After the Freeze: Issues Facing Some State Regulators as Electric Restructuring Transition Periods End
AFTER THE FREEZE: ISSUES FACING SOME STATE REGULATORS AS ELECTRIC RESTRUCTURING TRANSITION PERIODS END

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EXECUTIVE SUMMARY

Since the electric restructuring movement began, at least 24 states took action to introduce retail electric competition. The states had implemented a number of policies to promote competition and to protect consumers. However, unforeseen factors may have changed the vision of electric restructuring and just what it might mean for tomorrow. There now appears to be 17 states that are continuing with their respective electric restructuring plans.

The end is here or in sight for many of the restructuring transition periods designed as mechanisms to ease the industry and the retail customers into a market-driven environment. By the end of the transition periods, competitive forces were envisioned to be sufficient to provide appropriate price and availability stabilizers and, ideally, even downward pricing pressures. The problem is that competition has not materialized as predicted in all states and some states are facing the issue of what to do at the end of these transition periods. Consequently, some states are reassessing the future of restructuring. The report finds that state regulatory commissions in all states continue to use policies to protect consumers. Some have chosen to reinforce efforts to develop a competitive market. A few have opted to return to previous regulatory frameworks. And others have taken actions somewhere between these two ends of the continuum. Whatever the success of restructuring within a state, each commission must continually choose to stay or adjust their current course. If a state opts to adjust, they may entirely reverse direction, simply slow the transition, replace some or all of the non-working market with government involvement or further encourage choice.

Some of the original and modified transition policies are similar and some are not. This report examines these policies and in an attempt to provide analytical assistance to all state regulatory commissions – those continuing with restructuring and those contemplating restructuring. The report does not focus on the successfullness of electric industry restructuring overall, only the policies that regulatory commissions have implemented to achieve their regulatory goals.

“Go slow” is good advice in any uncertain market, where failure to act now will not eliminate any opportunities. States that have chosen to slow their existing processes or to not enter restructuring at this time are not going to lose the opportunities for future market creation. If the long-term market potential is there now, it will be there later. However, before extending rate freezes, existing rates must be examined. If fixed rates are uneconomic or artificially low, competitive entry is hampered. Where competition is desired but not realized and rates are below costs, it may be necessary to bring rates toward costs to foster a long-term competitive market.

The states that have continued with retail electric service restructuring are not waiting to address the issues caused by the underdeveloped fledgling market. Many of the states have taken clearly proactive steps to promote further development of the market and to continue to protect customers during that development. Whether these actions will be sufficient is not clear. What is clear is that that some time and many steps remain if a viable market is to develop and thrive long-term in an acceptable manner.
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FOREWORD

Market development is a difficult thing to predict and perhaps an even harder thing to mandate. Starting back in the mid-1990s policy makers and regulators in nearly half of the states used their best expertise and judgments to begin designing retail electric service markets within their states. Substantial transition periods and customer protection mechanisms were implemented to allow the markets to develop sufficiently. Unfortunately, all markets did not develop as expected. While some markets did develop, some failed to develop at all.

The causes are arguable. Assignment of responsibility is arguable. But what is not arguable is that the state regulators are proactively acting as necessary to manage the situations within their states. Whether those actions are to slow down, reverse, revise, or stay the course, it is clear that state regulators are on top of the issues.

This report summarizes the status of electric restructuring and considers the options available to states facing the issues of insufficient market development. It examines the issues of stranded cost recovery and rate caps relative to market development.

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September 2003
INTRODUCTION

Since the beginning of the electric restructuring movement several years ago, at least 24 states have taken some action to begin the introduction of retail electric competition in their respective states. Introducing competition to the retail side of the market has been anything but a simple process. When it all began, policy makers, customers and Wall Street, for varied reasons, embraced the promise of a better tomorrow with electric retail competition. Proponents cast the enticing lure of reduced retail electric prices. Some things have gone well, but not everything has gone as planned. Some states may say that almost nothing has gone as planned. Several unforeseen factors may have changed some of our vision of electric restructuring and just what it might mean for tomorrow. Of the original 24 states, there appear to be 17 that have continued with their original respective electric restructuring plan schedules and the introduction of competition to the retail electric market. On the other hand, apparently in light of the slower than expected market development and several headline events,\(^1\) some of the original 24 states have taken measures to slow, suspend or even reverse electric restructuring measures.

It is not surprising that the failure of retail competition to develop as quickly as desired is of concern to the states. But why is it such a pressing policy concern in some states? Since the Aug. 14, 2003 power outages in the northeast, Midwest and Canada, there have been a number of comments and speculations made regarding electric restructuring. Whether or not retail electric competition ultimately becomes a national long-term reality, transmission management, reliability and resource adequacy must be addressed. The relevant issue for some states is the expiration(s) of transition periods. Most restructuring plans included transition periods of two to seven years. These transition periods were intended to be mechanisms to ease the industry and perhaps more importantly the retail customer base, into a market-driven environment. During the transition periods, most plans called for retail rates to be capped or frozen for some or all customer classes. Several plans actually reduced and froze retail rates. These

\(^1\) The electric market experiences of California in 2000-2001, the collapse of Enron and the subsequent accounting exposures all likely contributed, at least on an emotional level, to some states’ decisions to reconsider electric restructuring.
transition periods were intended to provide the necessary time for the market to develop, while maintaining a high degree of guaranteed service and rate stability. By the end of the transition periods, competitive forces within the market were supposed to be sufficient to provide appropriate price and availability stabilizers and, ideally, even downward pricing pressures. The problem now appearing in several states is that competition is not materializing exactly as predicted and states are facing the issue of what to do at the end of the transition periods.

States are reassessing the environment and the future of electric restructuring. The range of actions resulting from these reassessments is as diverse as the states themselves. While some have chosen to reinforce efforts to develop a competitive retail electric market, others have opted to return to previous regulatory frameworks. And many others have taken actions somewhere between these two ends of the continuum. Regardless of the different actions taken or to be taken, at least two of the motivations are the same. Those motivations are to protect ratepayers from extreme rate increases and assure that the requirements of any regulatory compacts that may exist with the utilities that were restructured are met.

This report:

- Reviews the current status of retail competition
- Discusses the options available to states to address transition issues that have come or will come to a head
- Describes the steps several states have taken to extend, modify, delay or repeal state actions authorizing competition
- Provides conclusions and recommendations on the further evolution of retail choice in the electric industry
The Status of Competition

The success of competitive market development varies by state, regions within a state, customer class and one’s definition of success. Illinois and Ohio provide examples of varying signals of success. Illinois reports that nearly 12.5 percent of all retail electric sales have gone to competitive suppliers since the inception of retail choice in October of 1999. However, the Illinois Commerce Commission points out that there have been no suppliers marketing to residential customers and that a large number of the commercial and industrial (C&I) customers have switched to the “power purchase option” which is set to expire at the end of the transition period.\(^2\) Ohio is reporting a statewide migration rate of approximately 13.5 percent, primarily in northern Ohio where rates were relatively high prior to electric restructuring.\(^3\) Examples such as these can be found in most of the states that have implemented electric restructuring. Whatever the levels of success may be, many policy makers and observers agree that retail competition has not developed as robustly as hoped and planned. It is well documented that competitive long distance telecommunications market took more than a decade to reach a robust level. Certainly, and without surprise, development of the markets for small commercial and residential users has lagged well behind the large industrial users market. Still, for the states that have implemented electric restructuring, some are indeed reporting progress and competitive market growth.

Regional Market Growth

In an examination of the spread of competition throughout a state that has opened the markets, one will often find highly regionalized growth. Illinois, Ohio, Pennsylvania and Texas are just four examples of states that have noted regionalized market growth. Texas notes that competitive supplier activity has been most abundant in the large urban markets due to the scale achieved in marketing efforts in this area.

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However, Texas is also reporting that competition has begun to expand into south and west Texas.\textsuperscript{4}

Though much of the competitive growth is in regionalized pockets that often track the regions with historically higher rates relative to other regions within the same state, this is not cause for alarm. This growth pattern was to be expected and is a common pattern of market development.

**Commercial and Industrial (C&I) Market Growth**

C&I customer switch rates have been reported as high as 50 percent or more.\textsuperscript{5} In Illinois, more than one-third of the Commonwealth Edison load has switched to competitive suppliers. Illinois also notes that approximately 60 percent of customers with demand above 1 MW have switched from bundled to delivery service.\textsuperscript{6} The ability for customers to aggregate to increase their buying power seems to have been positive for C&I customers in Ohio and Texas. Ohio reported that more than 88 percent of commercial switching and nearly 20 percent of industrial switching is from aggregation.\textsuperscript{7} A group of 18 aggregators in Texas reported a savings of over $134 million dollars over rates paid in 2001.\textsuperscript{8} New York reported a total C&I load migration of 33.6 percent, some 1.93 million MWh. This was an increase of more the 30 percent over the past 12 months.\textsuperscript{9} The percentages vary notably from state to state, but nearly every active state reports that the large C&I users are the customers most likely to switch to a competitive supplier.

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\textsuperscript{5} The PUCO, Ohio reported in one utility area a commercial switch rate of 59.31 percent with a high industrial switch rate in another utility area at 30.87 percent. See *The Ohio Retail Electric Choice Programs Report of Market Activity 2001-2002: A Report by the PUCO*, May 2003.


\textsuperscript{8} Texas Public Utility Commission (Texas PUC), *2003 Report to the 78\textsuperscript{th} Texas Legislature – Scope of Competition in Electric Markets in Texas*, January 2003, p. 76.

Residential Market Growth

Measured on a percent of customer class basis, it is clear that small customers have seen the least benefit from electric restructuring across all active states. However, there are positive notes in that area. New York reported over a 17 percent increase in residential customer migration from March 2002 to March 2003. The Texas Public Utility Commission (Texas PUC) reported over 400,000 customers had switched to competitive suppliers, 80 percent of which were residential. The Texas PUC further noted that residential customers have between three and ten choices of competitive suppliers in those areas open to competition. Aggregation also seems to be a high point in the residential sector. In Ohio, aggregation appears to have been the key to residential migration, where it is reported that aggregation accounts for nearly 93 percent of all residential switching.

WHAT WENT RIGHT OR WRONG?

Why competition has not developed as fast as many hoped is a very debatable question that each state must eventually face. This brief report is not intended to examine in detail the factors that are affecting the development of the market. However, there are a number of major factors that might have played a role in each of the states to one degree or another. Among those factors are:

- The actual effectiveness of competition in the wholesale power market
- The large (and increasing) dependence on natural gas for generation
- Relatively low rate areas and/or rates frozen at, near or below cost levels
- Risk uncertainties for new generation and transmission facilities

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13 As generation demands more on natural gas, this demand naturally places upward pressure on prices. The current supply status of natural gas exacerbates this upward pressure on natural gas prices. As natural gas prices rise, the cost of electric production reliant on natural gas will also rise. Higher prices for generation lead to a narrowing of any competitive supplier margins that might exist between the cost of service and the target incumbent rate.
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- The California experience\textsuperscript{14}
- The relatively high cost and low profit to serve small customers
- The loss of confidence in corporate soundness and integrity
- Inadequacies of the transmission grids and operations
- Uncertainties surrounding standard market design (SMD) and potential federal actions\textsuperscript{15}

All of the above factors are cited in numerous policy maker and stakeholder arenas. Most states, whether or not they have decided to implement electric restructuring at this time, have considered all of the above factors at one time or another in their deliberations. Having considered the major factors that might hinder market development, a state that intends to begin or continue market development must then consider the options available to it that might serve to mitigate one or more of the factors and advance the state’s policy goals.

WHAT ARE THE OPTIONS?

Now that the end of some transition periods are occurring or are in sight, several of the active states have faced or are facing the question of what to do if the level of competition is not yet adequate to keep a check on retail price volatility. While some might worry that this is an urgent problem or even a pending national crisis, upon close examination it appears that the states are for doing what needs to be done. Of the states that are already mid-stream or further into electric restructuring, all seem to have kept a good handle on the situation.

What if the initial “transition period” end is here or in sight, the guaranteed price protections are scheduled to go away and the market is not sufficiently competitive? What is a state to do? The broad categories of options are described well by Matthew

\textsuperscript{14} The experience in California in 2000 was likely caused by a number of these factors, among others.
\textsuperscript{15} The large number of uncertainties that continue to surround the Federal Energy Regulatory Commission (FERC) proposal for a standard market design (SMD) are certainly a contributing factor to the slower than anticipated growth of the retail electric market. The states continue to have very divergent views of the SMD proposal. Some states strongly endorse the development of regional transmission organizations (RTOs) while other states strongly oppose the same. The original proposal, the subsequent white paper, and the possibility of congressional action on an energy bill all have added to the level of uncertainties. Regardless of where a state’s opinion lies with regard to SMD, the lack of any certainty about such major issues has inevitably chilled the development of competition.

1. **Encourage choice.** Redesign the system to either offer financial incentives to people who switch from regulated suppliers or raise the prices for people who do not switch such that they see the economic value in switching. Make switching easier. Experiment with real time pricing with some retail customers.

2. **Go slow.** At least for a while, small customers are not likely to switch. Find policy approaches tailored to the needs of small customers that bring benefits of competition but leave in place the protections of regulation. These approaches might best be classified as hybrids of regulation and competition. Apply lessons learned from restructuring even if retail competition is not permitted. Do not rush ending default service.

3. **Go back.** Decide that a truly competitive market is not achievable, at least in the near term, so reverse plans for retail competition and restore the vertically integrated utility.

4. **Government steps in.** Step back entirely from the idea of a competitive retail market and, instead, explore ways for the government to be directly involved in the procurement and sale of electricity.

5. **Transmission and Public Interest Policies.** There are several practices and policies that offer consumer benefits independent of the state of competition or the way the industry is organized. While the environment of change has sparked these innovations, they may apply in both competitive and monopoly states.16

While the five broad categories of options reasonably cover the options available to policy makers, the details of the definitions can be further refined. The definitions

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given for categories 3 and 4 seem to only describe the extreme side of each category. The authors seem to suggest an all or nothing approach to competition as it regards the “go back” and “government steps in” options. However, the regulatory environment in which utilities and states must operate rarely presents such “all or nothing” actions as viable options. More realistically, all of the categories may be interpreted as options that might be applied to varying degrees. Following is a more detailed discussion of the options, including examinations of how various states have used them.

The Appendix to this report is a brief snapshot of several states and the status of electric restructuring in those states. It shows some of the options several of the states have used. The table is not intended to be inclusive of all states with any electric restructuring activity or exhaustive of all the activity within the states listed. It focuses on transition periods, cost recovery mechanisms and any policy activities of note. This sampling of state activity clearly shows that states are keeping a tight grip on the situations within their respective states and taking actions deemed necessary and within their authority to maintain their policy goals.

“Encourage Choice”

Pricing Changes

Standard Offer Service (SOS), default or other transition rates are naturally a key factor in most switching decisions.\(^{17}\) The higher current transition rates are, the more likely a given customer is to shop in the market. If current rates are low, the incentive to switch is usually correspondingly low.\(^{18}\) There would even appear to be some threshold level of savings that a customer needs to first be encouraged to shop. In Ohio, despite mandated “shopping credits,” four of eight incumbent utilities have seen almost no

\(^{17}\) Standard Offer Service (SOS) usually refers to that service made available by the utility to customers who do not choose any alternative supplier. Default service often refers to that service made available by the utility for customers who at one time choose an alternative supplier, but subsequently elect to return to the incumbent utility. Both SOS and default service prices have been typically low and capped or frozen during the transition periods.

\(^{18}\) That is not to say that other decision factors such as reliability and fuel source do not influence the switching decision.
residential switching. This is generally attributed to the utilities’ low rates. Some states are trying to address competitive development concerns by adjusting SOS rates, default service rates and/or shopping credits. A prime example is New York. In March 2002, the New York PSC changed the shopping credit of New York State Electric & Gas (NYSE&G) customers from a fixed to a market-based rate. In the year following the adjustment in the shopping credit, NYSE&G saw an increase of nearly 72 percent in its customer migration rate. At a minimum, Maine, Maryland, Massachusetts, Ohio and Virginia appear to have considered or be considering SOS and default service rate designs that could assure additional rate stability after transition periods end and, could promote further market development. Each state must examine its options in light of the very specific conditions within that state.

The Power of the Environment

While price may be the first factor that most customers compare when considering a competitive choice, environmental impact is also a marketable difference. Some states placed renewable resources or environmentally focused offering requirements in their electric restructuring rules. In addition to environmental disclosure or labeling requirements, some states have highlighted the environmental component of a customer’s electric choice. An examination of electric choice marketing materials from many states finds a variety of examples. In February, the New York PSC began a proceeding specifically to develop a renewable portfolio standard for electric energy retailed in the state of New York. And, according to the Texas PUC of Texas, customers have “demonstrated a significant amount of interest in renewable rate offerings,” though these rates have “been priced at a premium.”

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20 New York State PUC, NYS Electric Retail Access Migration Reports, March 2003.
21 For three examples among many, see:
Not only are states educating customers about environmental options, but suppliers are doing so as well. Green Mountain Energy Company has developed its entire electric supply plan on the marketing of environmentally friendlier options and it appears to be a choice some customers will make. In Ohio, Green Mountain Energy Company was selected as the supplier for “Northeast Ohio Public Energy Council (NOPEC), the largest public aggregator in the United States,” representing 112 communities and more than 350,000 residential customers. In Oregon, Green Mountain Energy Company supplies Portland General Electric and Pacific Power in Oregon with electricity for its “renewable usage” and “habitat” options. Even though these options are nearly a cent higher per kWh than the basic rates, Oregon reports more than 26,000 customers have taken these options. There is clearly a subset of customers who are more likely to be influenced to switch as a result of the supply source and its relation to the environment. States that have not emphasized the environmental aspect of choice could certainly do so to further encourage choice and develop the market.

“Go Slow”

More than half of the states that had already initiated electric restructuring are continuing, albeit with perhaps even more caution than they initially applied to implementation. Going slowly was a concept originally built into almost all of the electric restructuring plans. Unfortunately, no one was sure just how slow was slow enough. Everyone recognized that you could not flash-cut to a fully competitive, market driven environment, but there was also fear of going too slowly. Now, with a little direct experience and the realities of the overall economy, it is safe to say that no state proceeded too slowly. It is probably safe to say that states could proceed even more slowly without detrimentally affecting the ultimate development of a competitive electric market. The primary tool for

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The “go slow” option is the transition period and the many adjustments that policy makers can make to the transition period assuming they have the authority within their state to do so.

Extension of Transition Periods

The extension of transition periods may be the simplest of the available actions to take mid-stream in an electric restructuring process. Several states have already taken steps to extend transition periods. 25 If nothing else, an extended transition period will provide policy makers time to consider any further actions that might be necessary to address the lack of market development. It may also be a way, in and of itself, to allow more time for sufficient competition to develop.

A transition period should not be extended without adequate prior analysis. In some cases, the extension of transition periods without concomitant actions may serve only as a short-term delay of an unchanged and undesirable outcome. Worse yet, the extension of a transition period wherein the details of the original transition period may be contributing to the slow market development will likely make matters worse at the end of the extension than if there had been no extension. The primary example of this possibility is where rates are frozen at or below the cost of service, as discussed above.

It may be the case that a state commission’s ability to simply extend a transition period is limited by electric restructuring legislation. In Ohio, where residential competition has developed on a regional basis, the PUCO adopted a recommended stipulation between the commission staff, major residential representation, major industrial user representation and Dayton Power & Light (DP&L) that acknowledged the lack of competitive development in the DP&L market. The stipulation extended the transition period for two years until Dec. 31, 2005. It also included a rate stabilization period until Dec. 31, 2008, wherein transmission and distribution rates will be frozen and

25 States including, but not limited to, Connecticut, Illinois, Montana and Ohio have either taken steps to extend transitions or have pending considerations to do so.
the price of generation will be capped. This example while placed under the heading of “go slow” could also represents the “public interest policies” option.

As mentioned above, several states have taken steps to extend transition periods and continue SOS and default rates into the next three to five years. While this certainly cools much of the immediate concern about retail price volatility if rates were to be market driven, the question remains – will extending the transitions bring about sufficient competition to let the market take over? It is probably too soon to tell whether three to five more years, or for that matter any specific length of time, will produce a sufficiently competitive market for all customers. Based on some of the early higher migration numbers, some may say that the C&I market is well on its way to becoming sufficiently competitive. Indeed, there are even some promising data points in certain markets that suggest retail competition for small customers may “have legs.” Some numbers from Illinois, New York, Ohio, Pennsylvania and Texas, among others, suggest that, at least in certain regions, large customers, small customers or both can benefit from open access. However, these numbers are localized at this time and each area involves certain limited contributing factors such as historically higher utility rates, substantial shopping credits or mandated customer placements. It would be problematic to extrapolate from these pockets of competitive development that, given enough time, sufficient and sustainable retail competition will definitively develop for both large and small customers on a wide geographic scale.

Stranded Costs

When implementing electric restructuring, most states were faced with the issues of stranded and/or transition utility costs. The first question was determining what, if any, stranded costs existed. Then, assuming there were costs, came the issue of whether those costs should be recoverable and, if so, how and when. Of the states still actively pursuing retail electric competition, the allowance of some or all stranded cost

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26 Case No. 02-2779-EL-ATA (and other consolidated cases). The lack of effective competition in the face of an expiring rate freeze was one of the factors that lead to the stipulation. The customers in this market have relatively lower rates than in those Ohio markets where much more competition has developed.
recovery was typically permitted via some sort of customer charge, often referred to as a customer transition charge (CTC) or unbypassable wire charge.

Where stranded costs and/or deferral balances remain a major issue, the continuation of a transition or market development period will not only allow more time for the market to develop but could also help to further diminish any stranded cost or deferred balances.\textsuperscript{27} In many cases, cost balances could be recovered more quickly than originally projected because migration from the utility is happening slower than expected. Several states with stranded cost recovery mechanisms have already seen reductions and eliminations in the CTC or are considering such. Much will depend on what, if any, regulatory compact a state believes exists between the utility and the state.\textsuperscript{28} Some states’ electric restructuring clearly allowed for total stranded cost recovery.\textsuperscript{29} Other states allowed only limited or almost no specific recovery.

\textbf{“Go back”}

Brown and Sedano define “go back”\textsuperscript{30} as the option of deciding that a competitive market is not achievable, at least in the near term, so a reversal of electric restructuring plans is in order. While this may be a reasonable characterization of what a few states have done, it is not necessary to view the option as a drastic “all or nothing” option. In fact, it is possible and advisable in many cases to “go back” less than all the way.

Some states have selected the broad approach to the “go back” option and taken explicit measures that essentially suspended or reversed the entire electric restructuring process. A couple of examples include Arkansas and California. In February, the

\textsuperscript{27} This assumes that rate caps are not significantly below cost. If caps are below cost, continuation of caps could add to deferral balances, to the degree the restructuring plan allows such transition cost recovery.

\textsuperscript{28} For a detailed examination of the issues regarding the regulatory compact and stranded costs see:

2. Rose, Kenneth, \textit{An Economic and Legal Perspective on Electric Utility Transition Costs.} (Columbus, OH: NRRI, July 1996).

\textsuperscript{29} Of course, the amount of those total costs to be recovered was, is, and should continue to be the subject of intense debate by relevant stakeholders.

Arkansas General Assembly, acting on advice from the Arkansas Public Service Commission (Arkansas PSC), repealed and reformed much of the 1999 law that was to set electric restructuring in motion. Prior to this legislative reversal, the Arkansas PSC had already taken several actions to implement the new law and begin electric restructuring. Similarly, California has suspended electric choice and has legislation pending that would reverse the restructured industry.

Other states have used the “go back” option more selectively and only stopped or reversed course on particular aspects of their respective electric restructuring processes (usually residential competition). For example, Nevada went back and decided that retail competition was not viable at this time for small customers, but recognized that large customers still might benefit from competition and therefore allowed customers over 1 MW to shop for alternative suppliers. In April of this year, the Nevada Public Utility Commission approved the migration of nine large customers. These customers account for nearly nine percent of Nevada Power’s total sales. The commission was able to determine that allowing these customers to leave the utility would actually benefit all remaining customers by avoiding some future high-cost power purchases.

Oregon recently concluded that its residential customers “would not benefit at this time from a choice of competing power suppliers,” despite the fact that non-residential customers have had the option to choose since early 2002. In both of these cases, the states’ actions are also good examples of the “government steps in” and “public interest policies” options discussed below.

Those states that have not yet had any actual implementation of electric restructuring, even if policy makers were officially considering such measures, are taking serious note of the slower than anticipated progress in the active states. Many have suspended formal proceedings. These states now appear less likely to proceed with electric restructuring in the short-term.

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31 Customers must receive prior commission approval before leaving the utility.
32 Nevada relies on the out-of-state market for nearly 50 percent of its electricity. If the utility is able to avoid significant high-cost spot market power purchases, the average cost for remaining customers should be reduced.
“Government Steps In”

As with the “go back” option, there are degrees to which the “government steps in” option can be implemented. Certainly, a state could decide to “step back entirely from the idea of a competitive retail market and, instead, explore ways for the government to be directly involved in the procurement and sale of electricity.”[^34] But there are also ways that a state could be involved to a more limited degree. New Jersey and Montana appear to be states that saw a role for more limited government intervention. New Jersey recently held an auction through which the utilities purchased wholesale power that would be needed to serve their customers after rate caps expire.[^35] Montana recently approved guidelines for NorthWestern Energy (the default provider) for electricity procurement for default customers.[^36]

“Transmission and Public Interest Policies”

Brown and Sedano are exactly right when they say that there are “several practices and policies that offer consumer benefits independent of the state of competition or the way the industry is organized.”[^37] Any one of the previous four options might fit under this category at times. Oregon’s decision not to proceed with retail competition for residential consumers, but to still create for those consumers a menu of service options including cost-of-service based rates, environmentally friendlier choice options and time-of-use service, is a prime example of bringing the benefits of innovation to customers even without a competitive market.[^38] “While the environment of change has sparked these innovations, they may apply in both competitive and monopoly states.”[^39]

[^35]: Rate caps were set to expire in summer of 2003 in New Jersey.
[^36]: Montana also used the option to “go slow,” by extending its transition period to 2007.
CONCLUSIONS AND RECOMMENDATIONS

A close examination of the status of states in which electricity markets have been restructured reveals many differing details from one state to the next. However, a higher-level examination of the electric restructuring states as a whole reveals that the overall picture is consistent. The states have used each of the above major options singly or in some combination to address their unique situations.

Going forward what is a state to do? Those states that have taken mid-course corrective actions should continue to closely monitor the factors influencing market development. Additional actions may be possible and warranted. Those states that have not implemented electric retail competition may want to continue to keep a watchful eye on experiences in the active states. In so doing, the later states can avoid some of the mistakes and oversights of the earlier states. Also, the existence of a competitive market in neighboring states could ease the process of market development in states that choose electric restructuring down the road. This span of time before other states implement electric restructuring could be used by the states and federal government to cooperatively resolve significant outstanding issues such as the development of RTOs and refinement of the wholesale market.

No one option is ideal for all states; in fact no one option is likely to be ideal for any particular state. Rather states should examine and pursue a combination of options.

Certainly, “go slow” is good advice in any uncertain market, at least as long as failure to act now will not eliminate any opportunities for the future. That would appear to be the case here. A state that has chosen to slow the process by extending the transition period or delaying the start is not going to lose an opportunity for future competitive development. If the long-term market potential is there today, it will be there tomorrow as well. A potential additional benefit of “going slowly” is where stranded costs and/or deferral balances remain a major issue. The continuation of a transition or market development period will not only allow more time for the market to develop but
could also help to further diminish any stranded costs or deferred balances. In many cases, cost balances could be recovered more quickly than originally planned because migration from the utility is happening slower than expected.

**Existing Rates**

For states that are proceeding with electric competition, a special look at existing rates is most likely warranted. During the transition periods most states capped, froze, or reduced and froze many, if not all, rates. Some states mandated the offering and set rates for SOS or default service, as well. The main reason was to ensure retail rate stability and service availability during the initial stage of market development. There may have also been some political or social policy influences to provide the customers with immediate benefits of the electric restructuring process. Whatever the reasons were for fixing these rates, the fixed rates essentially became the targets that competitive suppliers had to beat in order to entice retail customers to leave their incumbent utility. A well functioning market usually has a price to beat. However, if that price is uneconomic or in some way artificially low, competitive entry and growth is hampered. No effort is made here to determine what rates, if any, might be below cost. The purpose is merely to point out that a public policy to have some rates below cost and a public policy to create a competitive market in the same place are not easy to combine successfully.

The extension of a transition period for customers on a fixed price service from the incumbent utility where those prices are below the cost of service may only make the final transition to market prices more shocking to the customer. If a state’s primary policy is to eventually bring all customers in the state to the market, it may be appropriate if states are aware of below cost rates that they begin to bring these rates to and above costs during any transition extensions. In areas where rates are clearly below cost, competitive entry is severely hampered. In areas where customers already enjoy relatively low, but cost reflective rates, it is unlikely that competition will flourish in

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This assumes that rate caps are not significantly below cost. If caps are below cost, continuation of caps could add to deferral balances, to the extent the restructuring plan allows such transition cost recovery.
the foreseeable future. Of course, this is especially true for the residential and small non-residential customer segments of the market. Competitors (left to their own choices) will enter the low rate/low margin areas last – only after the margin has been skinned from every higher margin area first.

**Regionalized Development**

The initial development of competition in relatively high rates regions of a state, while lower-rate regions remain largely inactive, should please the state. A primary goal of electric restructuring was to bring relatively high rates down. To the extent that customers in high-rate areas are beginning to switch to lower-rate alternative suppliers, that goal is being met. States will want be vigilant in reminding customers in low rate areas that they have been enjoying the benefits of lower rates that customers in higher rate competitive entry areas are only now beginning to experience. Dr. Alan Schriber, Chairman of the PUCO, put it very plainly when he said:

> Simply put, the incumbent utility companies in these areas already offer their customers low rates, making it difficult for competitors to enter the market and lure customers away. This is the case despite the fact that the commission, by law, has imposed conditions upon the companies to provide incentives to would-be “shoppers.” **It is difficult to apologize for low rates.** [Emphasis added] 41

Especially where rates are low and still above cost, policy makers should not apologize for the lack of competition. Where it is clear to a state that a particular utility’s area is unlikely to become competitive before the removal of transition customer protections, the state should carefully examine actions that will assure that those customers continue to enjoy cost-reflective low rates after the transition period. Several examples of these types of actions were discussed above.

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41 Alan S. Scriber, Chairman, PUCO, Testimony before the House Public Utilities Committee of the Ohio General Assembly, June 4, 2003.
Accentuate the Positive and Eliminate the Negative

Each state will need to examine the factors that might be contributing to preventing the market from developing to the appropriate degree. It is likely that states will find that some of these factors can be mitigated while others cannot. Of the factors that can be improved, some would clearly be beyond the direct control of the states and would require federal or federal/state joint action. For example, further development of the wholesale market could make competitive entry more viable. More robust transmission grids with more interconnections and fewer bottlenecks would further enable an electricity market.

Perhaps we simply underestimated the time it takes to develop a sufficiently competitive market. Or perhaps we overestimated the competitive viability of some of the electric market sectors and segments. Perhaps we misevaluated the factors necessary to nurture an infant electric market. More than likely we did some of all three. It is too early in the process to definitively label any elements of any electric restructuring plans as failures or successes. However, within most of the active restructuring plans there appear to be some positive and some negative aspects. As the song says, “we got to accentuate the positive and eliminate the negative.”\footnote{Mercer, Johnny and Harold Arlen, “Ac-Cent-Tchu-Ate the Positive,” 1944.}
## A SAMPLE OF STATE ELECTRIC RESTRUCTURING STATUS AND ACTIVITY

<table>
<thead>
<tr>
<th>State</th>
<th>Transition Period</th>
<th>Cost Recovery</th>
<th>Notes</th>
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<tbody>
<tr>
<td>Arkansas</td>
<td>Not implemented</td>
<td>Allowed – Unmitigated stranded costs may be recovered via a CTC over three years</td>
<td>Most electric restructuring laws repealed by legislation Feb. 21, 2003 after the Kansas Corporation Commission recommends suspension of competitive proceedings.</td>
</tr>
<tr>
<td>California</td>
<td>Concluded</td>
<td>Allowed – The issuance of bonds to pay-off stranded investments was permitted. Used a CTC per kWh + charge to finance securitization that provided 10 percent rate reduction. San Diego Gas and Electric (SDG&amp;E) eliminated its CTC in mid-1999.</td>
<td>Suspended – Pending legislation to reverse electric competition. In accordance with Assembly Bill 57, the California Public Utilities Commission approved procurement plans for Pacific Gas and Electric Company, Southern California Edison and SDG&amp;E removing the responsibility from Department of Water Resources.</td>
</tr>
<tr>
<td>State</td>
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<tr>
<td>Delaware</td>
<td>Phased in access to competition. All open by Apr. 1, 2001. Transition periods differed by utility. Residential rates reduced up to 7.5 percent at start.</td>
<td>Allowed – Stranded cost recovery and transition cost recovery as well as deferred fuel charge recoveries via a CTC. Delmarva Power and Light Company had no CTC, DEC had a CTC and deferred fuel cost true-up.</td>
<td>Investigating creation of an SOS for after price caps are removed. Will select an SOS provider by July 2, 2004.</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>Open access to all customers began Jan. 1, 2001. Total rates reduced and capped until Feb. 7, 2005. Distribution rates further capped until Aug. 7, 2007.</td>
<td>Allowed – However PEPCO had no stranded costs and was required to share divestiture credits with customers.</td>
<td>Recently extended the transition period to 2006. Only Commonwealth Edison has significant switch rates. Little or no residential switching.</td>
</tr>
<tr>
<td>Illinois</td>
<td>Rates capped at 1996 level until 2004 for non-residential. Reduced and frozen for residential. SOS available during transition unless a customer category is declared competitive. Competitive group customers cannot return to SOS once they have switched.</td>
<td>Allowed – Partial recovery allowed via CTC through 2006. Only two of nine utilities had a CTC.</td>
<td>New SOS rates for approximately 47 percent of the customers in Maine went into effect on Mar. 1, 2002.</td>
</tr>
<tr>
<td>Maryland</td>
<td>SOS began Jul. 1, 2000. Most price caps expire in 2004. A few have already expired.</td>
<td>Very little stranded costs – two utilities had $0.0 and one utility had a large credit.</td>
<td>April 2003 – settlement adopted by the Maryland Public Service Commission to continue SOS after freeze. The settlement provides that utility SOS customers will pay a market price for electric service. Utilities will be able to recover verifiable and prudently incurred costs to procure electric supply.</td>
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43 As was the case for the customer group with demand over 3MW.
### A SAMPLE OF STATE ELECTRIC RESTRUCTURING STATUS AND ACTIVITY – CONT’D

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<tr>
<td>Massachusetts</td>
<td>Standard offer Mar. 1, 1998 through Dec. 31, 2005 started with a 10 percent discount. Went to 15 percent in 2000.</td>
<td>Allowed – Stranded costs still being recovered by all utilities via a CTC paid by all customers. CTC has decreased.</td>
<td>Fifty percent of customers on SOS. Another large percentage on default service. The commission says despite SOS being priced below cost, an active competitive market has developed for C&amp;I customers. Default service will likely continue to be necessary for smaller customers for, at least, a few years after the end of the transition period to ensure reasonably priced electric rates. The DET acts to make default service for large customers a &quot;short-term last resort service, rather than a longer-term alternative to competitive supply.&quot; 44</td>
</tr>
<tr>
<td>Michigan</td>
<td>Access to competition on Dec. 31, 2002.</td>
<td>Allowed – Consumers Energy CTC was $0.0 for 2002 and 2003. Utilities were permitted to securitize debt.</td>
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44 D.T.E. 02-40-B, Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service, p 7.
## A SAMPLE OF STATE ELECTRIC RESTRUCTURING STATUS AND ACTIVITY – CONT’D

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<td>Nevada</td>
<td>Originally, the Nevada Public Utilities Commission (Nevada PUC) has set Nov. 1, 2000 for the beginning of retail competition.</td>
<td>Allowed</td>
<td>August 2001 legislation reverses electric restructuring but allows 1MW and above customers to switch suppliers with prior Nevada PUC approval.</td>
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<tr>
<td>New Hampshire</td>
<td>Open access began to be implemented May 1, 2002. Three year transition.</td>
<td>Allowed – nonbypassable charge. Securitization permitted.</td>
<td>Held an auction through which utilities purchased wholesale power needed to serve customers for up to 34 months after rate caps are lifted summer 2003</td>
</tr>
<tr>
<td>New Jersey</td>
<td>Retail competition began Nov. 14, 1999. Transition period ends in August 2003 and all electric utilities are going through base rate cases.</td>
<td>Allowed – Sept. 9, 2002 new law gives the Board the authority to allow the utilities to issue transition bonds to recover deferrals resulting from the rate cap.</td>
<td></td>
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<tr>
<td>New Mexico</td>
<td>Originally retail access scheduled to begin opening in 2001.</td>
<td>Allowed</td>
<td>In May 2001, the legislature delayed the start of competition until January 2007.</td>
</tr>
<tr>
<td>New York</td>
<td>Full retail access opened at different times for each utility. As early as May 1, 1999 and as late as January 2002.</td>
<td>Allowed</td>
<td>March 2003, New York PSC reports 22.5 percent of load and 5.4 percent of customers have migrated including more than 320,000 residential customers. In March 2001, the New York PSC changed the shopping credit for NYSE&amp;G customers from a fixed rate to a market-based rate. From March 2002 to March 2003 customer migration for NYSE&amp;G increased nearly 72 percent. 45</td>
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45 New York State PSC, NYS Electric Retail Access Migration Reports, March 2003.
## A SAMPLE OF STATE ELECTRIC RESTRUCTURING STATUS AND ACTIVITY – CONT’D

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<td>Oklahoma</td>
<td>Originally – market to begin Jul. 1, 2002.</td>
<td>Allowed – via a CTC over three to seven years, however CTC could not result in a total rate increase.</td>
<td>Suspended – June 2002 by legislative action.</td>
</tr>
<tr>
<td>Oregon</td>
<td>Retail access for C&amp;I customers started Mar. 1, 2002. All consumers have the choice of receiving a regulated cost-of-service rate from the utility. Residential customers have portfolio of supply options available from incumbent utility.</td>
<td>Three percent public purpose charge on all bills to fund renewable energy developments. Transition charge for C&amp;I customers.</td>
<td>Utilities are not required to sell generation assets. Utilities can negotiate long term contracts to protect the consumer from the volatile spot market.</td>
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<td>Rhode Island</td>
<td>Retail access for all customers by Jan. 1, 1998. SOS available until 2009 and Last Resort Service to customers who leave the competitive market.</td>
<td>Allowed – Reasonable, verifiable stranded cost recovery is allowed via a CTC per kWh through December 2000 then through rates set by the Rhode Island Public Utilities Commission through 2009.</td>
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<tr>
<td>Texas</td>
<td>All customers in Electric Reliability Council of Texas area open to competition Jan. 1, 2002. Decreased and froze rates through 2004. Southwestern Public Service Company delayed until, at least 2007.</td>
<td>Allowed. Securitization used to reduce stranded costs</td>
<td>As of September 2002 approximately 401,000 (including approximately 320,000 residential customers) or 6.8 percent of customers in open access areas had switched.</td>
</tr>
<tr>
<td>Virginia</td>
<td>Opening of retail access varied by utility ranging from Jan. 1, 2002 to Jan. 1, 2004. Rates are capped for non-choosers thru July 2007.</td>
<td>Allowed – Stranded costs to be recovered in rates through 2007 via a special nonbypassable wires charge. Task force is considering proposals to eliminate the wire charges for C&amp;I customers, eliminate minimum stay requirements and lift rate cap.</td>
<td>The commission opened an investigation into default service for electricity customers.</td>
</tr>
</tbody>
</table>

Source: Author’s construct, based on a review of state legislative and regulatory proceedings, state legislative and regulatory web sites, press releases and interviews with state regulatory staffs. June 2003