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Session One: Setting the Standard for Standard Offers

Harvard Electricity Policy Group
Thirty-Second Plenary Session

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Massachusetts Standard Offer and Default Service: Definitions and Prices

Massachusetts Restructuring Act: Enacted November 25, 1997

- Retail customer choice starting March 1, 1998
- Two Different Utility-provided generation services: *Standard Offer Service* and *Default Service*
- 10% rate reduction for Standard Offer on March 1, 1998
- Additional 5% rate reduction for Standard Offer on September 1, 1999
- Standard Offer Service ends on March 1, 2005 – All Standard Offer customers become Default Service customers

Statutory Requirements for Standard Offer and Default Service

Standard Offer:

- Pre-determined rate schedule from 1998 to 2005 (except for NU)
- 10 and 15% discount off of inflation-adjusted 1997 total rates
- Available only to customers of record as of March 1, 1998

Default Service:

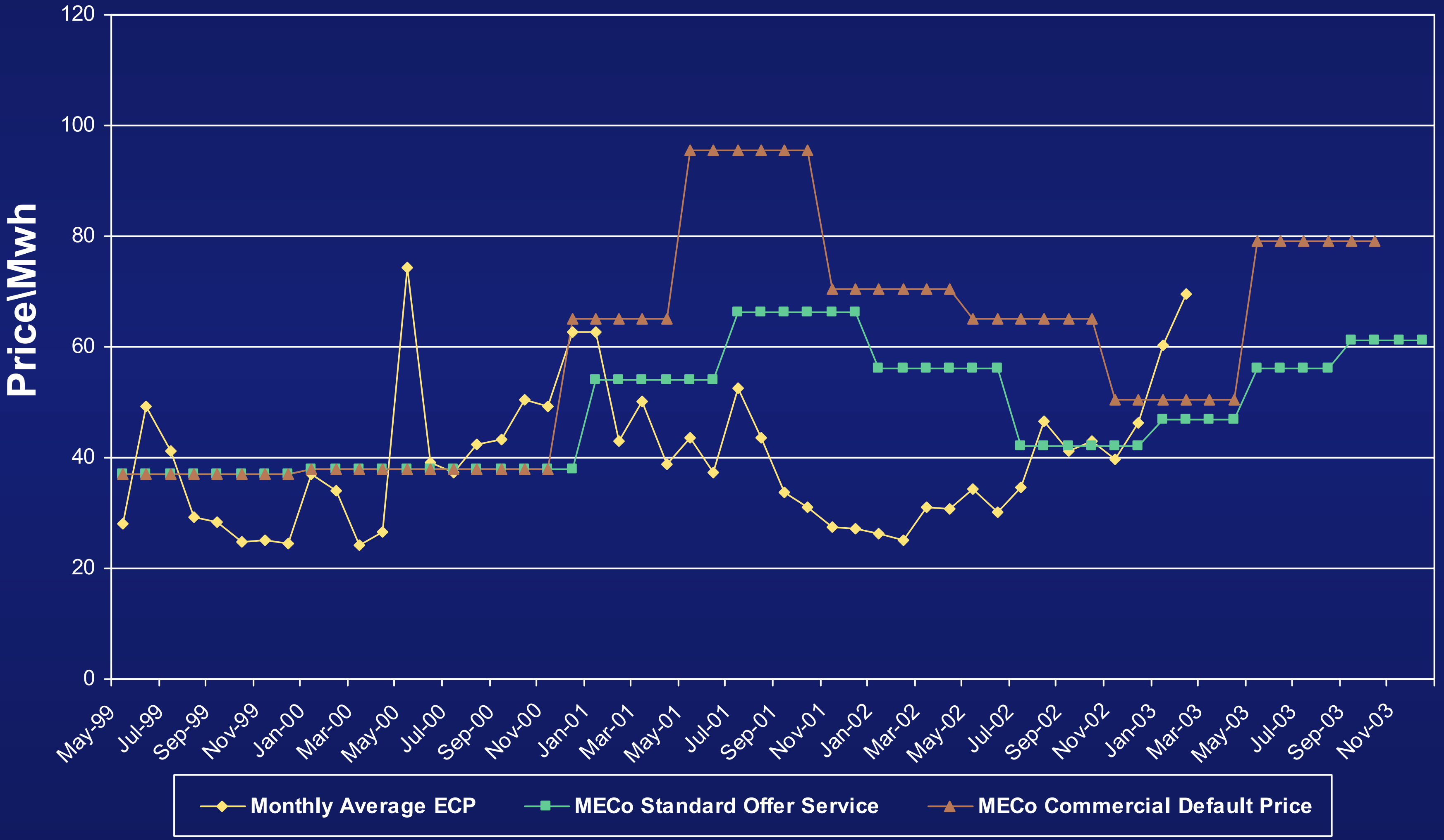
- Rates are the result of “competitive procurements”
- Rate shall not exceed the average monthly market price of electricity
- There shall be payment options with rates that remain uniform for periods of up to six months
- Available to new customers (i.e., began service after March 1, 1998), those who switch back from an alternative supplier, and all Standard Offer Service customers on March 1, 2005

Standard Offer Prices

- Prices for Standard Offer service are set by a pre-determined schedule, unless modified for Standard Offer service fuel adjustments (SOSFA)
  - Western Mass. Electric Co.'s standard offer prices were not the result of a settlement, so they are set based on the results of annual procurements

MECo Settlement Prices/kwh		Prices/kwh (w/SOSFA)
1998	2.8¢	2.8 ¢/3.2 ¢
1999	3.2¢	3.707 ¢
2000	3.8¢	3.8 ¢
2001	3.8¢	5.401 ¢/6.631 ¢
2002	4.2¢	5.626 ¢/4.2 ¢
2003	4.7¢	4.7 ¢/5.602 ¢/6.124 ¢
2004	5.1¢	

Comparison of Retail and Wholesale Prices



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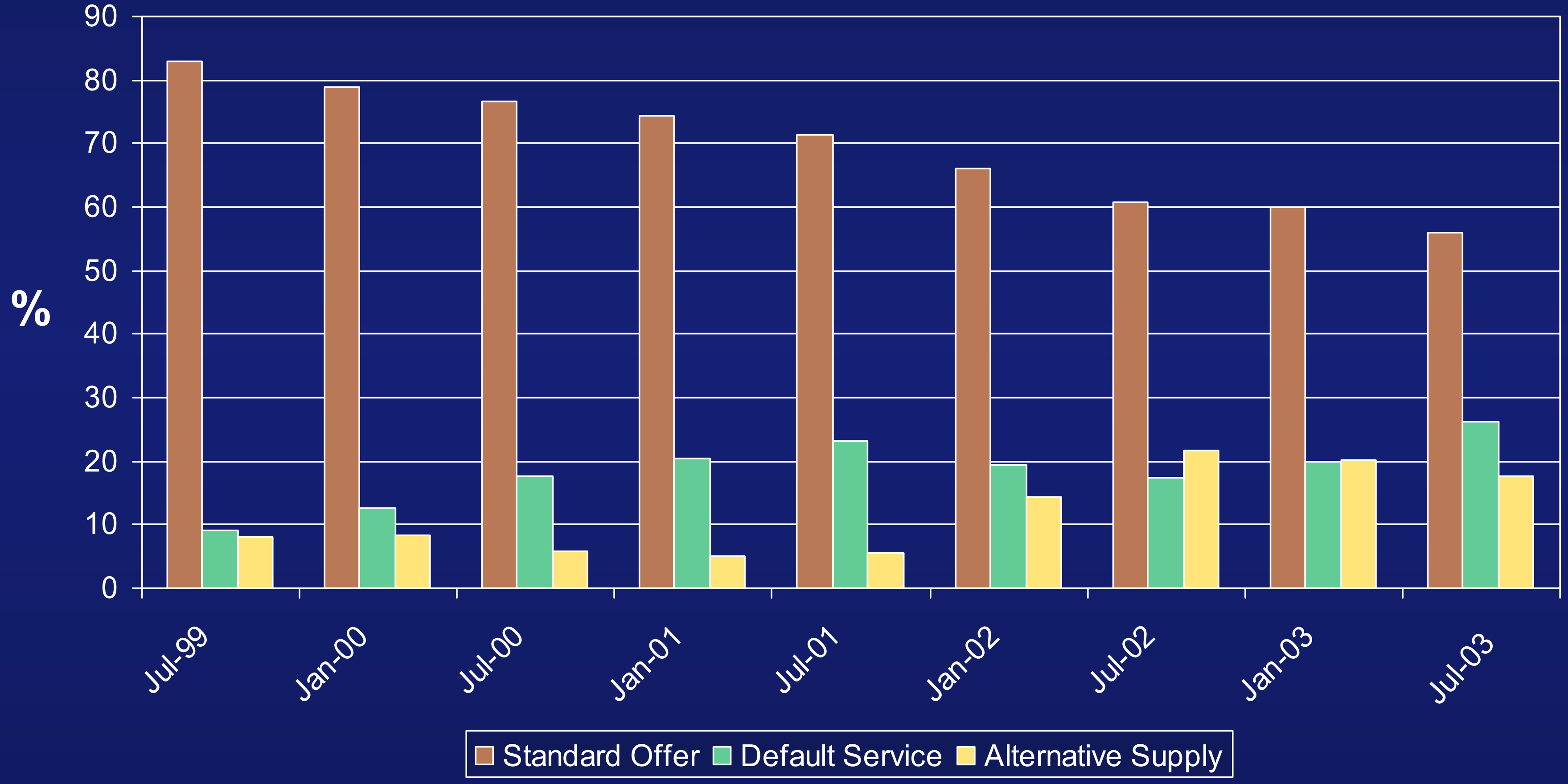
Distribution of Load



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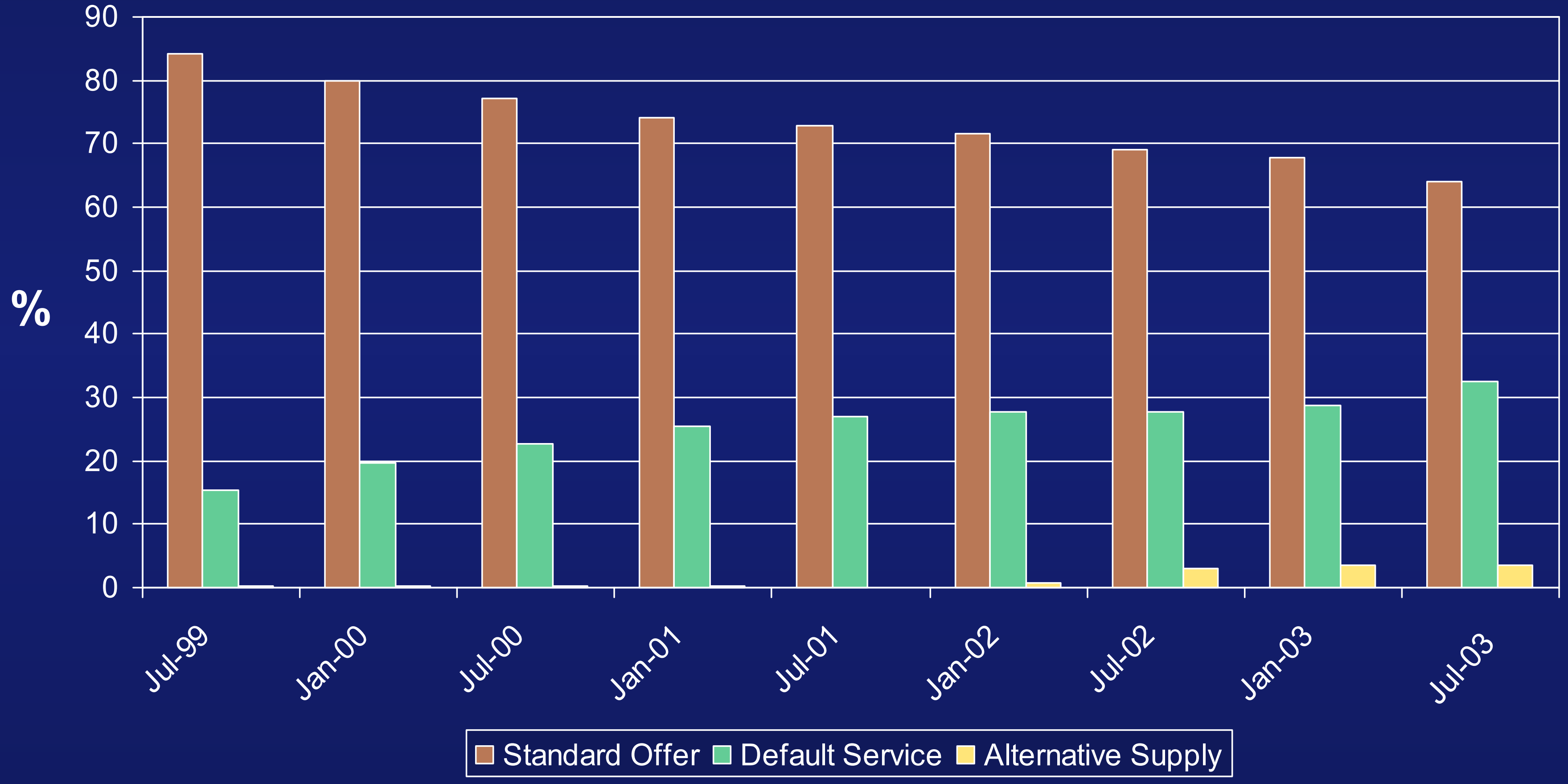
Distribution of Customers



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Changing Policies for Default Service in Massachusetts

Default Service Pricing Options

DTE 99-60-B, issued June 30, 2000

- Pricing varies by customer class (residential, commercial, and industrial)
- Two pricing options:
  - Varied by month
  - Fixed six-month (the average of the monthly prices)
    - Residential and small C&I will be on the fixed price option unless they choose otherwise
    - Medium and large C&I will be on the variable price option unless they choose otherwise
- Anti-gaming provision: fixed price customers who switch to a supplier during a six-month term will have bills recalculated using the variable monthly prices

Costs included in Default Service Prices

DTE 99-60-B, issued June 30, 2000

- Inclusion of administrative costs in the price sends the right price signal to customers
- BUT, the relatively small magnitude of the administrative costs does not warrant the imposition of this additional administrative burden

DTE 02-40-B, issued April 24, 2003

- No longer convinced that inclusion of these costs will have a negligible effect on default service prices. Costs that will now be included in the price:
  - Unrecovered bad debt
  - Costs of complying with the default service regulatory requirements, including required communications with default service customers
  - Cost of compliance with the Renewable Portfolio Standard

Default Service Procurement Terms

The primary issue considered was a balance between price certainty and a more efficient price

DTE 99-60-B, issued June 30, 2000

- Utilities are directed to use contract terms of anywhere from six months to one year

DTE 02-40-B, issued April 24, 2003

- Utilities are directed to use contract terms of twelve months, twice per year, for 50% of their load

DTE 02-40-C, issued September 11, 2003

- For medium and large C&I customers, utilities are directed to use contract terms of three months. Moving to monthly procurements will be studied further.

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Locational Marginal Pricing (LMP)

DTE 02-40-A, issued February 13, 2003

- LMP started in New England on March 1, 2003, with prices for load calculated for eight zones in New England. Massachusetts consists of three zones: NEMA/Boston, SEMA, and West/Central. The service territory for MECo crosses all three zones. The service territory for Boston Edison crosses two zones: NEMA and SEMA.

- The issue is whether retail prices for these two companies should be procured and differentiated by zone or averaged
  - Supply for default service should be procured by load zone
  - Default service prices for residential and small commercial customers will be averaged across load zones
  - To the extent that procurement costs are different between zones, default service prices for medium and large C&I customers will be different based on the zone the customer is located in

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The Future of Default Service

What is Default Service?

Is it a resting place for customers between suppliers?

OR

Is it the primary source of supply?

- **The answer may be different for different customer groups**
  - **In Mass., large and medium C&I customers are exercising retail choice, but small commercial and residential customers are not.**
  - **Mass. has instituted different procurement terms based on the level of switching by different customer groups.**

Policy Goals for Default Service

The regulatory goal is to find the most efficient market structure and delivery mechanism

"Competition is a process, not an end result."
Justice Stephen Breyer

- The goal is not to ensure market share for competitors or even guarantee the success of retail customer choice
- Regulators should not artificially stimulate customer migration by raising prices, structural separation, or "slamming"
- Maybe competitive wholesale markets and a pass-through of utility-procured supply prices represent the best outcome for mass-market customers

What will happen on March 1, 2005 in Massachusetts?

- As long as there is not a significant difference between standard offer and default service prices at the end of 2004, standard offer service will not be extended in Massachusetts
- There will be a true market test of retail customer choice for mass-market customers once standard offer service ends
- Conclusions about "market failure" in a market where most customers receive service below cost are premature
- Current procurement schedules provide an appropriate, regulator-determined balance between price efficiency and customers' desire for price certainty
- Suppliers are able to provide more than six months of price certainty and can offer value-added services

What if mass-market customers do not have choices or choose to shop?

- If the market test results in little or no shopping by mass-market customers, that should be viewed as an acceptable outcome
- If mass market customers do not exercise retail choice, then regulators will have to engage in some form of portfolio management for Default Service
- Considerations:
  - Should the portfolios be the same for each utility?
  - Would this open the door for prudence reviews?
  - Should the utility be able to profit or be harmed?
  - Resurrection of Integrated Resource Planning?
  - What is the optimal portfolio for regulators to use?

What about generation resource adequacy?

- The balancing act so far has been between price volatility and efficiency
- Is there a third leg of the stool – generation resource adequacy?

- The argument in favor is that regulators should use longer contract lengths to ensure generation resource adequacy. But, would this result in too much switching back and forth between Default Service and alternative supply?
  - If longer contracts are used, should large customers be restricted from switching if they choose Default Service?

Questions?

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