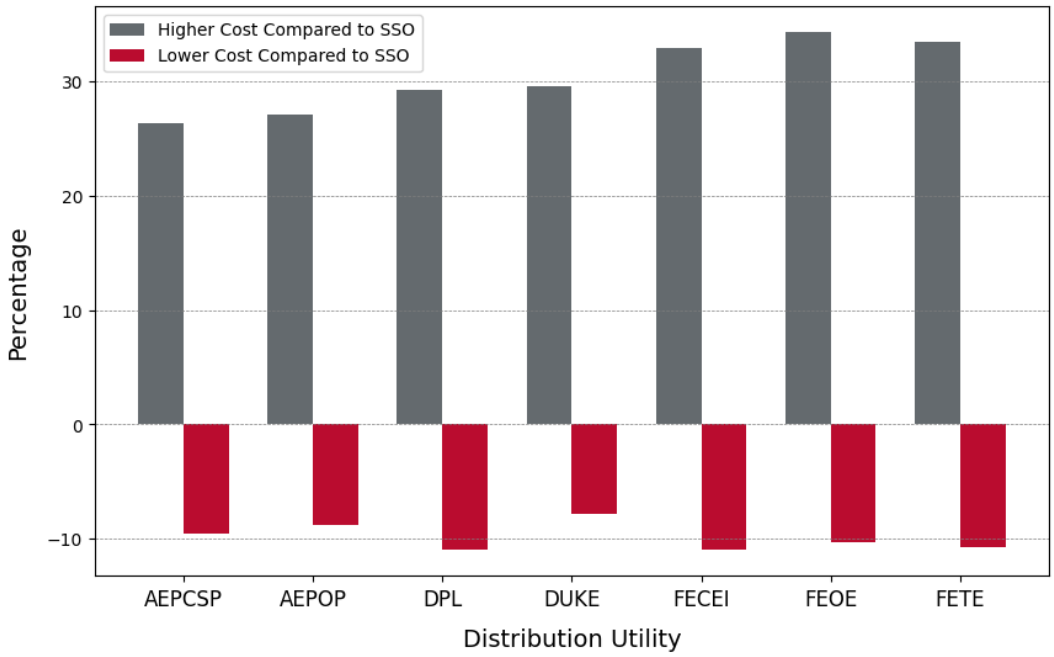

Figure 2. Comparison of CRES Costs vs. SSO Rates by Distribution Utility

3. Historically, cost-saving CRES offers have not been consistently available.

The study also evaluated the temporal (time-related) effects of CRES prices across delivery years. A delivery year coincides with the procurement schedule for a distribution utility and begins June 1st. SSO rates typically change at the beginning of each delivery year.

The study found that across most delivery years, even if a residential customer were to "shop" for cost-saving offers all 365 days out of the year—which would be a heavy lift for most households—they would be able to find cost-saving offers on only about half of those days. Cost-saving offers were available between 43 and 59% of the year.

However, in some delivery years for some territories, cost-saving offers could not be found for the full delivery year. This means that, in those years, CRES suppliers filed tens of thousands of residential CRES supply contracts in each service territory that were more expensive than the utility's SSO rate. In other words, cost-saving CRES offers have been, like a black cat in a coal cellar—difficult to find.

4. Historically, the median CRES offer has been marked up about 98% above the wholesale price of electricity; the SSO by about 73%.

The researchers also evaluated price markups. That is, how much higher the typical (or median) CRES supply offer has been historically compared to the wholesale electricity market on the same day. The wholesale electricity market is the larger multi-state market from which CRES suppliers purchase electricity before retailing it to consumers.

Figure 3 provides historical averages for the median CRES supply offer in each utility service territory across Ohio. Markups are compared using the day-ahead wholesale energy market price, which is when the bulk of electricity is acquired, and it excludes smaller cost components such as wholesale capacity. Historically, the wholesale price of electricity has been about 3.5 cents per KWh (yellow bar), while the SSO has been between 65 and 82 percent above that (blue bar). The median CRES offer, however, has been between 92 and 101% higher (green bar). Statewide, the median CRES offer has been marked up by about 98% above the wholesale market, and the SSO has been marked up by about 73%.

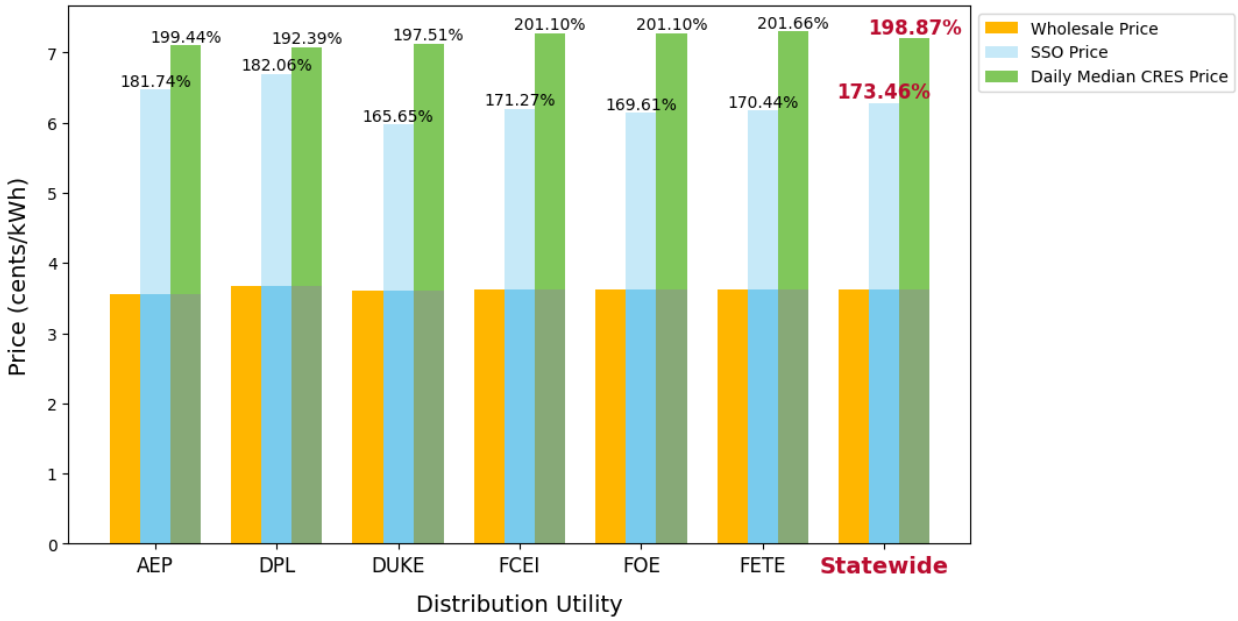

Figure 3. Comparison of Electricity Price Markups by Distribution Utility

Conclusions and Policy Recommendations

Ohio's Competitive Retail Electric Service (CRES) markets have offered Ohio's residential consumers cost-saving supply offers, as well as diverse attributes (e.g., renewable energy content), for many years. Those suppliers that have offered competitive pricing based on market fundamentals have delivered value to many.

However, basic economic principles that should be present in a "competitive" market are missing in Ohio's CRES marketplace. Fundamental market failures have persisted for at least a decade. The majority of supply offers have failed to provide consumers with cost-savings, and cost-saving offers have not been consistently available.

In Ohio there is a present and active debate in which some stakeholders recommend fundamental market revision in the form of re-regulation—returning to a vertically-integrated monopoly. The Ohio State University researchers caution against this and warn readers to not misinterpret their study's findings as suggesting re-regulation would improve these fundamental market failures. Re-regulation could worsen rather than alleviate the efficiency and cost-reduction concerns identified here.

There are however simple and direct actions that Ohio policymakers can take to help improve Ohio's retail electricity markets.

- **Establish a statewide Office of the Independent Market Monitor.**

Each restructured (or deregulated) wholesale market in the US has an independent market monitor that plays a critical role in ensuring that energy companies do not engage in market misbehavior. As an independent non-governmental entity, these market watchdogs have first-rate economists and other experts who actively and frequently monitor the behavior of energy companies and provide much-needed sunlight when market behavior gets out of hand. However, restructured retail markets do not have the same resource. While existing offices such as the Office of the Ohio Consumers' Counsel and the PUCO play key roles, they are state agencies tasked with multiple functions and do not have the same degree of independence or serve the same market analytic sunlight function as a dedicated market monitor. With access to Commission and full utility customer billing data, this Office would be empowered to routinely evaluate the efficiency and competitiveness of CRES supply offers, including more opaque offers such as variable rate contracts. Experts in this Office would operate independently, and would be tasked with impartial and objective analysis and reporting regarding the competitiveness and efficiency of these important marketplaces.

- **Establish a CRES supplier scorecard accessible on consumer utility bills and online.**

Empower the retail choice independent market monitor to develop a scorecard that rates the quality and competitiveness of CRES suppliers and offers. The scorecard will serve an important function in mitigating consumer information asymmetry by helping consumers understand which suppliers have consistent patterns of attempting to sell above-market rates, or engage in untoward market behaviors as measured by consumer complaints or recent investigations.

The scorecard would function in a manner similar to a Better Business Bureau, Moody's, or Fitch rating, by providing increased market transparency for Ohio's households. The scorecard should be accessible to consumers with clear and unambiguous access to its internet location presented clearly on each consumer's monthly utility bill. Additionally, consumers should be reminded of the scorecard during independent third-party verification when switching suppliers, such that consumers are clearly and unambiguously informed of a supplier's rating at the point of contract origination. The scorecard should not be structured to create a roadblock for market entry by new CRES suppliers.

- **Avoid implementing heavy-handed price controls or quotas.**

Several other states, as well as other countries, have observed similar problems with their restructured retail markets. Some of these jurisdictions have responded by implementing heavy-handed price controls and market redesigns. The study researchers caution against price caps and quotas, as known research demonstrates these policies are distortionary.

The findings, conclusions, and recommendations expressed in this report are the product of research conducted by the authors and do not necessarily represent the views of either the John Glenn College of Public Affairs or The Ohio State University.