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April 10, 2001

Donald S. Clark
Office of the Secretary
Federal Trade Commission
600 Pennsylvania Ave., NW
Washington, DC 20580

Reference: V010003 - Comments Regarding Retail Electricity Competition

Dear Mr. Clark:

This letter provides the comments of the Public Advocate, State of Maine, with respect to the Commission's general request for information and the thirty-seven specific questions attached to the Commission's "Notice Requesting Comments."

My obligations as Public Advocate are to represent utility consumers before state and federal regulatory agencies, the Legislature and the courts in any proceeding affecting the price and quality of utility services. My office has been in existence since 1981 where I have been employed since 1982 as a staff attorney and since 1986 as Public Advocate. I have served under three Governors of Maine in whose office the Office of Public Advocate is housed. I supervise a staff consisting of three lawyers, an economist and two support personnel and a \$1.2 million budget. In my current capacity as President of the National Association of State Utility Consumer Advocate (NASUCA), I have testified before the Energy and Natural Resources Committee of the U.S. Senate on electricity restructuring issues from the consumer advocate perspective.

The Office of Public Advocate was extensively involved in the effort at the Maine Legislature from 1995 to the present that led to enactment of the State's Restructuring Act in May 1997 and subsequently to consideration of amendments to that law. Since 1996, the Office of Public Advocate has convened regular meetings of the Maine Electricity Consumers Coalition, a diverse group of elderly, low-income, environmental, industrial and business consumers who have met on a monthly, or bi-monthly basis to pursue a common interest in shaping the direction of electric restructuring in Maine in a fashion that produces actual benefits for consumers. Unlike many other states, the development of electric restructuring in Maine was undertaken with a broad coalition of interests that developed a consensus approach. Finally, the Office has regularly



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intervened in proceedings at the Federal Energy Regulatory Commission (FERC) pertaining to wholesale electric markets and regularly attends Participants Committee meetings of the regional power pool, NEPOOL. I also serve as a member of the Advisory Committee to the Independent System Operator-New England (ISO-NE).

The office maintains a web site which provides updated information about the status of electricity competition in Maine. The site's address is <http://janus.state.me.us/meopa>.

A. OVERVIEW

The early experience with electric restructuring and retail choice was generally positive, beginning with the opening of retail markets in March 2000. The future, however, is strikingly uncertain. As of the date of retail choice, the Maine Public Utilities Commission (PUC) had completed an exhaustive examination of the costs of providing transmission and distribution (T&D) service for each electric utility in Maine, had identified compensable stranded costs and supervised the generation unit divestitures of the State's three largest utilities. Divestiture created a \$250 million fund (net of indenture-related payments associated with refinancing the utility's capital structure) for Central Maine Power Company (CMP) that was held for ratepayers in an Asset Sale Gain Account. The comparable number for Bangor Hydro-Electric Co. (BHE), a smaller investor-owned utility with 105,000 customers, was \$20 million. These proceeds from the generation divestiture are being used as an offset to the stranded costs identified for each utility and, in the case of CMP, are being amortized in rates over an eight-year period. Due to the elimination of generation-related costs and the reflection of the first year's amortization of the asset sale gain, CMP's rates for residential customers dropped by 9.8% on March 1, 2000. For BHE and Maine Public Service Company (MPS), the comparable price reductions on March 1, 2000 were 2.2% and 7.8% respectively. The PUC was also successful in lining up affordable power for the residential customers of CMP at 4.1¢/kWh for a two-year period through February 2002. In retrospect, this fixed price contract has turned out to be exceedingly attractive given recent increases in wholesale power prices.

These healthy reductions in bundled prices were accompanied by the entry into Maine's newly-opened market of a large number of newly licensed competitors, numbering 30 or more. As of January 31, 2001, almost 70% of CMP's industrial customers and 68% of Maine Public Service's industrial customers had contracted for their own electricity supply. In fact, at an estimated 30% overall, Maine has the highest percentage of electric load under competitive contract of any state in the country. With the exception of Bangor Hydro's customers, most other large customers in Maine so far have received benefits as a result of electric restructuring and the opportunity to negotiate market-based contracts. However, there is almost no shopping by residential customers and few, if any, marketers offering competitive services to residential customers.

Despite this promising start in Maine, there are two sobering realities now confronting us or just over the horizon. The first is an area of similarity with the

California situation: an inefficient wholesale power market whose operations may too often be successfully “gamed” by generators and power marketers. Large players appear to have maximized their grasp of particular markets, particularly in the case of the market for Installed Capacity. Generally, it is clear that wholesale markets continue to be immature, volatile and unpredictable in most parts of the country and, equally so, in New England. The second area of concern about the long-term viability of electric restructuring for Maine’s consumers is the result of recent actions by FERC. In December and more recently in March, FERC set at \$8.75/per kilowatt-month the deficiency charge for Installed Capacity (ICAP) in a manner that will seriously strain existing supplier contracts in New England and could impose major financial burdens on consumers. The ICAP charges in 1999 and 2000 traded generally in the zero to \$.17 range. Motivated apparently by California’s example, FERC has determined that a clear price signal favoring new generation construction is needed. We are exceedingly concerned that, by itself, this decision could wipe out all the gains made to date for consumers as a result of industry restructuring. These benefits for residential and small commercial customers were crucial to the adoption and approval of retail competition by Legislators and other policymakers in Maine. The inability to provide stable and predictable prices for retail customers in an increasingly volatile and immature wholesale market may threaten the political acceptability of retail restructuring in Maine and elsewhere throughout New England. In our view, it is FERC’s obligation to assure reasonable rates for wholesale markets, particularly when these markets are immature and states have undertaken significant steps to move toward a competitive market with the assumption that FERC would monitor and enforce its statutory obligations.

These actions and inactions by FERC have had an adverse impact on the ability of the Maine PUC to obtain Standard Offer service for residential and small commercial customers without significant increases in prices. As explained more fully below, Maine’s electric restructuring model does not impose rate caps or rate freezes on any part of the now-unbundled customer rates and T&D utilities do not have the responsibility for providing Standard Offer generation service. Rather, this service is provided by means of competitive bids supervised by the PUC and billed and collected by the T&D utilities. Not only has the Commission been unable to obtain fixed rate bids for even a year’s duration (with the notable exception of Maine Public Service’s customers and CMP’s residential customers), but the unpredictability of the wholesale market has resulted in Standard Offer rate increases for all commercial and industrial customers and, in the case of BHE, residential customers as well. These rate increases for residential customers, totaling 62% for generation service and 19% for the average residential bill, have severely impacted the public’s acceptance of the move to retail competition. This concern will be magnified in March 2002 when the current fixed price contract in effect for CMP’s residential customers expires.

Another matter that deserves to be mentioned in this overview is the approach that some competitive suppliers have begun to recommend in seeking to pursue their goal of moving to retail energy competition. In their view, the various state consumer protection and Default Service policies that are the subject of many of the FTC’s specific questions in this proceeding are directly related to the limited success of retail competition, to date,

by increasing the cost of offering competitive services to mass market customers. We do not share this view: whatever the causes of the lack of marketing by competitive energy suppliers to residential and small commercial customers, it is unlikely that the nuances of a state's consumer protection policies have had a significant impact. Rather, the degree to which competitive energy suppliers can offer a product that is priced below the price of Default Service is the key to whether marketers offer and customers shop. These decisions in turn are closely related to the state's restructuring decisions concerning stranded costs, unbundling and allocation of costs to generation and T&D service, whether divestiture has been ordered or offered, and how Default Service is priced. Even if all of these decisions are made "correctly" from the perspective of creating an opportunity for a competitive retail market, the operation of the wholesale market can destroy the careful planning of state regulators. This has occurred in Maine and Pennsylvania where state regulators deliberately sought to structure the Default Service price to stimulate competition by relying on unbundling policies, stranded cost decisions, reliance on competitive bidding, and strong consumer protection and education programs to stimulate customer interest and confidence in entering the competitive market. However, these decisions have been undercut, not by similarities or differences in consumer protection, disclosures, licensing, and billing requirements, but by events in the wholesale market.

Furthermore, the regulation of consumer protection for retail transactions has historically been a state responsibility, residing in either the State Attorney General or specific state regulatory agencies. Even where the federal government has taken an active role in standardized labeling or consumer protections, those actions are typically accompanied by a deferral to either state enforcement or the state's authority to adopt more protective policies. The ability of state authorities to protect consumers in developing retail energy markets will be particularly important during this period of transition when it is not yet clear what are the "best practices." Premature federal oversight and establishment of federal mandates could lead to the use of the "lowest common denominator" and halt the development of innovative and effective state and regional initiatives that may well prove more effective in the long run.

B. SPECIFIC QUESTIONS

History and Overview

1. Why did the state implement retail electricity competition? What problems of the previous regulatory regime was it trying to solve?

Maine confronted two, interrelated problems that made retail choice and electric restructuring exceedingly attractive. First, rates were high and, secondly, they incorporated a substantial amount of strandable costs. The stranded costs were attributable to past regulatory action, including: failed power plant projects, contractual commitments to conservation investments, and above-market contracts with qualifying facilities and independent power producers

(IPP's). These two issues (rates that already were high and strandable costs) created a real risk that the State's largest customers could find ways of demanding discount arrangements to stay on the system or of turning to new generating sources of their own and leave the system altogether. In either event, the result would have been further upward price pressure on bundled electric rates and fewer customers paying for stranded costs.

2. What were the expected benefits of retail competition? Were price reductions expected in absolute terms or in relation to what price levels would be absent retail competition? Were the benefits of retail competition expected to be available to consumers in urban, suburban, and rural areas? Were the benefits expected to be available for residential, commercial, and industrial customers? Were the benefits expected to be comparable for each group of customers?

The Maine Legislature did not mandate any pre-determined level of savings for consumers or for any particular group of consumers. Nor did it guarantee any particular level of stranded cost recovery for the State's utilities. However, the Maine Legislature did require investor-owned utilities to divest their generating assets and it delegated to the PUC the responsibility of identifying recoverable levels of stranded cost and of specifying a treatment for the divestiture-related gain. In the long-term, the benefits of competition for retail customers were expected to emerge as a result of power plant developers (and no longer ratepayers) bearing the risk of project failures. With respect to residential and small commercial customers, the proponents of retail competition (including my office) saw a realistic prospect that larger customers would be accountable for their own power supply decisions if they shopped for power and therefore no longer be able to shift costs to smaller customers when utility power supply decisions turned out to be costly. As a result, Maine put "all its eggs" in the development of a competitive retail and wholesale market to provide the benefits of competition to all customers, including residential and small commercial customers.

3. What factors or measures should the Commission examine in viewing the success of a state's retail electricity competition program? How should these measures be evaluated?

We think most consumers – large or small – place value on price predictability, for budgeting purposes and future planning. However, these values are particularly important to residential and small commercial customers, many of whom are not educated or do not

have the ability¹ to respond to price volatility and sharp rises in prices. Therefore, price stability and foreseeability of future prices are desirable features that we believe should be considered in evaluating the success of retail choice programs. Secondly, the extent of competitive activity, in terms of actual customers being served by competitive electric providers (CEP's) and as a percent of total load served by CEP's, is a critical benchmark of success. As mentioned earlier, nearly 70% of the power serving the large customer group in CMP and Maine Public Service's territory is provided by CEP's and not by a Standard Offer default provider. For the State as a whole, considering all classes, 30% of all load in Maine is now served by CEP's, according to a recent Xenergy multi-state comparison. However, almost none of this activity is occurring with residential customers. Finally, the number of licensed CEP's prepared to offer service to each customer class is a key consideration in determining how vibrant state's retail choice program may be. In Maine, less than 1% of residential customers are shopping or even presented with options to shop in CMP's and BHE's service territory, but this number is much higher for larger commercial and industrial customers.

4. What are the most successful and least successful elements in the state's retail competition program? Has the state taken steps to modify the least successful elements?

The most successful aspect of Maine's program is the statutory requirement that utilities sell their power plants and preserve the net gain for ratepayers to be used as an offset to stranded cost. CMP's divestiture of its units (sold to a Florida Power and Light affiliate) created \$850 million in value which, less the net book valuation that was built into CMP's mortgage indentures, still left \$250 million in ratepayer value for stranded cost mitigation.

The least successful aspect of Maine's program was an inability to influence wholesale prices in a regional market. Despite the fact that Maine is a net exporter of power to the rest of New England and has sited five new gas-fired units in the past two years (totaling 1600 megawatts), the prices paid for retail supply in Maine are driven entirely by market conditions in the rest of New England. Maine has not been effective in securing pro-consumer outcomes at NEPOOL, in the form of market rules that promote vigorous competition, or at

¹ The inability to respond to volatile price signals is due not only to the lack of metering and billing protocols that are designed to transmit price signals, but the usage pattern of many residential customers that is not capable of being "shifted" or "varied" to respond to price signals. Seniors on fixed income, families with small children, and working parents often cannot "invest" in alternative energy strategies or change energy use patterns without significant risk to health and safety.

FERC, in the example of ICAP charges for installed capacity. The State's PUC, the Office of Public Advocate and many industrial customers are actively involved in NEPOOL and ISO-NE proceedings but, to date, have very little to show for it in the form of lowered wholesale price levels or, most importantly for the long term development of the market, including increased competitive entry.

Consumer Protection Issues

1. What efforts were made to educate consumers about retail competition? How was the success of these efforts measured? Were the programs successful? Who funded these efforts? Who implemented the programs?

The Maine PUC received legislative approval to undertake a \$6 million education program prior to the start-up of retail choice in March 2000. The program consisted primarily of advertising in several media and an extensive round of speaking engagements throughout the state. By the end of the program, survey samples representing half of the State's population responding to questions exhibited an awareness of the fundamentals of retail choice. Due to the relatively small penetration of CEP's in residential markets (currently, .02, .17 and 9.3% respectively of CMP, Bangor Hydro and Maine Public Service's residential load), the PUC has yet to exhaust the full legislative authorization for this education program and is holding a portion of the \$6 million funding amount in reserve for use in the future as more residential competition emerges. All of these funds are derived from charges collected by T&D utilities in their current rates.

While there is general agreement that there is a reasonably high level of public awareness of retail competition, due to the educational program and the new bill format (discussed below), the lack of any marketing activity by competitive electric providers to residential customers has seriously dampened enthusiasm for competition and resulted in a "ho hum" approach by most residential customers. In other words, the very low level of shopping by residential customers is not due to lack of interest by customers, but, rather, in response to the lack of marketing and presentation of offers by competitive electric providers. Finally, for those customers who are experiencing significant bill increases directly related to restructuring as part of the Standard Offer service (in the sense that such unbundled bill increases could not have occurred under a rate of return regulatory regime), their awareness of retail competition is all too clear.

2. Do consumers have enough information to readily make informed choices among competing suppliers? Did the state coordinate its labeling

requirements about the attributes of a supplier's product, if any, with neighboring states? Is there a need for federal assistance to provide standardized supplier labeling? If so, what would be the most useful federal role?

Maine has required bill format changes, bill disclosures and uniform price disclosures for competitive generation service, including Standard Offer service billed by utilities. These disclosures are coordinated, using the same terms on both the uniform labels and bills. Maine did coordinate its efforts on uniform supply source disclosure with the other New England states and currently requires a twice-annual disclosure of competitive provider and Standard Offer supply sources on a standardized format. That format shows supplier specific information in categories that CEP's must also file annually with the PUC as a licensing condition. This disclosure includes a uniform price disclosure presented in a cents-per-kWh format, fuel type, and air emissions associated with the supplier's generation mix.

While there may be benefits to a federal or uniform disclosure format, there are potential difficulties that may slow the development of such an approach and state and regional efforts should not be supplemented in the meantime. Many of the key disclosures associated with a uniform label require a significant involvement and potential supervision of information that is resident at the regional ISO or that may be resident in the future RTOs. It is not possible to disclose meaningful fuel and environmental criteria, in our opinion, without reference to the regional spot market as the default energy supply. Tracking such information at the federal level would be neither efficient nor practical. Energy markets are primarily regional in nature and any federal efforts to stimulate the use of a uniform label should encourage and defer to regional efforts to develop such labels. In fact, this regional approach has in fact occurred in many areas, including New England, PJM, the western area, and the use of the Illinois disclosure label by the Ohio PUC in its development of disclosure labels to conform to Ohio's statutory directives.

Maine's disclosure label indicates the relative portion of the supplier with respect to a regional average for SO₂ and NO_x emissions, as well as establishing the percent of supply that comes from each of a number of supply sources. It appears to be an adequate platform for consumer comprehension about the source of supply. Maine's labeling requirements closely integrate price, fuel mix, and environmental air emissions. Chapter 306 of the Maine PUC's rules contains the details for this disclosure and its dissemination to customers.

3. Have consumers complained about unauthorized switching of their accounts to alternative suppliers (slamming) or the placement of unauthorized charges on their electric bills (cramming)? Were rules adopted to prevent these practices? Has the state taken enforcement action under its new authority against slamming and cramming? Have these actions been effective to curb the alleged abuses? Is there a need for federal assistance with slamming and cramming issues? If so, what would be the most useful federal role?

To date there has been no significant amount of consumer complaint about slamming or cramming in Maine. This may be a result of the State's small population (1.2 million) and relative lack of marketing activity directed at residential customers. There may well be a role for the Commission to play in deterring slamming or cramming but to date it is not an issue in Maine. The PUC has strong anti-slamming provisions and a workable complaint process for investigating slamming at Section 4(D) of Chapter 305 of the PUC rules. In fact, Maine's anti-slamming rules are typical of other states that have adopted similar rules for electric restructuring, such as Massachusetts, Pennsylvania, California, and Connecticut. We are not aware of any competitive provider that has indicated that these rules constitute a barrier to entry or that they pose any compliance difficulty. Maine's licensing requirements for CEP status are rigorous, well enforced by the PUC and they also are well publicized. So far, there has been no evidence that licensed CEP's are willing to risk license revocation proceedings at the PUC by engaging in unauthorized customer switches. There also is no evidence that customers are entering into supply arrangements with unlicensed providers.

I wish to also note that Maine's anti-slamming provisions consist of customer authorization and enrollment procedures that are similar to those recommended by the consensus Uniform Business Practices project sponsored by EEI and a national group of competitive energy suppliers.

4. How did the state facilitate the ability of customers to switch to a new supplier? Have these efforts been successful? Does the state allow consumers to aggregate their electricity demand? If so, has aggregation enabled consumers to benefit from retail electricity competition? If not, why not?

The state has attempted to make customer choice a process that is not complicated or burdensome. As previously noted, Maine's customer authorization and enrollment procedures are similar to those recommended by the Uniform Business Practices project. Furthermore, these procedures are embodied in electronic transaction

protocols that have been developed by both utilities and competitive energy suppliers. CMP can implement a valid switch order submitted by a supplier within 24 hours in most cases. Furthermore, there is no requirement of a “wet” signature in order to sign up with a CEP since our customer authorization rules, similar to most states, allow a customer to enroll with a provider orally (over the telephone), electronically (via the Internet), or in writing (using a Letter of Authorization).

Maine’s restructuring law does explicitly authorize aggregation by county governments, by the Maine Health and Higher Education Finance Authority (MHHEFA). Customer aggregation need not trigger licensing requirements under PUC rules depending on whether the aggregator actually takes title to any power. Despite these efforts, so far the only successful statewide aggregation of public entities has been an aggregation of towns and health care providers (MHHEFA) with no aggregators successfully marketing to residential customers. This circumstance is very likely the result of low Standard Offer (default) prices for non-shopping residential customers in CMP’s territory. Industrial customers and large commercial customers have successfully aggregated more than 200 MW of load in a consortium called the Maine Electric Consumers Cooperative (MECC). Currently, MECC customers are served by Enron under annual supply contracts.

5. Has the state established licensing or certification requirements for new suppliers to provide electricity to customers? Why? Which licensing provisions are designed to protect consumers? How do they operate? Has the state taken enforcement action against unlicensed firms? Have these actions been effective to curb unlicensed activity? Have these requirements acted as an entry barrier for new suppliers?

Although no enforcement actions involving unlicensed entities have been necessary to date, the PUC has been aggressive in monitoring compliance by licensed CEP’s with license conditions. Chief among these have been Maine’s uniform disclosure requirements and CEP compliance with surety bond requirements. The PUC’s licensing and consumer protection rules are codified at Chapter 305 and are available on the PUC web site (<http://janus.state.me.us/mpuc>). These rules incorporate a series of important consumer protections, including a customer’s right to sign up on a do-not-call list and not be subjected to any marketing. The rules mandate the use of plain language for generation service bills and include: a prohibition against the use of pre-payment meters to avoid compliance with disconnection rules, pre-cancellation notice to be provided no less than 30 days prior to cancellation, a minimum service period of 30

days, a requirement of affirmative choice either in writing or verified by a third party and a five-day right of rescission for any customer. Maine's electric restructuring statute strongly endorses consumer protection and licensing requirements designed to assure that competitive energy suppliers are both technically and financially qualified to do business with residential and small commercial customers. Suppliers who seek to do business only with large industrial customers are not subject to many of the bonding and disclosure requirements. Maine currently has 30 licensed CEP's so that these provisions have not deterred a wide variety of marketers from the licensing process. The lack of marketing activity directed to residential customers is more directly related to Standard Offer prices and the state of the wholesale market rather than licensing or consumer protection requirements themselves.

6. Did the state place any restrictions on the ability of a utility's unregulated affiliate(s) to use a similar name and/or logo as its parent utility, in order to avoid consumer confusion when the affiliate offered unregulated generation services? Why or why not? What has been the experience to date with the use of these restrictions? Are consumers knowledgeable about who their suppliers are?

Maine has in place both a statute and PUC rules governing transactions between a utility and any affiliate that: 1) require PUC approval before the creation of an affiliate; 2) require a demonstration that the utility will not subsidize the ongoing operations of the affiliate but will be compensated for employee time, materials and overheads; and 3) require compensation for the use of intangibles by the affiliate such as use of the utility name, logo, slogan or other marketing device associated with the utility. Finally, Maine's restructuring statute places a 33% limit on the amount of power that can be sold in a utility's service territory by a utility affiliate and prohibits outright power sales by the T&D utilities (35-A M.R.S.A. Section 3205(2)). Because of the latter provisions, no Maine utility is currently involved in marketing power, with the direct result that there has been no incumbency for a Maine utility to protect. The transition to retail competition in Maine occurred with the full support and extensive assistance of the T&D utilities because there no longer was a business purpose to be served by frustrating the entry of competitors. Suppliers and CEP's state that their dealings with T&D utilities in this state have been convenient and straightforward, possibly due to the absence of T&D incumbency in the marketing of power.

7. Did the state place any restrictions on third-party or affiliate use of a utility's customer information (e.g., customer usage statistics, financial

information, etc.)? What were the reasons for enacting the restrictions? What has been the effect of these restrictions on new marketing activity?

The PUC's rules at Chapter 305 ("Licensing Requirements, Annual Reporting, Enforcement and Consumer Protection Provisions for Competitive Provision of Electricity") in Section 4(J) provide that customer-specific information must be kept confidential in the absence of a written consent or third-party verification. Maine also by statute provides for the confidentiality of consumer information in the absence of customer authorization (35-A M.R.S.A. Section 320(B) (16-A) and 18). Affiliates are treated identically to third party vendors with respect to requests to a T&D utility for customer load data under a statutory "Standards of Conduct" Section (35-A M.R.S.A. Section 3205(3)(A) and (F)). These provisions serve the dual purpose of ensuring that customers retain control over information pertaining to their usage, payment and demand profiles and that emerging competition in retail markets is not undercut by transactions, requests for information or other practices in which a T&D affiliate benefits from special treatment not available to any other CEP. The Legislature's primary interest was to overcome any actual or perceived advantage in a newly opened market that incumbent utilities may possess in conjunction with their affiliates. These restrictions apply in full to Maine's two largest electric utilities but do not apply in such specificity and scope to T&D utilities serving 50,000 or fewer customers.

8. Has the state adopted any other measures intended to protect consumers (e.g., length of consumer contracts, automatic renewal provisions, etc.) as it implemented retail competition? What has been the effect of these measures?

Maine's consumer protection rules for electricity competition distinguish between small residential and commercial customers with demands below 100 KW and all other customers. Based in most cases on the specific directives of the Maine Restructuring Act (35-A M.R.S.A. Section 3200 et seq.), the PUC consumer protection rules establish comprehensive terms of service, rescission rights, requirements pertaining to written solicitations and verifying customer choice of a CEP, processing of slamming complaints and ordering refunds apply only to customers with demands below 100 KW. Maine's rules do not prohibit automatic renewal as long as the material terms of the contract have not changed and the customer has been notified of the renewal event. If a marketer seeks to make material changes to the contract or obtain renewal on different terms, the marketer must provide notice to the customer and obtain the customer affirmative agreement to the changes or renewed contract.

These provisions appear to be working as expected in establishing clear ground rules for competitive activity in residential and small commercial markets. These rules have made it possible for Maine's educational program to emphasize to customers that they will have comparable consumer protections if they leave Standard Offer Service and enter the competitive market, an issue that is very important to residential consumers as indicated by state surveys in Maine and elsewhere.

9. To what extent have suppliers engaged in advertising to sell their product(s)? Do some suppliers claim that their product is differentiated (e.g., that it has environmental benefits)? Has there been any enforcement or attempts to verify these advertising claims? Do any certification organizations, such as Green-e, operate in the state? Are they used by (or at least available to) a substantial portion of consumers?

There has so far been very little penetration of supply products that are differentiated based on higher renewable, solar or hydro content. Such claims will be subject to twice-yearly disclosure to customers in a format governed by PUC rule and in annual reports to the PUC from each CEP. There continues to be uncertainty about whether the categories for disclosure adequately specify the renewable portion of imports from Canada, or of system power.

Because Maine's in-state generator base is more than 50% renewable at present, claims of "green power" probably have had less influence in this retail market than elsewhere.

Retail Supply Issues

1. What difficulties have suppliers encountered in entering the market? What conditions/incentives attract suppliers to retail markets? Have suppliers exited the market after beginning to provide retail service? If so, why?

Maine has had no major withdrawals from supply markets since the market opened on March 1, 2000. However, CEPs indicate privately that Maine's 30% Renewable Portfolio Standard (RPS) poses a marketing problem and leads to higher costs for serving customers in Maine. The Maine Legislature anticipated that enacting the RPS requirement (at 35-A M.R.S.A. Section 3210) could cause retail supply prices to be higher than they otherwise might have been but was determined to "encourage the use of reasonable, efficient and indigenous resources" such as the biomass, hydro and cogeneration units, that, prior to March 1, 2000, accounted for more than 50% of the State's power production.

Suppliers whose contract obligations are already established also have expressed major concern about the FERC December 15, 2000 and March 6, 2001 orders in Docket EL00-62-015 that imposed prospectively on April 1, 2001 an \$8.75/kilowatt-month charge for Installed Capacity (ICAP). Because the CEP is obligated to cover this obligation prospectively or pay the charge, CEP's with existing fixed-priced obligations to serve retail load in Maine are now facing hundreds of millions of additional costs as a result of the FERC decision. The FERC order affects all suppliers in the regional market controlled by ISO-NE and NEPOOL market rules but the effects are particularly noticeable in Maine where Bangor Hydro's bundled supply/T&D rates now are at 16.7¢/kilowatt. This number is up dramatically from 14.22¢/kWh prior to restructuring, based on PUC data for Standard Offer service and pre-2000 prices. This increase does not account for the full effect of the FERC March 6, 2001 Order on Rehearing and expected future ICAP increases.

2. What are the customer acquisition costs and operational costs to service retail customers? How do acquisition and operational costs compare to profit margins for electric power generation services? Do retail margins affect entry? If so, how? Did the state harmonize the procedures suppliers use to attract and switch customers with other states' procedures, in order to reduce suppliers' costs?

There is no question that the adequacy of retail margins has a direct effect on competitive entry. The fact that margins available to CEPs in competition with a Standard Offer for CMP, Bangor Hydro and MPS's residential customers are exceedingly small (if not non-existent) is the primary reason that CEPs serve an exceedingly small share of these customer classes. Maine's consumer protection and licensing rules did take into account the rules that had been adopted in Massachusetts and Pennsylvania; the only two states that had adopted specific regulations at the time Maine's rules were under development. Furthermore, the development of the electronic data protocols in effect between T&D utilities and suppliers were developed based on the experiences in this area in Massachusetts. There has generally been a good deal of information consultation and interaction between utilities, suppliers, and regulatory personnel in the development of uniform disclosure labels, consumer protection and licensing rules, as well as the more detailed utility-supplier transactions.

3. Have customers switched to new suppliers? Why or why not? Are there greater incentives for certain customer classes (*i.e.*, industrial, commercial, residential) than for others to switch suppliers? Why or why not? Are penalties or different rates applied to customers that switch back to the

supplier of last resort? Are there other measures to determine whether customers are actively considering switching suppliers? If so, do these indicators show different patterns than the switching rate data?

Many more industrial and large commercial customers have switched suppliers than has been the case for smaller classes. This is due to their general sophistication in handling energy requirements, particularly at large manufacturing facilities, and their success (by means of the MECC aggregation) in securing attractive offers from suppliers.

The PUC does retain a penalty provision that is a condition on taking Standard Offer Service, requiring that if a non-residential customer leaves a CEP and takes Standard Offer Service that customer is obligated to stay on Standard Offer Service for 12 months or pay as a penalty two months-worth of charges for Standard Offer supply. This provision is designed to prevent CEP's from handling customer load (at relatively favorable prices) during off-peak periods and then pushing them on to Standard Offer Service during the summer peak period and splitting with the customer the resulting savings. This type of gaming can only drive up the costs of Standard Offer service, due to uncertainty about predicting the size of monthly demands, and therefore has prompted the PUC to adopt a two-month penalty payment requirement.

4. Have suppliers offered new types of products and services (e.g., time of day pricing, interruptible contracts, green power, etc.) in states where retail competition has been implemented? If so, describe the products and what customer response has been.

We are not aware of any specific innovation, or new marketing practice that has accompanied the introduction of customer choice on March 1, 2000. Two suppliers in the market are actively pursuing "Green Power" customers (Energy Atlantic and Interfaith Light and Power) but, to date, their participation rates have been insignificant.

5. What are the benefits or drawbacks of the different approaches to handling the supplier of last resort obligation for customers who do not choose a new supplier (e.g., allow incumbent utility to retain the obligation to provide generation services to non-choosing customers, auction the obligation, or assign the obligation to non-utility parties). What has been consumer reaction to these approaches? Is provider of last resort service necessary?

We believe a provider of last resort service is indispensable and - very likely - a permanent part of the competitive landscape. This is due to

the existence of credit worthiness problems for small and large customers alike, bankruptcies, mergers and customer relocations that, in each case, interrupt any ongoing relationship between a supplier and a customer. Furthermore, it is unlikely that there will be any political acceptance of alternatives to the current Standard Offer service requirement unless and until the wholesale market is working to provide stable and affordable prices for residential and small commercial customers.

Furthermore, the supplier of last resort that is provided under prices regulated by the state regulatory commission is crucial to assure that all residential and small commercial customers have access to electric service under regulated terms of service. Electricity is a vital necessity and significant harm can and does result if service is not affordable and accessible under reasonable terms. Our comments include a recently published paper by Barbara Alexander, "Default Service: Can Residential and Low Income Customers be Protected When the Experiment Goes Awry?" (April 2001). Ms. Alexander summarizes the Default Service experience for 9 states and provides important observations, including the following key point:

Any approach that seeks to pass through market-based prices to residential customers will increase price volatility due to the "abnormalities" that have occurred and that are likely to continue to occur in the infancy of the wholesale market and the development of regional transmission organizations. Whether states and state regulators will be pressured to ease up on promises of lower rates to mass market customers and either roll back or "reinterpret" rate caps and rate freezes remains to be seen. Clearly, there is a growing disconnection between the promises that state legislators and regulators have presented as the basis for the move to retail competition and the actual prices that the wholesale market is pressing to send through to retail customers. Furthermore, the move to competition has transferred the power to set rates for retail customers from the state regulators to FERC because of the growing importance of the operation of the wholesale market in the establishment of retail prices. When generation is no longer owned by the utility that has a state franchise and obligation to serve, state regulators 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 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. [at 7]

I have attached Ms. Alexander's report for your consideration in this proceeding because of the factual information that it contains about Default Service experiences, as well as her preliminary observations and conclusions.

Under Maine's competition scheme, affiliates of incumbent T&D utilities are limited to furnishing no more than 20% of the Standard Offer Service in their own territories (35-A M.R.S.A. Section 3205(2)B), although utility affiliates are free to compete in competitive markets outside of the parent's territory. All default service in Maine is handled by the PUC through an annual bid process for Standard Offer Service (*Ibid* at Section 3212). The combination of the reliance on the competitive bid process and the lack of any rate caps or rate freezes has made Maine particularly vulnerable to the instability of the wholesale market. This competitive bid process to date has yielded varying results for customers of Maine's T&D utilities. One utility (Bangor Hydro-Electric Company) has received, in the PUC's estimation, inadequate or unacceptably costly retail Standard Offer bids on two occasions. Both CMP and Maine Public Service have had greater success in attracting affordable and financially viable bids for Standard Offer service, particularly for residential customers. Because the residential classes of CMP and MPS have benefited from generally low-cost Standard Offer bid awards², customer reaction in those service territories has been generally favorable. Because residential customers in BHE's territory are served under a default service arranged by Bangor Hydro at the PUC's request pursuant to 35-A M.R.S.A. Section 3212(2)D, customers in that area occasionally express concern about continuing to receive supply service from their T&D utility despite restructuring of the industry, and about the high cost of these default wholesale arrangements. In fact, Bangor Hydro's residential rates for Standard Offer Service have increased 62% in the last year.

Retail Pricing Issues

1. How is entry affected by the price for the provider of last resort service (for customers who do not choose) or for default service (for customer whose supplier exits the market)? How does the price for the provider of last resort or default service compare to prices offered by alternative suppliers? Is the price for provider of last resort service or default service capped? If so, for how long?

These questions have already been answered in large part in response to previous questions. Under Maine's Standard Offer provisions, a bid award establishes an annual Standard Offer contract

² The Standard Offer bids that were accepted for CMP and MPS residential customers were tied to a simultaneous proceeding related to obtaining rights to certain QF facility generation that are unlikely to be repeated in the future. The CMP rates are in effect until March 2002.

arrangement but that arrangement is not necessarily capped. In fact, the default wholesale arrangement negotiated by Bangor Hydro in 2000 at the PUC's request was subject to two upward price versions after the Standard Offer prices were first established. These revisions reflected the PUC's decision to let 20% or more of Bangor Hydro's supply requirement float on spot market prices for the 2000-2001 Standard Offer year and not be locked in on March 1, 2000. The result has been a 12% increase in residential Standard Offer prices between March 1, 2000 and February 28, 2001, as a result of high wholesale prices in the regional spot market.

2. Has the state required retail rate reductions prior to the start of retail competition? What is the rationale for these reductions? How have state-mandated rate reductions prior to the start of retail competition affected retail competition?

Maine imposed no such requirement, but the required divestiture of generation assets was expected to result in customer benefits and potential rate reductions. In fact, these customer benefits did occur, but the volatility of the wholesale market and the FERC Order on ICAP charges have in most cases erased or will soon erase these customer benefits.

3. Do any seasonal fluctuations in the price of wholesale generation cause some suppliers to enter the market only at certain times of the year? How have these suppliers fared?

Because of very high wholesale prices during the summer period, the major public entity aggregator in Maine (MHHEFA) was unable to find any supplier until after the end of the 2000 summer peak period. Many large customers who assumed they had attractive enough load profiles to enable them to find a desirable CEP offer failed to do so during the spring and summer of 2000 due to a run-up in peak-period prices. These customers chose instead to stay with Standard Offer arrangements during high-cost peak periods.

4. How has the state addressed public benefit programs (e.g., universal service requirements, low income assistance, conservation education, etc.) as it has implemented retail competition? Which of these programs are necessary as competition is introduced and why? Are public benefits available to all customers or are they restricted to customers of the supplier of last resort? How does this affect retail competition?

Maine's electric restructuring statute specifically authorized the continuation and potential expansion of bill payment assistance programs for low income customers, energy efficiency programs, and a renewables portfolio

requirement for all licensed CEPs. The low income program is the subject of a pending rulemaking by the PUC. The energy efficiency or demand side management programs are under development by the State Planning Office which has the statutory responsibility for program planning and priorities for these programs. However, all these programs are funded by all customers by means of nonbypassable charges included in distribution rates.

Market Structure Issues

1. How has the development of Regional Transmission Organizations (RTOs) affected retail competition in the state?

New England has had in place since 1972 a power policy arrangement in which all the region's electric utilities accepted "tight pool" requirements (capacity reserve margins at 15 to 20%, capacity deficiency charges, emergency operating procedures and system dispatch of units whose transmission service was priced at a "postage stamp" pool-wide rate) in exchange for the reliability benefits of pooling. In 1997 the New England Power Pool (NEPOOL) established with FERC approval an Independent System Operator (ISO-NE) responsible for managing energy markets and operating the transmission system. In 1999 ISO-NE opened a day-ahead market for certain energy and capacity products and established markets for ancillary services. During the 1999 and 2000 period, NEPOOL transformed itself from a utility-only organization to one organized into five sectors each with a 20% voting share (generators, marketers, transmission owners, municipal electric districts and end-users). In 2000 the Governor of Maine requested membership status in the end-user sector, designating a State Planning Office employee and the Public Advocate as his representative and alternate.

As a result of this evolution, ISO-NE today resembles an embryonic Regional Transmission Organization in many critical respects. Further debate over NEPOOL's role and governance, the consolidation of ISO-NE and the New York ISO into a single entity and the role of New England's PUC regulators continues today over the further evolution of NEPOOL and ISO-NE.

2. Did the state require the divestiture of generation assets (or impose other regulatory conditions on the use of these assets) when retail competition was introduced? To what extent was divestiture of generation assets a component of the state's handling of a utility's stranded costs? Was divestiture used to remedy a high concentration of generation assets serving the state? Was there appreciable voluntary divestiture of generation assets? Has the state examined whether there has been

appreciable consolidation of ownership of generation serving the state since the start of retail competition?

Maine mandated generation divestiture prior to the start-up of customer choice and also prohibited T&D utilities themselves from selling or marketing power after March 1, 2000. The proceeds received upon the sale of generation assets were placed in a PUC-designated Asset Sale Gain Account and dedicated to the reduction of the stranded cost component in T&D rates. These accounts are expected to mitigate the impact of stranded costs for eight years for CMP and slightly less for Bangor Hydro and MPS. The Legislature mandated divestiture without opposition from Maine's utilities, notwithstanding the fact that divestiture was widely supported as a means to prevent the incumbent utilities from dominating restructured energy markets in Maine.

Since restructuring, there has been no generation consolidation (with three different entities purchasing CMP's, BHE's and MPS's generators) but mergers of the T&D utilities with out-of-state T&D entities have occurred for two of the three investor owned utilities in Maine in 2000.

3. If a utility no longer owns generation assets to meet its obligations as the supplier of last resort or default service provider, what market mechanism (e.g., spot market purchases, buy back or output contracts, etc.) does it use to obtain generation services to fulfill these obligations? What share of a utility's load is obtained via the different mechanisms? How are these shares trending? Is the market mechanism transparent? Is it necessary to monitor these market mechanisms? Why or why not? If so, what should the monitor examine?

Under Maine's competition scheme, the T&D utilities have no direct responsibility at all for default or Standard Offer service, unless a bid process conducted by the PUC each year fails to generate any satisfactory offers. The T&D utilities were not required to maintain any long term contracts to provide this service as a condition of the sale of their generation assets so that when a T&D utility is required to obtain Standard Offer service (due to the absence of acceptable Standard Offer retail bids, in the PUC's judgment) it must do so in the wholesale market. Otherwise, the T&D utilities have no obligation to meet the supply requirements of their customers.

4. Explain the state's role in overseeing operation of the transmission grid in the state and the extent to which public power or municipal power transmission systems are integrated into this effort. What is the

relationship between the state's role and the Federal Energy Regulatory Commission's role in transmission system operation in the state?

Maine has no public power entities that own transmission infrastructure. The Maine PUC has conceded to the FERC jurisdiction over the pricing of transmission services and has unbundled T&D rates in a proceeding completed in 2000, so that the transmission component is annually updated based on FERC-approved rates order for each T&D utility in the State.

5. Do firms that have provider of last resort or default service obligations (formerly "native load" obligations in the regulated environment) receive preferential transmission treatment? If so, how does this affect wholesale electric power competition? How and by whom should retail sales of bundled transmission services (*i.e.*, retail sales of both energy and transmission services) and retail sales of unbundled transmission be regulated? If by more than one entity, how should regulation be coordinated? What should the state's role be in overseeing wholesale transmission reliability?

The Standard Offer Service providers in Maine have no preferential access to the region's transmission system. In Maine the pricing and supervision of transmission services occurs at FERC and not at the PUC, based on the results of a PUC investigation captioned "Investigation of Retail Electric Transmission Services and Jurisdictional Issues," Docket No. 99-185.

6. To what extent did the state identify transmission constraints affecting access to out-of-state or in-state generation prior to the start of retail competition? Is the state capable of remedying these transmission constraints, or is federal jurisdiction necessary? How do the rationales for federal jurisdiction over electric power transmission siting compare to the reasons underlying federal jurisdiction over the siting of natural gas pipelines?

The State has long been aware of transmission constraints limiting peak-period transfers both at the New Brunswick border and in New Hampshire. The PUC views its ability to mitigate these constraints as a function of FERC jurisdiction and is an active member of the New England Conference of Public Utility Commissioners (NECPUC) in seeking to influence the ISO-NE decisions over which FERC has jurisdiction.

7. How have state siting regulations for new generation and transmission facilities been affected by the onset of retail competition? Has new generation siting kept pace with demand growth in the state? If not, why

not? Is federal jurisdiction necessary for siting of electric power generation facilities? Has the state actively monitored and reported the relationship between in-state capacity and peak demand in the state? What incentives do suppliers have to maintain adequate reserve capacity? What are the ways to value capacity in competitive markets? Is reserve sharing still important in competitive markets? Do other institutions/market processes provide a reasonable substitute for reserve sharing?

Because the PUC has no jurisdiction over the siting of non-utility generators, retail competition has created no change in terms of increased regulatory activity. To date, 1,600 MW of new gas-fired combustion turbine capacity has been brought on line or is completing construction, without any significant PUC involvement. The Office of Public Advocate was extensively involved in ISO-NE proceedings and NEPOOL decisions pertaining to assessing interconnection costs on new generators. Our objective was to ensure that incumbent generators selling their output into wholesale markets did not succeed in delaying or impeding the entry of new generation in wholesale markets, such as the 1,600 MW in Maine.

We continue to regard capacity reserves as a reasonable aspect of regional energy markets but we do not see a role for federal agencies in the siting of new generation facilities. Insofar as Maine currently is exporting more power than it consumes, we do not regard any capacity scarcity as imminent.

8. Since the start of retail competition, what has been the rate of generation plant outages (scheduled and unscheduled)? To what extent has the state monitored these outages and examined their causes?

Maine itself has undertaken no investigation of scheduled maintenance or forced outage rates for generators in New England. We are aware that ISO-NE is currently conducting an investigation of this issue.

Other Issues

1. What measures has the state taken to make customer demand responsive to changes in available supply? Has the state provided utilities incentives to make customers more price responsive? Has the state moved away from average cost pricing? What effect have these measures had on demand and on demand elasticity?

Maine has set rates based on estimates of the marginal cost of generation, transmission, distribution and customer service since the early 1990's. It also has undertaken a major set of ratepayer-funded

initiatives designed to secure energy and capacity savings at residential and business locations in the territories of the State's three largest utilities, since 1985. The budget for conservation programs at CMP reached \$25 million in 1990 or nearly 4% of total revenue. It had declined by 2000 to 1.5% of company revenues or approximately \$15 million. Maine's Restructuring Act grants to the PUC discretion over the necessary amount of conservation funding in each utility's service territory, provided that funding may be no less than .5% of utility revenue and no more than \$.0015/ for each kilowatt-hour of delivered electricity. At present, Central Maine Power is the only utility for which conservation-related collections in rates are at the \$.0015/ kWh maximum. All other T&D utilities in Maine currently incorporate the .5% minimum in T&D rates.

2. Has the state provided mechanisms and incentives for owners of co-generation capacity to offer power during peak demand periods? Has the state identified, reported, and facilitated development of pumped storage facilities or other approaches to arbitraging between peak and off-peak wholesale electricity prices?

Maine has actively supported ISO-NE programs (including a pilot program for summer 2001) to incorporate a demand-response in wholesale markets that resembles the interruptible contract programs that were in place prior to March 1, 2000. Maine's interruptible load aggregated a peak period reduction of 200 MW or more in the early 1990's, in response to a 30-minute notice from NEPOOL's satellite facility. There currently are no programs solely designed for peak shaving that retail ratepayers fund, although such programs are under active consideration in Maine.

3. What issues have arisen under retail competition that have required cooperation or coordination with other states? What approach was taken to securing this cooperation or coordination? Are there other issues requiring cooperation that have not yet been addressed? Which of these issues are the most significant?

The Maine PUC actively coordinates policy initiatives with NECPUC. Similarly, the Office of Public Advocate holds a seat as a voting alternative End-User Member of NEPOOL's Participants Committee. In both cases, Maine seeks to influence the development of a vibrant and efficient market for bilateral wholesale transactions and an efficient spot market for energy in the region. In both examples, Maine's efforts are ultimately subject to FERC jurisdiction and to the exercise of informed judgment by ISO-NE. Also, as previously noted, Maine participated in a regional forum to develop a uniform price

and environmental disclosure label that resulted in both Maine and Massachusetts adopting a similar label format.

4. How prevalent is the use of distributed resources (e.g., distributed generation) within the state? What barriers do customers face to implementing distributed resources?

Maine has in place a 100 KW ceiling for “net metering” arrangements that enable small-scale distributed generators (solar, hydro and wind) to consume power over distribution feeders on-site and carry over surpluses for up to one year without a need for additional metering or wholesale interconnection. There are 40 or more hydro sites in the state that sell their output into ISO-NE’s markets only with considerable difficulty due to the costs of NEPOOL membership, (\$50,000 annually), the cost of transmitting power to the regional system and the difficulty of aggregating small units into a single attractive renewable purchase.

No large-scale distributed generation projects have been proposed in Maine.

5. Which specific jurisdictional issues prevent state retail competition programs from being as successful as they might be?

As a result of the extreme price volatility in the wholesale market that is evident in California and the Western U.S., the high prices in the wholesale market that affected New York City last summer, the higher prices in the wholesale markets currently being experienced in PJM (although not as high as the California prices) and the higher wholesale market prices that have made it difficult to conduct successful bidding for Standard Offer Service in Maine and that have led to higher Standard Offer prices in Massachusetts, it is clear that the single largest impediment to the development of retail markets is the lack of a stable and competitive wholesale market. FERC’s desire to establish at high levels a price signal for installed capacity appears to be misplaced in a region that operates with a 20% revenue margin and is experiencing a supply surplus. This is one of many examples in which FERC has failed to exercise its lawful authority to assure fair and reasonable prices in the wholesale market. This failure to take action to ameliorate unfair market prices has threatened the viability of current retail restructuring efforts in many states and halted the development of retail markets in other states.

6. Which specific technological developments are likely to substantially affect retail or wholesale competition in the electric power industry that

may alter the manner in which states structure retail competition plans? Why? What time frame is associated with these developments?

We are not aware of any specific “technological events” that could directly affect the development of wholesale or retail competition in Maine. In particular, we are not aware of any technology that can provide affordable output for distributed generators at remote locations, at prices that are competitive with ISO-NE administered markets.

7. What are the lessons to be learned from the retail electricity competition efforts of other countries? Are there other formerly-regulated industries in the U.S. (e.g., natural gas) that allow customer choice and provide useful comparisons to retail electricity competition? If so, what are the relevant insights or lessons to be learned?

The residential customer’s opinion of long distance telephone competition has not been positive due to the extensive slamming, cramming, questionable surcharges, misleading advertising, and lack of adequate consumer protections for this industry. In fact, the public’s opinion of long distance telephone competition was a significant obstacle to the public and state legislative acceptance of retail electric competition in Maine and elsewhere and led to the inclusion of more significant licensing, consumer protection, price and contract term disclosures, and other public benefits built into many state restructuring statutes. While natural gas competition has not been implemented on as wide a scale as electric competition, it also has been plagued with slamming (primarily due to door-to-door marketing practices), customer confusion and, for residential customers, minimal price advantage.

We believe that the electricity markets are proving to be as resistant to change as the telephone industry, but possibly for very different reasons. Most observers have pointed to the continued presence of the local exchange provider as the major barrier to the development of meaningful competition in the telephone industry. The local telephone basic exchange service provider typically has both retail and wholesale sales objectives in that it must provide competitively neutral wholesale services to its competitors. However, Maine’s electric competition legislation severed this link between the T&D utility and the marketing and sale of generation by means of mandatory divestiture and the statutory limitation on the provision of Standard Offer service by the incumbent T&D provider’s sales affiliate. There is no evidence that the continued monopoly for T&D providers has inhibited the development of the retail market. However, the lack of adequate oversight in the nascent regional

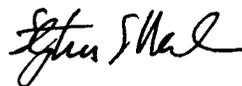
wholesale market has been a significant barrier to the development of a vibrant retail market. For example, the largest T&D utility in Maine (CMP) has not created a retail sales affiliate to market either to its former customers within its service territory or customers outside its service territory.

While electric utilities in other states that have restructured can reasonably be identified as potential obstacles to competition due to their role as the incumbent Default Service provider and their continued ownership of generation resources, that scenario does not explain the Maine experience. For the proponents of retail electric restructuring, Maine should be viewed as an example of the best possible opportunity for the development of a competitive market due to its reliance on divestiture, the lack of rate caps, the use of the competitive bid process to provide Standard Offer service, and the genuine effort to educate customers to benefit from the competitive experience. Unfortunately, these positive steps have not yet resulted in any significant benefit for residential customers due to developments in the wholesale market and certain actions by FERC.

Thank you for the opportunity of providing these comments and for the opportunity of contributing to the Commission's inquiry. Please do not hesitate to contact me in the event of particular questions. Barbara R. Alexander³, Consumer Affairs Consultant, of Winthrop, Maine assisted in the preparation of these comments.

For the Commission's information, I enclose several graphs that illustrate points made in these comments.

Sincerely,



Stephen G. Ward

Attachments

- "Default Service: Can Residential and Low-Income Customers be Protected When the Experiment Goes Away?," Barbara Alexander, April 2001
- "Retail Choice: Maine 2/01", OPA
- "Electricity Shopping Guide: 10/2000", OPA
- "Electricity Shopping Guide: 3/2001:", OPA
- "Total Residential kWh Rates: Changes 2000/01 to 2001/02", OPA

³ Ms. Alexander is the author of "A Blueprint for Consumer Protection Issues in Retail Electric Competition" (Office of Energy and Renewable Energy, U.S. Department of Energy, October, 1998).

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

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Barbara R. Alexander opened her own consulting practice in March, 1996. From 1986-1996 she was the Director, Consumer Assistance Division, at the Maine Public Utilities Commission. Her special area of expertise has been the exploration of and recommendations for consumer protection, universal service programs, service quality, and consumer education policies to accompany the move to electric, natural gas, and telephone competition. She authored AA Blueprint for Consumer Protection Issues in Retail Electric Competition@ (Office of Energy and Renewable Energy, U.S. Department of Energy, October, 1998). Her clients include national consumer organizations, state public utility commissions, and state public advocates.

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INTRODUCTION

The purpose of this report is to summarize and make some preliminary conclusions about the development of a default or provider of last resort service for residential and small commercial customers as part of the move to retail electric competition. 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.

Organization of the report. The first part of this report describes why Default Service is an important policy decision with implications for the ability of residential and low income customers to maintain a reasonably priced electric service. Preliminary observations and recommendations based on the analysis contained in Part II of this report are presented. Part II describes the individual state Default Service policies and programs for key states or those where significant implementation activity has occurred. This report does not summarize developments in every state that has moved to retail electric competition, but it does concentrate on those states that have actually moved to implementation of retail competition and Default Service or where substantial controversy has surrounded the decision concerning Default Service. Specifically, the following states are highlighted in this report:

- California
- Pennsylvania
- Massachusetts
- Maine
- New York
- Connecticut
- Nevada
- Texas
- Ohio

The legislative directives and regulatory implementation activities with respect to Default Service for each state are identified. Where information is available about impacts (participation levels, price changes, development of low income rates or discounts) on residential customers or low income customers, that information is presented.

Definition of Default Service. This service is labeled with different names (AStandard Offer@; AProvider of Last Resort@; ABasic Generation Service@), but in this report the term ADefault Service@ will be used to identify the service that is made available to any residential customer who chooses not to choose, who is unable to obtain competitive electric service, whose

competitive service is cancelled, or whose supplier is unable to provide service. 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 commission. 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 migration¹ 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 continue to receive an essential service at a regulated price.²

Second, utilities and some policymakers have argued, successfully in many states, that lower use customers are not seeking to move to alternative providers for electricity and are unlikely to benefit from a competitive energy market in the form of lower prices, at least in the early days of the development of the competitive market. Therefore, these customers are unlikely to seek alternative suppliers and alternative suppliers are unlikely to target such customers. That these arguments are also self-serving in that they result in utilities retaining a huge volume of customers without additional costs has not been lost on most observers, but has not changed the ultimate result.

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 red-lining 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 suffer an adverse credit history.

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. 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 maintain 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 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 the full scale implementation of retail competition has not yet occurred. An exception may be Pennsylvania, where the highest levels of residential customer shopping has been recorded of any state that has adopted full scale retail electric competition. Even in Pennsylvania, however, the percentage of customers who are shopping varies widely from 16% in PECO Energy's service territory to less than 1% in Allegheny Energy's.³ 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.

PRELIMINARY CONCLUSIONS AND OBSERVATIONS

While electric restructuring is still in a stage of transition in most states that have adopted this approach, the experience highlighted in this report suggest both why the nature and price of Default Service is paramount for residential and low income customers and what statutory models might work best at achieving a stable and reasonably priced Default Service:

1. With few exceptions, Default Service is provided by the incumbent utility and that utility is responsible for obtaining the generation service either from its own generating facilities or via contracts in the wholesale market. Only in California and in New York (Consolidated Edison) were the utilities required to provide this service by obtaining spot market power from the wholesale market and passing through this service to retail customers. Other states allowed utilities to use pre-restructuring methods of providing generation service, either through native generation units or long term contracts. The use of the competitive bid process supervised by the state commission in Maine and Pennsylvania (Competitive Default Service for some customers) was adopted as a means of opening up the competitive market and attracting new suppliers to the competition program for residential customers, as well as obtaining a lower price than the embedded cost of generation provided by the incumbent utility. Even where the state has mandated competitive bidding with some supervision of this process by the state commission, the utility continues to bill for this service and the only change is that the customer=s bill names a specific Default Service supplier.
2. Default Service has typically been structured 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 preserved the intra-class allocation of class responsibility for the utility=s 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. However, such an approach would shift costs to lower use customers and result in higher monthly bills in most cases for lower use customers. Rather, state regulators (often as a result of Legislative declarations) have implemented rate caps, rate freezes, or rate decreases using the current rate design so that residential customers will not see any detriment as a result of the move to retail competition.
3. Default Service is typically accompanied by the traditional utility protections that already apply to regulated services, such as 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, there is no sanctioned degradation of service quality or consumer protection as a result of the move to retail competition for customers on Default Service. Obviously, this policy approach is easier to maintain when the default provider is the incumbent utility, even if the generation portion of the bill is obtained via competitive bid, because of the close

connection between these policies and programs and the issuance of the monthly bill and its collection. This approach bodes well for low income and other payment troubled customers.

4. To date, most states have not isolated or segregated low-income or payment troubled customers compared to other residential customers in the provision of Default Service. As a result, the cost to serve, bill, collect, and interact with payment troubled customers has been integrated into the rates charged for all residential customers. At least in the short run, the concern of many low income advocates that market segmentation would result in higher priced electric service for certain residential customers has not occurred. The attempt to carve out a means to provide higher cost Default Service to low income or credit challenged customers in Nevada was roundly criticized and withdrawn.

On the contrary, most states have significantly expanded universal service programs and targeted bill payment assistance and energy conservation/weatherization programs to low income customers. Pennsylvania has quadrupled the size and budgets for its low income programs. Other states have created new programs targeted to low income customers that are funded through the regulated distribution portion of the bill.

As long as there are a substantial number of residential customers receiving Default Service, for any reason, the higher costs associated with serving customers who need more attention in the form of payment arrangements and payment difficulties will be spread among all residential customers or included in distribution (regulated) utility rates.

This approach seems to provide the highest possible level of protection, but does not bode well for the future if a competitive market does develop and most residential customers enter the competitive market. As the size of the default pool lessens to those who are unable to obtain service in the competitive market (as opposed to those who do not choose to shop for electricity), the ability to create a reasonably priced Default Service option for payment troubled or credit challenged customers is diminished. The more segmented this market becomes, the more likely that Default Service will be priced higher than that available in the competitive market if customers can pay their monthly bill on time and do not need more expensive customer care in the form of payment arrangements, medical emergencies, collection notices, and contract termination procedures. Because of the existence of legislatively mandated rate caps or protections during the transition period in most states, as well as the lack of the development of a vibrant and competitive market for residential customers, this legitimate concern is not yet apparent.

5. While most states adopted what appeared to be a cap or freeze on rates for a transition period, some states have not protected customers from increases in Default Service prices when the wholesale market has experienced volatile shifts in prices and sharp price increases. Massachusetts has interpreted the legislatively mandated rate cap or rate reduction as not including increases that reflect fuel or purchased power costs incurred by

the utility in the wholesale market. Maine's restructuring statute did not include a rate freeze or price cap and has approved the pass through of higher Standard Offer rates for some utilities. Other restructuring settlements, such as those approved by the New York PSC for Consolidated Edison and the Massachusetts electric restructuring legislation, both appeared to offer customers a rate decrease, but the fine print allowed the pass through of actual market power prices. Finally, the California Commission has approved rate increases on two occasions in the January-March 2001 period for two electric utilities that was not contemplated when retail competition was adopted due to the pressures from the higher market prices for electricity that utilities have been obliged to pay for Default Service power.

However, these experiences should be contrasted with that in Pennsylvania where the generation and T&D rate caps have so far worked to shield residential customers from any significant volatility in the wholesale market. Only one Pennsylvania utility (GPU Energy) has sought to evade the mandated rate caps, but that proceeding has been linked to the filing by the utility for approval of a merger with a large Ohio utility, FirstEnergy. Furthermore, Connecticut and Ohio have adopted firm rate caps for both distribution and generation Default Service for the transition period. As a result, there is experience that demonstrates that residential customers can be provided with rate decreases or rate caps, and the opportunity to shop for lower prices in a competitive market IF the wholesale market is relatively stable and utilities do not incur risks that threaten their economic viability.

6. 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 been successful. The one bid for residential customers that was accepted in Maine was tied to the use of certain purchased power contracts that made the bid viable. Several Pennsylvania utilities (GPU Energy, Duquesne Light) have sought to bid out 20% of their non-shopping residential customers, but no competitive bids submitted. The recent PECO Energy competitive Default Service was awarded by a negotiated contract. While Maine did not have a rate cap in place, the Commission has refused to accept some bids that would have resulted in higher fixed rates over the 1-2 year bid period. Suppliers have argued in these states that the price to compare or the current rate was too low or that certain contract terms (fixed price, contract term, billing and collection restrictions) made the proposal economically unviable. As a result of this experience, 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 in these bid programs.
7. 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)⁴ 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. According to NEMA, Default Service should not be used to address low income needs, but rather specific programs directed to low income customers should address these needs. Under the NEMA approach, default service should be designed as a short term transition mechanism that minimizes the use of this service over time. For example, NEMA has opposed the New York State Electric and Gas Co. (NYSEG) proposal to adopt long term stable rates for Default Service provided by the utility on the basis that it is an outrageous attempt to circumvent multiple Commission orders and precedent on issues including properly structured back out credits, the Provider of Last Resort function, the utilities exit of the merchant function, competitive provision of billing and metering, and uniform business practices.⁵ 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, A[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.⁶

Any approach that seeks to pass through market-based prices to residential customers will increase price volatility due to the abnormalities that have occurred and that are likely to continue to occur in the infancy of the wholesale market and the development of regional transmission organizations. Whether states and state regulators will be pressured to ease up on promises of lower rates to mass market customers and either roll back or reinterpret rate caps and rate freezes remains to be seen. Clearly, there is a growing disconnection between the promises that state legislators and regulators have presented as the basis for the move to retail competition and the actual prices that the wholesale market is pressing to send through to retail customers. Furthermore, the move to competition has transferred the power to set rates for retail customers from the state regulators to FERC because of the growing importance of the operation of the wholesale market in the establishment of retail prices. When generation is no longer owned by the utility that has a state franchise and obligation to serve, state regulators 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 a just and reasonable rates in the wholesale market. The transfer of authority from the 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.

8. In contrast to those who seek more price volatility and market based rates for Default Service, many states have pulled back or delayed the move to retail competition as a

result of the volatile prices that have been widely reported in California and New York. Such states include Nevada, New Mexico, Oklahoma, Montana, Arkansas, North Carolina, Minnesota. Clearly, state policy makers and legislators strongly resist putting the vast number of consumers at risk for higher or volatile prices for electric service as the price for moving to retail competition. Therefore, if the proponents of competition are to be successful in their advocacy, it appears that a stable and fixed price Default Service program will have to be considered as a key element in the public acceptability of the transformation of an industry.

9. Finally, in most states Default Service, at least with respect to its provision by utilities under rate caps or freezes, is a creature of a specific transition period. This period varies from 2-3 years to 9-10 years. This period is often linked to the recovery period for Stranded Costs. Those states in which transition periods are relatively short (e.g., Maine, Connecticut, Massachusetts, New Jersey, California) will face the necessity of identifying the provider of Default Service and the method by which that service is priced within the next 18 months. The volatility of the wholesale market that is projected to occur this summer in New England, New York, PJM, and Western markets does not bode well for any state regulator=s ability to establish a pricing mechanism for residential customers on Default Service that will reflect either the traditional residential rate design or rate stability. States may be forced to consider more frequent price changes or rate designs that reflect seasonal price spikes. These changes may result in further state legislative questions about the move to retail electric competition or attempts to roll back a state=s prior adoption of retail competition⁷ or extension of rate caps and regulation of Default Service.