

**DEFAULT SERVICE FOR RETAIL ELECTRIC COMPETITION:  
CAN RESIDENTIAL AND LOW INCOME CUSTOMERS BE  
PROTECTED WHEN THE EXPERIMENT GOES AWRY?**

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**APRIL 2002**

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This paper was originally published in April 2001 and updated in October 2001. This version reflects the most recent information available for state activities with respect to Default Service through 2001 and early 2002. However, readers are cautioned that the states described in this paper routinely consider changes to state restructuring policies that have a significant impact on the nature, price, and purpose of Default Service.

This report was prepared under contract with  
Oak Ridge National Laboratory Energy Division  
UT-Battelle, LLC  
Subcontract No. 4000007935

The opinions and conclusions expressed in this report are  
those of the author alone and do not represent  
the views of Oak Ridge National Laboratory or the  
U.S. Department of Energy

## INTRODUCTION

The purpose of this paper is to summarize developments with respect to Default Service for residential customers in key states that have moved to retail electric competition and provide recommendations with regard to this important policy for the near term. While every state has made some provision for Default Service, the identity of the Default Service provider and the pricing mechanism that governs this service has varied. This report will highlight those states that have taken recent steps to implement the policy decisions reflected in state electric restructuring legislation, compare their experiences, and make some preliminary observations about trends and impacts of these developments on residential and low income customers in particular. This paper focuses on the implications and policy considerations of Default Service for residential customers and does not address equally important aspects of Default Service for commercial and industrial customers.

Definition of Default Service. This service is labeled with different names (“Standard Offer”; “Provider of Last Resort”; “Basic Generation Service”), but in this report the term “Default Service” will be used to identify the service that is made available to any residential customer who chooses not to choose (or who affirmatively chooses Default Service), who is unable to obtain competitive electric service, whose competitive service is cancelled, or whose supplier is unable to provide service. While some states have separated these services, every state that has adopted electric restructuring has provided for this type of service, which has been widely acknowledged as essential to the transition to competitive markets. In reality, the lack of Default Service, supplied automatically to any customer without a competitive supplier of electricity, would mean that such customers would be physically disconnected from the distribution system. Default Service is viewed as a regulated service (even if priced pursuant to market conditions) in every state and its price, and terms and conditions are subject to regulation by the state regulator of electric utilities. In most states, the price of this service is linked to rate decreases or rate caps mandated by the restructuring legislation or a utility-specific restructuring decision. While this service is provided by means of or through the local distribution utility in most states, other entities provide or will provide this service in some states.

Importance of Default Service. This service has enormous implications for lower use residential and small commercial customers and low-income customers in particular. First, the political acceptability for the concept of energy competition depends in part on a smooth transition from the breakup of the vertically integrated monopoly to a system in which part of the service (distribution and transmission) is price-regulated and part (generation service) is subject to competition with an unregulated price. Legislators and regulators in most jurisdictions have concluded that customers will not tolerate mandatory change (e.g., forced migration<sup>1</sup> to the competitive market) or widespread confusion about the continuation of their electric service. Therefore, the concept of Default Service has been created as a method of allowing customers to do nothing and continues to receive an essential service at a regulated price, at least during a transition period.

Second, policymakers have argued, successfully in many states, that lower use customers are either not eager to enter the competitive market or are unlikely to see lower prices, at least in

the early days of the development of the competitive market.<sup>2</sup> As a result, a service is required to ensure that such customers can continue to receive electricity as an insurance that the market will not in fact “work” and produce multiple suppliers with products that are likely to interest most residential customers.

Third, consumer advocates have pushed primarily for rate caps or rate decreases for residential customers and low-income program expansions for low-income customers as the “price” for the move to retail competition. This approach complements the desire for stability by residential customers who may not be ready to jump into the competitive market, but this approach also carries with it the implication that the creation of a competitive market is less of a priority than providing basic service at an affordable price.

Finally, low-income advocates have feared redlining and discriminatory conduct by unregulated competitive providers for energy services and expect that their clients will not be desirable customers. These advocates often focus on the potential for adverse experiences in other competitive markets, the trend evidenced in many markets to segment the market, and the concern that low-income customers may be discriminated against because of their lower usage and the assumption that such customers are more likely to require more customer care in the form of payment arrangements and collection activity.

Given these conflicting interests surrounding the need for the Default Service mechanism, it is no wonder that the implementation of state policy in this regard has been fraught with controversy and downright intrigues. If you believe that the prime imperative that must govern the decisions surrounding the implementation of retail competition is the need to create a competitive market as fast as possible, Default Service is a tool that should be wielded to achieve that end. For these advocates, the market power of the incumbent utility should be broken up at all costs. On the other hand, if you believe that the competitive market is unlikely to develop in the near future or that when developed, is likely to result in higher prices or less stable prices for residential customers, Default Service is viewed as a tool to maintain important consumer protections and the longstanding acceptance of the universal service aspects of basic electricity service for residential and low income customers. Both these conflicting approaches are reflected in the state decisions examined in this report.

Whatever the motivations and decisions concerning Default Service, the early experience in every state demonstrates clearly that this service will provide electricity service to the vast majority of residential and small commercial customers in the near future. This is because in most states residential customers have not shopped or selected an alternative provider or alternative providers have abandoned the market and focused on larger commercial and industrial customers. Even in Pennsylvania where the highest level of customer shopping has occurred, the percentage of residential customers who are shopping has never exceeded 30% in any utility service territory and was less than 10% in most utility areas.<sup>3</sup> Whether this lack of shopping in other states is due to lack of competitive marketing by suppliers, the economics of the market, or the decisions of regulators that have favored incumbent utilities, the fact remains that the Default Service decisions have been the primary factor in determining the price and identity of the provider of basic electric service for the overwhelming number of customers in states that have implemented retail electric competition.

## MODELS FOR DEFAULT SERVICE

There are three basic models that the states have used to structure Default Service. The key variables in all these models are (a) Who provides the service?; (b) At what price?; and (c) For what group of customers?.

1. Local Distribution Utility with Rate Cap or Rate Reduction: Under this approach the local distribution utility retains the obligation to provide Default Service to customers who choose not to choose and any other customer who affirmatively requests this service after entering the competitive market. This service is typically provided with rate caps or rate reductions for a period of time that often reflects the utility's right to recover stranded costs.<sup>4</sup> Whether the local utility provides this service by means of retained generation assets, contracts for its obligation at specified prices that accompany the sale of such generation assets, or goes into the wholesale market for needed energy, the price is regulated (either as the total bill or as unbundled components of the total bill) and the utility has the obligation to serve. In states that have adopted this approach, the customer receives an unbundled bill from the utility in which generation service is presented in a manner that allows the customer to compare prices and shop for this competitive service. This model for Default Service is the most common and is currently in use in Pennsylvania, Ohio, Maryland, New Jersey, Delaware, Connecticut, New Hampshire, Virginia, and Michigan. A variation on this theme has been used in Massachusetts and Rhode Island, where the local distribution utilities remain responsible for the provision of Default Service, but this service is itself split between those customers who choose not to choose and who were served by the utility at the time of the implementation of retail competition (Standard Offer Service) and another group of customers who entered the competitive market and sought to return to the utility or who became customers after the implementation of retail competition (Default Service). While the local distribution utility is required to provide both services, the method used for pricing the two services are different. Another variation on this theme has been used in Texas where all customers were transferred from the vertically integrated local utility to the retail sales affiliate of the utility at the onset of retail competition. However the price that this retail affiliate must provide service is regulated ("Price to Beat") for a period of years, with a rate reduction of at least 6% compared to pre-competition rates. Under this approach, the identity of the Default Service provider has been changed compared to the prior utility, but the rates remain regulated. However, the Texas model<sup>5</sup> is unique in that the Price to Beat utility is not the automatic provider of service to all customers. While most customers can move in and out of Price to Beat service during the transition period, some customers are automatically transferred to a separate Provider of Last Resort that has been established to provide service to customers whose

supplier defaults or customers who are terminated by the retail supplier (e.g., termination of contract for nonpayment). The price for Provider of Last Resort service reflects the result of a competitive bid that is likely to mimic short-term wholesale market prices.

2. Competitive Bidding for Retail Generation Portion of Utility Bill: Under this approach the state has mandated that the price for Default Service must be established by means of a competitive bid to provide retail generation services. In some states, such as Maine, the state regulatory commission conducts the competitive bidding and awards the bid directly. The most recent round of bidding for residential customers in Maine was awarded in late 2001 for a 2-3 year period at fixed rates that were only slightly in excess of current rates or, in the case of one utility, significantly lower. In other states, such as Pennsylvania (for a percentage of the customer load), the utility conducts the bidding pursuant to regulatory supervision. In effect, this approach requires the local distribution utility to obtain the necessary generation to provide Default Service from retail competitive providers and reflect the identity of the provider on the utility bill. The major issue with respect to this type of approach is whether the “winner” gets to provide merely generation services (as reflected on the customer’s bill issued by the local distribution utility) or can obtain the entire retail billing and collection relationship with the customer. The restructuring settlements for several Pennsylvania utilities contemplated obtaining a portion of the utility’s Default Service load by means of competitive bidding for generation service, as well as billing and collection of the entire bill. However, this approach was not successful due to the requirement that such service be offered at rates equal or below the rate caps imposed on the utilities. PECO Energy finally obtained a bid from New Power to provide generation service only (via the utility-issued bill) for over 200,000 customers, but even this experiment has failed since the default of New Power and the return of these customers back to PECO Energy.
3. Pass Through of Spot Wholesale Market Price: This model for Default Service requires the utility to provide service, but it is priced by means of a pass through mechanism that reflects short-term (i.e., less than six months or spot market) prices on the wholesale market. There is no retail provider of electricity specifically identified on the customer’s bill. Rather, this approach is closely linked with the desire to pass through “real time” wholesale market prices to retail customers. The utility is typically obligated to obtain this service through a transparent mechanism, such as a bid or purchase of electricity at spot market prices. The intent of this approach, according to its proponents, is that customers will see the “true” cost of electricity and make purchasing and usage decisions that will result in overall lower prices in the long run. However, the short-term results due to the use of this approach has exposed residential and small commercial customers to volatile prices and overall higher prices compared to pre-competition utility service. This approach is used in Massachusetts to price the Default Service that is applicable to customers who return to the local utility or who are not otherwise eligible for the Standard Offer Service. Consolidated

Edison in New York also uses this method to price Default Service to all customers. This approach has been the most controversial means for pricing Default Service.

## OBSERVATIONS

It is possible to summarize developments that have occurred to date in the various state models that are explored in more detail in this Report. These observations reflect state experiences that reflect one or more aspects of the three models identified above:

- Most residential customers have not seen any significant change in prices since the onset of retail electric competition in most states. This is due to two developments. First, most states “anointed” the local utility to provide Default Service at rates that reflect the same prices that were in effect just prior to restructuring or at slightly lower overall rates. Second, the competitive market for residential customers has not developed as many initial proponents had suggested. Only a small minority of residential customers has chosen an alternative provider for generation service in any state and many generation providers have halted their initial forays into the mass market for the retail sale of electricity, concentrating instead on commercial and industrial customers. As a result, few customers have left Default Service and even if customers wanted to do so, there are few marketers (and in many states, no marketers) offering electric service at lower prices.
- Low-income customers (typically defined as those with household income below 150-175% of federal poverty guidelines or who are already enrolled in state or federal financial assistance programs) have seen an increase in the availability of programs that offer rate discounts or percentage of income payment plans, as well as energy efficiency and weatherization programs. This is because the adoption of electric restructuring legislation was accompanied by increased funding for universal service programs in some states or, in other states, the creation of new programs funded by other ratepayers.
- However, it is not clear how long residential customers can rely on the current prices for Default Service and universal service programs to provide a safety net when electric restructuring enters the post-transition phase. Those states that have relied on statutory or regulatory price caps and rate reductions for residential customers have yet to confront how to transition from these price protections to other mechanisms when the transition period is over. In some cases, the decisions are being deferred and in other cases, the transition period is being lengthened.
- Suppliers and some policymakers in several states have pointed to price protections associated with Default Service as the reason for the lack of the development of the competitive market, suggesting that it may be difficult to retain price protection in the future. Other policy makers express frustration with the promises and actual results delivered due to retail electric competition and wonder how to “undo” deregulation. According to John Harwood, speaker of the Rhode Island House of Representatives, “Here we are five years later, and the rates are going up in the air on us. We felt there would be more competition and lower prices—but instead we have no competition and higher prices.”<sup>6</sup>
- Even where prices have been allowed to rise to reflect short term wholesale market rates,

robust competition for residential customers has not emerged.

- States have typically structured Default Service to resemble the pre-restructuring rate design that was used by the local utility. In other words, states have unbundled transmission, distribution, and generation charges in a manner that preserves the historical rate design. This has left intact the inter- and intra-class allocations of responsibility for the utility's distribution revenue requirement. Some utilities have proposed changes in rate design to shift recovery of the distribution portion of the bill from usage-based charges to fixed monthly customer charges, i.e., increasing the minimum monthly charge and reducing the amount of the distribution revenue requirement collected via kWh charges. However, such an approach would shift costs to lower use customers and result in higher monthly bills in most cases for lower use customers.
- Default Service is typically accompanied by the traditional utility terms of service and consumer protections, such as the regulations that apply to the application for service, billing and billing dispute procedures, termination of service protections, the right to payment arrangements, medical emergencies and severe weather disconnection moratoria. Therefore, in most cases, there has been no sanctioned degradation of service quality or consumer protection as a result of the move to retail competition for customers on Default Service. It is not clear whether this linkage can be maintained in the future if non-utility providers seek to provide this service and bill and collect for both regulated and unregulated charges.
- As long as there are a substantial number of residential customers receiving Default Service for any reason, the higher costs associated with serving those customers who need more attention in the form of payment arrangements, medical emergencies, and additional customer service will be spread among all residential customers or included in distribution (regulated) utility rates. This was the universal approach to residential customer rates and class rate design prior to restructuring. This approach may not be tenable in the future if a competitive market does develop and most residential customers enter the competitive market, leaving those with credit challenges or poor payment history behind.
- If Default Service is limited or designed to serve an isolated group of credit challenged customers or those who have been terminated by competitive suppliers, it is likely that the price for this service will be higher than competitive prices offered to other residential customers and higher than current traditional utility rates that reflect averaged costs for residential customers.
- Those states that have relied on short term wholesale market prices for Default Service in any form (not the typical state approach, but reflected in the competition programs in New York (Consolidated Edison), Massachusetts, and Texas (for POLR customers)) have been unable to provide this service without significant price volatility and overall price increases compared to Default Service available to programs in other states. This has

occurred even though the affected customers typically do not have the ability to “respond” to these price signals by using alternative fuels or relying on sophisticated metering technology to ameliorate high price periods.

- Low-income customers are clearly more at risk in a system that adopts the Texas POLR model because this approach focuses on those that drop out of the competitive market and does not link this smaller group to the larger pool of residential customers who do not shop for electricity in the competitive market.
- There is no evidence as yet that any competitive supplier can or seeks to provide service to residential customers at the embedded costs reflected in current rates charged by most utilities for generation service when it is linked to billing, metering, and customer care services. The use of a competitive bid to obtain generation service, while theoretically appealing because it results in the entry of a competitive supplier with little or no acquisition costs, has not generally been successful. As a result of attempts to bid out Default Service in Pennsylvania, it appears that the provision of retail Default Service with the full panoply of consumer protections embedded in the current utility practices and procedures are not easily duplicated or capable of being replicated for the unbundled price of generation and billing services being offered by incumbent utilities.
- Some commenters have urged states to adopt Default Service policies that will pass through market based rates even during the market development period and argue that customers must experience as close to real time pricing as possible in order for a genuine competitive market to development. For example, the National Energy Marketers Association (NEMA)<sup>7</sup> points to the role of the incumbent in the provision of Default Service as a significant impediment to the ability of competitive providers to enter the mass market. NEMA recommends that default service be awarded based on price bids supervised by the state commission and the price for this service should “account for changing market conditions.”<sup>8</sup> Others have argued that the lack of “price signals” in rates that are fixed and capped to avoid the volatility of the wholesale market contribute to higher prices in the long run and slows down the development of a competitive market. FERC has noted, “[L]ack of price-responsive demand is a major impediment to the competitiveness of electricity markets.” Also, “The fact that retail customers had no incentive to adjust their usage based on price contributed to the price spike.”<sup>9</sup>
- Clearly, there is a growing disconnection between the promises that state legislators and regulators initially presented as their basis for the move to retail competition and the actual events that have occurred or not occurred in the last 4-5 years. As a result, states and state regulators in states that have restructured may be pressured to ease up on promises of lower rates to mass market customers and roll back or “reinterpret” rate caps and rate freezes.
- The use of municipal aggregation to provide a stable price for residential customers is still viewed favorably by consumer advocates, but the only place in which this approach is being used on a large scale is in Ohio. Even this approach, however, may be successful

only because of its reliance on the terms of utility restructuring settlements that offered a certain percentage of the utility's generation to alternative suppliers at low prices. The Cape Electric Compact in Massachusetts has not been able to obtain rate quotes that are less than Standard Offer Service provided by the local utility, but a proposal to allow the Compact to provide Default Service at lower rates than that service is provided by the local utility is moving forward. Any successful use of municipal aggregation appears to require the use of the "opt out" approach or negative option approach to assure sufficient volume of customers to interest bids by competitive suppliers.

- The risk of price volatility is increased by the infancy of the wholesale market and the uncertainty associated with the role of FERC and the emerging regional transmission organizations. Whether these initiatives will result in more or less price stability is not clear, but state consumer advocates remain concerned about the "federalization"<sup>10</sup> of the pricing of electricity sold to retail customers, particularly in light of FERC's failure to control spot market gaming and the exercise of market power in certain regional markets and the agency's perceived inability to correct market-based rates even when it finds they are unreasonable.
- There is no evidence that Congress will mandate retail electric competition at the state level. As a result, Default Service policies will remain in the hands of the various states. However, because of the importance of the operation of the wholesale market in the delivery of retail prices to Default Service customers, the move to retail competition has transferred the power to set rates for retail customers from the state regulators to FERC. When generation is no longer owned by the utility that has a state franchise and obligation to serve and must obtain energy for its customers in the wholesale market under FERC's jurisdiction, state regulators may lose the ability to ameliorate price spikes or supervise plant investment and return on that investment. Only FERC has the authority under the Federal Power Act to assure "just and reasonable rates" in the wholesale market. The transfer of authority from the restructuring states to FERC in the development of a competitive electricity market will have significant impacts on residential and low-income customers who are captives of the Default Service provider.
- In contrast to those who seek more price volatility and market-based rates for Default Service, many states have pulled back, delayed or outright rejected the move to retail competition. Such states include Nevada, New Mexico, Arizona, Oklahoma, Montana, Oregon, Arkansas, North Carolina, Iowa, and Minnesota. California, the originator of retail competition, has ended retail electric competition by statute.

## RECOMMENDATIONS

If short term wholesale market prices are likely to reflect volatile prices and the uncertainty associated with new institutions and market forces that are not entirely understood, what should states do with respect to Default Service? Should states adopt different pricing methodologies to allow market forces to be reflected in residential customer rates? If so, should these rates be structured to reflect the short-term market prices or a fixed and stable price that reflects long-term prices? Should states allow payment-troubled customers to be charged higher rates to maintain or obtain electric service? Should Default Service be tied to lesser consumer protections or more targeted benefit programs? Finally, should Default Service be designed to further the development of the competitive market and at what cost?

The answers to these questions will be very different depending on the policymaker's views of the purpose of Default Service.

➤ **Full Speed Ahead.** If Default Service is intended to be a bridge to a competitive market, then the service will be designed to stimulate the entry of retail marketers and its pricing method will tend to “drive” customers into the arms of marketers. It is this approach that typically results in proposals to pass through short-term market prices or that seek to increase prices for Default Service to make it possible for marketers to offer lower prices to Default Service customers or offer products to avoid the volatility of Default Service.

➤ **Go Slow.** Alternatively, Default Service could act as a benchmark to assure that competition will offer as good or better service at better prices than delivered by traditional regulation or as a hedge in case the competitive market does not develop in a timely way or the wholesale market does not mature. Under this approach, Default Service will be designed to assure stable and affordable prices for customers who do not shop or who are not the subject of offers by mass market retail providers. In this viewpoint, the competitive market will woo customers by offering either a product that is not otherwise available (“green” energy; time-of-use meters; bundled products) or a basic product that is in fact cheaper than the more traditionally priced electric service.

Proponents of the “full speed ahead” approach to Default Service have lost some steam in the last year with the collapse of the California market, the decimation of the numbers of competitive marketers that focus on residential customers, the scandals associated with the Enron Corporation who was the leading proponent of retail energy competition in every state, the volatility of the wholesale market where that market has been used as the basis for residential energy prices, the failure of FERC to react promptly to numerous allegations of market failure, and the failure of the competitive bidding approach for Default Service in Pennsylvania. These same developments have stimulated consumer advocates to focus on the “go slow” or “go slower” approach.

Based on the individual state experiences and the events that have accompanied the first several years of full-scale electric competition, I recommend the following key ingredients for Default Service policy:

1. **Default service should be designed as a stable and quiet haven for residential customers on the assumption that the development of a retail competitive market might take longer than originally contemplated and might result in upheavals in the early stages of its development.** This service should not “drive” customers to a competitive market that may experience volatile prices or the exercise of unlawful market power, particularly when the design and operation of the wholesale market is in a stage of infancy and over which state regulators have little control.

2. **Default Service should be designed for a lengthy period of time** and reflect stable and fixed prices that are established to reflect a mix of generation assets and time periods.

3. **Default Service should be structured and disclosed on customer bills as “price to compare”** so that customers can shop and compare this service to offers from competitive marketers. Marketers faced with this approach to Default Service will be able to structure their business models and marketing programs to reflect a known target.

4. **Default Service should be designed to provide rates to the full range of residential customers who do not shop, who enter and then leave the competitive market, or who are customers of competitive provider who choose to leave the competitive market.** Those who may be “left behind” in a competitive market, such as rural, low-income, payment troubled, or credit challenged customers, should not be isolated in the provision of this service.

5. **Default Service should be billed and collected by incumbent utilities because there is no evidence that competitive providers can provide these services at less than current prices. However, the state regulatory authority may wish to consider regularly bidding out the generation portion of this service to creditworthy competitive providers under a stated rate cap or set of rate regulations that assure long-term stable prices.** The ability to compete for this service should be an indication of the competitive market’s ability to provide stable and reasonably priced service to mass market customers. Over time the state authority may also want to explore the potential of competitive billing for this service, but only after competitive providers have demonstrated the ability to provide this service with the same or lower cost and reflective of the current service quality and consumer protections provided by incumbent utilities.

6. **Default Service should be provided with the same consumer protection rules applicable to incumbent utilities.** The provider of this regulated service should be empowered to use the collection tool of disconnection of service.

7. **Default Service should not be accompanied by switching fees or surcharges that would discourage customers from freely moving in and out of the competitive market.**

8. **Low income customers should not be restricted in their ability to move in and out of the competitive market, but rather should be allowed to carry any bill payment assistance programs for which they qualify to competitive providers.** While states may want to explore the use of aggregation to obtain lower cost energy for customers who receive bill payment assistance benefits, such approaches should not link the receipt of benefits to the aggregator's energy service.

9. **In the long run, policymakers in the restructuring states may need to devise a Default Service that reflects the development of a robust retail market in which competitive marketers are serving the vast majority of residential customers. Under this scenario, Default Service may be equivalent to a "fail safe" service used primarily by those who either move in and out quickly or those who are unable to obtain service from other marketers (low usage, payment troubled or credit challenged customers).** This scenario does not need to be addressed at this time because it is unlikely to occur due the lack of development of the retail market. However, it is not too early to establish the basic principle that retail electric competition should not deaverage rates to create a new class of residential "losers" as the price for the development of competition. Consumer advocates should seek legislative and policy commitments that reflect the need to provide affordable electricity for all residential customers. This commitment will require more than the creation and funding of a targeted "low income" program for several reasons. First, such programs are rarely sufficient in scope or funding to meet actual needs. This is particularly true for those families with incomes slightly above the poverty guidelines. Second, due to flawed program design, inefficient enrollment techniques, and the rapid turnover of the low-income population, the penetration rate for these programs is usually significantly less than the eligible population. Third, there is no net benefit in providing a new subsidy (e.g., a discount in the monthly customer charge) that is less than the increased price for electric service (such as those passed through to Consolidated Edison's residential customers last year) that results from a volatile energy market. Rather, this commitment to affordable service is likely to require consideration of a Default Service price support mechanism that is reflected in the rates of all other customers.

## STATE SUMMARIES

**California.** Although it was the first state to move to retail electric competition, California established a market structure and pricing mechanism for Default Service that has not been copied by other states. California's restructuring statute,<sup>11</sup> enacted in 1996, required incumbent utilities to serve any customer as a default provider and mandated a 10% rate reduction to accompany the move to competition. Actual full-scale retail competition began in March 1998. As of that date, utilities were required to sell all the power they owned and buy needed power for Default Service from the Power Exchange utilizing the spot market until the end of the transition period, April 2002, at which time stranded cost recovery was to be completed. A separate organization, the California Independent System Operator (ISO) was given control of the transmission system and required to maintain the safety and reliability of the electric system, as well as the obligation to buy sufficient power to balance the power needs of the system.

The Commission required that utilities pass through the wholesale price of electricity as reflected in the Power Exchange rate to their customers. This rate was calculated weekly based on hourly price changes and so the price for this service varied every month and was subject to more significant variation between the summer and winter months. During the transition period when utilities were supposed to be collecting stranded costs, this volatility was masked in part by a mandated 10% rate reduction. In other words, no matter what the price of the power bought by the utility from the Power Exchange, the resulting total bill had to be 10% lower during the transition period. The initial rate reduction was funded by securitization of the utility's stranded costs. It was expected that stranded costs would be paid off by the end of the transition period, thus opening up the market to seek customers by offering lower bills than reflected in the 1998 rates. In other words, this feature of the California restructuring plan in which customers were to see rate reductions, but that utilities were to obtain most of the Default Service power from the wholesale market, was fully understood by policymakers and utilities from the onset of restructuring.

Universal service and energy efficiency programs were also explicitly approved as part of the move to retail electric competition and the long-standing tradition for including the costs of these programs in the rates paid by all customers was continued with the Legislative endorsement of the 15% rate discount at each electric and natural gas utility through the California Alternative Rates for Energy (CARE) program. This discount is calculated based on the total bill, including energy.

After the implementation of competition, a residential Default Service customer in California<sup>12</sup> received a monthly bill that stated the unbundled energy costs and then broke down the total electricity charge into the following components:

- CTC (Competitive Transition Cost) Charge (stranded costs)
- PX Energy Charge: "The Average PX charge is based upon the weighted average costs for purchases through the Power exchange. This service is subject to competition. You may purchase electricity from another supplier." The customer is informed of this charge on their bill, that is, the average PX charge per kWh during the billing period.

- Transmission Charges
- Distribution Charges
- Nuclear Decommissioning Charges
- Public Purpose Program Charges
- Trust Transfer Amount (securitization of stranded costs and the mandated rate reduction)
- Other Charges

If a customer shopped for electricity and selected a competitive provider, the bill would be calculated as if the customer was a bundled service customer and then show a credit for the amount of the PX price for that month. In other words, in order to compete with Default Service, the supplier had to sell generation service at a retail price that was less than the wholesale spot market price passed through by the utility. This exercise was made even more difficult for the supplier because the utility's PX charges varied every month to reflect the market wholesale price, but the volatility was masked by the overall 10% rate reduction. As a result, competitive providers were not able to market the sale of generation in a manner that allowed a customer to compare the price of generation that appears on the utility's monthly bill. No matter what price was stated for PX Energy on the customer's bill, the total bill reflected a 10% rate decrease during the transition period. The reason why most suppliers early on decided that they could not compete in the residential market in California is not hard to determine in light of this approach.

The legislation intended that the rate reduction would disappear when the utility had paid off its stranded costs. This was expected to occur no later than April 2002. At that point, the actual monthly PX price would appear on the customer's bill. The Commission was forced to confront the consumer implications of passing through the variable PX price for energy sooner than expected, however, when one utility paid off its stranded costs earlier than projected. In early 1999, San Diego Gas and Electric obtained PUC approval to end the 10% rate decrease and begin billing that actual PX Energy charge. On an annual basis, both the Commission and the utility expected that customer's total bill would decrease.<sup>13</sup> However, the potential volatility associated with the "normal" seasonal increase in the PX wholesale price during the summer months was addressed by putting a cap of 12.5% on the increase associated with any summer electric bill (July, August, September). If the total bill would otherwise increase by more than this amount due to the PX energy prices, SDG&E was authorized to collect the difference from its customers in future bills, thus attempting to levelize the expected modest seasonal volatility in rates.

The Commission strongly supported the notion of "accurate price signals" in a related decision: "Only through accurate price signals can customers understand how their usage impacts the system and make economically efficient choices. The price of electricity fluctuates; thus far, consumers have not been impacted by these fluctuations. Consumers should have the opportunity to respond to such market signals as they see fit, which may include shifting load, conserving power, or procuring the commodity through direct access. As the market evolves, we would expect ESPs to offer products and services that will allow greater means to smooth bills."<sup>14</sup> Of course, all electric utilities were required to continue offering budget payment plans.

These assumptions about annual customer savings were proven wrong when in May 2000 PX energy rates began to increase dramatically. Bills for SDG&E customers increased 200-

400% during the summer of 2000. While customers were paying 3.5 cents per kWh for the generation portion of the bill prior to the end of the transition rate reduction, they were facing charges as high as 20 cents per kWh by mid-summer.

While SDG&E passed through these high wholesale power prices to their customers, other electric utilities had to pay the same higher costs for this wholesale power, but were unable to pass through these charges to customers because they were still subject to the 10% rate reduction (Southern California Edison, Pacific Gas & Electric). Nonetheless, because of the structure of the California electric market, these utilities had to continue buying power through the PX. Throughout the summer and fall of 2000, the rising wholesale power costs and resulting high bills for San Diego customers and shockingly high power costs that could not be recovered from customers imposed on the other two utilities rapidly resulted in a “crisis.” Utilities and state officials sought intervention by the Federal Energy Regulatory Commission (FERC) to establish caps on rates for wholesale power. Average prices in the wholesale market were four to five times the prices of a year earlier, and three to four times the level that the utility could charge customers. The shortfall for PG&E and SCE was approximately \$5 billion by late fall. However, the assumption that the high prices would ameliorate with the onset of winter proved false and the deficits continued to mount.

The California Legislature and the Commission reacted to the SDG&E bills by enacting a rate freeze, retroactive to June 1, 2000. Under this rate freeze, the utility cannot charge a residential customer more than 6.5 cents per kWh for the generation portion of the bill through December 2002, which is still a substantial increase, compared to rates charged in 1999. The excess costs incurred by SDG&E are being carried in a balancing account for later rate treatment. In addition, on August 24, 2000, President Clinton released \$2.6 million for additional fuel assistance in the San Diego area.

By the end of 2000, both PG&E and SCE were facing junk bond ratings for their securities and the refusal of some generators to sell power to the utilities because of their fear of nonpayment. Public discussion of bankruptcy was widespread. In December, wholesale power rates hit \$600 per megawatt hour, compared to \$120 in June and \$22 at the time deregulation went into effect in March 1998. Power costs for November and December alone, exceeded the total cost for all of 1999 by 28%. In mid- January 2001, rolling blackouts hit the northern part of California, including parts of downtown San Francisco. Southern California Edison announced a workforce reduction of 1,850 jobs in the December, 2000-January, 2001 period. Reduced expenditures for operations and maintenance were put into place totaling \$465 million.

As a result of these financial emergencies, both PG&E and SCE filed for permission to halt the transition phase, end the 10% rate reduction, and allow them to pass through the actual PX prices. In reaction to the financial emergency facing PG&E and SCE, the PUC authorized temporary rate increases for all PG&E and SCE customers, with an average 9% increase for residential customers, effective January 2001.<sup>15</sup> Also, as a short-term measure to allow power to keep flowing, the California Legislature authorized the State Department of Water Resources (DWR) to buy electricity on behalf of the utilities. Beginning in January 2001, the DWR spent about \$50 million per day to buy power for the utility customers and initiated negotiations to buy power under long-term power contracts with generators directly. In early February, the

Legislature enacted an even more sweeping measure that guaranteed that the State will provide the major role in the purchasing of electricity for many years. Under this legislation<sup>16</sup>, the State was authorized to enter into long-term power contracts and pay for the energy by means of revenue bonds that will be reflected in all customer bills. As a result, the DWR will sell power to retail customers and use the utilities to bill and collect on behalf of the State. Meanwhile, the two utilities owe generators \$12 billion and have defaulted on payments for power bought several months ago. Finally, in March 2001, the PUC approved another round of rate increases for SCE and PG&E that are targeted to customers who use 130% or more of their baseline electricity level.<sup>17</sup>

Many observers have identified the key factors that have given rise to this crisis:

- increased electricity demand;
- lack of adequate generation supply;
- a poorly designed market structure (the creation and duties of the ISO and PX are unique to California);
- the impact of rising natural gas prices throughout the country, thus causing increased costs to operate some generating facilities;
- manipulation of the market by the generators who bought the plants previously owned by the utilities (Enron, Dynergy, Duke Energy, Reliant Energy, and Southern Company);
- mismanagement by the utilities who could have obtained fixed price contracts in the fall of 2000 and refused to do so, thus taking their changes with the volatility of the wholesale market; or
- simply bad luck (i.e., lower rainfall in the Pacific northwest).

These reasons will be the subject of vociferous arguments by others. Unfortunately, the final result is likely to include higher rates for electricity for all customers.

In addition to the adverse impact in California, the volatile wholesale market has had a negative effect on other states, notably Oregon, Washington, and Montana. The adverse impact on Oregon and Washington has occurred even though those states have not adopted retail electric competition because utilities in those states must enter the wholesale market to buy power for their customers, only to find high prices, reflecting the market needs of California consumers, as well as the rapid growth in demand in their own regions. A number of publicly owned or municipal utilities in the Pacific Northwest implemented significant rate increases in 2001.

The impact in Montana is particularly adverse. Montana adopted retail electric competition in 1997.<sup>18</sup> Larger customers, who had pushed for the legislation, were able to shop for competitively priced electricity before residential customers. Many large industrial and commercial customers entered into contracts for electricity with prices linked to wholesale market rates. The price charged for electricity took a substantial jump in the summer of 2000, mirroring the California market. Many factories, refineries and mining companies have temporarily shut down or reduced employment as a result of soaring power costs. A survey of industrial customers in Montana in early 2001 revealed that higher electricity prices will force more than half of Montana's largest manufacturers to make major business changes in the upcoming year. Since the summer of 2001, electricity rates in Montana have increased tenfold.<sup>19</sup>

As a result of these developments, the move to retail competition for residential customers has been halted and the Commission has attempted to force the local distribution utilities to assume an obligation to serve at regulated rates.

While California continues to pay a heavy price for its flawed and failed scheme to achieve retail electric competition, significant strides have been made to expand the benefits provided to low income customers and significant efforts undertaken to expand participation in these programs.

When the Commission adopted the 3 cents per kWh increase in May 2001 it also exempted those customers with usage below 130% of the “baseline” usage amount and all low-income customers on CARE rates (no matter their usage level). The purpose of this rate increase was to pay for the electricity being purchased by the Department of Water Resources (DWR) on behalf of the electric utilities. This increase in revenue (about \$5 billion annually) was in addition to the \$1.5 billion rate increase approved by the Commission in January. The new residential customer rates increased kWh prices from 13-15 cents to 20-25 cents, depending on the usage pattern in excess of the 130% baseline level.<sup>20</sup>

At the same time the Commission ordered a Rapid Deployment<sup>21</sup> of low income programs, increased eligibility from 150% of federal poverty income guidelines (PIG) to 175% PIG for the rate discount (CARE) and energy efficiency program (LIEE), and increased the amount of the CARE discount from 15% to 20% of the total electric bill. The Commission drew on additional funding provided by new legislation to focus \$100 million on paying for CARE discounts and increasing enrollment in the CARE program.

The Rapid Deployment for CARE and LIEE ordered by the PUC has had modest success. While enrollment has increased at all utilities, PG&E continues to lag far behind SCE and SDE&G in its penetration rate. While community-based organizations can contract with utilities to receive a “capitation fee” for an enrollment of a qualified customer in CARE, a relatively modest number of successful enrollments have occurred as a result of this approach.

In comments to the PUC (and endorsed by other low-income advocates), AARP<sup>22</sup> has proposed that the Commission adopt a more efficient approach for CARE enrollment, namely:

The current CARE application process requires the applicant to complete and sign an application form. This approach is administratively unwieldy and expensive when the applicant’s income and assets have already been evaluated for participation in well-established federal and state low-income programs. The current process is also unlikely to enroll all potentially eligible low-income customers because the additional utility application process poses a “barrier to entry” that can easily be removed without increase in program costs. Furthermore, the current CARE application allows self-declaration based on a confusing definition of “gross household income” that is likely to be misunderstood by many customers.

The current CARE eligibility criteria are not typically used by other states because many

utilities and state commissions rely on categorical eligibility to qualify or enroll customers in utility discount or bill payment assistance programs.

The PUC should adopt a definition of “household” and “income” for CARE that allows for categorical eligibility with Food Stamps, TANF or CalWORKs, Medicaid or Medi-Cal, SSI, and LIHEAP. The distinctions between CARE’s household income calculations and those in effect for these other programs are not necessary or meaningful considering the scope and size of the CARE program and the need to foster enrollment of low income customers in the face of the current energy crisis.

The Commission should take a leadership role to contact and encourage the relevant California assistance agencies to design and implement a negative option mailing to all current beneficiaries of the named assistance programs. The recipients of the mailing should be informed about CARE and their eligibility for this program, as well as provided with a manner in which to decline enrollment if they so choose. After a reasonable time, the name and address of all remaining individuals should be transmitted to the natural gas and electric utility served by that individual for enrollment in CARE. The Commission should order the utilities and Energy Division, assisted by interested parties, to coordinate with the Commission’s efforts to work with other California assistance agencies in the implementation of this project.

The Commission has yet to rule on any changes to the CARE application process.

**Massachusetts.** The Massachusetts restructuring statute<sup>23</sup> creates two services: “Standard Offer Service” (SOS) and “Default Service.”<sup>24</sup> Standard Offer service is provided by existing utilities to all customers who choose not to choose and it is through this vehicle that the statutory mandate for rate reductions (10% in year one and 15% beginning on September 1, 1999) was reflected. Standard Offer service is only available for the transition period of seven years (until March 1, 2005). The Act provides a limited set of circumstances under which a customer may enter the competitive market and then return to this service, but basically new customers who move into a distribution utility’s service territory after competition begins or who seek to return to regulated rates after swimming in the competitive waters are not able to receive SOS. Customers who were being served by utilities in March 1998 may enter the competitive market and return once within 120 days, but otherwise customers who enter the competitive market are not otherwise eligible for Standard Offer Service. However, pursuant to statute, low-income customers (defined as those receiving the low income rate discounts available at each utility) can return to Standard Offer service at any time.

Default Service is available for those customers who move into the service territory after the onset of competition and those who wish to return to regulated service after entering the competitive market. As of late 2000, more than 500,000 residential customers were “qualified” for Default Service pricing, primarily because they had moved to a new location since March 1, 1998. Unlike SOS, however, Default Service is required by the legislation to reflect “market based rates” and is not subject to the rate caps or rate reductions associated with SOS. Because it was not clear how this term should be implemented, the Massachusetts Department of Energy and Telecommunications (DTE) decided early on that until the mechanisms for procuring and pricing Default Service could be fully implemented, utilities should provide those eligible for Default Service with the Standard Offer price.<sup>25</sup> However, the DTE initiated a proceeding to implement the market price requirement for Default Service in June 1999,<sup>26</sup> noting that “. . . Default Service pricing and procurement will affect the types and number of bids to supply Default Service and could have implications for the competitiveness of the retail market.”<sup>27</sup> The decision about how to reflect growing market prices for electricity for Default Service customers will eventually affect all customers, even low income customers who are exempt from the Default Service during the transition period. However, after February 2005, Default Service will become the only service that any residential customer can obtain if they are unable to obtain or retain service in the competitive market.

In mid-2000, the DTE decoupled Default Service rates from SOS rates.<sup>28</sup> The Department ordered utilities to pass through a price that reflects short term priced service obtained by bids in the wholesale market. The price must be fixed for six-month intervals or offered as a month-to-month variable rate for a six-month period. Residential customers who must obtain Default Service will be automatically placed on the fixed price rate, but will be offered the month-to-month variable price as an option. Commercial and industrial customers will be put on the variable price option and must seek the fixed rate upon request. Utilities were ordered to obtain bid prices by customer class, but some utilities stated that they were not able to implement multiple Default Service prices in their current billing systems. The Department rejected a suggestion that the Default Service prices include any administrative costs associated with the procurement of Default Service or other costs, such as bad debt expense. In a later Order<sup>29</sup>, the Department clarified that the utility should reconcile the cost for this service

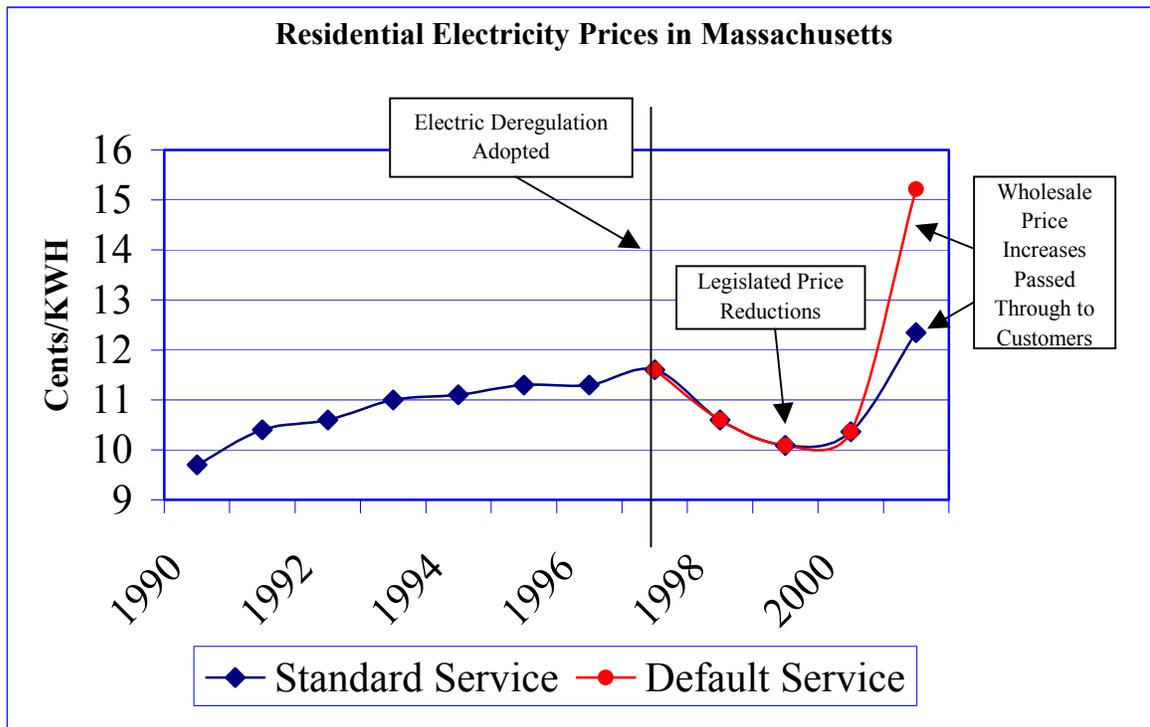
annually and that the over- or under-recovery would be passed to all customers. The Department's objective in its decisions about Default Service was to "send an efficient price signal."<sup>30</sup>

The new Default Service rates went into effect on January 1, 2001. These rates are substantially higher than SOS rates, namely 7.032 cents per kWh at Boston Edison (residential) and more than 8 cents at Fitchburg Gas and Electric and Western Massachusetts Electric Co. While affected customers were issued bill notices to explain the forthcoming rates, bills containing these higher rates were not issued until February 2001. At the same time that the Department moved to market based rates for Default Service, it was requested by electric utilities in late 2000 to make significant increases in Standard Offer Service as well. The basis for these requests was the rising fuel prices in the wholesale market. In effect, the utilities sought a fuel clause adjustment to their rates and alleged that the Restructuring Act did not intend to prevent such fuel clause adjustments in mandating the 10-15% rate reductions. In a Letter Order issued on December 4, 2000<sup>31</sup>, the DTE agreed with the utilities and confirmed that the utilities had been accruing deferred fuel costs and should not continue to do so. As of August 2000, the utilities had accrued standard offer service deferrals of \$10 million for Fitchburg, \$60 million for Massachusetts Electric, and \$144.8 million for NSTAR companies (Boston Edison and two other electric utilities). These accruals were estimated by the utilities to increase substantially throughout 2001. The Commission ordered an annual change in SOS to reflect actual fuel costs incurred by utilities, subject to reconciliation of actual costs incurred to provide this service. Utilities were also ordered to inform customers of these price changes by means of a bill insert.

Customer choice in Massachusetts continues to be only a theoretical possibility for most customers. Of 2.5 million customers, only 2,463 were on competitive supply as of June 2001 (.1% of all customers). Only .04% residential customers were taking generation from a competitive supplier. Competitive suppliers, such as Utility.com and Essential.com, have either gone out of business or stopped serving residential customers. Even the much-touted community aggregation program authorized under the Massachusetts restructuring legislation and initiated by a consortium of municipalities has been unable to deliver lower price electricity because the supplier picked by the Cape Light Compact (Select Energy) backed out under a contract clause that allowed such action if wholesale power costs increased.<sup>32</sup> Meanwhile, rates for both Standard Offer Service (SOS) and Default Service increased significantly in 2001 and then dropped somewhat in 2002 due primarily to activities in the wholesale market.

In June 2001 the DTE approved a new round of rate increases for the generation supply portion of SOS, applicable to the July-December 2001 time period. Residential customers of Boston Edison eligible for SOS pay 7.445 cents per kwh, compared to 6.215 cents during January-June, 2001 or 4.5 cents in 2000. Massachusetts Electric Co. customers (a subsidiary of National Grid) pay 6.631 cents per kwh, compared to 5.401 in January-June, 2001 or 3.8 cents in 2000.

Since wholesale power prices have increased significant throughout the New England ISO since the onset of deregulation in 1998, the price for Default Service was much higher than for SOS throughout 2001. The monthly variable rate for the generation or supply portion of the bill for a Default Service residential customer for the period July-December, 2001 varied among



utilities, but was typically 10-11 cents per kwh in the summer and 7-9 cents in the winter. The fixed rate option was generally in the 8-9 cents per kwh range. For example, Massachusetts Electric's fixed residential Default Service rate is 9.213 cents per kwh for the period May-October, 2001.<sup>33</sup>

Another way to evaluate or compare the pre-restructuring prices to those in effect in 2001 would be to compare the total bill price for residential customers. The graph<sup>34</sup> shows the average statewide prices charged for the total bill for SOS and Default Service at each electric utility in comparison to pre-restructuring prices. The average total bill for a residential Default Service customer has increased over 30% since 1998, the onset of retail electric competition in Massachusetts.

These prices were substantially higher than forecast by utilities or regulators or that could be explained by higher energy prices generally. According to a filing by Western Massachusetts Electric Co. seeking approval for an energy efficiency plan, actual electricity prices were 77% higher than that price projections used in earlier plans to calculate program benefits for 2000 and 2001. These higher prices for the generation portion of the electricity bill were almost double the price increases that occurred for heating oil and natural gas.<sup>35</sup>

In the face of higher prices and lack of both supplier and customer participation in retail electric choice, the DTE opened an investigation into the status of the competitive market, with the avowed intent of "taking all appropriate steps to bring the benefits of industry restructuring to electricity consumers."<sup>36</sup> The focus of the early steps explored by the DTE was to stimulate supplier interest in Default Service customers and, based on comments from suppliers gathered at technical meetings in early 2001, increase supplier access to information about default service customers. The Commission ordered that utilities should make available lists of customer name, address, and rate class to all licensed suppliers who were prepared to serve customers

immediately and then sought comment on whether or how suppliers should obtain access to further customer-specific information, such as credit history and load/usage data. In addition, the Commission sought comments on whether consumers should be able to electronically enroll with suppliers.

On October 15, 2001, the DTE issued its final order<sup>37</sup> and, with respect to the issue of access to customer usage information, stated, “Access to a customer’s historic usage is critical for suppliers to project what their wholesale costs would be as that customer’s retail supplier” and that the current system to requiring specific customer authorization by the supplier is “cumbersome and inefficient.” [at 10] The Commission stated that it was “convinced that, with proper education efforts, the vast majority of customers will appreciate the value of having their historic usage information included on the Customer Information Lists” [at 11] and adopted an “opt-out” system in which customers can prevent the release of their usage information by contacting the local utility. This opt out process will require utilities to provide two consecutive bill messages and bill inserts to customers to inform them of the release of this information and how to prevent the release of the information (by telephone or letter), resulting the first generic release of the Customer List information in February 2002.

Responding to the general tenor of most commenters, the Commission ruled that utilities should not provide suppliers with customer’s credit or payment history and that the Customer List should not be filtered by removing customers with late payment histories. With respect to the concern that the use of tariffed rate classifications would reveal those customers on discount rates available to low-income customers, the Commission required the utilities to use rate classifications that do not reveal this information to suppliers.

In Phase II, the Commission announced that it would further explore several important issues designed to further restructuring. First, the Commission will explore how and whether distribution utilities should act as “brokers” for its Default Service customers, that is, in assisting or acting as a middle man to stimulate customer enrollment with competitive suppliers. Second, the Commission will explore how municipal aggregators can aggregate Default Service customers within their municipal boundaries. The pending proposal by the Cape Light Compact proposal to provide such a service as a pilot project<sup>38</sup> will be used to issue generic guidance on this matter. Finally, the Commission will explore the details concerning Internet-based enrollment.

It is clear that Massachusetts policymakers are currently set on a course that will make use of the pricing mechanisms for Default Service to stimulate the development of a competitive market.

**New York.**<sup>39</sup> Unlike most other states, New York has implemented retail electric restructuring by means of administrative decisions by the Public Service Commission. There is no statutory mandate for retail electric restructuring. The New York Public Service Commission has issued orders and approved restructuring settlements that have phased in retail electric competition for all customers, but the implementation of restructuring has varied among the different electric utilities. While the Commission has conducted outreach and education, the level of shopping activity by residential customers is relatively low.<sup>40</sup>

In all its restructuring decisions, the Commission required the local electric utility to provide Default Service, referred to as the Provider of Last Resort, at least during the transition period, the term and pricing for which varies by individual utility settlements. In most decisions, the settlement resulted in either a rate freeze (e.g., New York State Electric and Gas Co.) or modest rate reductions for residential customers. Unlike other settlements, however, Consolidated Edison proposed to provide Default Service by relying on the wholesale market and passing through this rate on a variable basis every month. At the time of the restructuring settlement, both Con Ed and the Commission portrayed the settlement as one that would result in a 10% rate reduction for customers over the five-year term of the plan.<sup>41</sup> However, the plan allowed for Con Ed to pass through its actual wholesale power fuel costs. This provision has, contrary to the public statements at the time of the plan adoption, resulted in significant rate increases for the generation portion of the bill beginning in the summer of 2000. As of July 2000, Con Ed residential customers were paying 10 cents per kWh for generation alone, far higher than the 4-5 cents paid by residential customers in upstate New York utilities and far higher than the 3.3 cents per kWh paid in 1997. The average monthly bill for residential customers increased from approximately \$52 in November 1999 to almost \$75 in July 2000 and leveled off at over \$60 by late 2000.<sup>42</sup> This resulted in a total bill rate of over 19 cents per kWh, an increase of about 4 cents per kWh since 1999.<sup>43</sup> The resulting furor<sup>44</sup> led to investigations that concluded that New York's wholesale market was flawed and Con Edison publicly warned the Commission that a "California-type" situation could result without prompt action from both the New York PSC and FERC. Both the PSC and Con Edison initiated petitions to FERC to control prices on the wholesale market.<sup>45</sup>

In part due to the experience with market power prices in the summer of 2000, the Commission initiated a major investigation of its competition policies, including the POLR service.<sup>46</sup> The Staff was required to issue a "strawman" proposal for POLR service in mid-January 2001.<sup>47</sup> Options being considered by working groups included the gradual elimination of the utility in the provision of commodity services and the use of a competitive bid to obtain POLR service at market-based rates. The Staff's approach is based on the notion that the utility should ultimately not have any obligation to serve except for regulated delivery or distribution functions and that customers should be expected to enter the competitive market by a date certain and then be "given" to competitive marketers in proportion to the market share obtained by the marketer. Among the many issues being considered in the Working Groups is whether the Commission has the legal authority to order or even approve any utility's proposal to exit the retail market and become a "wires" only utility. The parties have submitted briefs, but no decision or ruling from the Commission has yet occurred on this significant issue. However, the comments submitted by the New York Attorney General and the Staff of the PSC suggest that any move to a model in which the utilities seek to exit the obligation to serve would not be

possible without a statutory change to the New York Public Service Law.<sup>48</sup>

Also under consideration in this proceeding is whether New York should adopt a comprehensive program to assure reasonably priced electricity for low-income customers. While several utilities have agreed to small-scale programs to provide bill payment assistance to low income customers, there is no consensus as yet as to any statewide program design or funding mechanism for such programs.

The progress and future of electric restructuring in New York continues to be uncertain, but rising prices, uncertain supply in the New York City area, and uncertainty about the market monitoring role by FERC stimulated more public attention to restructuring in late 2000 and early 2001.<sup>49</sup> Some policymakers have begun to raise significant concerns and urge the Commission to either slow down or make significant changes in this process<sup>50</sup>. While the Public Service Commission continues to take the leadership role, the New York Assembly<sup>51</sup> passed an overhaul of electric restructuring that is unlikely to be favorably received in the State Senate and is opposed by the Republican leadership, including the Governor. Meanwhile, rates and bills for consumers served by Consolidated Edison (Con Edison) and Orange & Rockland customers continue to reflect volatile wholesale market prices because they are allowed to pass through wholesale spot market prices to retail customers. Other New York utility customers are receiving service under rate caps or mandated rate reductions. As of May 2001, only 189,352 residential customers (5% overall) throughout the state were obtaining competitive energy service. However, this was a 50% increase since May 2000.<sup>52</sup>

The New York Commission has refused to review Con Edison's retail rates and tariff provisions, even in the face of persistent public outcry and consumer advocates' attempts to force the Commission to review retail prices charged in the summer of 2000 in light of the statutory requirement of "just and reasonable" rates.<sup>53</sup> However, the Commission has approved a "hedging" mechanism in the market price rate structure that was implemented beginning in August 2001.<sup>54</sup> Furthermore, the ability of New York to survive the summer without significant power outages and the existence of a price cap<sup>55</sup> on wholesale prices at NYISO has tempered the nature of the price spikes that have occurred. Even so, the rates in effect for New York City residential customers remained very high in 2001. ConEd provides its customers with estimated rates for a six-month period every May and November. However, the actual price charged for the generation supply portion of the bill varies according to a complicated formula that is designed to reflect the wholesale market. In the summer of 2001, customers were charged 10.9 cents per kwh in May, 9.37 cents in June, 12.16 cents in July, and .0913 cents in August. Compared to comparable months in 2000, the 2001 prices were 74% higher for May, 8% lower in June, 9% lower in July, and 26% higher in August. As a result, prices were higher overall in the summer of 2001 compared to 2000.<sup>56</sup>

While all electric utilities have implemented a form of retail competition for most of their residential customers, the form and degree of participation by both customers and suppliers in these programs varies widely. As a result, the Commission initiated numerous working groups and conferences to grapple with the developments in the retail energy markets both in and out of New York, the rise in wholesale power prices on the NYISO, and the lack of uniformity in the models, programs, and policies in effect for retail competition in the various electric utilities in

2000. Finally, on July 13, 2001, the Administrative Law Judges assigned to the Commission's generic competition proceeding published a Recommended Decision.<sup>57</sup> Among the more significant recommendations were proposals to do away with the two-tiered system of consumer protections and apply the Home Energy Fair Practices Act policies to all competitive energy providers and require that all energy providers be directly regulated by the PSC. Also significant was the recommendation that the Commission adopt an explicit "universal service goal" for the electric industry and endorse low-income programs and rates. The Judges recommended as well that the Commission should focus first on the development of workable wholesale competitive markets prior to any full-scale implementation of retail competition. With respect to the Default Service issue, the report rejected the notion of a POLR service that is more expensive than service from non-POLR providers, stating that "Charging higher rates for essential energy services to those who have few, if any additional choices and who may be least able to afford them was not generally believed to be just and reasonable."<sup>58</sup> While favoring competition models that will eventually remove the utility from the obligation to provide the energy commodity, the Judges recommended an approach that would not require a specific POLR, particularly if all energy providers were governed by the same consumer protection policies and rules and each had an obligation to serve. However, the Judges did not make clear how all customers would be migrated to competitive providers, and even the authors recognized that a POLR would have to exist for short term services, such as when a provider goes out of business. In the short run, the decision recommended the continuation of utility-supplied default service until the wholesale market was viable and could be relied upon to provide reasonable price signals and stimulate suppliers to make offers to mass market customers. The Commission has yet to rule on these recommendations and they remain in limbo as of April 2002.

Upstate New York utilities, such as New York State Electric & Gas Corporation (NYSEG) and Niagara Mohawk, have proposed multi-year rate plans in which prices for generation service will be locked in for a 6-8 year period, while providing customers with the option to seek lower prices in the competitive market. This would substantially lengthen the transition period for these utilities. NYSEG in particular has been very vocal about the need to provide stable and fixed prices for residential customers in particular and in April 2001 published a paper on the New York State's Electric Energy Crisis that described the "broken train" that is the New York wholesale market and linked the coming period of uncertainty in wholesale prices with the need to provide price certainty to consumers during this transition period.<sup>59</sup>

**Pennsylvania.** . The Pennsylvania restructuring legislation<sup>60</sup> provides that the local electric distribution utility must serve as the default provider for a minimum of three years, after which the Commission has the authority to establish the method by which the default provider will be selected. The price of this service must reflect the rate caps contained in the legislation. Section 2804 of the Customer Choice Act requires two different rate caps. The first rate cap is on the charges for regulated distribution service and is operative for 54 months or until the Competitive Transition Charge (Stranded Costs) is completed and all customers have choice, whichever is shorter. The other rate cap applies to the generation portion of the utility's rate and is for nine years or until the CTC is completed and all customers have choice, whichever is shorter. The first rate cap sets a ceiling for all distribution company rates, both for generation services sold to customers by the distribution company and for the distribution/transmission portion of the bill. The second rate cap sets a ceiling only for the generation portion of a utility's charges to customers who purchase generation from the utility, including stranded cost recovery charges, so that these charges will not exceed "the generation component charged to the customers that has been approved by the commission for such service, as of the effective date of this chapter," i.e., January 1997.

Section 2807(E)(1) of the Act specifies that an electric distribution company has an obligation to serve, including the obligation to produce or acquire electric energy for its customers, while such utility collects stranded costs or until 100% of its customers have choice, whichever is longer. Section 2807(E)(2) requires the Commission to establish rules that will govern the provider of last resort service after the end of the phase-in period. The legislation specifically authorizes (but does not require) the use of competitive bidding to obtain POLR service after the end of the transition period. Even so, the pricing structure of those future rules must still assure compliance with the rate cap provisions during the period in which stranded costs are being recovered.

In summary, under the Customer Choice Act, the electric distribution company must provide generation services to any customer who is not eligible to choose or who, for any reason, seeks to obtain generation services from a distribution company. During the operation of the rate caps, the price for this generation service cannot exceed the rates for this service in effect on January 1, 1997. Customers who try the competitive market and then return to their distribution company still receive the protections of the rate cap. The only rates that are not applicable to the rate caps are for new services. Utilities may in fact seek to obtain this generation service from other sources, but the total customer bill, in the case of the first rate cap, or the generation portion of the bill (plus the stranded cost recovery charges) in the case of the second rate cap, cannot exceed the rates in effect on January 1, 1997, except for a narrow set of reasons set forth in the Act. These reasons include a petition by a utility that seeks to demonstrate that its financial viability is at significant risk unless the Commission makes a changes in the rates subject to these rate caps. As a result, Pennsylvania's legislation provides residential customers with a "real" rate cap that was intended to prevent customers from being subjected to market prices during the transition period, but would stimulate customers to leave Default Service if competitive providers could structure offers that reduced the price of the generation service or offered additional services to customers.

The statutory rate caps have been extended in numerous settlements of both restructuring

proceedings and other proceedings, such as the merger between PECO Energy and Unicom in 2000 and the divestiture of power plants by GPU Energy and Duquesne. Total rates are capped at January 1, 1997 levels until 2005 in many cases and generation rates are capped at set levels until 2010 in most service territories. Furthermore, the restructuring proceedings resulted in settlements that in most cases reduced current rates from 2% to 8%, a result that was not mandated by the Competition Act. This extended transition period was designed to make rates stable for customers so that the wholesale market could develop gradually.

Most important, the Pennsylvania Commission unbundled the utility's January 1, 1997 rates in a manner that created a default price for generation service (referred by the Commission as the "shopping credit", a term that does not appear in the legislation) that complied with the statutory rate caps and was still more than the then-expected retail market price of electricity. As a result, competitive suppliers were able to offer retail rates for generation service that were below the Default Service price in most cases and where the spread between these two prices was largest, more competitive shopping and supplier activity has occurred. As of January 1, 2001, 568,492 customers had switched to alternative suppliers, of which 473,852 were residential customers. While the percentage of residential customers that have switched varies by utility, 33% of Duquesne's residential customers and 16.2% of PECO Energy's residential customers have switched. PennFuture<sup>61</sup> has estimated that Pennsylvania consumers have saved \$2.84 billion since January 1, 1997. At the same time, these restructuring case settlements have resulted in a significant expansion (a fourfold increase in some cases) of low income bill payment assistance and energy assistance programs. For example, in PECO Energy's service territory, 80,000 low-income residential customers are on a discounted rate program funded through distribution rates. Also, GPU Energy utilities agreed to a 4-fold increase in spending for its Customer Assistance Program, modeled on a percentage of income payment plan.

The Commission issued Interim Guidelines for Provider of Last Resort Service (November 19, 1998, Docket No. M-00960890F0017) to govern an electric utility's obligations pursuant to the Customer Choice Act. These guidelines basically set forth the obligations of the electric distribution utility pursuant to those provisions of the Act already described above. The most controversial aspect of the guidelines was whether the Commission should regulate how the utilities should communicate with its customers about Default Service, some commenters alleging that some utilities were in effect "marketing" to customers to urge them not to shop or choose an alternative provider. The Commission stated:

Since the Commission has a substantial government interest in creating and promoting the formation of a vibrant and effective competitive market for electric generation, some constraints on PLR (Provider of Last Resort) marketing by EDCs are necessary to advance that interest and further the intent of the Act. As an incumbent provider, the EDC possesses an inherent advantage which could be used to undermine competition if unregulated marketing of its PLR role is permitted. In particular, the marketing of the PLR function by EDCs needs to be restrained to avoid anti-competitive conduct so that the objectives of the Act are advanced and fulfilled.

Slip Op. At 14.

This overall policy was then implemented by prohibiting the utilities from using their customer mailing lists to promote the PLR function unless the mailing lists were made available to all other competitive providers for a reasonable fee. The Commission also prohibited utilities from using consumer education funds (recovered from all ratepayers) to promote PLR services and emphasized that it would prohibit any marketing which disparaged competitive providers or implied false facts or made misleading statements. The Commission also reemphasized that utilities may impose no conditions on a customer who receives PLR service or who returns to PLR service. In other words, a utility may not impose any security deposit or other condition of service for a customer returning to PLR service if that customer was previously served by the utility. This policy will prevent the utility from relying on the customer's payment experience or unpaid debt owed to competitive suppliers in providing PLR service.

In response to the actions of some suppliers who cancelled customer contracts and "dumped" customers onto POLR service when prices in the wholesale market increased in the summer of 2000, the Commission issued an Order<sup>62</sup> which allowed utilities to file tariffs to require commercial and industrial customers to remain with POLR service for a period of 12-months upon a return to this service. However, utilities are not allowed to impose such terms on residential customers.

Finally, the Commission has approved several individual utility restructuring plans and settlements that call for the use of a competitive bid mechanism to select the provider of last resort for some portion of the electric utility's residential customers prior to the end of the transition period mandated by the statute. In the GPU Energy, PECO Energy, PP&L and Allegheny service territories, the utility was obligated to offer at least 20% of their non-shopping residential customers for Default Service by means of a competitive bid. For example, the PECO Energy restructuring settlement provides that on January 1, 2001, 20% of all PECO's residential customers (to be determined by random selection and specifically including low income and payment troubled customers) will be "assigned to a provider of last resort-default supplier other than PECO that will be selected on the basis of a Commission-approved energy and capacity market price bidding process."<sup>63</sup> This service is referred to as Competitive Default Service (CDS).<sup>64</sup> A key component of all the settlements, however, was that any bid must comply with the generation rate cap that would otherwise be applicable to the distribution company. Furthermore, the settlements allowed the CDS provider to assume the billing and collection responsibility for the entire customer bill, including the regulated utility charges, but subject to the relevant consumer protection and customer care functions in accordance with the same regulations applicable to electric utilities.

The Commission finalized the guidelines under which the competitive bid process would occur on April 29, 1999 [Docket No. R-00973953, and P-00971265] and established the qualifications for CDS bidders, the process by which the CDS provider will be selected, and the terms and conditions for CDS service. While some commenters sought a bid option in which the supplier could bid for generation supply alone without the customer care (billing and collection) function, the Commission rejected that proposal:

The winning CDS bidder will perform customer care functions, including: billing, credit, advanced meter reading, collections and notices, disputes and disputes resolution, call

center activities, switching generation suppliers and EDI/EDEWG transactions. PECO EDC will perform the following customer care functions: physical termination, restoration of service after a physical termination, maintenance and repair of PECO EDC-owned meters, administration of universal service programs (CAP, LIURP, CARES and Hardship), call center activities related to distribution system outages and emergencies, and discontinuance of service.<sup>65</sup>

In addition, the Commission ruled that revenues associated with performing billing and collection in conformance with utility rules, uncollectible expense and universal service costs will be portable with customers assigned to the CDS provider and will be provided to the CDS provider to the extent it is providing these services.

In these guidelines the Commission specifically reiterated its long-standing position that no competitive supplier, including the CDS provider, could physically disconnect a customer for nonpayment of competitive charges. A customer may be subject to disconnection for the failure to pay default or PLR service, but this process must conform in every respect to that required for electric utilities and only the electric utility will be allowed access to the customer's meter to perform this function. Furthermore, the Commission required the CDS provider to submit prices for this service based on the Aexact block rate structure and rate design<sup>®</sup> for each customer class. The rates must be fixed for an annual term and the CDS provider must serve all the randomly assigned customers.

The Commission refused to adopt a methodology for pricing Default Service proposed by some competitive providers known as the "stranded cost prepayment methodology." Pursuant to this approach, a bidder submits a bid which agrees to charge customers the same rates which the electric utility currently charges, but, at the same time, recognizes that there is value in providing that service. In recognition of this value (obtaining a large volume of customers with no marketing or administrative acquisition costs), the bidder bids a lump sum cash payment that it would be willing to pay to obtain the bid. This cash payment was proposed to be applied to the utility's stranded costs for all residential customers, not just customers receiving the competitive Default Service. The Commission rejected this approach because it would have resulted in higher prices for generation service for those customers served by the CDS provider and the resulting benefit that was proposed to be provided to all residential customers was likely to be small in any case.

However, the bid process, first initiated by GPU Energy in early 2000, was unsuccessful in attracting bidders for this service at any electric utility. In the Commission's approval of PECO Energy's merger with Unicom in June 2000, however, it accepted a stipulation<sup>66</sup> which made certain changes in the prior restructuring settlement concerning Competitive Default Service. As a result of these changes, PECO Energy was able to negotiate for the provision of POLR service with individual suppliers and eliminate the requirement that the successful bidder assume the customer care function. Subsequent to these changes to the "rules" for CDS, the Commission approved<sup>67</sup> an agreement entered into by PECO Energy and New Power Company, Inc. that was effective in April 2001. At that time 20% of PECO's residential customers who had not yet chosen a competitive supplier were switched to New Power for their generation supply. PECO Energy continues to bill and collect the total bill. Customers served by New Power have

received a 1-2% discount off the current PECO shopping credit (price for generation service under the capped rates).

Pennsylvania's highly touted electric restructuring program began a gradual slow down, at least as measured by customer shopping statistics, in 2001. Many competitive suppliers have left the residential market, some have declared bankruptcy, and others have "dumped" their customers onto Default Service provided by utilities.<sup>68</sup> Wholesale market prices have increased in the PJM area, but there is a vigorous effort led by the affected states to establish PJM wholesale market rules that discourage California-type price spikes and provide demand side options when prices do spike. However, while shopping by residential customers may be slowing down or even stopped entirely in some service territories, residential customers remain protected from any price spikes in the wholesale market and the universal service programs (both energy efficiency and bill payment assistance) are expanding due to restructuring proceedings and settlements.

Since July 2000, the number of suppliers has dropped significantly and the number of residential customers served by alternative energy providers has fallen from 444,154 to 322,000 as of October 1, 2001 (this figure excludes Competitive Discount Service customers, a service that is discussed in the next paragraph). In most utility distribution service territories the percentage of residential customers served by alternative suppliers is less than 1%, with the exception of Duquesne Light (31%) and PECO Energy (10.9%, a percentage that excludes Competitive Discount Service customers).<sup>69</sup> Also, the number of suppliers remains very small, only one-two in most cases, with one of those typically a "green" provider at higher prices than the utility's default service. In a significant blow to the appearance of competition in a state that touted itself as a national leader in electricity competition, even the CDS program has failed. New Power announced in the spring of 2002 that it would end its provision of this service and return all its customers to PECO Energy prior to its contractual obligation. The failure of competitive providers, particularly New Power, has led Pennsylvania's Consumer Advocate to describe any Provider of Last Resort other than the local utility as the "Provider of Next to Last Resort."

While the statutory rate caps (most of which were extended in various restructuring proceedings and settlements in 1998) remain in place at most utilities, GPU Energy initiated a proceeding to increase rates and break the rate caps in place for its two Pennsylvania electric distribution companies (Metropolitan Edison and Pennsylvania Electric) at the same time that it applied for approval of a merger with FirstEnergy, a Ohio utility. GPU Energy sought to raise prices because it had relied almost entirely on the wholesale market for the power supply necessary to provide default service after it had divested most of its power plant facilities and the company claimed that those wholesale prices had risen unexpectedly compared to the predictions associated with deregulation in 1997 and 1998. The Commission linked this request to the company's merger proceeding. On May 24, 2001, the Commission issued an order that approved the merger, but postponed a decision on GPU's request to raise rates. With respect to the proposed rate increase, the Commission convened a collaborative meeting to seek a negotiated settlement. A settlement was reached among most parties and the Commission approved it on June 14<sup>th</sup>, stating, "The settlement allows GPU to defer for ratemaking and accounting purposes the difference between what it must charge customers for generation under

the rate caps and its actual cost to supply electricity. Customer rates will not increase, but the electric choice shopping credit will rise, possibly allowing more customers the opportunity to shop for a competitive supplier.”<sup>70</sup> As a result, the customer’s total bill will not increase, but GPU can defer any excess wholesale power losses through 2005 and carry them on the company’s books until 2010. At that point, wholesale power losses will be used to offset and reduce the deferred losses, with any losses remaining at the end of 2010 being written off. A number of parties appealed this decision and the case is currently pending before the Pennsylvania Supreme Court.

Finally, at least one PUC Commissioner has publicly begun to question the notion that rate caps are beneficial to consumers. According to Commissioner Terrance J. Fitzpatrick,<sup>71</sup> there are two policy changes that would enhance competition in retail electricity markets, while still protecting consumers from unreasonable price increases. He proposes that the PUC be given discretion to set a utility’s generation charges at a level that is linked to some degree to actual wholesale costs. Second, utility generation charges should be gradually modified to reflect variations in the value of electricity caused by supply and demand. He argues that utility generation charges should reflect the reality that electricity is more valuable during period of high usage.

**Texas.** The Texas electric restructuring statute was enacted in 1999<sup>72</sup> and calls for the implementation of retail electric competition for all customers beginning January 1, 2002. The Texas industry model is different than that adopted in most states. Under the Texas approach, customers will obtain electricity service from a “retail electric provider” or REP. A REP will have the sole retail relationship with its customers and will obtain the necessary transmission and distribution services on a wholesale basis from the former public utilities. The REP is responsible for all of the necessary contacts with customers, as well as billing and collection for the total electricity service. As of January 1, 2002, all customers were switched to the “affiliate” REP, the retail REP formed by the former local electric utility to provide electric services to customers under the Price to Beat.

The affiliate REP must provide service to all customers who are transferred to this service under the “Price to Beat” rate, which is at least 6% less than the rates in effect in 1999<sup>73</sup>. In effect, the affiliate REP will provide Default Service under a rate reduction scheme that resembles that in most states. However, customers who are transferred to the affiliate REP will have left their “utility” and entered the competitive market, albeit at a rate that is regulated for a transition period. The Price to Beat will remain in effect until January 1, 2007 (five years) or until at least 40% of the residential load served by the former electric utility is being served by a non-affiliate REP. Unlike the rate caps in effect in Pennsylvania and several other states, the Price to Beat rate is subject to adjustment based on the cost of fuel at least twice per year.

Another aspect of the Texas restructuring model that is unique is the role played by the Electric Reliability Council of Texas or ERCOT. The wholesale power market in most of Texas is under the control of the Texas PUC and not subject to the jurisdiction of the FERC. As a result of this anomaly, Texas is truly a “world unto itself” for electric regulation. ERCOT plays a crucial role in retail competition, as well as its paramount role in assuring reliability of service and proper pricing of transmission service in the wholesale market. ERCOT sought to provide the retail customer database for all REPs and supplant the role typically played by the local distribution utility in most states to implement customer access to competitive providers. Under the Texas approach, a customer selects a REP who then submits a switch order to ERCOT. ERCOT then implements that switch by informing the customer of the impending switch via postcard that allows the customer 10 days to cancel without penalty. ERCOT also electronically informs the new REP of the customer’s premise, usage and meter information which ERCOT obtains from the distribution company. Finally, ERCOT informs the old REP of the customer’s “drop” of service. ERCOT has constructed a database that assigns every retail electric customer a unique identifier so that customers can be properly matched with their REP of choice (or their local affiliate REP if they do not choose).

One of the most closely watched aspects of the Texas version of retail electric choice was the operation of the ERCOT switch procedures which were tested in a pilot program that began in July 2001. Under this pilot program, a certain percentage of customers for each utility were allowed to select a competitive REP. While there was a reasonable level of interest in this program by residential customers, particularly in those utility areas that received marketing attention from several REPs who offered service below current rates, there was significant delay and controversy in the operation of the ERCOT database and switching program. Most of the switches that occurred in the early months were manually handled and the automated switch

process was not operating a full speed until late in 2001. Most customers who selected a REP were not switched in time to receive more than one bill during the pilot period and prior to need to decide whether to move to full-scale competition on January 1, 2002.<sup>74</sup> While there was some debate as to whether the PUC should have recommended a delay in the January 1 implementation, the PUC in fact did recommend that the full scale competition program and the switch of all customers to the affiliate REP should occur on January 1, 2002.<sup>75</sup>

The number of competitive providers that participated in the pilot program varied by utility service territory, but was modest at best. Furthermore, one of the larger participants, Shell, dropped out of the retail market and its customers had to either go back to the utility or select another REP. As of January 2002, 8 REPs were marketing in the TXU Energy (Dallas area) and Reliant Energy (Houston area) service territories, but only 2-3 REPs were marketing in Texas-New Mexico Power, West Texas Utilities, and Central Power and Light areas. According to the PUC's report to the Texas Legislature's Restructuring Oversight Committee on February 5, 2002,<sup>76</sup> the range of savings (compared to the Price to Beat) varied among the REPs and was dependent on a customer's usage profile. For example, several REPs in the Reliant service territory were offering higher prices (Green Mountain Energy for 100% renewable power), but most offered savings in the 2-10% range for an average bill. In almost all cases, customers who used significantly below the average usage level of 1,000 kWh (i.e., at 500 kWh) would experience rate increases from all REPs because of the effect of the REP rate structure.<sup>77</sup> The PUC has publicly reported that approximately 150,000 customers have switched to competitive providers as of mid-February 2002, but the PUC does not yet provide switching information on its website.

One of the most aggressive marketers is New Power Energy, which is offering two plans: "Basic Service Plan" (which shows a savings of 12% for users over 1,000 kWh per month in the Reliant territory) and "Texas Super Saver" (which shows a slightly lower level of savings at all usage categories, but locks in rates for a longer fixed period). This company, which was owned in part by Enron, announced that Centrica, a U.K.-based energy company that also markets energy under the names of Energy America and Direct Energy, agreed to buy New Power, but this proposed acquisition was cancelled by Centrica in April 2002 because of its concerns about risks associated with liabilities incurred by Enron. Energy America is best known for its controversial practices in obtaining customers by door-to-door marketing<sup>78</sup> and New Power has also recently initiated a large-scale door-to-door marketing campaign in Texas.

Most observers expect that more intense marketing will occur during the spring and summer period in Texas when electric bills are normally higher due to the air conditioning load and hotter temperatures.

Customers who do not qualify for the Price to Beat rate or who are terminated by the REP for the failure to pay or maintain service conditions will not be physically disconnected. Rather, such customers will be transferred to the Provider of Last Resort service. This service must be provided by an entity selected by the Commission according to a bidding procedure that is designed to replicate the competitive market. The Commission issued final rules that govern the bidding process for this service and sought bids according to a Request for Proposals in mid-2001.

Pursuant to the Commission's rule, the POLR service will provide a basic, standard retail service package to any customer no longer served by the customer's REP or whose REP defaults in its obligations to the distribution utility or with respect to other license conditions. The POLR service is viewed as a safety net service, but will also be available to any requesting customer. POLR rates will distinguish between three customer classes: residential, small commercial, and large commercial customers above 1 MW. The POLR price will be a fixed, non-discountable, seasonally differentiated, firm rate that must be fully hedged or fixed for the time period of the bid, established as a minimum of one year. The POLR service will not include any competitive service offerings, innovative rate structures, or options other than basic, standard rates and service options. The POLR provider has an obligation to serve, but may deny service based on the same criteria applicable to utilities under the Commission's pre-restructuring consumer protection rules. There are no minimum service terms or fees associated with this service, except that a customer that elects a levelized or budget payment plan (which the POLR provider must offer) may be required to agree to a six-month term of service. Only the POLR provider may disconnect service for nonpayment. While customers who are "dropped" by a REP will automatically be transferred to the POLR, such customers can seek to return to the Price to Beat service at any time, subject to the payment of any deposit or other credit requirements imposed by the affiliate REP. Such customers can also seek service from any REP in the competitive market. Customers will not be required to pay the "old" REP's unpaid debt to leave a REP and choose another or return to Price to Beat rates under the affiliate REP.

The PUC intended to award the POLR service based on competitive bids. However, the competitive bidding process failed to obtain sufficient bids that were deemed acceptable by the Commission. Finally, on July 27, 2001, the Commission appointed Assurance Energy, an affiliate of TXU Energy, as POLR for residential and small business customers in portions of the service territories of Reliant HL&P, Central Power & Light, and Entergy Gulf States, and negotiated contracts with Entergy Solutions to serve customers in northeast Texas (SWEPCO) and with First Choice Power to serve customers in the western portion of TXU's turf. Rates were established for the first six months of 2002, but the contrast between the POLR rates with the current utility rates and the forthcoming Price to Beat (6% less than current rates) to be charged by the affiliated REPs next year were stark. Assurance Energy's contract reflected POLR rates for residential customers at 14.9-15.9 cents per kwh (inclusive of generation and distribution charges) in the summer and 11.9-12.9 cents per kwh in the non-summer months, plus a \$10 monthly customer service charge. As a result, the POLR will charge an average of \$164 and \$134, respectively for a customer using 1,000 kwh for POLR service. However, a residential customer of Reliant HL&P paid only \$110 for 1,000 kwh in July 2001, resulting in a 50% rate increase for a customer who must use POLR service because the REP has cancelled the contract or stopped providing service for any reason. POLR customers served by other appointed POLR providers in other service territories are likely to pay even higher rates compared to Price to Beat customers.

The Commission later signed contracts with StarEn Power (an affiliate of Reliant) to provide POLR services for the TXU customers in the Dallas-Fort Worth area and First Choice Power (an affiliate of TNMP) to provide POLR services to the TXU west service area other than DFW. These contracts also approve extremely high electric rates compared to current or

projected Price to Beat Rates.

In addition to the higher rates for electricity, the contracts contain a number of additional fees and charges that will result in higher bills for affected customers, such as an account initiation fee (amounting to a switch fee for being changed to POLR service), and requirements for deposits or prepayment for service that must be paid within 10 days of initiating service for those customers with poor or no credit history, a barrier to service that will likely apply to customers who reach the POLR due to the failure to meet the bill payment requirements of the REP. The POLR can seek to disconnect service for nonpayment of these deposit or prepayment requirements.

The initial POLR rates negotiated and approved by the PUC were highly criticized by consumer organizations and several Legislators who were members of the Restructuring Oversight Committee. In addition, the Office of Public Advocate filed appeals of the Commission’s POLR orders, alleging procedural and due process defects in the manner in which the contracts were negotiated and approved. Furthermore, the drop in price for natural gas (a key determinant of electric rates in Texas due to the prevalence of natural gas as the generating fuel) also suggested that the POLR rates were too high. As a result, the Commission re-negotiated the POLR contracts and the final rates, while still 20-30% higher than the Price to Beat in all cases, are lower than the original POLR rates:

**Comparing 2001, Price to Beat, and POLR Residential Rates<sup>79</sup>:**

	Corpus Christi	Houston	Dallas
12/2001 Rate	9.57	10.40	9.67
PTB Rate (1/2002)	8.80	8.62	8.25
POLR Rate	10.72	10.86	8.40-10.24
POLR as % of 2001 Rate	112%	104%	86-106%
POLR as % of PTB Rate	122%	126%	102-124%

These rates do not include the separate fees charged by most POLRs for new account initiation, deposits, or separate fees for certain collection activities, such as issuing a disconnection notice or conducting a premise visit.

Consumer organizations are concerned with more than the POLR price, however. They fear that REPs, including the affiliated REP, will cancel customer contracts at a much higher frequency than utilities used the disconnection tool in the past in order to rid themselves of credit

risky and payment troubled customers, thereby making it easier for the affiliated REP to provide the Price to Beat rates and still make a profit. As is typical of utilities in most states, Texas utilities have issued a vast number of residential disconnection notices each month, but only disconnect a very low percentage of those customers who are “eligible” for disconnection under the consumer protection rules. Furthermore, Texas utilities actually disconnected residential customers at significantly different rates, according to statistics gathered by the Texas Legal Services Center. Consumer advocates argue that the affiliated REP or any REP will have no incentive to retain customers and work with them to avoid termination of service when there is no risk to the REP by canceling the customer’s contract and transferring the payment problem and the increased collection costs associated with such customers to the POLR. Will payment troubled customers be able to obtain lower priced service from alternative REPs or will the electric version of the “phone sharks” appear that promise payment troubled customers a lower rate than POLR, but a much higher rate than the Price to Beat service? While customers can seek to transfer to the Price to Beat service from the affiliate REP, will they understand this right and be able to do so with the required credit requirements that the new REP can impose? Will they understand the penalty imposed by moving to POLR service (in the form of much higher prices) until the bill becomes unaffordable and disconnection inevitable? These are the questions that are troubling both the consumer representatives and the Commission as they move into retail competition in early 2002.

The Commission promised the Legislature’s Oversight Committee that it would review the POLR rule in early 2002. A workshop was held to review potential alternatives to the structure of the POLR service and the POLR selection process on February 26, 2002, after which the Staff published a proposal for public comment<sup>80</sup> that would make a significant change in POLR service. Under the Staff’s draft, customers who are terminated by REPs would not be automatically transferred to the POLR provider, but rather transferred to the Affiliate REP and served at Price to Beat prices during the transition period. POLR service under the higher priced contracts would be restricted to those residential customers whose REP defaulted or who failed to choose a REP at the initiation of service at a new location. The Affiliate REP would have the authority to seek physical disconnection of service under the same rules as applied to the incumbent utilities under this approach. This is a significant policy shift and would protect the vast majority of residential customers who were likely to be transferred to the POLR from having to maintain electricity service at high prices compared to other customers served by Price to Beat rates.

As part of the electric restructuring legislation, low-income electric customers (defined as those with household income at or below 125% of federal poverty guidelines) are eligible for a rate discount of 10% (or more, depending on available funding) that must be provided by all REPs.<sup>81</sup> Texas is also attempting to lead the way by using automatic enrollment procedures to reach eligible customers. All recipients of Food Stamps, TANF, and Medicaid or Low Income Medicare will be automatically enrolled in the low-income electric discount under the LITE-UP TEXAS program. This automatic enrollment is being accomplished by means of an electronic data transfer from the Texas Department of Human Services to ERCOT, the keeper of the customer database. However, there have been reports that this database transfer is encountering problems in enrolling eligible customers promptly<sup>82</sup> and low-income advocates have called for expedited enrollment procedures and urged all REPs to solicit eligibility and enrollment directly

from customers. Low-income customers who are not already enrolled in the underlying financial assistance programs may self-certify their income eligibility by filling out an income calculation worksheet.

. Under consumer protection rules adopted by the PUC, a REP is subject to a broad array of consumer protections that are similar to those that applied to the former electric utilities. However, the PUC ruled that a REP, including an affiliated REP offering Price to Beat service, cannot disconnect customers for nonpayment, but can only terminate a customer's contractual relationship. ERCOT will automatically transfer customers without a REP to the POLR, an entity that will have an obligation to serve customers who cannot obtain or do not have service from a REP for any reason. Unlike REPs, the POLR can disconnect a customer for nonpayment, using the traditional utility procedures and options for payment arrangement and reconnection.

**Ohio:** Ohio also adopted retail electric restructuring in 1999, with an implementation date of January 1, 2001.<sup>83</sup> This legislation retains the utility as the Default Service provider and establishes rate caps for the “market development period” through 2005. Except for certain energy efficiency and universal service riders and the effect of taxation changes, the unbundled rates must not exceed the total bundled rates in effect in 1999. Where the Ohio PUC had already approved rate decreases or such decreases were scheduled to go into effect, the restructuring statute preserved and mandated those rate reductions as well. In addition, the generation portion of the bill for residential customers only must reflect a 5% reduction (that will appear on the customer’s bill in the form of a credit) during the transition period. This rate reduction may be altered or removed by the Commission no earlier than 2003 if the Commission finds that it has unduly discouraged market entry by competitors.<sup>84</sup> However, the extent to which the generation rate reduction is in effect has been the subject of negotiations and settlement provisions in the various utility transition plans. The utilities were not required to divest their generation resources. These rate caps are firm and do not include an exception for increased fuel costs. During this period the utility remains obligated to provide Default Service. This aspect of Ohio’s restructuring program is similar to the default service and rate cap policies in effect in Pennsylvania.

Ohio has also legislatively endorsed the PUC’s long standing universal service programs for low-income customers. The Percentage of Income Payment Plan (PIPP), in which low income customers are required to pay no more than 15% of their annual household income for electricity and natural gas service, will continue and be integrated with the federal LIHEAP or fuel assistance program administered by the Ohio Department of Development. Riders that are included in regulated utility rates and paid by all customer classes will fund this program, as well as increased energy efficiency programs.

An interesting and unique feature of the Ohio legislation is the emphasis on customer aggregation. Municipalities may adopt an ordinance that aggregates all residents within its boundaries. This aggregation program, if adopted by an ordinance, may use the “opt out” method. Under this method, all residents are automatically included in the aggregated group unless they choose not to participate. Residential customers may opt out of the aggregated group every two years without paying a switching fee.<sup>85</sup> A municipality may also use the “opt in” method in which the town negotiates a price with a supplier and residents must then sign up with the local government, permitting it to purchase electricity on their behalf. Those who do not provide affirmative permission will remain with the local utility in Default Service or may select another competitive supplier. Ordinances which specify that “opt out” method were adopted by hundreds of Ohio communities in the fall of 2000. Subsequently, a consortium of northern Ohio municipalities formed to serve nearly 400,000 customers in the area surrounding Cleveland negotiated a contract with Green Mountain Energy Co. for a six-year supply contract to serve customers in FirstEnergy’s service territory. Service was initiated in September 2001. Such contracts are possible in part due to the restructuring settlement reached for the FirstEnergy proceeding that was approved by the Ohio PUC in which 20% of the utility’s generation was made available to competitors in the early years of competition.<sup>86</sup>

The Default Service obligation under the rate cap provisions continues through the market development period, i.e., through 2005. Beginning in 2006, the restructuring legislation

requires the distribution utilities to offer a market-based price for this service obtained through competitive bidding. The Commission must adopt rules setting forth this competitive bid process by January 1, 2004<sup>87</sup>.

In the Commission's restructuring rules, customers may be subject to a minimum stay requirement for Default Service. Customers who switch during the summer months will be subject to a 12-month minimum stay provisions, but customers who switch back into Default Service during any other month may do so without restriction. Additionally, residential customers are not subject to any minimum stay requirements during the first year of competition, i.e., calendar year 2001. The Commission has also approved a maximum \$5 switching fee.

**Maine:** The Maine restructuring legislation<sup>88</sup> has taken the boldest step in the elimination of the current utilities from the retail sale of generation service. Utilities were required to divest<sup>89</sup> their key generation sources and the Standard Offer Service must be priced according to a competitive bid supervised by the Commission. While utilities are responsible for delivering the Standard Offer to its customers, the generation portion of this service must be obtained in a bid process regulated by the Maine PUC. The PUC has promulgated regulations governing this procurement of Standard Offer Service and awarded the first competitive bid for this service effective March 1, 2000, when retail competition began for all customers.

Unlike Massachusetts, Maine has only one Standard Offer and customers are not restricted as to their movement into or out of this service. Furthermore, there are no statutory rate caps or rate reductions applicable in Maine. Therefore, the price for generation service obtained as Standard Offer service will operate as the “price to compare” for customers contemplating a move to the competitive market.

Pursuant to the Commission’s rules,<sup>90</sup> the residential rate for this service must be in a fixed cent per kWh that does not vary by level of usage or time of year or day. Bidders must submit rates for a minimum one-year period. Providers must agree to accept any or all customers in one of three rate classes: residential and small commercial; large commercial; industrial customers. Therefore, all residential customers will remain as a block. If more than one provider is selected, rates will be averaged among the providers for the particular class in question and rates may not vary based on customer location within a specific service territory. The distribution utility will issue a single bill to Standard Offer customers that will show all unbundled charges and prominently display the name of the Standard Offer provider. As part of the responsibility for billing and collecting the total bill, the distribution utility can charge the provider the incremental costs of administering standard offer service, including bill issuance, bill calculation and collection. Each standard offer provider will be allocated a share of the uncollectible accounts in the standard offer class or classes the provider serves in a manner that reflects the provider’s share of sales in the applicable standard offer class. The reasonable costs incurred by the distribution utility in collecting this service, including uncollectible accounts, can be recovered as part of the revenue requirement of the utility. Residential customers cannot be charged a fee to obtain this service unless the Commission determines in a later proceeding that a fee applied to those customers who are frequently switching from competitive to Standard Offer service or vice versa is warranted.

As required by the Maine legislation, a large investor-owned distribution utility may not provide standard offer service except through an affiliate, and the affiliate may submit a bid for only a maximum of 20% of a standard offer class within its own service territory.

The Maine PUC issued three RFPs on August 2, 1999 for the standard offer service for the three investor-owned utilities, but then rejected the proposals (of which there were only a few) for the two largest utilities on October 25, 1999. A new solicitation ensued with somewhat different bid criteria which allowed bidders to link their Standard Offer bid price offers to the concurrent utility RFP process for the sale of each utility’s generation entitlements to Qualifying Facilities contracts, most of which are classified as renewable energy sources. On December 3, 1999, the Commission selected a successful bidder for the largest utility for the residential and

small commercial class at a rate of \$0.04089/kWh.<sup>91</sup> This has been widely viewed as a relatively low price that is likely to lessen marketer interest in competing for residential customers. The successful bidder offered this fixed rate for two years, which the Commission accepted. The Commission did not receive an acceptable bid for other classes and the utility was ordered to obtain the necessary generation service on the wholesale market and provide this service at an administratively determined price.

Other Maine utilities (Bangor Hydro-Electric Co. and Maine Public Service Co.) did not receive bids that were deemed acceptable by the Commission so that those utilities were ordered to go into the wholesale market and obtain power for its Standard Offer customers. Bangor Hydro decided to obtain the necessary electricity by using the spot market and short-term contracts. As a result, when the wholesale power rates increased in the summer of 2000 throughout New England, it sought and obtained permissions from the PUC to increase rates significantly for residential (and other) customers. Effective October 1, 2000, residential rates increased to 6.016 cents per kWh, an increase of 32.5% for the generation power of the bill and a 10-12% increase in the total bill. As a result, customers of Bangor Hydro (approximately 30,000 customers) saw their Standard Offer rates increase similarly to those approved in Massachusetts. Small commercial customers for all three electric utilities have also seen significant rate increases as a result of their market-based rates. However, residential customers of Maine's largest electric utility (Central Maine Power) were provided with stable rates that remained below wholesale market rates until March 2002.

The Commission then undertook a new round of bid solicitations for all three investor-owned utility customers in late 2001 and announced new rates, effective March 1, 2002.<sup>92</sup> The Commission accepted a bid offer from Constellation Power Source Maine that will result in a very small rate increase for generation service for Central Maine Power Company's residential customers (from 4.09 cents per kWh to 4.950 cents per kWh), a rate that was widely viewed as acceptable in light of the high wholesale power prices that had been in effect earlier in the year. Even more importantly, the Commission accepted a three-year contract, thus locking in these rates. The result of this latest bid solicitation also resulted in lower prices for Bangor Hydro-Electric Company's residential customers (from 7.3 cents per kWh to 5 cents per kWh) from the same provider. As a result of this bidding process and the resulting retail rates, the Maine Commission has promoted its approach to the provision of Default Service. Certainly, the prices obtained through this process are lower than those paid by Default Service customers in Massachusetts. However, there is one important aspect of these prices that may not be necessarily replicated elsewhere. The successful bidder was able to obtain rights to the purchase of utility entitlements at specified prices as a condition of the bid award. As a result, the successful bidder was able to access utility Qualified Facility contracts at prices that no doubt contributed to the provider's ability to offer the three-year fixed prices. Finally, whether the Commission's decision to enter into three-year contracts at fixed prices will be viewed as positive will depend on the future wholesale market prices available in the New England power market when new generation is due to come on line in 2002 and 2003.

**Connecticut:** Connecticut's restructuring legislation<sup>93</sup> mandates retail competition for all customers by July 2000. The Legislation promised that total rates must be reduced by 10% compared to rates in effect on December 31, 1996 and that this rate reduction must remain in effect through the transition period (2000-2003). Similar to Maine, utilities must divest their non-nuclear generation resources in order to collect stranded costs. There is no deadline for the recovery of these costs and, in fact, the DPUC will set the recovery period for this costs to accommodate the legislatively mandated rate reduction for the early years of competition. Rates were reduced at the two largest utilities by 4-5% in anticipation of electric retail competition in 1999. The additional reductions to meet the 10% reduction in the total bill occurred on January 1, 2000. Utilities are obligated to provide Standard Offer Service for the transition period (2000-2003) to any customer who does not shop which must be obtained, in part, by a competitive bid process. Beyond that date, there is no legislative mandate for regulated rates for generation service. Effective January 1, 2000, all customer bills show unbundled rates and a separately stated Generation Service Charge. The Department Public Utility Control (DPUC) recently completed proceedings in which the Standard Offer rate was established for its two largest investor-owned electric utilities.<sup>94</sup>

In its decisions, the DPUC determined that the Generation Service Charge must reflect the retail price to provide energy, that is, the wholesale price plus marketing, personnel, overhead, taxes and profit. The latter group of costs was estimated as \$0.005 per kWh to \$0.01 per kWh. For United Illuminating residential customers the GSC will be five cents per kWh (4.3 cents per kWh for residential heating customers). This price was approved based on a settlement between the utility and Enron in which Enron offered to provide the Standard Offer service for a four-year period. The GSC rate for Connecticut Light and Power customers was set after CL&P conducted an auction for 50% of its Standard Offer needs (50% will be provided by the utility's affiliate, Energy Select). In September 1999, the independent bidding agent received eight final bids to provide portions of the approximately 2,000 MW put out to bid. Based on the least cost standard offer bid provided and other contract terms, the CPUC accepted bids from NRG Power Marketing, Inc. and Duke Energy Trading and Marketing Northeast L.L.C. Residential customers will pay a GSC rate of 5.5 cents per kWh. These bids are for a fixed price through 2003 and will not vary by price spikes in the wholesale market. The bids allowed the DPUC to implement the 10% total bill rate reduction.

Unlike the bidding process in Pennsylvania, however, these bids were conducted by the utility in the wholesale market. The winning bidders in Connecticut will not "get" the customers nor do the customer bills name the power supplier. Rather the price obtained by the utility for this transition obligation to provide SOS will be passed through on the utility's unbundled bill and all customers remain with the utility unless the customer selects a competitive provider.

SOS customers in Connecticut can move in and out of this service, but the utility can implement a 12-month stay requirement once a customer's returns to SOS after entering the competitive market the first time. However, utilities may not impose a switching fee or a higher SOS rate to returning customers.

## ENDNOTES:

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<sup>1</sup>Georgia has implemented a natural gas competition program for Atlanta Gas Light that requires customers to select a competitive marketer by a date certain. Those who were remaining were assigned to a competitive marketer, but this program has not been replicated for electric competition in any state. The experience of the Atlanta Gas Light program has been controversial. See, e.g., Greene, Kelly and Brooks, Rick, "Georgia's Gas Deregulation is Messy, but Offers a Lesson to Other States," Wall Street Journal, January 15, 2001. In late 2001 the Governor appointed a Blue Ribbon Task Force to examine the current program and propose reforms. The Georgia Legislature recently adopted significant reforms, including more specific consumer protection and customer service obligations for competitive providers and the creation of a subsidized Default Service for customers who cannot obtain service or who are disconnected for nonpayment. HB 1568, see [http://www.legis.state.ga.us/Legis/2001\\_02/sum/hb1568.htm](http://www.legis.state.ga.us/Legis/2001_02/sum/hb1568.htm).

<sup>2</sup> Of course, many advocates maintain that residential and small commercial customers are unlikely to ever see substantial benefits as a result of the move to retail electric competition. However, that issue is not addressed in this paper.

<sup>3</sup> Pennsylvania Electric Shopping Statistics, January 2001, published quarterly by the Office of Consumer Advocate and available at <http://www.oca.state.pa.us>

<sup>4</sup> Regulators define Stranded Costs as those costs that the utility would not recover in a competitive market for investments in generation that were approved under traditional cost of service regulation.

<sup>5</sup> As of the writing of this paper, the Texas PUC has opened a proceeding to consider a change in the method of providing POLR service to residential customers whose service is terminated by a competitive electric provider for nonpayment. The discussion of the Texas model in this report summarizes the new approach that is the subject of public comment.

<sup>6</sup>As quoted in Caffrey, Andrew, "Undoing Deregulation," Wall Street Journal, September 15, 200, <http://interactive.wsj.com/archive/retrieve.cgi?id=SB1000471406896519973.djm>

<sup>7</sup>NEMA, National Guidelines for Restructuring the Electric Generation, Transmission and Distribution Industries, Washington, D.C., January 1999. Also, Press Release, "National Energy Marketers Association Cites Political as well as Economic Factors for Price Volatility," August 8, 2000.

<sup>8</sup>NEMA letter to the New York PSC, Case 96-E-0891, March 16, 2001, available on NEMA's website: <http://www.energymarketers.com>

<sup>9</sup>FERC, Staff Report to the FERC on the Causes of Wholesale Electric Pricing Abnormalities During June 1998, Washington, D.C., September 22, 1998; FERC, NSTar Services Company, Order on Complaint and Conditionally Accepting Market Rule Revisions, FERC, Docket No. EL00-83-000 et al., Washington, D.C. July 26, 2000.

<sup>10</sup>Both the National Electric Reliability Council (for wholesale electricity markets) and the Gas Industry Standards Board (for retail electric and natural gas markets) have called for the development of uniform standards and business practices for competitive markets. GISB has now been transformed into the North American Energy Standards Board (NAESB). See <http://www.naesb.org>. These developments, coupled with the growing role of FERC in the wholesale market and the impact of the wholesale market on retail rates, has shifted the debate about prices from the various state regulatory commissions and their statutory consumer advocates to federal fora.

<sup>11</sup>. AB 1890, eff. September, 1996.

<sup>12</sup>. This listing and explanation is taken from the residential Southern California Edison bill which appears on its website: <http://www.sce.com>

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- <sup>13</sup>. “CPUC Approves Settlement of SDG&E Changes Once Capital Investment is Paid Off,” CPUC Press Release, May 27, 1999. See also the SDG&E tariffs and residential bill explanation at its website: <http://www.sdge.com>
- <sup>14</sup>. California PUC, Final Opinion Regarding Policies Related to Post-Transition Ratemaking, Decision 00-06-034, June 8, 2000.
- <sup>15</sup>. California PUC, Interim Opinion Regarding Emergency Requests for Rate Increases, Decision 01-01-018, January 4, 2001.
- <sup>16</sup>. ABx1, enacted February 1, 2001.
- <sup>17</sup>. San Francisco Chronicle, “70% to Pay Bigger Bills, PG&E Says Firm’s Estimate Higher than PUC Chief’s,” March 29, 2001, URL: <http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2001/03/29/MN90356.DTL>
- <sup>18</sup>. Senate Bill 390 (1997), “Electric Utility Industry Restructuring and Customer Choice Act” (Title 69, Chapter 8, MCA).
- <sup>19</sup>. Dow Jones Newswires, “Montana’s Industries Pinched by High-Flying Power Prices,” January 22, 2001, <http://interactive.wsj.com/archive/retrieve.cgi?id=BT-CO-20010122-0011943.djml>.
- <sup>20</sup>CPUC Release, “CPUC sets new electric rates for PG&E and Edison customers”, May 15, 2001, Docket Nos. A0010028, A0011038, A0011056, Decision 01-03-082, March 27, 2001.
- <sup>21</sup>CPUC, “CPUC Directs Rapid Deployment of low-income assistance programs,” May 3, 2001, Docket No. A0011-009, Decision 01-05-033.
- <sup>22</sup>AARP Comments, CPUC, Joint Commissioners’ Ruling on Automatic Enrollment Dated June 14, 2001, Docket R-98-07-037, June 29, 2001.
- <sup>23</sup> An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provision of Electricity and Other Services, and Promoting Enhanced Consumer Protections Therein, House No. 5117, November 19, 1997.
- <sup>24</sup> G.L. c. 164, §1B(d) and implemented in the Massachusetts DTE regulations, 220 C.M.R. §11.04.
- <sup>25</sup>.Massachusetts DTE, Letter to Massachusetts Electric Company regarding Pricing for Default Service, June 1, 1999.
- <sup>26</sup>Order Instituting a Notice of Inquiry/Generic Proceeding into the Pricing and Procurement of Default Service, D.T.E. 99-60, June 21, 1999.
- <sup>27</sup>. Ibid. Order at 2.
- <sup>28</sup>. Massachusetts DTE, Investigation by the DTE on its own Motion into the Pricing and Procurement of Default Service Pursuant to G.L. c. 164, §1B(d), Order, DTE 99-60-B, June 30, 2000.
- <sup>29</sup>. Order Addressing Recommendation of the Working Group on Default Service Issues, DTE 99-60-C, October 6, 2000.
- <sup>30</sup>. Ibid., at 10.
- <sup>31</sup>. Re: Standard Offer Service Fuel Adjustments, DTE 00-66, 00-67, 00-70, December 4, 2000. The consumer organizations complained that this decision had been reached without the development of record evidence as to the fuel procurement practices of the utilities, but did not object to the Department’s analysis of the legislation and the ongoing deferrals of fuel costs. Whether or not the Legislature exempted fuel costs from the rate reductions, the public education materials by all parties never explained to the public that the rate decrease would be subject to reconciliation of fuel costs in the future. See, e.g., the DTE website explanation of Electric Restructuring in Massachusetts: <http://www.state.ma.us/dpu/restruct/competition/index.htm>.
- <sup>32</sup>While it has not been able to deliver lower priced electricity, the Compact has recently taken over the delivery of energy efficiency programs in its service area from the local utility (NSTAR) and has become a focal point for consumer advocacy in statewide policy debates.

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<sup>33</sup>The Commission rejected Mass. Electric's proposal to offer a 12-month fixed price option for Default Service in addition to the DTE-mandated six month option, stating that the six-month option sends the proper price signal to customers and that this should be accompanied by a renewed effort by the utility to market a 12-month budget billing plan to its customers. Letter Order, D.T.E. 99-60, MECo's Default Service Pricing, April 3, 2001.

<sup>34</sup>Many thanks to John Howat at the National Consumer Law Center, Boston, MA for the use of his graph.

<sup>35</sup>Order, Petition of Western Massachusetts Electric Co. for approval by the D.T.E. of a three-year Energy Efficiency Plan for 2000-2002, D.T.E. 00-79, September 25, 2001.

<sup>36</sup>Massachusetts DTE, Order Opening Investigation into Competitive Market Initiatives, D.T.E. 01-54, June 29, 2001, at 1. This Order and the comments summarized in this section are available at the Massachusetts DTE website: <http://www.state.ma.us/dpu/electric/compmarketisu.htm>

<sup>37</sup>Order, D.T.E., 01-54-A, October 15, 2001, [http://www.state.ma.us/dpu/electric/01\\_54/1015order.pdf](http://www.state.ma.us/dpu/electric/01_54/1015order.pdf)

<sup>38</sup>D.T.E. 01-63, Cape Light Compact Default Service Pilot. Subsequent to the issuance of the Competitive Service order, the DTE issued an approval of the proposal by the Compact to seek bids for serving the 42,000 default service customers within its municipal service boundaries at rates that would be above the Standard Offer price, but below the local utility's Default Service price.

<sup>39</sup>This paper was, for the most part, written prior to the terrorist attacks on September 11, 2001, and does not reflect the effects of those attacks on New York. There has been a dramatic decrease in energy consumption in New York City since that event, which has no doubt contributed to lower wholesale market prices.

<sup>40</sup>As of October 2000, only 175,196 residential customers had selected a competitive marketer or ESCO, 3.2% of the statewide total. By December 2000, the residential customer migration had increased slightly to 3.4% of all residential customers. By far the largest number are customers of Consolidated Edison (41%) and Niagara Mohawk Power (24%). The New York PSC publishes customer migration statistics at [http://www.dps.state.ny.us/Electric\\_RA\\_Migration.htm](http://www.dps.state.ny.us/Electric_RA_Migration.htm).

<sup>41</sup>New York Public Service Commission, Case 96-E-0897, In the Matter of Consolidated Edison Co. of New York, Inc.'s plans for Electric Rate/Restructuring pursuant to Opinion No. 96-12, February 28, 2000. See also Opinion 97-16 at 2, ("New York City and Westchester consumers will receive lower average electric bills."), 15 ("For all other customers, there will be a 10% rate reduction phased in over the term of the Settlement."), 26 ("The 10% cumulative base rate reduction for commercial and residential customers is firm, and no longer dependent on future contingencies.")

<sup>42</sup>Office of the State Comptroller, New York, "Electric Deregulation in New York State: The Need for a Comprehensive Plan," February, 2001, Chart C.

<sup>43</sup>PSC data as summarized by the Public Utility Law Project in their comments on the PSC Price Spike Mitigation Proposals, see fn. 42.

<sup>44</sup>Wall Street Journal, "Mismanagement of NY Power Mkt Costs Millions—Utilities," October 5, 2000, <http://www.interactive.wsj.com/archive/retrieve.cgi?id+DI-CO-200001005-006703.djml>

<sup>45</sup>See, Department of Public Service Pricing Team, Interim Pricing Report on New York State's Independent System Operation, December 2000; "Con Edison Asks FERC to Close Loopholes That Enable New York Generators to Exercise Market Power; Additional Price Protection for Customers and a More Competitive Marketplace Sought," Con Edison Press Release, March 2, 2001; "PSC Chair Announces Five Point Plan for Regional Energy Markets and Managing Demand for Electricity," PSC Press Release, February 20, 2001.

<sup>46</sup>New York PSC, Case 00-M-0504, Proceeding on Motion of the Commission regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering the Development of Retail Competitive Opportunities.

<sup>47</sup>Energy Competition Next Steps, Draft Phase I and II Consensus Report, Case 00-M-0504, January 2001.

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<sup>48</sup> . Press Release, New York State Electric and Gas Co., “NYSEG Proposes Electric Price Protection Plan that Freezes Rates and Assures Energy Reliability,” March 8, 2001, <http://www.nyseg.com> .

<sup>49</sup>Banerjee, Neela and Perez-Pena, Richard, ”Power Politics: A Failed Energy Plan Catches Up to New York,” New York Times, June 1, 2001.

<sup>50</sup>See, e.g., H. Carl McCall, New York State Comptroller, “Electric Deregulation in New York State: The Need for a Comprehensive Plan, Feb., 2001.

<sup>51</sup>New York State Transitional Energy Plan, 11 separate pieces of legislation. These bills are summarized and links to the bills themselves are provided at <http://www.pulp.tc>.

<sup>52</sup>New York PSC, May 2001 Electric Retail Access Migration Summary, [http://www.dps.state.ny.us/Electric\\_RA\\_Migration.htm](http://www.dps.state.ny.us/Electric_RA_Migration.htm)

<sup>53</sup>AARP and the Public Utility Law Project (PULP) and others petitioned the PSC to initiate a proceeding to investigate rates charged by Con Edison in 2000, but the Commission denied that petition on May 2, 2001. New York PSC, Order Denying Petition, Case 00-E-1750.

<sup>54</sup>New York PSC, Order Concerning Sharing Mechanism and Directing Filing of Tariff Amendment, Case 96-E-0897, July 18, 2001.

<sup>55</sup>FERC finally approved a “circuit breaker” or automated mitigation procedure for NYISO in late June 2001. When bids on the day ahead market exceed \$150 per MW hour, an automatic review occurs to prevent a generator from withholding capacity to drive up prices. This mechanism is separate from the wholesale price of power, which is capped at \$1,000 per Mwh throughout the Northeast.

<sup>56</sup>Consolidated Edison provides price comparisons between its own prices and suppliers offering service in its territory at <http://www.energyguide.com/finder/welcome.asp> By the fall of 2001, prices offered by alternative suppliers (many of whom were offering fixed rates) were uniformly higher than the default service provided by ConEd, due to the drop in wholesale market prices compared to ConEd’s estimates.

<sup>57</sup> Recommended Decision, Proceeding on Motion of the Commission Regarding Provider of Last Resort Responsibilities, the Role of Utilities in Competitive Energy Markets, and Fostering Development of Retail Competitive Opportunities, Case 00-M-0504, July 13, 2001.

<sup>58</sup>Recommended Decision, fn.87, at 46.

<sup>59</sup>NYSEG, “New York State’s Electric Energy Crisis and New York State Electric & Gas Corporation’s Comprehensive Solution”, April 2001, available at <http://www.nyseg.com> .

<sup>60</sup> Electric Generation and Customer Choice Competition Act (1996), 66 Pa. C.S. §§101, et seq.

<sup>61</sup> PennFuture, a Pennsylvania public interest organization, has monitored the development of the Pennsylvania energy markets closely. See <http://www.pennfuture.org>

<sup>62</sup>. Pennsylvania PUC, Final Order, Guidelines Addressing Return of Customers to Provider of Last Resort Service, Docket No. M-00960890F0017, June 22, 2000.

<sup>63</sup> . Pennsylvania PUC, Joint Petition for Full Settlement of PECO Energy Company’s Restructuring Plan and Related Appeals and Application for a Qualified Rate Order and Application for Transfer of Generation Assets, Docket No. R-00973953, Order Approving Settlement, May 14, 1998, Issue L, Paragraph 38.

<sup>64</sup>.Another provision of CDS requires that a supplier must provide at least 2% of its offered energy supply for CDS service from renewable resources in order to be a qualified bidder. This increment must increase annually by .5%. The Commission can

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reduce this requirement if the cost of power from the renewable resources increases the cost of the entire block by more than 2% over what the power would cost without the renewable requirement.

<sup>65</sup>.Annex A, PECO Energy rules for Competitive Default Service, February 28, 1999, Q.7(b).

<sup>66</sup>.Pennsylvania PUC, Application of PECO Energy Co., Pursuant to Chapters 11,19,21 and 28 of the Public Utility Code, for Approval of a Plan of Corporate Restructuring..., Order, Docket No. A-110550F0147, June 22, 2000. As part of the merger settlement, the transmission and distribution rate cap was extended until December 2006.

<sup>67</sup>.Pennsylvania PUC, PECO Energy Co. Competitive Default Service Program Bidding: Joint Approval of Competitive Default Service Coordination Agreement, Order, Docket No. A-110550F0147, November 20, 2000.

<sup>68</sup>As of July 1, 2001, three competitors remained in GPU Energy's service territory, servicing 4,800 customers. This is a 90% drop from the 47,000 customers who were buying electricity from competitors on April 1, 2001.

<sup>69</sup>Office of Consumer Advocate, PA Electric Shopping Statistics, July 2000 and October 2001. Available online: <http://www.oca.state.pa.us>

<sup>70</sup>The PUC's decision, the settlement, and a press release about the GPU merger decision is available on the PUC's website: <http://puc.paonline.com/>

<sup>71</sup>Fitzpatrick, T., "Electricity Competition is the Keystone State," Public Utilities Fortnightly, October 15, 2001, at 14-16.

<sup>72</sup>. Senate Bill 7, amending the Public Utility Regulatory Act (PURA), §§39.101, et seq.

<sup>73</sup> The PUC set the Price to Beat rates in December 2001 and reflected a greater than 6% rate decrease for most utilities to reflect recent price drops in natural gas. For example, the average cents per kWh for Reliant Energy was reduced 17%, from 10.40 cents to 8.62 cents per kWh. This rate is all inclusive of distribution, transmission and energy charges. Overall, rates were reduced from an average of 8.5 cents per kWh in effect in late 1999 to 8 cents per kWh on 1/1/02.

<sup>74</sup> ERCOT in fact switched 67,000 customers during the pilot program and has stated that it can now switch at least 15,000 switch orders per day. See the ERCOT website for further information: [www.ercot.com](http://www.ercot.com)

<sup>75</sup> The Commission has delayed retail competition for those non-ERCOT utilities serving areas in northern Texas and southeastern Texas (Entergy, Southwestern Electric Power or Swepeco).

<sup>76</sup> <http://www.puc.state.tx.us/about/oversight/EURLOC.pdf>

<sup>77</sup> Under Texas price disclosure rules, REPs must factor in the effect of both fixed and variable charges in calculating the average cents per kWh for Electricity Facts Labels. As a result, a REP that charges a fixed monthly fee in addition to what appears to be a low cents per kWh energy charge may end up costing the customer more than the Price to Beat rates, particularly for low usage profiles.

<sup>78</sup> Energy America has entered into consent decrees in New Jersey and Georgia concerning allegations that its marketers deceived customers into believing that it was the utility or that customers had to choose a marketer or go without electricity or natural gas in the newly competitive market.

<sup>79</sup> This Chart was presented by Commissioner Perlman at a conference in Austin, TX on February 26, 2002, but the "apples to apples" comparisons are not otherwise available on the PUC's website. Instead, the PUC website provides POLR rates as energy only (without the T&D portion) and the Price to Beat Rates are presented as all-inclusive rates.

<sup>80</sup> See <http://www.puc.state.tx.us/rules/rulemake/25360/25360.cfm> for the Staff Strawman Proposal and schedule for

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this proceeding.

<sup>81</sup> Section 25.454 (c) of PURA authorizes the Rate Reduction Program and Section 25.453(f) authorizes a Targeted Energy Efficiency Program. These programs are funded by means of a System Benefit Charge imposed on all customer classes. The Commission approved a non-bypassable fee of \$.65 per MWh for FY 2002 (total of \$62.3 Million) to be charged as part of the transmission and distribution utility nonbypassable charges. See <http://www.puc.state.tx.us/electric/projects/24116/24116.cfm> for further information on the funding orders.

<sup>82</sup> In mid-January, low-income advocates alleged that 500,000 eligible customers were not receiving the discount because of computer snafus and delays.

83. Amended Substitute Senate Bill No 3, 123<sup>rd</sup> General Assembly, eff. October 5, 1999.

84. Sec. 4928.34 and 4928.40.

85. Rule 4901:1-10-32 and 4901:1-21-16, Ohio Administrative Code.

86. Ohio PUC, In the Matter of the Application of FirstEnergy Corp. on Behalf of Ohio Edison Co., The Cleveland Electric Illuminating Co., and The Toledo Edison Co. for Approval of their Transition Plans and for Authorization to Collect Transition Revenues, Case No. 99-1212-EL-ETP, Opinion and Order, July 19, 2000.

87. Sec. 4928.14.

88. An Act to Restructure the State's Electric Industry, P.L. 1997, ch. 316 (codified as Chapter 32, of Title 35-A, M.R.S.A. §§3201-3217).

89. The California statute did not require divestiture, but there were economic incentives if a utility divested its fossil fuel generators. Pennsylvania's statute prohibited the PUC from requiring divestiture.

90. Chapter 301, Standard Offer Service, eff. July 31, 1999.

91. Order Designating Standard Offer Provider and Rejecting Certain Bids (CMP), Docket No. 99-111, December 3, 1999. The successful bidder was Energy Atlantic, an affiliate of Maine's smallest investor-owned utility, Maine Public Service Co.

<sup>92</sup> Maine PUC, Order Designating Standard Offer Provider and Directing Utilities to Enter Entitlements Agreements, Docket No. 2001-399, October 2, 2001. The Maine PUC publishes the Standard Offer rates for all Maine utilities on its website: <http://www.state.me.us/mpuc>

93. Bill 5005, An Act Concerning Electric Restructuring, Public Act 98-28.

94. Docket No. 99-03-36, DPUC Determination of The Connecticut Light and Power Co. Standard Offer, October 1, 1999 and December 15, 1999; Docket No. 99-03-35, DPUC Determination of United Illuminating Co. Standard Offer, October 1, 1999.