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THE REGULATED RATE OPTION TRAP

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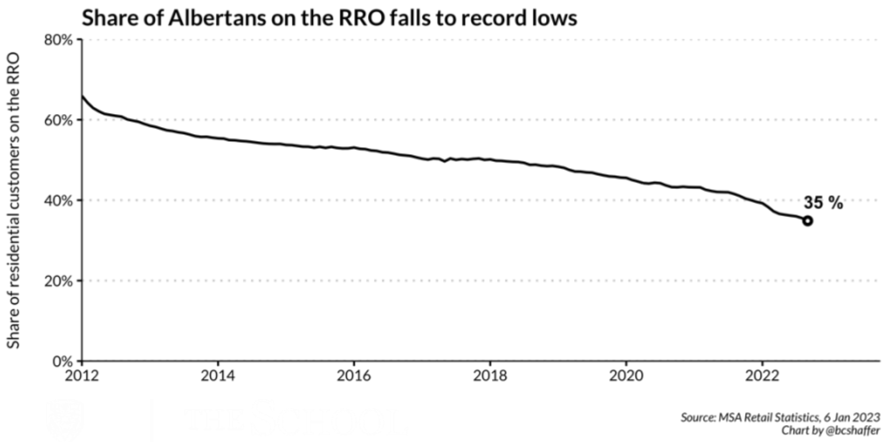
With soaring electricity prices this winter, the Government of Alberta capped what customers on the regulated rate option (RRO) would pay. However, the policy design for the cap has some serious consequences.

Albertans have two main options when it comes to their electricity bills. Option 1: do nothing and you get the regulated rate option (RRO) from your default provider. The RRO price changes from month to month based on a regulated formula that moves with wholesale market prices. Option 2: sign up with a competitive retailer. These retailers can also offer floating rates but the more popular offering tends to be a fixed rate, where your price for every kilowatt-hour is set for the next 1 to 5 years.

Recently, fixed rates have been the clear winner. In 2022, a typical household choosing a fixed rate saved roughly $600 on their annual electricity bill. The figure below illustrates how consumers responded to fixed-rate savings, showing the share of households on the RRO falling to a record low 35%. Why would anyone remain, and what's in store for them when it comes to repaying the cost of the recent price cap?



The first reason some households have remained on the RRO is that people are generally inattentive to electricity rates. Moreover, even when made aware, people are busy. Spending time thinking about electricity rates, and taking the time to make the switch, is often not top of mind. The effort required may simply not be worth it for many households.

But the other reason for not switching involves credit. Households with low credit may not be eligible for contracts with competitive retailers or are required to pay a security deposit they simply can't afford. As a result, these customers are often unable to access fixed rates that would provide them with more certainty and in some cases savings. The design of the RRO cap policy has created a new problem on top of this one.

As electricity prices rose at the end of 2022, RRO rates were capped at 13.5 cents/kWh over the first 3 months of 2023 to provide cost relief to consumers.

The catch is: some of those who benefited from the cap can flee the RRO and avoid the cost, leaving those that remain with an ever-increasing burden.

That price cap came at a $200 million cost, which, under the current policy design, will be recovered by raising the RRO rates from April 2023-Dec 2024. As a result, customers who remain on the RRO will face a roughly 2.5c/kWh additional charge on their bills. This added cost will make competitive rates more attractive, increasing the incentive to leave the RRO for those who are able to make the switch.

How many households don't have that luxury? This depends on the credit requirements from individual utilities and household credit scores. But given that the average credit score in Alberta is close to the minimum requirement of many competitive retailers, it could be as many as half the current RRO customers are there not by choice. If these households are forced to remain on the RRO rate due to credit barriers while others leave, the repayment of the $200 million cost of the cap falls squarely on those who can least afford it, doubling the cost recovery adder imposed on a dwindling base.

There are two steps government could take to address these issues and ensure the cost of the cap doesn't unduly burden those least able to afford it. First, government can and should step in to cover security deposits and credit requirements, enabling all customers to access the certainty of fixed rates. Second, if the current exodus from the RRO continues, government will likely have no choice but to cover the entire cost of the cap. Backstopping with taxpayers' money will be the only option to avoid a spiral where the Albertans who can least afford it are paying the $200 million cost.

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