

**PRELIMINARY COMMENTS ON MARYLAND'S STANDARD OFFER ELECTRIC  
SERVICE POLICIES: STARTING DOWN THE PATH TO PROVIDE BENEFITS TO  
RESIDENTIAL CONSUMERS**

**BEFORE THE MARYLAND PUBLIC SERVICE COMMISSION**

**CASE NO. 9064**

**ON BEHALF OF THE MARYLAND OFFICE OF PEOPLE'S COUNSEL**

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These comments by the Office of People’s Counsel respond to the Public Service Commission’s request for presentations and comments “at a policy level of detail on the current approaches to retail competition, standard offer service (SOS) and default service, as well as other innovations for retail market design, SOS or default service that may have emerged as a result of actual market experience.” These comments have been prepared with the assistance of Barbara R. Alexander, a consultant to the OPC. Ms. Alexander has spoken and written widely about the implementation of retail electric competition since opening her consulting practice in 1996, after ten years as the Director of the Consumer Assistance Division of the Maine Public Utilities Commission. She has participated in legislative and regulatory proceedings in Maine, Pennsylvania, New Jersey, Montana, Illinois, and the District of Columbia, as well as conducted research concerning default service and other impacts of restructuring for state and national organizations. Ms. Alexander’s resume is attached to these comments.

These technical comments, in conjunction with additional comments submitted directly by OPC, address the issues identified in the Commission’s Notice of Technical Conference issued on May 25, 2006. Additionally, these technical comments are primarily directed to policies and programs that should be adopted for service to residential customers. While many states include “small commercial” customers in these programs, Maryland has not yet adopted a uniform definition of this group. These comments will:

- Provide a high level summary of the criteria that should govern the development of Standard Offer Service policies for Maryland’s residential (and possibly small commercial) electric customers; and
- Describe the types and sources of factual information that the Commission should consider when considering what policies to adopt for future SOS planning, procurement,

and management.

A. BRIEF HISTORY OF MARYLAND'S ELECTRIC RESTRUCTURING  
EXPERIMENT: WHY ARE WE HERE?

I. MARYLAND ADOPTED RETAIL ELECTRIC COMPETITION WITH THE HOPE  
THAT MARKET FORCES WOULD RESULT IN LOWER ELECTRICITY PRICES  
COMPARED TO TRADITIONAL REGULATION.

Similar to almost every State in New England and the Mid-Atlantic region, Maryland adopted retail electric restructuring in 1999 with the expectation that it would lead to lower prices compared to traditional regulation and open the door to new products and services offered to customers.<sup>1</sup>

Maryland's restructuring statute requires electric utilities to provide "standard offer service" (SOS) pursuant to specific directives, but the original assumption was that this would be a temporary service or one that was only used by fewer customers over time and only in-between movements to other energy suppliers. During a four-year "transition" period, utilities were obligated to provide SOS under a cap or rate freeze after an initial rate reduction of 3% to 7.5%. This "rate freeze" obligation was supposed to end June 30, 2003 under the statute, but this obligation was extended until June 30, 2004 in some of the restructuring settlements voluntarily entered into by the utilities and other parties prior to the onset of retail competition. This obligation was extended even longer for two electric utilities, until July 2006 for residential

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<sup>1</sup> The only state from Maine to Virginia that did not adopt retail electric competition was Vermont. While New York did not adopt a statutory mandate for restructuring, its state Public Service Commission has implemented this policy on a utility-by-utility basis. Subsequent to 2000, no state has adopted retail electric restructuring and several states have halted or substantially revised their previously adopted electric restructuring mandates, including California, New Mexico, Nevada, Arkansas, Oklahoma, West Virginia, and Montana.

customers of Baltimore Gas & Electric and until July 2008 for Allegheny Power's residential customers in their respective restructuring settlements.

Section 7-510(c) governs the provision of Standard Offer Service by the electric utilities. SOS is automatically provided to any customer that does not have an electricity supplier for any reason or who has chosen SOS. However, the statute anticipated that the obligation by an electric utility to provide SOS would end on July 1, 2003 unless one of two exceptions is operative. Under the first exception, the utility has chosen to continue to provide this service, which all the Maryland electric utilities have done through various settlements. Under the second exception, a utility must continue to provide SOS to residential and small commercial customers if the Commission "finds that the electric supply market is not competitive or that no acceptable proposal has been received to supply electricity to those customers. ..." This determination must be made annually. If the obligation to provide SOS is extended, it must be provided at a "market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return." Section 7-510(c)(4) of the Act calls for the Commission to establish procedures for the competitive selection of electricity suppliers for the provision of SOS and implement such an approach by July 2003, but this process can be delayed by the Commission.

Section 7-514 gives the Maryland Commission the authority to conduct investigations of the "retail electricity supply and electricity supply services markets and determine whether the function of one of these markets is being adversely affected by market power or any other anticompetitive conduct." If the Commission finds that market power or anticompetitive conduct "is preventing the electric customers in the State from obtaining the benefits of properly functioning retail electricity supply and electricity supply services markets, the Commission may

take remedial actions within its authority to address the impact of the market power or any other anticompetitive conduct activities.”

With respect to “public purpose” programs, the Maryland Act contained provisions designed to assure funding and implementation of a statewide Universal Service Program consisting of bill payment assistance and weatherization for low income customers, as well as authority to adopt energy efficiency and demand side management programs, a program to “encourage” renewable energy resources, and a consumer education program. The surcharges to pay for these programs are collected through the distribution or regulated portion of the electric bill from all customer classes.

In 2004 the Maryland Legislature adopted a Renewable Energy Portfolio Standard (Section 7-701-7-709) and mandated the creation of a system that facilitates trading of credits representing the generation of electricity using renewable resources. The RPS is effective with electricity sales in 2006. This statutory mandate was adopted with the intent to diversify the electricity supply, lower air pollution, and “lower the cost to consumers of electricity produced from these resources.” Under the RPS, the percentage of new renewable resources in the generation supply of each supplier grows from 1% from Tier 1 and 2.5% from Tier 2 resources in 2006 to 2% Tier 1/2.5% Tier 2 in 2008, 3% Tier 1/2.5% Tier 2 in 2010, up to 7.5% for Tier 1 resources in 2019. Utilities that provide SOS can pass through the “commercially reasonable additional costs, if any...” incurred to comply with this mandate. There was no apparent linkage of this effort to expand renewable resources with the overall cost for electricity for Maryland’s consumers.

II. THE STANDARD OFFER SERVICE POLICIES IMPLEMENTED TO DATE HAVE REFLECTED SHORT TERM WHOLESALE MARKET PRICES AND WERE

DESIGNED WITH THE ASSUMPTION THAT A MORE VIBRANT RETAIL  
MARKET WOULD DEVELOP FOR ALL CUSTOMER CLASSES TO OFFER  
ALTERNATIVE PRICES AND SERVICES

The Commission adopted several interpretations of the SOS provisions of the restructuring law in 2002<sup>2</sup>:

- The Commission can decide whether the electricity supply market is competitive without conducting a competitive bidding process. The Commission determined that the statute allows two alternative paths to call for the extension of the SOS obligation: either the Commission finds that the market is not competitive or it conducts competitive bidding with a failed result.
- The Commission can delay the implementation of a SOS selection process for reasons other than and independent from the alternatives described in Section 7-510(c) 3. In other words, the ability to delay the use of a competitive bidding process to select the SOS provider can be done independently of a decision concerning the extension of the utilities' obligation to provide SOS.
- The competitive bidding process can be used to obtain electric generation supply at either a wholesale or retail basis. While the Commission determined that the statute is not clear, it choose to supervise a process by which the utilities obtain generation supply in the wholesale market, the price of which is passed through to their retail customers, or supervise a process by which suppliers bid to service SOS customers at retail.

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<sup>2</sup> Maryland PSC, Order No. 77806, Case No. 8908, May 30, 2002.

- When asked to provide guidance on whether the electric utilities (or any other party) should provide a “provider of last resort” service when a competitive supplier terminates their relationship with a residential or small commercial customer or such customers refuse to accept service from the competitive supplier, the Commission declined to do so.

On November 15, 2002, a Settlement Agreement was filed with the Commission to resolve the provision of SOS and default service to customers by means of a competitive selection of wholesale supply service for specific service periods. After a lengthy period of briefs and argument, the Commission approved the Settlement on April 29, 2003.<sup>3</sup> In approving the Settlement, the Commission found that retail competition had not developed as intended and noted that as of March 28, 2003 only 3.9 percent of all customers (3.7 percent residential and 5.2 percent non-residential) were taking service from a competitive supplier, representing 16 percent of the peak load obligation. As a result, the Commission determined that SOS must be extended pursuant to the option allowed under the Act.

Under the terms of the Settlement, four types of SOS must be offered: one residential SOS and three types of non-residential SOS. Most important to our concerns today, the settlement commits the electric distribution utility to providing SOS to residential customers for a four-year period beyond the otherwise applicable rate cap period that was agreed to in the restructuring settlements.<sup>4</sup> The utilities agreed to provide SOS by relying entirely on a

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<sup>3</sup> Maryland Public Service Commission, In the Matter of the Commission’s Inquiry into the Competitive Selection of Electricity Supplier/Standard Offer Service, Case No. 8908, April 29, 2003.

<sup>4</sup> As a result, for example, the BGE obligation to provide SOS under the terms of the settlement was extended four years beyond the 2006 end of the rate caps as set forth in the earlier restructuring settlement.

wholesale power bidding process.<sup>5</sup> The utilities must attempt to obtain 1-, 2-, and 3-year contracts, with 50 percent of the load to be served obtained through a 1-year contract, 25% of the load served through 2-year contracts, and 25% of the load served through 3-year contracts. All the contracts must be of a specific type, i.e., full-requirements service at a fixed price for the duration of the contract. In addition to the generation supply contract rates, utilities are allowed to add an “Administrative Charge” to the wholesale price. Included in the Administrative Charge is an “Administrative Adjustment.”

The Settlement sets out four components of the future price of generation supply:

- A seasonally-differentiated and, where applicable to the existing rate class, time-of-use differentiated load weighted average of the prices obtained through the competitive bid
- Transmission costs directly related to the SOS load obligation incurred by the utilities
- Applicable Taxes and
- A specified Administrative Charge intended to recover the utilities’ prudently incurred and verifiable incremental costs and reasonable return on those costs associated with the provision of SOS. For residential SOS, it is set at 4 mills per kWh in the Settlement and it is composed of several different factors:
  - 1.5 mills per kWh for a return to utility shareholders, including cash working capital revenue requirement;
  - .5 mills per kWh for the incremental costs associated with the obligation to arrange for and provide SOS (excluding residential SOS uncollectibles);
  - The settlement sets a proxy of 2 mills for the calculation of that portion of the SOS price that reflects the uncollectible expense for this service. Since there is an uncollectibles factor already reflected in SOS rates for BGE (but not other

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<sup>5</sup> Shorter service periods and a reliance on shorter-term wholesale market pass through mechanisms are established for larger commercial and industrial customers in the Settlement.

utilities), the Settlement calls for a reduction for in the remaining 2 mill/kWh portion of the Administrative Charge that is specified for each utility (1.1 mills for Baltimore Gas & Electric, 0.0 mills for Pepco and Conectiv), subject to revision in future base rate cases; and

- Administrative Adjustment, which is basically the difference between the 4 mills/kWh and the other specified factors above. For BGE, the Administrative Adjustment will be set of .9 mill/kWh, equal to the 4 mills less 1.5 mills for return, less .5 mills for incremental cost, and less 1.1 mills for SOS-related uncollectibles. The other utilities will reflect the full 2 mill/kWh portion as the Administrative Adjustment.

The revenues from the Administrative Adjustment will be credited back to residential distribution service customers in a per kWh credit. This Adjustment increases the apparent price of providing the retail service against which competitive suppliers compete and returns to residential ratepayers all revenues associated with this Adjustment. In fact, the Settlement calls for a reduction in this Adjustment to the Administrative Charge if competition more fully develops during the term of the Settlement.

Finally, the Settlement contains a provision that identifies the point at which customer switching to competitive suppliers may adversely impact the revenues of the supplier who has won the bid to provide the generation portion of the bill. Unless there is a 25 percent shift in customer load, there will be no fees or additional charges associated with switching, and the supplier providing SOS will bear the risk of reduced sales volume due to customer switching to other suppliers. Since only 3 percent of residential customers have ever experienced switching in Maryland, attaining this volume level to trigger switching fees or exit fees was deemed unlikely in the near term.

### III. SOLE RELIANCE ON SHORT TERM WHOLESALE MARKET CONTRACTS HAVE CONTRIBUTED TO UNACCEPTABLY HIGH ELECTRICITY PRICES AND INCREASED PRICE VOLATILITY FOR RESIDENTIAL CUSTOMERS

Under the settlement that the Commission approved for Standard Offer Service, the two utilities with 2004 deadlines for their rate caps conducted an RFP process to obtain wholesale market contracts for this service. With respect to residential customers, Conectiv and Pepco sought 50% of the load for a one-year contract, 25% for a two-year contract, and 25% for a three-year contract. Both solicitations were fully subscribed and both results were approved by the Commission and the new prices were put in place on July 1, 2004. Pepco's residential customers saw an average total electric bill increase of 15% with an annual average Standard Offer service generation charge of \$.0568. This price for generation supply reflected over a 20% increase in that portion of the electric bill. Conectiv's residential customers saw a 10.5% increase in the average total electric bill with a \$.0577 charge per kWh for the generation portion of the bill. This was also a 20% increase in the generation supply portion of the total electric bill.

The Pepco and Conectiv solicitations in 2005 yielded additional price increases for the generation portion of the bill because the solicitations were for 50% of the residential class (that portion of the load that was the subject of a one-year contract in 2004) and the resulting price averaged the results of the prior contracts and the new contracts: 6.6% increase in generation price and a 4.5% average total annual bill increase for Pepco; and 8.7% increase in generation price and a 5.8% increase in the average total annual bill for Conectiv. In June 2005, the Pepco generation charge for residential customers was \$.0605/kWh and Conectiv's residential generation price was \$.0631/kWh.

The solicitations for 2006 resulted in an even more dramatic price increase. As of July 2006, Conectiv's residential generation price will be \$.0979/kWh, a 55% increase in the generation portion of the bill and an average total bill increase of 35%. Pepco's residential customers will see an average annual bill increase of 39% due to the new generation price of \$.1063/kWh.

At the same time, BG&E obtained 100% of its residential SOS obligation using this same process and signed contracts with wholesale suppliers that will result in an annual average total bill increase of 72% for residential customers. The generation portion of the bill will increase from \$.0457/kWh to \$1063/kWh, a 133% increase.

Clearly, the dramatic increase in electricity prices, the lack of any sustained and vibrant retail market for residential customers, as well as the ongoing lack of certainty in the "rules of the game" with respect to long term reliability of supply in the wholesale market have contributed to a general concern that restructuring is not headed in the direction anticipated by its authors.

In August 2001 an executive of BG&E wrote an article published in the Public Utilities Fortnightly about the Maryland electric restructuring experience.<sup>6</sup> Acknowledging that a "fully developed competitive market for retail electric generation" did not yet exist, he pointed to the rate freeze and price protections of Standard Offer Service as the key barrier to preventing competitive energy suppliers from being able to seek residential and other commercial customers. Striking a common theme of those who decry the lack of retail competition, the fact that electricity prices were too low was viewed as the "problem" in the development of a

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<sup>6</sup> Switzer, Sheldon (Director, Electric Pricing and Tariffs, BG&E), "Retail Choice Is Working, Despite the Wait for Real Competition," Public Utilities Fortnightly, August 2001 (pp. 25-36)

competitive market and the author warned about the potential for a significant price increase (similar to that which occurred in the California electricity market) if wholesale market prices significantly exceeded the Standard Offer price. According to Mr. Switzer, retail competition was “working” because the transitional policies were headed toward an end to the price freezes and, with higher prices, would come greater competition:

In the long run, we can expect to see suppliers distinguishing themselves by offering different sorts of energy services to customers. That is, the supplier will offer the commodity at a reasonable price, perhaps with risk mitigation services, but will also help customers to use electricity more efficiently. Many suppliers no doubt will work actively with energy service companies to address the need for the efficient use of energy on the customer’s side of the meter.”

He also foretold that when price freezes were ended and prices were increased, some will want to return to “the good old days of rate-of-return regulation,” but he urged policymakers not to “re-regulate” because competition will provide benefits once the wholesale market is competitive and the “power pool” is operating efficiently.

Mr. Switzer’s vision has not actually occurred in Maryland or any State that has adopted retail competition. Whether or not rate caps are in effect and whether or not residential and small commercial customers have been exposed to “market” prices, retail competition for these customers has not developed. Prices have increased dramatically to reflect short term wholesale market prices (driven by the price paid to the most expensive generator in the market which, in the PJM market and New England and New York markets, is natural gas fired generation). Yet competition has not developed and very few, if any marketers, seek residential customers or provide energy efficiency and “risk management” services to such customers.

Maryland is no exception to this general trend. As of October 2002, only 3.4% of electric customers in Maryland had migrated to a competitive supplier. Of this statewide

migration total, only 3% of residential customers statewide (4% of the entire residential load) had selected a supplier. At that time only two suppliers were making offers to residential customers. As of March 2003, the residential shopping percentage had risen slightly to 3.7% statewide. By the end of 2004, a total of 42,676 or 2.2% residential customers were served by a competitive supplier among the four electric utilities, over 99% of which were in Pepco's service territory. The Commission's website stated that three suppliers were offering service to residential customers in BG&E territory, 2 in Conectiv territory, 4 in PEPCO territory, and none in the Allegheny Power area in 2004. A year later, as of December 2005, even this small enrollment had dropped dramatically. Only 28,041 residential customers were enrolled with a competitive supplier and again over 90% of those customers were in Pepco's service territory. At that time, only two marketers remained in Maryland who were offering competitive electric service to residential customers and one of them was an affiliate of Pepco. The fact that rate caps were eliminated for Pepco and Conectiv in 2004 and the electric generation or Standard Offer prices rose to reflect wholesale market prices did not result in any substantial increase in marketing by competitive suppliers to residential customers is also typical of other states, a matter that the OPC will address briefly in these comments, as well in the evidentiary phase of this proceeding.

**B. WHAT CRITERIA SHOULD GOVERN THE PLANNING, PROCUREMENT AND  
MANAGEMENT OF STANDARD OFFER SERVICE FOR RESIDENTIAL  
CUSTOMERS?**

I. THE POLICIES ADOPTED BY THE MARYLAND COMMISSION SHOULD BE DESIGNED TO ASSURE THE HIGHEST LEVEL OF BENEFITS TO RESIDENTIAL CUSTOMERS.

The Commission must act in the best interests of residential customers and establish the policies for SOS that will provide the greatest benefits. Standard Offer Service is the only practical vehicle by which any benefits from restructuring can be provided to residential customers. These benefits, if any exist, can certainly not be provided by relying solely on short term wholesale market commodity contracts that reflect highly volatile and immature market prices. The Commission should use the power of the aggregated residential class to get the best bargain on their behalf. The retail market should drive the development of products and services that retail customers want from the wholesale market and not the other way around. Retail customers in Maryland are not the “captives” of forces beyond our control and there is no inevitability that requires that the Commission continue the past practice of allowing the utilities to pass through short term wholesale market contract prices to residential customers for their essential electricity services.

While there are theoretically several options to the designation of the entity that should be responsible for planning, managing, and providing SOS to residential customers, OPC recommends that the Commission require the local distribution utility to act as the agent and on behalf of residential and small commercial customers. The local distribution utility is the most logical entity to plan, acquire, and manage SOS that conforms to the overall policy directives of the Commission. In the evidentiary phase of this hearing, OPC will present evidence that will show that the experiences in other states regarding other institutional options for providing SOS have demonstrated that such options are not practical and that they are unlikely to result in lower

prices that relying on the portfolio management approach implemented by the local distribution companies. Part D of these comments outlines in detail the type of evidence that the OPC suggests should be the subject of the additional testimony and hearings in this proceeding.

The Commission's policies should be neutral with respect to the ability of marketers to offer different electric services to residential customers. However, the Commission should not rely on competitive providers to assure the primary customer benefits reflected in SOS. If marketers can offer services that are lower priced or that reflect attributes that customers may want, i.e., green power, more volatile prices, alternative metering or DSM services, they should be free to make such offers pursuant to licensing and consumer protection rules.

II. THE PRIMARY GOAL FOR THE MANAGEMENT OF SOS FOR RESIDENTIAL CUSTOMERS SHOULD BE TO ACHIEVE THE LOWEST PRICE OVER A REASONABLE PERIOD OF TIME.

The purpose of Standard Offer Service should be to assure stable, reasonable, and affordable rates for residential and small commercial customers who are not served by a competitive electricity supplier. This can only occur with a longer planning horizon and the reliance on a diverse portfolio of electricity supply resources that provide long-term price signals and stable prices. It is not appropriate to assume that Maryland's generation supply portion of the electricity bill should be acquired in a wholesale market in which the entire portfolio of potential generation resources are priced based on the marginal cost of the most expensive unit in the system, i.e., natural gas fired electric generation.

The overall basic approach to the pricing of Standard Electric Service should be to reflect the actual and documented costs associated with the acquisition of this service through the

approved procurement plan. The intent of this service is not to artificially stimulate the development of a competitive market or to price this service in such a way as to drive customers to competitive suppliers. Rather, Standard Offer Service will act as a “price to compare” for competitive offers, to the extent any are made to residential customers.

Finally, and most importantly, it is vital that the retail Standard Service policies drive the development of a wholesale market that has failed to deliver reasonable and affordable prices for electricity. In part this is due to the lack of finality with respect to the “rules of the road” and the development of a well accepted method to assure long term capacity development and system reliability. Because of this failure, it is incumbent on the states and the retail markets to drive the development of wholesale products that meet their needs and not the other way around. State regulators should continue to look for ways to assure long term price stability for essential electricity usage for residential and small commercial customers. They can best achieve this goal not by relying entirely on short term products with the accompanied almost certain price volatility, but by transforming the retail default service into a managed portfolio that includes the option of long as well as short-term contracts, innovative contract pricing terms, and bilateral contracts.

It is not possible to assure long term affordability and stable prices without a longer term planning horizon, such as 10-15 years. This longer term horizon will allow the SOS provider to consider and integrate its energy efficiency, renewables, and traditional generation supply options to achieve the long term lowest cost for SOS customers. Such an analysis will carry risks because a longer term planning horizon will require an estimate of future costs and prices to evaluate various portfolio options. These risks should be identified, evaluated, and addressed by the portfolio manager in its proposed procurement plan.

The Commission should require each electric distribution company to submit a procurement plan for the acquisition of Standard Electric Service that reflects the following requirements:

- a. A minimum of a 10 to 15-year planning and acquisition horizon;
- b. Acquisition strategies that will provide the lowest total cost and stable prices over the term of the plan;
- c. A portfolio that will reflect a diversity of electric supply and cost-effective demand reduction products and services and so reduce the risk of price volatility due to any one event or fuel price; and
- d. A portfolio in which the use of spot market and short term transactions is reduced to a minimum consistent with a reasonable assessment of risk with respect to both price and generation supply availability during the term of the plan; and

To the greatest extent possible, the utility should use competitive or transparent contract processes to acquire any portion of Standard Offer Service. However, this does not mean that the utility needs to use the same process for all contracts or services purchased to implement the SOS procurement plan. Rather, for example, the utility could conduct a request for proposal or auction for some products, issue an RFP and negotiate a bilateral contract with other providers, invest in or otherwise procure physical assets, and issue a performance-based RFP to acquire energy efficiency services under specific conditions setting forth cost effectiveness criteria and time of delivery.

II. THE PURPOSE OF SOS SHOULD NOT BE USED AS A “STICK” TO DRIVE CUSTOMERS TO ALTERNATIVE PROVIDERS OR “FORCE” THE DEVELOPMENT OF A COMPETITIVE MARKET.

The goal of restructuring was to provide customer benefits and there is no basis for interpreting the Maryland restructuring statute as suggesting that customers must be given an “ugly” service to drive them into the arms of marketers. This is particularly true when there is no factual basis for concluding that such an approach would work in any case. The goal of restructuring was not to achieve a certain level of customer switching or migration. The goal of restructuring was to create the potential for using competitive market forces to achieve the ultimate goal of long term lower costs for electricity. In other words, the use of a competitive market was a means to an end and not an end in itself. Since a retail market for residential customers has not developed and has not provided the products and services designed to drive down electricity prices, it is up to the Commission to focus on how these benefits can be provided to residential customers. In other words, the Commission should take actions to provide benefits to residential customers since they are unable to obtain such benefits themselves relying on competitive forces alone.

In developing its policies the Commission should take into account the evidence OPC will present during the evidentiary phase of this hearing on the experiences in other states, as well as Maryland, with respect to any reliance on competitive marketers to deliver benefits to residential customers. Such marketers have entered and exited the market based on short term price changes in the wholesale market and to reflect their ultimate business plans. Many marketers originally sought to make a big splash in the new retail electricity market and promised long term investments and presence in the market. Many of these same marketers

declared Bankruptcy and exited the market suddenly, dumping their customers back into the utility “default” service. Others quietly sold their customer base to other marketers or gradually exited the residential electricity market and concentrated on commercial and industrial customers. Some of the most well-known examples include:

- The Pennsylvania PUC required PECO Energy to seek bids from competitive suppliers to provide default service in its service territory, attempting to implement the so-called “retail” default service model. After several failed attempts to obtain bids that met the bid criteria, NewPower was selected to provide this service for 300,000 residential customers. Prior to the end of its contract obligation, NewPower (an affiliate of Enron and AOL) notified PECO that it could no longer serve its customers, declared Bankruptcy and all the customers were returned to PECO in 2002.
- At least two energy suppliers have abandoned their contractual obligations in Pennsylvania’s retail energy market, resulting in harm to residential customers. Titan Energy marketed natural gas to residential customers in Pennsylvania and other states, obtaining deposits from customers in return for a fixed rate contract. The company declared bankruptcy in 2000. The Pennsylvania Office of Consumer Advocate intervened in Bankruptcy Court on behalf of residential customers and obtained refunds of deposit checks to 6,300 customers. In 2001, Utility.com abandoned the Pennsylvania electricity market without complying with the required 90-day notice to its customers and suddenly went out of business, dumping its customers onto the utility’s POLR service and violating its contractual promise to provide a 20% discount on electricity supply service. Again, the Pennsylvania OCA intervened in Bankruptcy Court and obtained a total of \$325,000 in refunds.

- Natural gas marketers in Ohio, Illinois, New York, and other states have routinely entered and exited the residential market based on their own financial condition. In several cases, these marketers were offering customers fixed price contracts, but when the wholesale market jumped up unexpectedly the marketers were unable to deliver under their contractual promises and so dumped their customers back to the utility at much higher prices.
- One of the largest “national” marketers—Direct Energy, formerly known as Energy America--has been the subject of frequent state investigations in many states for its contract and customer service practices, including slamming and billing errors. States in which this company has signed consent orders or been the subject of investigations include Texas, Ohio, Michigan, Pennsylvania, and Georgia. One condition of several of these state consent orders was that the marketer would cease activities until significant reforms were made in its marketing practices. In some cases, the company simply exited the market rather than comply.

These “horror” stories clearly demonstrate that (1) individual residential customers are in an unequal bargaining position with competitive energy marketers and must assume the risk that their energy provider may not be able to deliver on their contractual promises; (2) marketers come and go and do not have an obligation to serve; and (3) there must always be a “default” provider for these essential energy services that has an obligation to serve and an obligation to provide these essential services at a reasonable and stable price. The Commission cannot and should not rely on the ephemeral goings and comings of competitive marketers to provide essential electricity services to customers who suffer grave consequences when electricity is either not available or is not otherwise affordable.

Finally, it is important to determine what customers want in the design of their electricity price for SOS. The Commission's actions should not be guided by some theoretical justification about what would be "good" for consumers in a perfect economic world, but rather actual retail customer preferences. Surveys have documented that residential customers prefer stable electricity prices and would be willing to pay a small premium to achieve this goal. The Maine PUC conducted a survey on exactly this point several years ago and found that the vast majority of customers would rather have lower standard offer prices than have a greater number of competitive suppliers from which to choose.<sup>7</sup> AARP surveys in Connecticut and New York have also documented customer preference for price stability and less frequent price changes for essential electricity service.

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<sup>7</sup> Nearly  $\frac{3}{4}$  of all respondents preferred the lower prices to the option of having more choices in the competitive market for electricity and  $\frac{2}{3}$  opposed the notion of raising the standard offer price to encourage entry by competitive suppliers. This was true across all demographic and usage profiles. The survey is available on the Maine PUC website: [http://www.state.me.us/mpuc/industries/electricity/standard\\_offer/standard\\_offer\\_study.html](http://www.state.me.us/mpuc/industries/electricity/standard_offer/standard_offer_study.html)

C. IN AN ERA OF HIGHER ENERGY PRICES GENERALLY AND HIGHER ELECTRICITY PRICES SPECIFICALLY, THE COMMISSION SHOULD EVALUATE THE NEEDS OF LOW INCOME AND OTHER VULNERABLE CUSTOMERS AND ASSURE THAT BENEFITS AND PROGRAMS EXPAND WITH THESE NEEDS

I. THE STATE MAY NEED TO REVISE ITS ESTIMATE OF NEED FOR LOW INCOME CUSTOMERS TO ASSURE THAT ESSENTIAL ELECTRICITY SERVICES REMAIN AFFORDABLE

Maryland's restructuring law included a mandate for a ratepayer funded Electric Universal Service Program. This program is currently funded at \$34 million, \$33 million of which is allocated to customer bill payment assistance and \$1 million for an additional contribution to the Weatherization program. This program is implemented by the Maryland Office of Home Energy Programs, and coordinated with the OHEP implementation of the Maryland Low Income Assistance Program (LIHEAP), which provides a once per year benefit for a household's primary home heating fuel.

This funding mandate for EUSP should be reviewed in light of the rapid and extraordinary increase in electricity prices that will occur in 2006 and possibly beyond.

II. THE COMMISSION SHOULD CONSIDER OTHER CHANGES IN ITS POLICIES AND PROGRAMS TO RESPOND TO THE NEED FOR FAIR TREATMENT OF ALL CUSTOMERS IN THE FACE OF HIGHER ELECTRICITY PRICES.

The Commission should consider reviewing and possibly reforming its customer protection regulations that provide the minimum standards governing natural gas and electricity utilities in their interactions with customers for application of service, deposits, billing options, late fees, payment plans, and disconnection or termination of service. While these programs and policies are not targeted directly to low income customers, many of these minimum residential service standards provide an indirect, but important, means by which vulnerable customers can obtain and retain essential electricity services. It will be important to review and consider reforms to these policies to make sure that utility credit and collection practices reflect the reality of what is likely to be an increase in bill payment difficulties for residential customers of low and moderate income means.

D. THE COMMISSION SHOULD CAREFULLY INVESTIGATE AND EVALUATE EXPERIENCES AND FACTS CONCERNING THE IMPLEMENTATION OF RETAIL COMPETITION IN OTHER STATES AND THE FACTUAL BASIS FOR ANY PROPOSALS CONCERNING HOW SOS SHOULD BE PROVIDED IN MARYLAND

I. THE COMMISSION SHOULD REQUIRE PARTICIPANTS IN THIS PROCEEDING TO DO MORE THAN ALLEGE THEORETICAL LONG-TERM BENEFITS ASSOCIATED WITH THEIR PREFERRED VISION FOR SOS POLICY.

The Commission should base any “findings” and policy initiatives on factual information and not theoretical benefits or empty promises, particularly those that transfer substantial risks of failure to achieve the promises to residential customers. The following categories of information should be carefully considered during the evidentiary phase of this proceeding.

1. Investigate availability of competitive alternatives to provide customers with electricity products and services that customers want in Maryland and other similarly situated states.
  - a. Extent and scope of retail marketer activities in other states:
    - i. Number of marketers licensed and marketing to residential customers
    - ii. Types of products and services offered to residential customers.
2. Obtain information on “default” service policies and programs in restructuring states, particularly recent trends and developments:

a. **Pennsylvania.** Pennsylvania has had considerable experience with bidding out default service to retail providers. While the larger utilities have rate caps that extend for several more years, the smaller electric utilities have ended their “transition” periods and have negotiated or conducted bids to obtain POLR service for their customers. Recently, the small utility Pike County Power and Light conducted a wholesale market solicitation for its customers that resulted in a 125% increase in the generation supply portion of the bill and an estimated average annual increase of 75% in the total electric bill. In response the Commission attempted to interest retail electricity providers in bidding to serve these customers at a lower price without success. Customer shopping in PA was always concentrated in a few service territories with the highest generation prices, but has dropped dramatically throughout the state in the last several years, even in those service territories without capped prices.

b. **Maine:** Maine never implemented rate decreases or rate caps in its move to retail electric competition in 1999. Rather, the PUC itself conducts the wholesale market contract negotiations on behalf of residential and small commercial customers for Standard Offer Service. Since 1999, the residential price for SOS has increased over 100% even though the Commission has attempted to negotiate 1-3 year contracts and most recently has adopted a “laddering” approach. Recent legislation requires the Commission to consider using energy efficiency contracts paid through SOS to moderate energy prices and has imposed a statutory goal of achieving the “long term lowest price” for

SOS using a variety of contract terms and types. In addition, recent statutory changes authorize the Commission to negotiate long term capacity contracts to be paid through distribution rates. During this entire period there has never been a significant number of competitive marketers seeking residential customers.

c. **Massachusetts.** The “regulated” price for generation service ended in February 2005, but even prior to that time utilities were allowed to raise default prices to reflect fuel costs. The Department requires the utilities to obtain two default service products for residential customers: (1) a six-month fixed rate; and a (2) monthly variable rate. Customers are provided the fixed rate option unless they affirmatively ask for the variable price service. For residential and small commercial and industrial customers, the Department directed each distribution company to procure 50 % of its default service supply semi-annually, for 12-month terms. As a result, default service prices for these smaller customers (for both the monthly and the six-month pricing options) are now based on an average of the results of two separate procurements. As a result of relying on these short term wholesale market contracts, prices have risen dramatically, particularly in the last several years.

When restructuring began in 1998, a residential customer of Boston Electric Co. paid 2.8 cents per kWh. This has steadily risen to the current price of 12.66 cents per kWh, a whopping 350% increase. In the last year the price rose over 60%. Even so, there has been no significant marketer activity for residential customers. As of April 2006, 8.7% of residential customers were

served by a competitive supplier, but less than 1% of Boston Edison's residential customers had migrated to another supplier. The vast bulk of this shopping total is composed of customers in a municipal aggregation program that serves several small towns called Cape Light Project.

d. **Delaware.** The sole investor owned utility, Delmarva, operates under a rate cap that is due to expire in July 2006. The results of the bids for serving residential and small commercial customers will require the average residential customers to pay 56% more for their total electric bill. There has never been any marketer interest in serving residential customers in Delaware.

Upon public disclosure of these impending price increases, the Governor called for a special task force and the Legislature subsequently enacted reforms for the future SOS policy in that State. These new policies require Delmarva to prepare a 10-year procurement plan that will integrate a diverse electricity supply portfolio, including energy efficiency, renewables, and the option of utility construction of new generation units. The overall purpose of this plan must be to "acquire sufficient, efficient and reliable resources over time to meet its customers' needs at a minimal cost."

e. **New Jersey.** The New Jersey electric utilities operated under a rate cap until 2001, at which time the Public Utilities Board instituted an internet-based auction to acquire Basic Generation Service for all customers not otherwise served by a competitive energy supplier. The auction for residential and small commercial customers obtains a fixed price product. Suppliers bid for "tranches" within all the utility service territories. The auction occurs

annually, but the BPU has gradually moved to acquiring 1/3 of the load for residential and small commercial customers for a three-year contract each year. BGS prices have steadily increased and the most recent auction results will blend 10-11 cents per kWh energy with prior contract prices. There has never been any significant residential shopping in New Jersey and almost no marketers are making offers to residential customers.

f. **Texas.** Texas has a unique market structure that no other state has duplicated for retail electric competition. Under the Texas model, there is no “utility” default provider. When retail competition was initiated in 2002, all customers were transferred to the retail competitive energy affiliate of the former utility. Retail Electricity Providers (REPs) other than the affiliate serve 20-25% of residential customers. The price that is charged by the affiliate REP (the former utility) is allowed to increase twice per year based on the price of a short term index for natural gas. Under the Texas PUC’s regulations concerning this service, the REP is not required to seek a rate decrease based on the same index, in part due to the stated purpose of providing sufficient “headroom” for other competitive energy providers to offer a lower price to customers. As a result, the total electric bill in Texas has increased dramatically (over 80%) since January 2002. A residential customer of Reliant Energy on the Price to Beat (default) service who uses an average of 1,000 kWh for electricity has seen an 89% increase in her total electric bill from April 2002 to April 2006.

g. **Western States.** California, Montana, Arizona, and New Mexico adopted retail electric restructuring in the late 1990's and they were all impacted by the western U.S. market "implosion" in 2001-2002. Each of these states, some of which have repealed retail electric competition for residential customers, have all subsequently adopted a long term procurement planning approach for default service. The utilities in all these states file a 10-15 year plan to serve their customers and must demonstrate that they have considered all low cost options and integrated a diverse portfolio of traditional contracts as well as energy efficiency options to reduce risk and provide stable prices.

## II. THE COMMISSION SHOULD NOT ADOPT THE "NEW JERSEY" MODEL

The Commission's Notice for this investigation asks whether the "New Jersey" model should be adopted. The OPC recommends that the Commission not adopt the New Jersey model to obtain Standard Offer Service because it reflects the same defects that are associated with the approach to SOS in Maryland to date, i.e., the purchase of relatively short term wholesale market contracts with consequence price volatility and lack of integrated portfolio management. The prices paid for residential SOS service in New Jersey based on the most recent auction were similar to those prices that resulted from the BG&E contract solicitation and the bids accepted for Delmarva and Pepco. Most importantly, this approach fails to take into account the need for a longer procurement planning process, the diversity of various contract types and contract terms, nor does this model effectively integrate the option to lower prices with targeted energy efficiency or demand side management programs. While the New Jersey approach of laddering its contracts (buying 1/3 each year) and relying on three-year fixed price contracts have provided

some benefits to consumers by blunting the impact of recent wholesale market price increases, next year's auction is likely to result in another significant price increase. There is no significant difference between the New Jersey approach and that currently in place under the SOS settlement agreement in this regard.

Rather, OPC recommends that the Commission carefully review the approaches recently adopted in Delaware and Maine and follow their lead in adopting an integrated and diverse portfolio for SOS that reflects a longer planning horizon and that specifically is governed by the over arching objective of "long term lowest price" for this essential energy service for residential customers.

### III. THE EVIDENTIARY PHASE OF THIS PROCEEDING WILL SHOW THAT IN MARYLAND AND ELSEWHERE THERE IS NO RETAIL COMPETITIVE MARKET FOR ELECTRICITY IN EXISTENCE FOR RESIDENTIAL CUSTOMERS

The evidentiary phase of this case will make it clear that there is no state in the Mid-Atlantic, Midwest, or New England area that can demonstrate that it has developed a robust retail electricity market for residential customers. Even when significant marketing activity has occurred, such in some of the Pennsylvania service territories in 1999-2000; such activity has not been sustained for any length of time. While the Commission may want to obtain further information to inform it concerning why this has occurred, the fact remains that there is no success story to evaluate or emulate. While marketers with experience in Texas often point to that model as a means of creating a "successful" competitive market for residential customers, the market structure in Texas is unique and the rapid and volatile price mechanism for default service in that State is unlikely to be politically acceptable in Maryland or elsewhere. Even that

the Texas system, which adopts the “ugly” default service approach to drive customers to alternative providers, there is a relatively low level of customer migration and there has been a significant level of “churn” in marketer exit and entry in the last year.

Marketers frequently allege that they must see more volatile prices that reflect short-term wholesale market trends to sustain their interest in seeking residential customers. On the other hand, owners of generating facilities have confirmed that the lack of long term planning and investment in long term contracts for new generation facilities are likely to threaten our the reliability of electricity supply in the near future.

E. HOW SHOULD THE COMMISSION CONSIDER RETAIL RATE DESIGN AND DEMAND RESPONSE OR “ADVANCED” METERING PROPOSALS IN THIS PROCEEDING?

I. ANY PROPOSALS TO ADOPT CHANGES TO RESIDENTIAL RATE DESIGN OR IMPOSE NEW METERING AND DEMAND RESPONSE PROGRAMS ON RESIDENTIAL CUSTOMERS SHOULD BE CAREFULLY EXAMINED FOR COSTS AND BENEFITS.

In response to the assertion that residential customer SOS prices should not be volatile and reflect short term wholesale market prices because they are unable to respond to such price signals without significant hardship, some observers argue that Time of Use (TOU) rate designs and meters would allow consumers to shift usage and avoid high electricity bills. However, there is a significant gap between the theory of what residential customers should or would do with such price signals and the reality of what customers will in fact do. The Commission should carefully evaluate information on demand response programs targeted to residential customers to obtain factual information on costs, benefits and results. The Commission should obtain information on TOU programs implemented in other states, as well as other demand response programs that might target specific appliance usage, such as air conditioners, at periods of peak usage.

Any such programs will require new metering and communications technologies that have significant costs that should be carefully considered when talking about “real time” pricing and “time of use” price programs. Finally, any such changes will require significant consumer

education, outreach, and research, another expense that should be factored into the costs and benefits of such programs.

Furthermore, any change in rate design always produces “winners” and “losers” and the Commission has an obligation to determine what customer usage profiles can benefit by reducing their overall bill under a specific change in rate design or which customers are likely to experience higher electricity bills. This is particularly the case with residential customers, many of whom use electricity for basic services and do not have the practical option to shift usage or significantly reduce usage without hardship. In the mid-1980’s, Central Maine Power Co. in Maine had a mandatory TOU tariff for residential customers that used over 2,000 kwh in any one winter month. The intent of this tariff was to target electric heat customers, but of course it “captured” many other high use residential customers. In any case, as prices rose generally and the price differential became greater between the peak usage hour and the off-peak hours, customer complaints to the utility and to the Maine PUC increased dramatically. Many elderly customers in electrically heated housing complexes had no realistic option concerning their usage of electric heat because of the health consequences of reducing their thermostats on the coldest winter days and nights. Mothers with small children complained because of the high cost of their electric bill and recounted their inability to cook dinner or use hot water during peak usage periods because of the needs of their children for dinner and bathing. Low income families in electrically heated apartments felt “trapped” with high electricity bills without the financial resources to move or install replacement for their electric heat units. Finally, with the onset of restructuring, the Maine PUC made the TOU program voluntary.

The Commission should also review the results of the more recent experience with mandatory residential TOU pricing programs at Puget Sound Energy in Washington. A two-year

program was halted due to customer complaints and the documentation that most customers ended up paying higher bills rather than lower bills under the program, directly contrary to the marketing message used by the utility when the program was introduced.