

**Standard Offer Study and Recommendations  
Regarding Service after March 1, 2005**

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## I. EXECUTIVE SUMMARY

The Legislature has directed the Commission to investigate and provide recommendations in several areas related to electricity retail competition and standard offer service. The Commission conducted its investigation throughout the year and presents its findings and recommendations in this report.

Some type of standard offer, or default, service remains necessary after March 1, 2005. However, its purpose and design should be tailored to reflect the nature of competition expected to prevail at that time. In market sectors where retail suppliers are providing options and reasonable prices for customers, standard offer service should not be "just another supply option," but should serve as a last resort or contingency service. By its design, standard offer service in these sectors should encourage and sustain customer out-migration to the retail market. Standard offer prices should closely track changes in the wholesale market, and other features of its design, such as treatment of customer credit, should parallel the market as much as possible.

In market sectors where retail competition has not developed, standard offer service should be used to capture competitive market benefits for customers. In such sectors, standard offer service should not be designed to force customers into a market, and prices should not deliberately be set above-market in the hopes that suppliers will respond and effective competition will develop.

The electricity market currently has both of the above sector types, with medium-to-large commercial and industrial (C&I) customers in the former and residential and small commercial customers in the latter. In Maine, as of August 2002, 60% of the load in the medium/large customer sector was being served by retail suppliers, leaving only 40% on standard offer service. At certain times in the last few years as much as 73% of the medium/large load has been served by retail suppliers. In Maine, the percentage of total state load served by competitive suppliers is greater than in any other state.

In contrast, retail competition in the residential and small commercial sectors has not emerged to any real degree in Maine or elsewhere. Suppliers have not shown much interest in small customers and remain focused on larger customers where profit margins are higher and administration less complex and less costly. When (or if) suppliers will turn to residential and small commercial customers is unclear. Until then, standard offer service in a form similar to what is now available should remain available, and measures that encourage supplier entry and access to small customers, but do not harm non-shoppers, should be pursued.

The Commission should be authorized to make a "green offer" electricity supply option available to residential and small commercial customers beginning March 1, 2005, and that option should remain available until a retail market for green products develops. The green offer would not be a second default service, but in other respects

would be administered in much the same way the Commission now administers the standard offer.

The Legislature should not authorize negative-option, or “opt-out,” municipal aggregation in Maine. This type of municipal aggregation is unlikely to bring widespread benefits for residential and small commercial customers and could actually hinder the development of retail competition. Furthermore, the mere possibility that municipalities would aggregate this way could increase standard offer prices as suppliers’ bid prices reflect this load uncertainty risk.

## II. BACKGROUND

Prior to March 1, 2000, electricity was supplied by regulated utility companies that had an obligation to serve all customers in their franchise areas. When the Legislature enacted Maine’s Electric Restructuring Act, P.L. 1997, ch.316, it eliminated this obligation to serve, prohibited utilities from providing supply service, and allowed, but did not require, unregulated retail companies to compete to supply electricity to customers. So that all consumers in Maine would continue to have access to electricity at reasonable prices, the Legislature directed the Commission to ensure that standard offer service would be available to all electricity consumers. The Legislature further directed the Commission to strive for at least three standard offer service suppliers in each utility service territory, but only if multiple suppliers would not cause rates to be significantly higher. 35-A M.R.S.A. § 3212.

As required by the statute, the Commission promulgated Chapter 301 of its rules to govern the terms of standard offer service and the structure of the competitive bidding process by which standard offer providers are selected. The Commission has amended Chapter 301 on several occasions in light of actual market conditions and participant behavior.

Since 1999, the Commission has conducted several competitive bid processes to acquire standard offer service. Although the initial bid processes did not yield retail suppliers for all customer classes, the recent efforts to find retail suppliers have been successful. Standard offer service is now provided to all customer classes of Central Maine Power Company (CMP), Bangor Hydro-Electric Company (BHE) and Maine Public Service Company (MPS) by retail suppliers chosen by the Commission through competitive bid processes.<sup>1</sup>

The Act requires that standard offer service be available until March 1, 2005. Originally, the Commission was to conduct this investigation during the first six months of 2004. However, the Legislature amended the law last session to require that the

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<sup>1</sup> The consumer-owned utilities have procured standard offer service through their own processes.

investigation occur in 2002 so there would be sufficient time for it to fully consider the issues and allow any changes to be implemented before March 1, 2005.

On April 26, 2002, the Commission initiated an inquiry pursuant to Chapter 110, § 1201 of its rules as the procedural vehicle for conducting the required investigation and preparing this report and recommendations. The Commission sought broad participation and solicited input and views from a wide variety of interests through several means.

As the first step, the Commission issued a request for comments on the specific questions contained in the legislation and related issues. The Commission received written comments and subsequently held a conference so that it could discuss various positions and viewpoints with the commenters. Maine's utilities, the Public Advocate, the Industrial Energy Consumers Group, and several electricity suppliers and aggregators participated in this stage of the investigation.

The Commission's staff also held several less formal discussions with individuals and small groups, including most suppliers currently active in Maine. We initiated these to learn about the plans and understand the perspectives of suppliers in Maine's market. The discussions elicited suppliers' views on many topics, including: the status of electricity markets in Maine, New England and other regions; how these markets are likely to develop in the future; the effect of Maine's rules and regulations on the markets; future plans with respect to the Maine market; and how the Commission's standard offer process could be improved. Staff also asked suppliers what changes could be made to the status quo, and whether such changes would influence the supplier's participation in either the standard offer or the non-standard offer retail market. These discussions provided us with much useful information and insight and have guided many of the recommendations contained in this report.

To obtain the views of residential and small business customers, the Commission engaged the services of Critical Insights, a Portland-based market research company. Although the views of large business and industrial customers are usually represented in Commission proceedings, individual small customers typically do not participate. We undertook market research so that the opinions and preferences of residential and small business customers could be considered as changes to standard offer and the retail market are evaluated. We discuss the survey in section V of this report and provide the results in Appendices C and D.

The Commission also researched standard offer and default service in other states. In the course of this research, we learned what approaches other states have found to be beneficial, what problems they have encountered, and what changes or new approaches to default service or market structure in general are being considered.

In researching the municipal aggregation issue, staff interviewed various individuals with expertise in the area, as well as representatives of interested stakeholder groups in Maine. We also talked with staff members at public utilities

commissions in Ohio and Rhode Island, as well as participants in the Cape Light Compact, an active municipal aggregation group in Barnstable County and Martha's Vineyard, Massachusetts.

Finally, the Commission issued a draft report containing tentative findings and recommendations and invited interested persons to provide comments. We received written comments from a variety of interests, including customers, utilities, suppliers and aggregators. This report reflects our consideration of these comments.<sup>2</sup> In addition, several commenters noted the need to provide more detail on particular recommendations contained in the report. The Commission anticipates that it will conduct several proceedings during 2003 to determine the details of any modification to the standard offer process and to address many of the issues presented in the comments. Thus, interested persons will have further opportunities to provide input to the Commission on matters raised by this study. The Commission will also continue to provide the Legislature with periodic updates on its implementation of the Restructuring Act, as well as annual restructuring reports, and will offer further recommendations to the Legislature as warranted.

### **III. STANDARD OFFER SERVICE AND RETAIL COMPETITION: MODELS AND RESULTS**

In this section, we provide information on retail competition and standard offer service in Maine and in three other states with markets that have been relatively active. For additional information on other states, we refer the Legislature to a recent report issued by the National Regulatory Research Institute (NRRI) entitled "2002 Performance Review of Electric Power Markets." The report, which was one of our sources about standard offer service in other states, covers several states (including Maine) in detail and is available from NRRI at [www.nrri.ohio-state.edu](http://www.nrri.ohio-state.edu).

#### **1. Standard Offer Service**

All states that have restructured their electric industry and deregulated supply provide for some type of supply service for customers who do not choose a competitive supplier or whom no competitive suppliers will serve. These services are variously called default service, provider of last resort service and standard offer service. Some states have more than one type of service for these customers.<sup>3</sup>

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<sup>2</sup> These comments, as well as others submitted in the course of our study, are available on the Commission's website [www.state.me.us/mpuc](http://www.state.me.us/mpuc) through the PUC virtual case file (Docket Number 2002-169).

<sup>3</sup> Unless referring specifically to a state with both standard offer and default services, we use these two terms interchangeably throughout this report.

## Maine

In Maine, the Restructuring Act provides for only one type of default service -- standard offer service. Maine's standard offer service is a retail supply service procured and priced through a competitive bidding process conducted by the Commission. T&D utilities cannot bid to provide standard offer service, and affiliates of T&D utilities are restricted to providing no more than 20% of standard offer service in the affiliated T&D utility's service territory. If retail bids are insufficient or unacceptable, standard offer service is to be provided by the T&D utilities through wholesale contracts. Either way, suppliers are chosen through a competitive process in which proposals are evaluated primarily on price. The winning bid(s) sets the standard offer prices that customers pay.<sup>4</sup>

The Commission is currently engaged in its fourth set of standard offer bid processes. We met with mixed results in our first two attempts. The bid processes for service beginning March 1, 2002 (the third year for standard offer service) were more successful.

Maine's standard offer model is unique in that suppliers serve at retail. As a result, suppliers who were accustomed to traditional wholesale supply arrangements were initially apprehensive about participating in Maine's standard offer process. Moreover, during the first two standard offer years, the regional wholesale markets were still developing and there was significant price volatility and uncertainty about market rules and how they would be implemented by ISO-NE and reviewed by FERC. Suppliers were either reluctant to bid at all or their bids reflected significant risk premiums. By the third year, the wholesale markets had become more stable and many supplier concerns about Maine's retail model had been resolved. As a result, participation increased and there was vigorous competition among the bidders and a corresponding benefit in terms of price.

There now appears to be a functioning competitive market for standard offer service in Maine. However, sustaining this market depends to a large degree on the state of the wholesale markets, which can be volatile and which are still developing and changing, to some extent in response to FERC initiatives. In addition, in northern Maine (which is not part of the New England control area), although there has been some competition, there has been a limited number of suppliers active in the market. Finally, the merchant electricity industry is currently in serious financial turmoil, due both to Enron-like accounting and trading practices and the overall downturn in the economy. Accordingly, although recent standard offers solicitations have been successful, the Commission must continue to be flexible and adapt its processes and approaches to meet unforeseen conditions.

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<sup>4</sup> Appendix A provides standard offer service prices in the CMP, BHE and MPS territories since March 1, 2000.



### Other States

The Maine standard offer model contrasts with most other states, where some or all of the default-type service is priced administratively rather than competitively. For instance, Massachusetts distinguishes between standard offer and default services, and offers both to different classes of residential customers.

Standard offer service is provided to all customers who were customers of the T&D utility on the date retail competition began and who have not received supply from a competitive supplier. Standard offer service is supplied by the T&D utility, but its price is set administratively. Initially, Massachusetts's standard offer prices were set so that the combined T&D and standard offer prices would be a specified percentage below pre-restructuring bundled electricity prices. The standard offer price has been periodically increased to bring it to market levels with the expectation that customers would enter an emerging retail market. That market has not yet developed in Massachusetts.

Default service is provided to all customers who newly seek service, who move from one location to another, or who have previously received service from a competitive supplier. Default service is supplied by T&D utilities, who obtain and price the service by periodic competitive bids.

The Massachusetts T&D utilities must acquire their supply in the wholesale market and, because the administratively-set standard offer price has at times been lower than the market cost of supply, the utilities have accrued large cost deferrals that must be paid back with interest by ratepayers in the future. The below-market standard offer prices have also hindered the development of retail supply alternatives. Although standard offer prices have been increased each year, the amount of the increase is unrelated to the market.

Pennsylvania also sets default service prices administratively. Initially, these prices, called "shopping credits," were set at levels intentionally high enough to encourage retail suppliers to compete, and many customers, including residential consumers, switched to competitive suppliers. However, when market prices rose above the administratively-set "shopping credit," customers returned to service from the incumbent T&D utility, which is the Pennsylvania version of default service.

In Texas, electric utilities were required to separate their business activities into three units: a wholesale electric power generation company, a T&D company and an affiliated retail electric provider (AREP). When retail competition began in Texas on January 1, 2002, all customers who had not made a choice were transferred to the AREP of their T&D utility. Residential and small commercial customers receive service from the AREP at a "price to beat" rate, which is set by the Public Utilities Commission of Texas (PUCT). The "price to beat" rates are bundled, i.e., they include all T&D charges as well as supply. By statute, the "price to beat" rate had to be set initially at least six percent below the rate in effect prior to January 1, 2002 and, subject to PUCT

approval, may be changed twice per year to reflect changes in natural gas and power prices. Other commercial and industrial standard offer customers receive market-based rates.

The PUCT also designates at least one retail electric provider (REP) in each service territory as the Provider of Last Resort (POLR). The POLR provides service to customers whose suppliers go out of business or whose service is terminated by the supplier, e.g., for non-payment. POLR suppliers are chosen and prices established through a competitive bid process.

The Texas REP (either affiliated or not) also bills its customers and performs some of the customer care functions that in most other states (including Maine) are handled by the T&D utility. This has led to delays in switching and billing customers, as well as increased time and complexity when customers request service changes or new service. For example, it has taken two or three months for some customer switches to new suppliers to become effective.<sup>5</sup> In addition, large numbers of customers did not receive electric bills at all for several months, and the time to process service requests, such as for a move to a new location, has gone from one or two days to two to five days.

There are elements of every state's retail access program that are unique. However, common to most except Maine are standard offer services that are provided by incumbent utilities or their affiliates and prices that are administratively set. In such states, including Massachusetts, Pennsylvania and Texas, it is difficult to measure the success of retail competition either by price or switching activity, because there is no necessary link between prices and the market. The mere fact that customers have received rate reductions is not conclusive, nor are switching rates in and of themselves. In Massachusetts, although customers received rate reductions initially, they will some day have to pay off the deferrals that accumulated as a result of those reductions. In Pennsylvania, once considered to lead the nation in successful retail competition, that the shopping credit was inflated (relative to market) must also be considered when evaluating the success of customer switching.

In Maine, standard offer service prices are not set administratively. Rather, standard offer service is obtained in the competitive market and the retail prices that standard offer customers pay fully reflect that market. Thus, by design, the effects of competition are captured and flowed directly to customers, and new deferrals are largely avoided.<sup>6</sup>

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<sup>5</sup> Maine requires switches to occur in most cases by no later than the customer's next meter read date.

<sup>6</sup> There were some relatively minor amounts deferred in the year ending February 2001 when CMP and BHE provided standard offer service through wholesale market purchases.

2. Retail Competition

As anticipated, migration from the standard offer to competitive suppliers in Maine began with the state’s largest customers. By the end of 2000, approximately two-thirds of Maine’s large industrial load and a third of the large industrial customers were purchasing supply from a competitive supplier, but the load of most medium customers continued to be served by the standard offer. Calendar year 2001 saw a significant increase in migration of the medium customers to competitive suppliers. By the end of 2001, almost half of the medium customer load had migrated to retail suppliers, and additional large customer load had migrated as well. When standard offer service prices fell effective March 2002, some load returned to the standard offer.

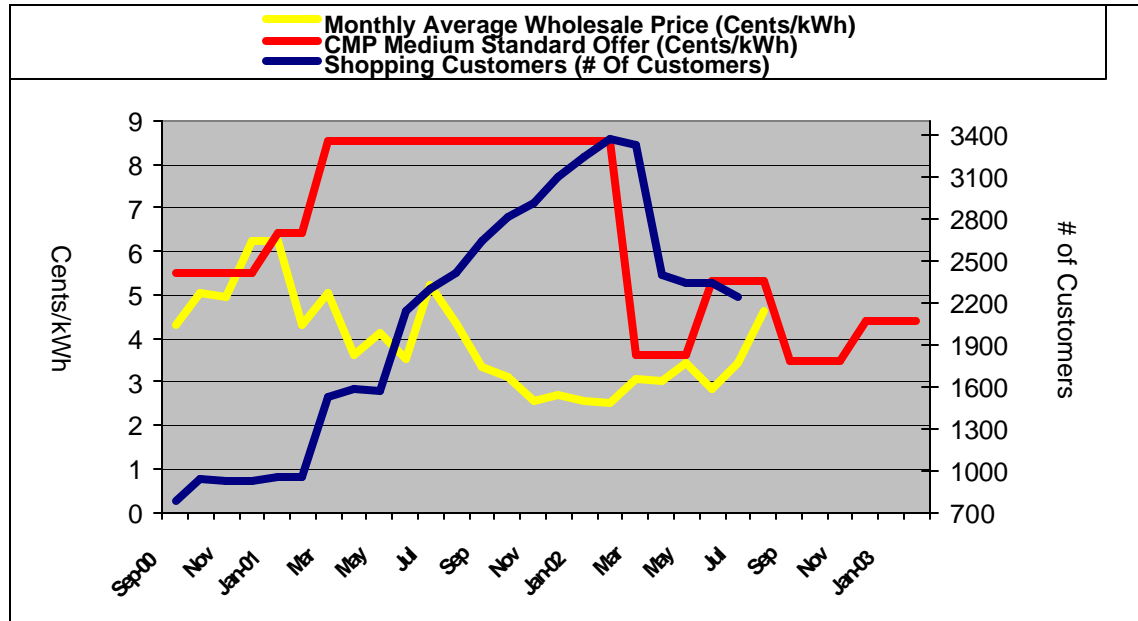
**Percentage of Load Served By Competitive Suppliers in Maine:**

Month	BHE			CMP			MPS			State Total
	Res/S Comm.	Medium	Large	Res/S. Comm.	Medium	Large	Res./S <sup>7</sup> Comm.	Medium	Large	
Oct-00	<1%	3%	28%	<1%	9%	64%	9%	76%	52%	27%
Jan-01	<1%	3%	29%	<1%	15%	65%	9%	65%	74%	29%
Apr-01	<1%	7%	31%	<1%	21%	75%	9%	63%	53%	33%
Jul-01	<1%	9%	41%	<1%	29%	81%	9%	52%	82%	37%
Oct-01	<1%	20%	69%	<1%	36%	88%	4%	37%	88%	43%
Jan-02	<1%	28%	74%	<1%	45%	90%	10%	56%	88%	46%
Apr-02	<1%	35%	86%	<1%	47%	89%	14%	65%	99.6%	47%
Jul-02	<1%	35%	43%	<1%	33%	80%	31%	69%	99%	37%
Oct-02	<1%	34%	48%	<1%	30%	80%	32%	64%	98%	37%

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<sup>7</sup> See page 15, note 18, for an explanation of the relatively higher residential and small commercial migration in the MPS service area.

**Relationship Among Wholesale Market Prices, Standard Offer Prices and Retail Market Penetration:**



With certain exceptions, other states with active retail markets have had similar experiences, although Maine has clearly been a leader in terms of load migration.

**Summary of the Statewide Percentages of Customers and Load That Have Switched to Competitive Providers for States with Active Retail Markets:**

State	Percentage Customers Switched	Percentage Load/Usage/Peak load Switched	Date of Information
District of Columbia	7.4%	48.6%	Jun-02
Maine	1.3%	37.0%	Jul-02
Maryland	3.4%	16.6%	Jun-02
Massachusetts	3.2%	31.3%	Jun-02
New Jersey	0.2%	1.6%	Jun-02
New York	5.2%	18.9%	May-02
Ohio	13.8%	11.8%	Mar-02
Pennsylvania	5.5%	7.9%	Jul-02
Rhode Island	0.58%	12.9%	Jun-02
Texas	7.3%	19.2%	May-02 for load and Jul-02 for customers

Source: NRRRI

#### IV. COMMISSION RECOMMENDATIONS

In this section, we provide our recommendations in response to the questions posed by the Legislature. We note at the outset that our recommendations have been prepared against the backdrop of an industry that is dealing with serious financial problems, the effects of which on the markets are not yet fully known.

In the wake of the Enron scandal, other major energy companies were found to have been engaging in misleading or fraudulent trading and accounting practices; many individual companies and the industry generally have suffered as a result. Electricity trade publications have for months been replete with articles about energy companies targeted for investigation by FERC or the SEC or downgraded by one or more financial rating agency, or that have abandoned or scaled back their business in electricity sectors. For example, recent publications report that ten of the largest power sellers in the country have substantially reduced their electricity trading operations; to date this year S&P had issued about 90 downgrades of companies in the utility and merchant energy sector, and described the pace of downgrades as “accelerating;” Moody’s had 80 such companies in “junk bond status.”<sup>8</sup>

<sup>8</sup> From *Power Markets Week*, Aug. 5, 2002 and Aug. 12, 2002.

Electricity markets can be affected by this climate in several respects. Participant numbers can shrink, and those that remain can become more risk-averse. Corporations must focus attention and resources on preparing for litigation or on restoring their financial health, rather than on transacting electricity deals. We raise these concerns not to be alarmist, or to convey pessimism about the future of retail competition, but to inform the Legislature of the state of the industry as it considers the issues before it.

In addition to industry instability, wholesale markets remain in flux. Market structures and rules continue to change; these changes will affect Maine's retail market as well as our market for standard offer service. In light of the industry and market instability, we recommend that the Commission retain sufficient flexibility to respond to changes as they occur.

The rest of this section provides our recommendations to the Legislature's questions as they are set forth in the statute. Each question is stated verbatim in bold italics directly before our response.

***1. Are the goals of this chapter (35-A M.R.S.A. Chapter 32) best fulfilled if standard offer service ceases altogether on March 1, 2005 or at a date certain after March 1, 2005?***

For the reasons discussed below, standard offer service should not cease either on March 1, 2005, or at a date certain after that. However, depending on how retail competition has developed in a particular market sector, the purpose and design of standard offer service should be modified.

There are several goals embodied in the Restructuring Act. Stated generally, the primary goal was to deregulate electricity production and supply, and establish a framework within which competitive markets could efficiently provide these products and services to consumers. As explained below, complete elimination of standard offer service does not further this goal.

There are two properties of electricity that distinguish it from other commodities and support the continued need for a default service, even where retail competition appears to be well-developed. First, reasonably-priced electricity is essential for most homes and businesses. Second, electricity will flow to load even if there is no retail transaction intended by a supplier or customer.

Thus, even in market sectors where retail access has developed and appears sustainable, some form of standard offer or default service must continue to exist. In sectors where there is little or no retail competition, standard offer service is even more important because it will be the source of supply for most (or all) customers. Although standard offer service must continue to exist in both sector types, its purpose and design should differ based on the strength of the retail market. In well-developed market sectors, standard offer service should not be viewed as simply one more choice

on a menu of supply options. Instead, it should be a last resort or contingency service. By its design, it should encourage and sustain customer out-migration to the market. In market sectors with little or no retail access, standard offer service should be acknowledged as the supply source for most or all customers, and designed to capture competitive market benefits until effective retail competition develops.

Maine's retail market currently has both types of sectors. Medium and large C&I customers have supply options and are exercising them. In contrast, residential and small commercial customers have virtually no options. In the following sections, we discuss in more detail how standard offer should be designed in each of these sectors.

### Medium and Large Commercial and Industrial

As noted above, retail competition in Maine's medium and large C&I markets has developed and appears to be working effectively. Based on our research, it appears that the vast majority of customers in this sector can access retail suppliers.<sup>9</sup> However, there may be some customers who cannot acquire supply from a retail supplier. This could be due to bankruptcy, for instance, or other circumstances that render a customer a real or perceived credit risk. Furthermore, there may be events, such as supplier default, that occur with little or no prior notice and result in a service lapse. Because any such lapse would be contractual only (electricity would continue to flow to the load), there must be some entity to "own" the load and some way for the customer to pay for the supply it receives.

For these reasons, standard offer service cannot be eliminated completely. It continues to have a necessary role in this sector as a last resort or contingency service. However, it should be designed to minimize customer switching between standard offer and market products based on price or other customer preferences, and its existence should not interfere with the market. Standard offer service for these customers should be designed to encourage and sustain customer out-migration while at the same time providing last resort or contingency supply service as necessary.

To achieve these objectives, we recommend changes in three design aspects: (1) price level and structure; (2) penalty fees for switching on or off; and (3) treatment of credit risk.

First, the prices of medium and large C&I standard offer service should track changes in the regional wholesale market as closely as practicable. This will accomplish two things: it will prevent standard offer from becoming an attractive option when market prices are rising and, because most C&I customers prefer predictable and stable prices, it will allow suppliers to compete on this basis by offering alternatives with longer-term price stability and predictability.

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<sup>9</sup> We will continue to carefully monitor the market and may modify our standard offer approach if the market ceases to provide reasonable supply options for most customers in the medium and large C&I sector.

Standard offer must not continue to encourage a “here-today-gone-tomorrow” retail market, as happened to some degree this year. Since March, 17% of the load that had previously been in the market has returned to standard offer. Market prices rose after standard offer supply was procured and prices fixed for a one-year term. It has been difficult for suppliers to compete against standard offer for much of this year because standard offer prices have remained below market prices.<sup>10</sup>

To mitigate this problem, C&I standard offer price changes should more closely follow market changes. This could occur through more frequent standard offer solicitations, e.g., every quarter or six months, or through indexed pricing mechanisms that could allow for monthly or even more frequent changes.<sup>11</sup> By tracking market changes more frequently, disparities between standard offer and market prices will be lessened. Standard offer prices should also vary by season (or more frequently, e.g., by month) rather than be averaged over a several-month-long term. This will further ensure that standard offer prices better reflect market costs and discourage arbitrage between the market and standard offer service.

We note that pricing standard offer this way does have a disadvantage. In the likely event that standard offer customers will include some financially weak businesses, their inability to secure price predictability in electricity costs could jeopardize their ability to get necessary financing, especially if they are heavy users of power.

Second, the opt-out fee that is currently charged to customers when they leave standard offer service and return to the market should be reconsidered, and possibly eliminated.<sup>12</sup> As noted previously, standard offer service in this market sector should be designed to encourage and sustain out-migration. Our research suggests, however, that at least in some cases the opt-out fee may have the opposite effect. For instance, customers who returned to standard offer earlier this year have had a powerful incentive to remain there for 12 months rather than return to the market and pay the opt-out fee. We plan to re-open our standard offer rule early in 2003 to consider the opt-out fee and whether it should be redesigned, eliminated or replaced, such as by a fee for re-entry to standard offer. We note that the need for an opt-out fee or any other mechanism to deter strategic switching will depend to a large degree on how closely standard offer prices track market prices.

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<sup>10</sup> The financial collapse of Enron and its relatively sudden exit from Maine’s market provides an additional explanation for the movement of customers back to standard offer service.

<sup>11</sup> During 2003, the Commission will explore the feasibility of indexed pricing for purposes of the standard offer.

<sup>12</sup> The opt-out fee is a penalty mechanism intended to deter strategic switching between standard offer and the market. The fee is charged to customers and is equal to twice their highest monthly standard offer bill.



Finally, standard offer service should not be a safe-haven from credit and financial security requirements typically faced by customers in the retail market.<sup>13</sup> Utilities can require customer deposits and payment plans for standard offer charges, and their current practice is do so for customers for whom deposits would be required for T&D charges.<sup>14</sup> We will initiate a proceeding in 2003 to consider whether our credit and collection rules should be revised to give utilities greater flexibility to require credit assurances (e.g., ability to require deposits when an existing T&D customer enters standard offer service) and to provide utilities with the proper incentives to manage the credit associated with standard offer service.

We acknowledge, however, that due to the legislative policy prohibiting the disconnection of T&D service for the nonpayment of competitive supplier charges, 35-A M.R.S.A. § 3203(3), it is not possible to precisely equate the credit risk of competitive suppliers with that of standard offer service. The credit risk associated with standard offer service will be relatively lower because utilities may disconnect customers for the nonpayment of standard offer charges. A countervailing consideration is that competitive suppliers have a greater ability than utilities to reduce the accumulation of uncollectible amounts in that they can act more quickly to terminate service upon the nonpayment of charges. Additionally, the recommended changes to the pricing and structure of the standard offer discussed above will make it more volatile and unpredictable and thus less desirable than competitive supply for most customers. This should have the effect of discouraging customers from relying on the standard offer as a safe-haven from financial security requirements.

An alternative approach to equalizing credit requirements among competitive supply and standard offer is to expose the standard offer provider to the actual bad debt risk, as opposed to the current approach, whereby an uncollectible adder is estimated and fixed prior to each standard offer solicitation. The alternative approach, however, is not practical because: (1) the standard offer supplier has no knowledge of its customers' financial status (or even its customers' identities); and (2) management of the

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<sup>13</sup> Competitive Energy Services, LLC (CES) has proposed that retail suppliers be allowed to shift their bad debt risk to the T&D utility (or its ratepayers), thereby eliminating customer credit as a factor in the market. We are currently considering comments on the CES proposal. At this point, we note a concern about the elimination of customer credit risk and the management thereof from the competitive market in that the management of customer credit risk can be a major factor upon which suppliers compete for customers.

<sup>14</sup> Because the bad debt amount is fixed for standard offer suppliers, the utilities currently have the responsibility to minimize standard offer-related write-offs. The issue of whether the utilities should have the financial risk of standard offer-related write-offs has not yet been determined, but the Commission will do so in a future proceeding.

receivables, including disconnection for non-payment, is in the hands of the utility, not the supplier.<sup>15</sup>

With the type of changes discussed above, standard offer can continue to serve its necessary purpose as a last resort or contingency service for medium and large C&I customers while interfering minimally in the retail market. It should be recognized, however, that there are disadvantages to particular customers from this approach. If the goals of stimulating and sustaining customer out-migration are achieved, customers eventually left on standard offer may only be those with poor credit or other features that make them unattractive to the market (e.g., poor load profiles). If this occurs, standard offer prices would then reflect the higher costs or risks of this customer group. This is a natural result of moving to a competitive market from regulation, where good credit risk customers have tended to subsidize customers with credit problems. The deregulation of an industry will expose such subsidies and allow customers that are perceived as good credit risks to obtain lower prices. Despite this impact, the State does retain the ability to act in a more direct manner to ensure that customers with credit problems have access to reasonably priced electricity (e.g., through direct ratepayer or taxpayer guarantees).

#### Residential and Small Commercial

There is virtually no retail competition for residential and small commercial customers, either in Maine or elsewhere.<sup>16</sup> In the CMP and BHE service areas, there are currently no suppliers offering to serve small customers and, except for a brief offering of a green product, there never have been.<sup>17</sup> This was the case even when standard offer prices for BHE were well above market (7.3 cents/kWh) in late 2001 and early 2002. Until retail access develops for these customers, standard offer service should be acknowledged as their primary (and perhaps only) supply option and, as such, should be fully available. Standard offer service should also be designed to

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<sup>15</sup> We will continue to review the uncollectible adder imposed on standard offer service prior to each new term to ensure it reflects expected uncollectible amounts as closely as possible.

<sup>16</sup> There is limited activity in certain states, most notably Ohio, Texas and the District of Columbia. In Ohio, small customer switching is largely a result of municipal aggregation. In Texas and D.C., there are retail suppliers marketing to small customers, but even in these locations the penetration rate is well below 10%.

<sup>17</sup> There has been a moderate amount of retail activity in the small customer sector in the MPS service area, although this appears to be due to factors unique to northern Maine, such as the prior existence of an energy-purchasing consumer coalition and the fact that, as a general matter, suppliers and customers are more likely to know and have contact with one other. Additionally, "small commercial customers" in the MPS service area includes customers with a larger demand than those in the CMP and BHE areas.

capture the benefits of a competitive wholesale market for small customers who would not otherwise receive them from a retail market.

Standard offer service should not be designed to force small customers into the market, nor should its prices be increased in the hope of attracting suppliers. Based on our research over the last several months, the lack of supplier interest in this sector appears to be driven largely by forces external to Maine. Suppliers are focusing first on larger customer markets where margins are greater and administration is more cost-effective on a per-customer basis. Complex and expensive systems (such as for Electronic Data Interchange (EDI)) must be built and maintained, and customers must be solicited and managed. Since corporate resources are not unlimited, it seems natural that suppliers have focused first where profit margins per customer are the highest. In addition, the corporate and financial problems described earlier that are now plaguing the industry further limit resources and enthusiasm for new and unproven ventures. Finally, the wholesale market has developed more slowly than anticipated and is still in a state of considerable flux. How long it will be before suppliers focus on the small customer market in Maine is unclear.

We have therefore concluded that retail competition is unlikely to develop for small customers by March 1, 2005, and at this point we cannot predict when that will occur. We recommend that Maine continue the basic model we now use to procure and price standard offer service for small customers. Doing so will provide small customers with competitively acquired and market-priced supply. Because suppliers must compete to provide standard offer service, although on an aggregate rather than individual customer basis, small customers are already receiving the benefits of competition. When there is evidence (either in Maine or elsewhere) that suppliers are competing on an individual-customer basis in this sector, the approach to standard offer service should be reconsidered.

Despite the lack of progress in the development of a small customer retail market, the Commission continues to support full retail competition for the small customer sector and believes that such an outcome is achievable. In the next section, we recommend several measures to facilitate the development and operation of this market.

## ***2. Should opportunities for retail aggregators be changed to ensure greater participation in competitive markets by residential and small commercial customers beginning March 1, 2005?***

We recommend several measures to create new opportunities for all retail suppliers, including aggregators.<sup>18</sup> These measures will increase the potential for direct

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<sup>18</sup> These measures should take effect March 1, 2005 for CMP and BHE, but could begin earlier for others if the current standard offer provider's term ends prior to that date.

retail transactions between suppliers and small customers by increasing supplier access to these customers and reducing the costs and complexity of customer acquisition and administration.<sup>19</sup>

Because of our reluctance to assume that any Maine-specific feature will drive the development of retail competition for small customers, we recommend only measures that do not adversely affect non-shoppers, i.e., customers that receive standard offer service. We have focused on tangible and direct measures that facilitate the operation of the retail market rather than on strategies to attract suppliers by the pricing or design of standard offer service.

Our recommendations are based on our research over the last several months, including input from suppliers as to what would and would not induce them to consider Maine's small customer markets. Thus, we are optimistic that these changes will prove helpful. However, the measures we propose do not *ensure* retail competition will develop nor could any measure do so because, as noted previously, the present lack of competition is largely driven by factors external to Maine.

All of the measures we propose flow from the characteristic that most clearly distinguishes the residential and small commercial markets from others: the size of individual customers. Although the total load in this sector may exceed that of the larger customer markets, each customer account is much smaller but must still be individually solicited and managed. In contrast to customers in the large C&I sector, who typically use more than 100,000 kWh/month, average residential and small commercial customers use only about 500 kWh/month. Thus, it takes more than 200 residential and small commercial customers to provide the kWh sales volume of just one large customer. Because prices are charged on a "per kWh" basis, success in this market will require that suppliers be able to acquire and administer a large number of customer accounts as cheaply and easily as possible. Suppliers must feel confident that they will recover their fixed costs, such as for EDI systems, and earn an overall profit that is sufficient to justify the dedication of corporate resources to this market. We believe the steps outlined below can help in this regard.

### Recommendations

#### Provide Customer Lists and Customer Data to Suppliers

Upon request, T&D utilities should provide suppliers with lists of residential and small commercial accounts in their service territories, including each customer's mailing address. T&D-provided lists are superior to other data bases, such as telephone directories, because each customer's identity will match perfectly with the T&D's systems, thereby making enrollment and billing simpler and less prone to errors. This is

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<sup>19</sup> There are signs in other states that small customer or "mass" markets are beginning to develop. Not surprisingly, these signs are appearing first in larger markets than Maine, including nearby Massachusetts and Connecticut.

particularly evident in the case of commercial customers, whose business names and locations may differ from what appears on their utility account, or who may change their names.

We intend to initiate a proceeding in 2003 to determine what additional customer information should be provided with the customer lists. Information sought by suppliers in other states has included customer account numbers, usage data and credit history. Our research has indicated that suppliers consider access to this type of information, particularly customer names, addresses and account numbers, to be an extremely important feature of a State's small customer market.

In deciding whether information should be made available, we would consider the information's usefulness to suppliers, and the feasibility and consumer privacy impact of making the information available. Additionally, we will consider whether existing consumer protection rules adequately guard against abuses such as unauthorized enrollment (i.e., slamming), or whether additional safeguards should be implemented. For example, in states where customer lists are provided, the T&D utility may be required to notify a customer when it receives an enrollment for the customer's account, and the T&D company may also be the recipient of customer recisions.

Prior to releasing any list or customer information to suppliers, customers would have notice and an opportunity to opt off the list. We would establish these notice and opt-off procedures in the proceeding noted above with the objective of ensuring that customers have sufficient notice and time to allow them to opt-off. For instance, a written notice would be provided by mail by the T&D utilities to their customers for two consecutive months, with a 2-week period thereafter for customers to opt off. Finally, we anticipate restricting the use of customer information to the marketing of electricity only.

#### Allow Supplier Access to Customers via T&D Utility Bill

Another way to increase supplier access to customers significantly is through customers' T&D bills. For a fee, utilities could disseminate marketing or solicitation material for suppliers. The fee would be Commission-approved so that all suppliers are treated equally, and set to fully compensate the T&D utilities for providing this service. Due to constitutional considerations, however, T&D utilities may have to agree to the use of T&D bills for this purpose.

#### Require T&D Utilities to Produce & Mail Disclosure Labels

T&D utilities in Maine are currently required to produce and distribute disclosure labels for standard offer suppliers but not for other suppliers. This may give the standard offer supplier a cost advantage over other suppliers. Therefore, we intend to consider extending the availability of this service to any supplier that wants it, much like consolidated billing is now. We recognize that standard offer service may have an inherent cost advantage in this regard due to the relatively large number of identical

labels that are required. Nevertheless, the provision of this service by utilities to competitive suppliers (even at a higher cost than that for standard offer service) may be of some benefit to particular suppliers, and could be part of a package of measures to facilitate operation of the retail market for small customers. Finally, it is worth considering whether this disclosure label service should be provided on an averaged-cost basis so that all standard offer and competitive suppliers pay the same fee for the service. We will consider this matter in a future proceeding.

### Other Options

There are other approaches intended to stimulate small customer retail competition that the Legislature may consider. We describe the most-widely considered options below, and explain why we have not recommended them.

### Adders

By the term “adders” we refer to any method of administratively setting standard offer prices that results in standard offer customers having to pay prices in excess of the cost of their supply service. In other states, terms used have included: “shopping credits;” “price to compare;” “retail adders;” or “headroom.” Adders have been used in other states, and vigorously advocated but never implemented in Maine.

The theory of adders is that without such adjustments standard offer prices would be too low to allow retail suppliers to compete because retail suppliers face certain costs, e.g., marketing and customer acquisition, not borne by standard offer suppliers. By increasing standard offer prices using adders, proponents argue that retail suppliers will then be able to compete to the ultimate benefit of customers.<sup>20</sup>

We do not recommend adders for several reasons. First, as stressed throughout this report, the factors that underly the current inactivity in small customer markets are largely external to Maine. Increasing Maine’s standard offer prices with adders, then, is unlikely to result in anything but higher standard offer prices. We note that standard offer prices already reflect a price premium for load risk (which can be substantial) because standard offer suppliers cannot control or predict how much load they will have to supply during their term of service. Load risk is far greater for standard offer suppliers than other suppliers, who can protect themselves by selling pursuant to contracts with set terms. Second, our experience to date indicates that even when standard offer prices were well above market, as they were for BHE small customers

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<sup>20</sup> In its comments, Competitive Energy Services proposed that “customer service” costs borne by competitive providers be recognized by specified reductions in the T&D bills of customers that switch to competitive service. Presumably, the cost (i.e., revenue loss) to the utilities from such reductions would be borne by standard offer customers. If so, the CES proposal may be, in essence, an adder. However, we will examine the proposal in more detail before standard offer service is next solicited for small customers.

during 2001, competition did not develop. Third, other factors, most notably price movement in the wholesale market, appear to be far more significant than adders in terms of enabling suppliers to compete against standard offer service. Fourth, adders could create “a price umbrella” just below which suppliers would tend to price their products, potentially resulting in a retail market with above-market prices. Thus, even if the standard offer revenue attributable to adders are recaptured and flowed back to customers, the effect on retail market prices would be to increase costs to customers in a way that could not be recaptured. Finally, based on our recently conducted surveys, there appears to be considerable opposition among residential and commercial customers for an approach whereby standard offer prices would be increased to boost competition (See Appendices C and D).<sup>21</sup>

### Direct Assignment

Under direct assignment, every small customer would be assigned to a retail supplier. The pool of retail suppliers to which customers would be assigned would be determined, for example, through a bidding process in which suppliers compete for the right to receive customers. Customers would be assigned to the winning suppliers randomly or through some other predetermined mechanism.

Generally, direct assignment schemes suffer from what we consider to be a serious flaw – customers pay different prices based on the “luck of the draw.” In other industries that have used direct assignment to move customers into the competitive market, such as long distance telephone, the approach has not been well-received by customers. Under a direct assignment plan being considered in Massachusetts, however, all customers would pay the same supply price. This price would be the “clearing price,” or highest bid, from among the group of suppliers chosen for direct assignment. Each supplier would be paid only its bid price, and the extra revenue recovered from customers would offset T&D rates.

Proponents of direct assignment argue that it will jump-start retail competition. Suppliers will be attracted in the first instance by the opportunity to receive a large block of load with little or no customer acquisition costs. Once in the market, suppliers will compete for each other’s customers. This competition is made even more likely in the plan being considered in Massachusetts by setting the price equal to the highest winning bid. Opponents of direct assignment argue that it is the antithesis of retail choice and simply slamming by another name.

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<sup>21</sup> When 400 residential customers were asked how they would feel about increasing the standard offer price to encourage more electricity suppliers to compete in the market, thereby increasing their supply options and possibly reducing their supply prices, 60.3% opposed or strongly opposed this approach, 24.5% were neutral, while only 13.8% supported or strongly supported it, with 1.5% expressing no opinion. Commercial customers were slightly more favorably inclined toward this alternative, although those opposing it still outnumbered those supporting it by 59% to 17%.

At this point it is unclear whether Massachusetts will go forward with any direct assignment plan and, if so, whether the plan will work as intended. We note that, even if the plan does work as intended, it could result in a “price umbrella” effect similar to that described above for adders. We do not recommend direct assignment at this point, although we intend to closely monitor any plan pursued in Massachusetts for possible future consideration in Maine.

### Municipal Aggregation

The other approach most often proposed for retail competition in the small customer markets is municipal aggregation. We discuss this approach later in this section.

### **3. *Beginning March 1, 2005, should any standard-offer provider selected by the commission pursuant to subsection 2 be required to offer at least one standard offer service that is composed entirely of renewable resources as defined in section 3210?***

The Legislature should modify the Restructuring Act to authorize the Commission to provide for the availability of a “green offer” service beginning March 1, 2005.<sup>22</sup> The green offer supply would comprise only renewable resources as defined in the portfolio requirement statute,<sup>23</sup> 35-A M.R.S.A. § 3210 and would be available as an option to all residential and small commercial customers. The green offer provider would not necessarily be the same as the standard offer provider, although it could be,<sup>24</sup> and customers would receive green offer service only by affirmative choice; thus it would not be a default service in any sense.

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<sup>22</sup> It is unclear whether absent legislation the Commission would have the authority to provide for a green offer service. It is the Commission’s view, however, that such a program should not be implemented without explicit legislative authorization.

<sup>23</sup> Because there is no consensus as to what resources should be considered “green,” it is our view that the green offer should simply include those resources that the Legislature has already designated as renewable for the purposes of the portfolio requirement. These are sources of generation that either qualify as small power production facilities under federal regulations or that do not exceed 100 megawatts in capacity and rely on: fuel cells; tidal power; solar arrays and installations; wind power installations; geothermal installations; hydroelectric generations; biomass generators; or municipal solid waste with recycling.

<sup>24</sup> It is possible the best approach may be to have the same supplier for both the standard and green offers. Thus, the Commission should have the flexibility to impose such a requirement.



Under the green offer program, customers would periodically have the opportunity to choose a green offer supply product at specified prices.<sup>25</sup> Customers would be notified of this opportunity through direct mail, either separately or as part of their T&D bill, and could then sign up for the service quickly and easily, such as by a return-mail postcard or through the internet.

The green offer supply would be procured and administered in much the same way the standard offer supply is currently handled. The Commission would conduct a competitive solicitation to select green offer suppliers and establish prices, and would likely coordinate the green offer process with the standard offer process, although suppliers could participate in the green process only.

Once selected, a green offer supplier could market its product if it chose to do so. Because the green offer would not be a “second standard offer” or a default service, the green offer would operate like other competitive services in terms of the utilities’ enrollment and billing systems, thereby creating no green offer specific problem for the utilities in this regard.

Except for a limited time at the outset of restructuring, a viable competitive market for green supply products has not developed either in Maine or elsewhere in the region. This is primarily a consequence of the lack of an active market for residential customers in general. Presently, suppliers do not expect a large enough demand for green products to justify the costs of entering the market in the absence of a broader residential market. Although it would be preferable for green supply products to be provided through an active retail market, we do not expect such a market to develop in the near term. Thus, a green offer program can meet customer demand for a green product until that market develops.<sup>26</sup> We are concerned, however, that the green offer could have the effect of slowing the development of a competitive market for other green products. Accordingly, the Commission would monitor the development of residential and green markets throughout the region and would act quickly to phase out

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<sup>25</sup> To prevent green offer prices from diverging from standard offer prices during times of declining wholesale market prices, we would consider requiring that enrollment opportunities coincide with the beginning of standard offer terms.

<sup>26</sup> The Commission’s recently-completed survey of residential and business customers indicates significant interest in a green product. In response to survey questions, approximately 55 percent of residential and 49 percent of business customers expressed a willingness to pay more for electricity from environmentally clean sources.

the green offer if green markets appeared to be developing elsewhere or if there is evidence that the green offer is inhibiting the development of such markets.<sup>27</sup>

**4. Should this chapter be amended to enable aggregators, beginning March 1, 2005, automatically to receive by contract, for a term designated in that contract, the designation as competitive electricity provider for all the electric accounts in a given municipality if:**

**(1) That municipality adopts a “negative-option” form of municipal aggregation, following notice and opportunity for hearing, by means of a recorded vote of the municipal officers of the appropriate governing body; and**  
**(2) All customers in that municipality reserve the right to leave the municipal aggregation and designate a different provider, in writing, within a time period established by legislative enactment?**

The Commission recommends against amending the restructuring law to authorize negative option municipal aggregation. Under Maine’s bid based standard offer process, Maine’s residential and small commercial customers are already receiving the benefits of the competitive power supply market on a default basis. In our view, negative option municipal aggregation will not advance the goals of retail access in Maine or provide any significant benefits to Maine’s ratepayers. Moreover, merely authorizing such aggregation is likely to result in higher standard offer prices and make it more complicated and costly for suppliers to compete in the small customer “mass market.” The costs and complexities municipalities would face in soliciting and negotiating power supply contracts and administering the negative option would be significant. If authorized, municipal aggregation would also raise issues of fairness in how municipal groups are formed and how prices are established for customers.

Municipalities and other public entities can already act as aggregators under current Maine law. 35-A M.R.S.A. §3202. In order to do so, however, the municipality, like any other aggregator, must solicit and affirmatively enlist each customer. In other words, each customer must “opt-in.” Under negative option municipal aggregation, a municipality could acquire all customers automatically, unless a customer affirmatively chose not to participate, or in other words, “opted-out.” Because of the financial and human resource limitations of municipal bodies and the inertia of residential and small commercial customers, it is generally thought that municipal aggregation on any appreciable scale is unlikely to occur unless it is done on negative option basis.

In this section, we discuss the risks and benefits of negative option municipal aggregation, and other states’ experiences with this approach. As noted above, we recommend that it not be authorized in Maine. However, in this section, we also identify

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<sup>27</sup> Similarly, since we do not propose to initiate a green option until March 1, 2005, the Commission should have the discretion not to establish a green offering if a private market had developed for green power by that time, or if a green market existed only for certain classes, to exclude those classes from the Commission’s green offering.

certain provisions that we believe would be necessary in any law that allows municipal aggregation, should the Legislature disagree with our recommendation.

### Benefits and Risks

Proponents of municipal aggregation argue that, because of high customer acquisition costs and relatively low profit margins per customer in the residential and small commercial markets, municipal aggregation is necessary for competition to develop in these sectors. If a municipality can aggregate on a negative option basis, large numbers of small customers can be acquired relatively cheaply and easily, creating a larger and more profitable customer base for suppliers.

Under negative option municipal aggregation, the town manager, selectman or other authorized representative would negotiate a supply contract on behalf of the residents and businesses of the community.<sup>28</sup> Unless a resident or business took some affirmative step to “opt-out,” it would become a customer of that supplier and receive service under the terms of the negotiated contract. In essence, negative option municipal aggregation is much like a “mini-standard offer” within the municipality, although without the right to leave at any time.

Negative option municipal aggregation is supported by those who assert that: (1) it is a better/more efficient way to aggregate customers than by utility service territory; and (2) it will jump start retail competition for small customers by encouraging supplier entry and raising customer awareness. In our view, neither theory is persuasive. The first theory is that suppliers would have more opportunities to bid for aggregated loads than under the status quo, and smaller suppliers, who might not be able to bid on the standard offer load of an entire T&D utility, would also be able to participate. The entry of more suppliers, then, would increase competition for standard offer type service and drive prices down. However, most proponents recognize that sufficiently large aggregated groups cannot be achieved on a single-municipality basis and that municipalities would have to band together and form coalitions.<sup>29</sup> All other things being equal, the larger the coalition the greater the benefits. However, as the aggregated groups become larger they also begin to resemble Maine’s current utility-wide standard offer groups, and the benefits of bringing more and smaller players into the market are less likely to be realized.

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<sup>28</sup> In the alternative, the municipalities could aggregate residents only.

<sup>29</sup> This has been the case even in a state like Ohio where individual municipalities are far larger than in Maine. For example, the Northeast Ohio Public Energy Council (NOPEC) formed a group to represent 100 communities with more than 600,000 potential customers. Another group in the Toledo area included more than 130,000 customers. In contrast, the *total* number of residential customers in the CMP and BHE service territories is in the range of 600,000.

The second possible benefit of municipal aggregation is that it would “jump start” the retail market for small customers. The theory is that with more suppliers active in Maine and the increased customer awareness about supply choice that would accompany municipal aggregation, suppliers would begin to solicit individual customers and/or customers would begin to seek retail suppliers. Although this is possible, in our view it is at least as likely to have the opposite effect. Currently in Maine standard offer acts as the price to beat for suppliers in the competitive market. Standard offer prices and term lengths are set on a company-wide basis and are well-known and easily understood by suppliers. If there were several different aggregated municipal groups with different prices to beat and varied term lengths, it would be more difficult for suppliers to market to small customers on a “mass market” basis. In addition, the possibility that retail customers of a supplier could automatically be taken away through a municipal aggregation plan could deter suppliers as well. Finally, in other states where municipal aggregation has occurred (Ohio and the Cape Light Compact area of Massachusetts) it simply has not had the effect of stimulating the retail market.

A third possible benefit of municipal aggregation is that it could provide small customers with a “second bite at the apple” if their standard offer prices had been set when the market was at a high point and then later dropped. The availability of municipal aggregation would give small customers a market option that they might not otherwise have. However, the fact that groups of customers could leave standard offer en masse as market prices dropped would be a major risk factor considered by standard offer bidders. Even if no municipality used this approach, simply authorizing negative option municipal aggregation would in and of itself create a significant load migration risk for standard offer suppliers and lead to higher bid prices. Indeed, some suppliers would likely not bid at all. Thus, even though at times municipal aggregation could achieve lower prices for certain customers than standard offer, there is no guarantee that these price benefits would exceed the risk premium for all other customers that remain on standard offer service.

It may be possible to limit the effect on standard offer prices of the migration risk by requiring municipal aggregators to have completed their processes, including the opt-out process, prior to the time standard offer service is solicited. However, this process would create a dilemma for either the aggregation supplier who would not know how much of its load would migrate to the standard offer or, to the extent that movement in and out of the aggregation group is limited, for the residents of the municipalities would not know the standard offer prices (i.e., their “price to beat”) when deciding whether to opt-out of the municipal aggregation. A constraint on the movement in and out of the aggregation would also eliminate what is perhaps the most significant benefit to customers of municipal aggregation, that being the ability to access the market when market prices have declined below standard offer prices.

If municipal aggregation actually developed in Maine, it is unlikely that its results would be evenly distributed throughout the State. Procuring and negotiating contracts for electric power supply require considerable technical, financial and legal expertise and a significant amount of resources, both in terms of time and money. This is

supported by our experience in acquiring standard offer service, where preparing RFPs (including all necessary load data), evaluating bids and negotiating contract terms have required substantial amounts of staff resources over a several month period of time. Municipalities would incur further costs to administer the program, including costs for public education campaigns, sending out and processing opt-out cards, and identifying eligible residents and businesses and providing their load data to potential suppliers. It is possible that the larger and more affluent communities in the State, given their greater access to both human and monetary resources, would take advantage of municipal aggregation early on in the process, leaving customers in smaller, less economically advantaged areas with a standard offer price inflated as a result. There is also the risk that certain communities would be perceived as being unattractive to suppliers (e.g., because of customer credit) and be excluded from municipal aggregation groups on this basis.

In addition, customers in neighboring communities but different aggregation groups would likely have different rates, due simply to the timing of their bid processes. To the extent that municipal aggregation results are not evenly distributed, whether due to community characteristics or timing differences, residents in the higher rate communities are likely to perceive the system as being unfair.

Finally, as was discussed previously, Maine's retail market for C&I customers is currently active and many of these customers are already in the market. If a municipal aggregation included these customers automatically, there would be contract problems if the customers failed to opt-out and, there would be justifiably unhappy customers if they were switched to a higher rate.

### The Experience of Other Jurisdictions

As of this date, only three states, Rhode Island, Ohio and Massachusetts, have adopted negative option municipal aggregation.

Ohio's municipal aggregation law, enacted in 1999, requires that a town ordinance or resolution authorizing a town to participate in a negative option municipal aggregation agreement be put out to vote at the next general or primary election and be approved by a majority of those voting. If approved by the voters, the authorizing governing body must develop a plan of operation which is then put out for comment at two duly noticed public hearings. Following adoption of the plan, each customer to be included in the aggregation must be provided a disclosure statement which provides the rates, charges and other terms and conditions of switching, including the procedure to opt-out. The plan must allow every enrolled person the opportunity to opt-out every two years without paying a switching fee.

In terms of number of participants, Ohio has had the greatest success with its municipal aggregation program. Currently, there are approximately 600,000 customers participating (Ohio's population was over 11 million in 2000). The largest aggregation group in the state is the Northeast Ohio Public Energy Council (NOPEC), which consists

of approximately 94 participating communities. While participating municipalities have been able to achieve some savings for their constituents relative to the available standard offer price,<sup>30</sup> the level of participation and the amount of savings should be viewed in the context of Ohio's overall restructuring process and standard offer pricing policy. Unlike Maine, Ohio did not require its incumbent integrated utilities to divest their generation resources at the time of restructuring. Standard offer service in Ohio is provided by the incumbent utilities and is largely based on the utilities' embedded costs, which for some are quite high compared to current market rates. These high standard offer rates and general customer dissatisfaction with their utilities (at least in part because of high rates), underlie the high participation rates in Ohio's municipal aggregation program. This is evident from the fact that nearly all of the aggregation activity in Ohio has occurred in the northern part of the State, the area with the highest utility rates.

The Ohio experience has not been without problems. First, the process of identifying which customers are actually in a municipality has proven more difficult than anticipated. Municipal boundary information is not contained in any utility database and customer mailing addresses do not always follow the boundaries of towns. Second, despite Ohio's legislation, requiring a ballot and notification prior to enrollment with the municipal aggregation's CEP, the Ohio Public Utilities Commission has received a number of complaints from customers who believe they were "slammed" by the municipality. Third, Ohio's requirement that municipal groups file their aggregation business plans with the PUC has met with some negative reaction from the towns and is currently being challenged in the Ohio courts.

Massachusetts enacted legislation authorizing opt-out aggregation in 1997. Massachusetts' aggregation statute allows a town to initiate an aggregation program by a majority vote at the town meeting or by the town council, or for a city to approve such a program by a majority vote of the city council. After such approval, the municipality must develop a load aggregation plan which shall provide for universal access, reliability and equitable treatment of all customers. The plan is to be filed with the Massachusetts Department of Telecommunications and Energy for its review and approval. The plan must also include the organizational structure of the program; the rates and costs to participants; a description of program's operation; and the rights and responsibilities of program participants. Participants may opt-out without penalty within 180 days of the plan's implementation.

As in Ohio, participation in the municipal aggregation program in Massachusetts has been influenced by standard offer prices. The standard offer price in Massachusetts is administratively set. Unlike Ohio however, the standard offer price in Massachusetts has typically been and is currently below market. Prices for Massachusetts' default service, however, are set in each service territory based on the

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<sup>30</sup> Based on our interviews, the NOPEC savings appear to be approximately 1% of the standard offer price.

market. In March 2002, the Cape Light Compact<sup>31</sup> entered into a 2-year pilot program on behalf of 45,000 default service customers, at rates of 4.894¢/kWh for service in 2002 and 4.798¢/kWh for service in 2003. Due to fluctuations in market prices, the Cape Light Compact's aggregated rates for May and June were 22% below the State's default service rates, while the rates for July and August were 11% below the default service rates. Because the Massachusetts default prices are reset every six months (based on the market), it is not possible to know today what price advantage or disadvantage the Cape Light's program will ultimately have compared to default service.

The Cape Light Compact is the only municipal aggregator that provides service in Massachusetts. The Compact's 2002 pilot program represents the culmination of years of work, a significant amount of money including grants that were available to the Compact, extensive community outreach and the support of the communities involved. Even with this effort, the pilot has had some implementation difficulties. Most notably, the incumbent utility could not enroll customers at the start of the program. The incumbent utility has also been unwilling to do budget billing for the supplier.

Rhode Island's legislation authorizing municipal aggregation was enacted June of this year. The Rhode Island statute requires a town that wants to participate in the negative option program to put the issue to a ballot vote and receive approval of a majority of those voting. Following approval, the municipality must file an aggregation plan for review and approval by the Rhode Island Public Utilities Commission (RIPUC). After receiving RIPUC approval, the municipal authority may solicit bids and must provide the results of the bid process to the RIPUC, which then has five business days to suspend further action if it finds that the results are not in conformance with the plan or that the statutory requirement that the winning bid price be lower than the standard offer is not met. The Rhode Island statute also requires municipalities to fully inform their citizens of the automatic enrollment process, their right to opt-out without penalty at the time of implementation and every two years thereafter, and to prominently state all charges and instructions on how to receive a list of all other supply options. Since the legislation authorizing Rhode Island's negative option was enacted only recently, there is no track record in Rhode Island as of this date.

### Recommended Provisions

If the Legislature decides to enact legislation authorizing negative option municipal aggregation, we would recommend that the following provisions be included.

- That, similar to Ohio and Rhode Island laws, there be a requirement that the issue of negative option municipal aggregation be put out to vote, either as part of the town meeting process or as part of a ballot initiative.

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<sup>31</sup> The Cape Light Compact was formed in 1994 and consists of all municipalities in Barnstable County and Martha's Vineyard. Shortly thereafter, the Compact lobbied for municipal opt-out aggregation and community choice and received a grant to study the issue.

- That aggregating entities be required to hold hearings on their aggregation plans.
- That the participants in the plan be provided with adequate notice of rates, charges and terms of service prior to implementation. In addition, the terms of opting-out without penalty must be clearly spelled out.
- That, similar to the Ohio and Rhode Island legislation, participants be provided an opportunity to opt-out without penalty at the time of implementation and not less frequently than every two years thereafter.
- That the automatic enrollment provisions of the negative option only apply to customers on standard offer service.

We recommend against any provision that would require the municipal aggregators to file a plan with the Commission for review and approval, or any requirement for Commission approval of the winning bids. We believe such requirements would impair the ability of municipalities to finalize power supply agreements, where time is often of the essence, and would cloud the issue of who was responsible for the design of the program and its ultimate success or failure.

## V. RESIDENTIAL AND COMMERCIAL CUSTOMER SURVEYS

The Commission engaged the services of Critical Insights, a Portland-based market research firm, to conduct a survey of residential and small and medium commercial customers in Maine. The survey covered several topics related to electricity and retail competition. Our primary objective was to obtain information on the relative importance to these customer groups of choice vs. price. We also sought information on customer knowledge about restructuring and the likely response to a green supply product.

In this section, we summarize some of the survey's key findings. The complete results are provided in Appendices C and D.

### Residential

- 41% of residential customers responded that it is “not important” or “not at all important” for their household to have a broad selection of suppliers from which to choose, with an additional 30% neutral on this point.
- 84% responded that the price of electricity supply is “important” or “very important” to their household.
- Given the choice between lowest possible standard offer prices and more choice among suppliers, 74% chose lowest possible standard offer prices.



- When asked how likely they would be to shop if there were suppliers in the marketplace, 75% responded “somewhat” or “very likely.” When asked about the level of savings needed to make it worth their time to shop around, 79% replied that total electric bill savings would have to be 10% or more, 43% replied that savings would have to be at least 20%. Because supply is typically less than half of the total electric bill, then, this indicates that 79% of residential customers would require competitive supply prices to be more than 20% below standard offer, and 43% would require competitive supply prices to be more than 40% below standard offer.

### Commercial

- When asked how likely they would be to shop if there were suppliers in the marketplace, the same percentage of commercial customers as residential (75%) responded that they would be “somewhat” or “very likely.” When asked what percentage savings on their monthly bill would make it worthwhile to shop, 47% replied that savings of 10% or less would make it worthwhile.
- 71% of commercial customers responded that the price of electricity supply is important or very important to their business.
- 49% responded that it is “not important” or “not at all important” to have a broad selection of suppliers from which to choose, with an additional 26% neutral on this point.

## **VI. CONCLUSION**

It has been almost three years since Maine’s electric industry was restructured and our markets opened for retail competition. In our view, the restructuring process has generally been a success, although, of course, any assessment depends at least in part on expectations at the outset. Maine’s retail markets have developed well for medium and large customers, and a significant number of these customers now acquire their power supply in the competitive market. For small customers, although retail competition remains the ultimate goal, for the reasons stated in the report this goal has not yet been achieved. In this respect, electricity is consistent with other formerly-regulated industries, such as long distance telephone, where competitive markets for small customers have also evolved more slowly. Until retail markets develop for small customers, standard offer service as it is procured and priced in Maine provides them with the benefits of competition through the wholesale market.<sup>32</sup>

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<sup>32</sup> It may bear noting that when the residential customers in our survey were asked how they would feel if the Public Utilities Commission were to continue to obtain standard offer services for households at the best possible price, which may lead to little or no retail competition in the sale of electricity in Maine, 43.1% supported or strongly supported this effort, 37.3% were neutral, while only 17.5% opposed or strongly opposed it, with 2.3% expressing no opinion. While we remain committed to the

In our view, the present lack of a small customer market in Maine is not an indication that our restructuring efforts have failed, nor can such a market be created solely by Maine's laws or rules. As noted throughout this report, other factors are more influential in this regard. As the Legislature considers the issues before it, we recommend that it proceed cautiously, bearing in mind that Maine's residential and small commercial customers now receive the benefits of competition through our standard offer bid process and, as indicated by our surveys, these customers are not clamoring for change in this respect.

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eventual development of a competitive retail market for residential customers, this does not seem to be a matter of great urgency for those customers.