Retail Energy Supply Association

Retail Energy Supply Association
Critical Electricity Restructuring Issues in Massachusetts

May 11, 2007

Introduction

The Retail Energy Supply Association ("RESA") is a broad and diverse group of retail energy suppliers who share the common vision that competitive retail energy markets deliver a more efficient, customer-oriented outcome than a regulated utility structure. We are devoted to working with all stakeholders to promote vibrant and sustainable competitive retail energy markets for residential, commercial and industrial consumers. RESA's members include many of the most active competitive retail electricity suppliers in Massachusetts and a number of other restructured states. We are pleased to present this summary of our members' views on the critical electric restructuring issues facing Massachusetts today.

RESA Principles in General:

RESA seeks to further a comprehensive list of principles when approaching any market issue. Key principles include:

- Retail competition is superior to regulated service as it delivers customer-focused service, spawns innovative products and leads to the most efficient allocation of resources.

- All consumers (including low income and special needs customers) should have the opportunity to participate in competitive retail electricity markets.

- Basic/Default Service should be viewed as a transitional service; as competitive retail markets further develop, a date certain should be established for implementation of full retail energy competition based on real-time electricity prices for selected customer classes.

- State policymakers should adopt uniform and transparent business rules across all utility territories for fundamental market elements to facilitate development of efficient markets.

- Mandated government social programs should be implemented in a competitively neutral manner.

Issues Specific to Massachusetts:

The Massachusetts retail electricity market is a major success story. Due in large part to clear and market-oriented business rules established by the Department of Public Utility's ("DPU") predecessor, the Department of Telecommunications and Energy ("DTE"), the number of large and medium-sized customers on competitive supply has steadily increased to among the highest levels in the United States. Competitive options for residential and small business customers have been slower to develop, and have been limited mainly to service provided by the Cape Light Compact, the municipal aggregation group composed of towns on the Cape and Islands. Several suppliers have begun to offer service to these customer groups, however, sometimes in competition with the Compact.

This strong performance can and should be improved. RESA supports policies that would enhance the effectiveness of competitive retail markets in Massachusetts and increase the benefits of those markets that would be enjoyed by customers and the Commonwealth in general. The potential benefits from more efficient retail electric markets go far beyond downward pressure on the unit price of power. As important as that element of the market may be, RESA believes strongly that it would be a mistake to focus solely on "price per kilowatt-hour" as the criterion for judging the success or failure of the competitive market. Price alone may be the proper focus for pure commodities, but electric restructuring efforts around the country and around the world have shown that electricity is not a pure commodity, akin to winter wheat or pork bellies. Rather, electricity is a bundle of highly value-laden attributes, of which unit price is only one.

Indeed, in its first year, the Patrick administration has emphasized non-price values that are increasingly important locally and globally. The goal of adding energy efficiency, conservation, renewable and demand resources; improved fuel diversity and security; reduced power plant emissions; alternate energy as an engine for economic development; and the Commonwealth's participation in the Regional Greenhouse Gas Initiative all show the complex role that electricity and natural gas play in the Massachusetts economy. The evidence from restructured markets shows that competitive markets are uniquely suited to empower consumers to give voice to their desire for innovative choices that reflect concerns far beyond those recognized in the traditional, vertically-integrated utility model.

For example, the American Wind Energy Association's survey of the wind industry shows restructured states leading the way in wind development. Texas has a total of

25,000 megawatts of new wind capacity seeking interconnection with the grid operator, which is an amount of capacity nearly equal to the peak summer load in all of New England. Upstate New York has also seen a high level of wind power development. Restructured states like Texas and New York have also seen the development of a range of green products available at the consumer level. Where customers are able to choose, they are increasingly choosing products and services that are consistent with the Patrick administration's priorities.

We believe that with steady improvements in its market structure, Massachusetts will see expanded choices and innovation far beyond what one could expect in a fully-regulated market. Ensuring that sustainable and vibrant market structures exist for expanded choices would be consistent with the documented desire of Massachusetts customers to choose their electric supplier, and to express their growing concern with a number of energy-related issues through those choices.[1]

Key issues and initiatives include the following:

- **Changes to Make Basic/Default Service Pricing More Market-Based.**
    - *Large/Medium Customer Classes.* The current quarterly cycle for procuring Basic/Default Service electricity supply for medium and large customers is more reflective of market conditions than past Basic/Default Service terms. Still, it results in "point in time" prices that quickly diverge from current market prices. Pricing electricity for these larger, more sophisticated customers in closer alignment with market prices – ideally based on real-time hourly prices – would have beneficial impacts for customers and society in general. These include providing customers with transparent, timely data that will enable them to make better purchasing decisions and more conscious and educated decisions on how they use or curtail their use of electricity, which could help relieve strains on the power grid during critical times.[2] It is widely understood that market reflective pricing is the key component used when evaluating curtailment opportunities and benefits.

---

1 See Public Opinion Research by Opinion Dynamics conducted on behalf of New England Energy Alliance, *available at* http://www.newenglandenergyalliance.org.

2 Moreover, real-time pricing also offers the best opportunity for Basic/Default Service customers to save money over time, as prices immediately reflect downward market pricing changes without having to wait for the next procurement cycle. This effect would have lead to significant savings in early 2006, when fuel prices returned to a more normal state following Hurricanes Katrina and Rita, while customers supplied through fixed price procurements were locked into prices set at the top of the market.

- The DTE has issued many decisions expressing interest in real-time pricing for large and/or medium-sized customer classes.[3] RESA also has filed comments in Docket No. 06-101 in support of an investigation into real-time pricing for large customers pursuant to the Petition of the Division of Energy Resources ("DOER Petition").[4] RESA believes that the DOER Petition and other docket filings support a move to real-time pricing in the Commonwealth for large customers and, potentially, medium-sized customers as well. RESA urges the DPU to take action to implement real-time pricing as soon as practicable. In the interim, RESA would support efforts to shorten procurement periods for large and/or medium-sized customers below the current three-month cycle, such as moving to monthly procurements as a transitional measure.[5]

- *Residential and Small Commercial Classes.* The current procurement approach for these classes is overlapping one year procurements for half of the Basic/Default Service supply. The resulting six-month retail rate does not reflect current market conditions and is at odds with the goal of creating sustainable and robust competition for these segments. It is also at odds with the goal of increased conservation, energy efficiency, and demand response at all customer levels, as residential customers do not see the true benefits of reducing their consumption at times of highest costs to the electric system. RESA would support shortening the procurement periods to the quarterly cycle that has served larger customers or even a monthly cycle.

---

[3] See, e.g., D.T.E. 02-40-B, DTE Investigation into the Provision of Default Service, Order (Apr. 24, 2003), p. 37 (observing that the most efficient way to provide large customers with efficient price signals is to adopt hourly wholesale spot market prices for Basic/Default Service); D.T.E. 06-74, Petition of Fitchburg Gas and Electric Light Company for Approval to Initiate a Large Customer Default Service Procurement Program (approving without written order a pilot program to solicit power for large customers on Basic/Default Service at a variable monthly price tied to the real-time locational marginal price for the West Central Massachusetts load zone); D.T.E. 05-84, Petition of NSTAR Electric for Approval of Revised Tariffs, Order (Jan. 12, 2006), p. 16 (noting that hourly pricing for large customers would eliminate the need for customer switching rules designed to curb migration risk).

[4] The DOER Petition was filed on October 31, 2006 in D.T.E. 06-101, Petition of the Massachusetts Division of Energy Resources for an Investigation Energy Into Dynamic Pricing for Basic/Default Service.

[5] See, e.g., D.T.E. 05-84, Comments of RESA (Dec. 19, 2005), pp. 17-18 (asserting that, although real-time pricing is optimal, monthly procurements are the next best approach).

- RESA opposes recent efforts by utilities to gain discretion to implement longer procurement cycles for these classes.[6] Longer cycles have significant potential adverse consequences, including shielding residential customers from market-based price signals, locking in above-market prices for lengthy periods, and creating boom-bust competitive switching cycles which discourage competitive suppliers from undertaking a long-term strategy to secure residential and small commercial customers in the Commonwealth.

- Instead of long-term procurements, RESA supports other market-based approaches for residential and small commercial customers, such as the time-of-use pricing model described in the DOER Petition.[7]

- **Limitations on use of the Basic/Default Service Adjustment ("DSA")**

  - Massachusetts utilities have been permitted to exclude certain generation supply costs deemed (by them) to be hard to quantify from wholesale procurements that establish the Basic/Default Service rates. Instead, the utilities purchase these costs separately, include an estimate of them in the Basic/Default Service rates and true the estimate up to actual charges on an annual basis using the DSA mechanism for that purpose. The DSA factor is then charged or credited to all of the utility's customers through distribution rates rather than just those customers who take Basic/Default Service. Some of the costs recovered in this fashion have been very substantial (for example, the massive uplift charges experienced in the Southeastern Massachusetts ("SEMA") load zone in 2006 and 2007).

  - The exclusion of these costs distorts the marketplace and harms customers. In particular, it: (i) artificially depresses Basic/Default Service prices that serve as the price to beat for competitive suppliers; (ii) impairs the ability of customers to make an apples-to-apples

---

[6] See D.T.E. 05-85, Petition of Boston Edison, et al. for Approval of Rate Settlement Effective January 1, 2006, Order (Dec. 30, 2005), p. 9 (approving a settlement that requires NSTAR Electric to procure Basic/Default Service supply for residential customers under laddered contracts that may extend up to three years); D.T.E. 06-55, Petition of Western Massachusetts Electric Company for Approval of Settled Rates, Order (Dec. 14, 2006), p. 13 (approving settlement which stipulates that WMECo will work with the Attorney General to adopt a staggered schedule of longer-term procurements for residential customers).

[7] See supra n. 3.

comparison of Basic/Default Service and competitive pricing offers; and (iii) unfairly penalizes customers who participate in the competitive market by charging them for generation costs incurred on behalf of Basic/Default Service customers on top of the price paid to their competitive supplier.

The Department recently in reviewing NSTAR and National Grid Basic Default Service rate filings has acknowledged the validity of these concerns and promised to open an investigation to consider changes to current practices relative to the DSA mechanism. RESA supports opening such an investigation at the earliest practicable date.[8] Changes to current DSA practices should include imposing limits or guidelines on use of the DSA, requiring monthly or, at most, quarterly true-ups through the DSA in place of the current annual reconciliations, and ensuring that customers of competitive suppliers are not subject to over charges for generation service by virtue of the DSA.

The recent experience with the use of the DSA to pass on unexpected uplift charges in the SEMA zone is also a good illustration of the overall role the new DPU can play in supervising the utilities that are subject to its primary jurisdiction. While the substantive issues surrounding the SEMA uplift matter were determined by ISO New England, Inc., which is subject primarily to federal rather than to state jurisdiction, the DPU serves a key function in the ultimate ratemaking treatment of any issue that results in costs that must be collected from Massachusetts utility customers. This fundamental dynamic of the dual federal-state regulatory structure means that the DPU can be an important advocate for the basic goals of the Commonwealth in the context of these federal processes, even where the DPU is not the ultimate decision-maker. We urge the DPU to send a strong message that going forward it – and not the regulated utilities themselves – will be the lead advocate for ratepayers' interests in these forums, and that the DPU will use its ratemaking authority to influence the outcome of such matters to the full extent possible for the benefit of Massachusetts citizens.

- **Consideration of small customer incentive programs**
  - New York's Electric Supply Company ("ESCo") referral program has shown great success in allowing smaller commercial and residential customers to test the competitive market. There is a great deal of value to be had in serving these market segments, but under the present system that value is captured mainly by the regulated utility, which pays nothing for it. As a result, many small customers require incentives to enter the competitive market, such as guaranteed savings for a period of time. Additional programs like utility purchase of supplier receivables are also needed to allow competitive suppliers to overcome the tremendous advantage that utilities have in retaining their market share among smaller customers. Furthermore, the DPU should re-examine the current practice of automatically placing new

[8] See December 15, 2006 Department Letter Order to NSTAR re Basic/Default Service Rates (no docket no.) at 4-5 (promising to open an investigation "in early 2007"); December 15, 2006 Department Letter Order to National Grid re Basic/Default Service Rates (no docket no.) at 3-4 (same).

customers or customers re-initiating service after a move on Basic/Default Service and, instead, adopt a program that presents such customers with choices available in the competitive marketplace. Massachusetts could easily implement such programs at little or no cost to ratepayers.

- **Improved cost allocation between Transmission & Distribution and generation.**
  - It is critical to a successful retail market that generation service costs of the utilities be placed in the correct rate categories so that competitive electricity suppliers can compete with utility retail generation service on an even playing field. Proper classification of utility costs also allows for the identification and realization of efficiency opportunities, with the resulting gains passed on to customers (the heart of restructuring's origin). Massachusetts made a solid step in the right direction where the DTE, in the Docket No. 02-40 and 03-88 proceedings, reclassified certain costs (notably relating to bad debt) out of transmission and distribution rates paid by all customers and into the Basic/Default Service price charged only to those customers not choosing competitive supply. RESA supports efforts by the Department to determine whether additional costs should be similarly reclassified.

- **Improved Data Exchange with Utilities.**
  - Data exchange between utilities and suppliers regarding customers coming onto or off of Basic/Default Service or transitioning from one supplier to another is an area worthy of DPU attention because it can help minimize costs to all parties and foster competition. Standard protocols and business transactions are developing and are very welcome, but the barriers that remain are slow to be resolved due to the need for regulatory approvals, obsolete systems, and differences in motivations between utilities and suppliers. The DPU should participate actively in efforts to make data exchanges more efficient. To that end, it should timely open dockets where needed to facilitate prompt resolution of disputes between suppliers and utilities with regard to data exchange systems and protocols.

* * * *