

NCAT Study Finds Default Service Decisions in Several States Pose Higher Risks for Residential Customers

BUTTE, MT (July 9, 2003) In a study released this week, a national expert on utility consumer affairs says that recent decisions in three Eastern states could prove risky for residential electricity customers and result in more volatile prices. Author and consumer affairs consultant Barbara Alexander examined recent developments on the design and pricing of Default Service in six states that have adopted retail electric competition and who are ending their rate freeze or transition period.

The decisions made by regulators in Maryland, New Jersey, and Massachusetts "indicate a cause for serious concern and a likelihood that current trends, if not reversed, will carry significant risks of harm to consumers, particularly residential consumers," Alexander wrote. The paper, titled "Managing Default Service To Provide Consumer Benefits In Restructured States: Avoiding Short-Term Price Volatility," (<http://neaap.ncat.org/experts/>) was prepared for the National Center for Appropriate Technology (NCAT), a non-profit in Butte, Montana, that has served economically disadvantaged people since 1976 by providing information and access to appropriate technologies that can help improve their lives.

Default Service refers to the electric service provided to customers who do not choose a competitive electric supplier, or who are not able to obtain service from a competitive supplier - the vast majority of residential and small commercial customers in most states that have adopted retail electric competition.

Recent developments in New Jersey, Maryland, and Massachusetts have based the price of default service almost entirely on short-term wholesale market prices, Alexander's research shows. Relying on short-term markets is risky, she said, because of the possibility of volatility in prices, including price spikes and other external events such as fuel emergencies. Other states are taking a more long-term view of the Default Service obligation. Both Montana and Connecticut, in particular, have recently adopted legislation that requires Default Service to be priced and managed based on long-term price trends and reflect a balanced portfolio of short- and long-term energy resources, including renewable resources.

Alexander called for a "new regulatory vision" to guide default service acquisition that is "proactively managed to provide benefits to consumers." The key attributes of a Default Service policy that will provide consumer benefits, according to Alexander, are as follows:

- * Assures reasonably stable, reliable, affordable, and environmentally sustainable energy services
- * Relies on a longer term, diverse portfolio of electricity resources to assure balance and reduce risks of short term volatility in prices, increased regulatory costs or other external events
- * Lowers environmental impacts of electricity generation, and allows for displacement of old, inefficient generation with new, more efficient generation, resulting in lower overall cost
- * Strengthens the development of new public benefit programs, and supplements existing programs through resource procurement policies, to assure affordable service for low-income customers, renewable investments and cost-effective energy efficiency resources
- * Enhances the development of a healthy wholesale electricity market.

The aspects of states' decisions that Alexander found troublesome are as follows;

Maryland: A requirement that 50 percent of the customer load be obtained in the form of a one-year contract is likely to delay any planning and capacity to manage a portfolio of products to obtain long term price stability for residential customers. It also includes an administrative charge that is heavily weighted toward utility interests, resulting in higher prices for generation supply service.

Connecticut: While its legislation attempts to establish default service policies for a longer time period, providing more stable rates, it also has some anti-consumer aspects, including a pass-through of utility administrative costs, a lack of a specific planning "horizon," and a likelihood of increased rates due to pass-through of "federally mandated congestion costs" and the impacts of the renewable energy mandates for the default service portfolio.

New Jersey: The state's restructuring legislation mandated 10 percent electric rate reductions; however, unlike any other state, it also required ratepayers to reimburse utilities for deferred balances that might accumulate as a result of those discounts. As a result, New Jersey ratepayers now have a deferred balance debt of over \$1 billion that will come due once rate caps expire in August 2003. The state is also unique in that it has bid out its entire customer load for 2003 and 2004 through an auction process. While this approach reflects the most sophisticated effort of any state to attain "true" wholesale market prices, the auction process reflects only short-term market trends with no long-term price stability, resource acquisition, or portfolio management occurring.

Massachusetts: Management of default service in this state is crucial because all customers who don't have competitive suppliers must take this service at the end of the transition period in March 2005. Despite volatility in its default service prices since 2000, the state is firmly committed to the creation of a competitive market and the establishment of pricing methods that reflect "market" prices and "price signals," defined as relatively short-term wholesale market prices. As a result, utilities will be allowed to procure 50 percent their default service supply semi annually for 12-month terms, a change from previous practice that allowed 6-month terms.

States that have made positive strides in the development of default service are Montana and Pennsylvania. Highlights include:

Montana: The state's new default service regulatory rules require the default service utility to "plan and manage its resource portfolio in order to provide adequate, reliable and efficient annual and long-term default electricity supply services at the lowest total cost." State legislation includes similar language.

Pennsylvania: While no recent decisions have been to impact the post-transition default service, the state is one of the few to bid out retail customers to default service providers, generally without success. However, its approach is positive because such bid programs require the supplier to provide generation service at or below the long-term price caps in effect for the largest electric utilities. Furthermore, the Pennsylvania experience with this program has heightened the regulatory awareness of the need for strong security instruments to protect consumers if the supplier defaults or, as occurred with NewPower, declares bankruptcy.

The study is part of NCAT's continuing effort, through its National Energy Affordability and Accessibility Project, to document how restructuring is affecting low- and moderate-income residential consumers. It was funded by the U.S. Department of Health and Human Services Administration for Children and Families.

For more information, contact Barbara Alexander at - (207) 395-4143 (E mail: barbalex@ctel.net) or Kay Joslin at NCAT at 406-494-4572, (kayj@ncat.org). The study can be found online at NCAT's National Energy Affordability and Accessibility Project (NEAAP) website at: <http://neaap.ncat.org/experts/>.