National Energy Marketers Association

COMMONWEALTH OF MASSACHUSETTS

BEFORE THE DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of	)	
Telecommunications and Energy on	)	D.T.E. 02-40
its own Motion into the Provision	)	
of Default Service	)	

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM) hereby submits comments pursuant to the Department's, "Order Opening Investigation into the Provision of Default Service," [hereinafter "Order"] issued June 21, 2002, in the above-referenced proceeding.

NEM is a national, non-profit trade association representing wholesale and retail marketers of energy, telecom and financial-related products, services, information and related technologies throughout the United States, Canada and the U.K. NEM's Membership includes wholesale and retail suppliers of electricity and natural gas, independent power producers, suppliers of distributed generation, energy brokers, power traders, and electronic trading exchanges, advanced metering and load management firms, billing and information technology providers, credit, risk management and financial services firms, software developers, clean coal technology firms as well as energy-related telecom, broadband and internet companies.

This regionally diverse, broad-based coalition of energy and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas, electricity and related products, services, information and technology in a competitively neutral fashion;
- Rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Competitively neutral standards of conduct that protect all market participants;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and

- Policies that encourage investments in new technologies, including the integration of energy, telecommunications and Internet services to lower the cost of energy and related services.

The Department defined the scope of this investigation to include: "(1) the price components to be included in default service rates, including administrative and bad debt costs and the effects of locational marginal pricing; (2) default service pricing options; and (3) procurement schedules and strategies."[1] The Department also stated it would consider, "whether distribution companies should serve as the default service providers of last resort or whether this function can and should be provided by other entities."[2] NEM appreciates the opportunity to provide these comments on the issues delineated by the Department. NEM has developed, "***National Guidelines for Designing and Pricing Default Energy and Related Services***," (a copy of which is attached hereto and incorporated by reference) which inform the comments set forth below.

I. Price Components of Default Service Rates and Default Service Pricing Options

The pricing of default service is critically important to the development of a new competitive market because the default service price serves as the "price to compare" – the target against which all competitive offers are judged by consumers. Default service must be priced at retail rates for each customer class. If the default service price is subsidized or set artificially low, i.e., if it does not reflect the true costs of providing retail generation service, true competition on the basis of price and quality of service will not be possible. Competitive suppliers will be challenged to cover their costs and offer products that provide value to customers. If the incumbent utility acting as the default service supplier is permitted to subsidize retail energy services by passing through wholesale price signals and embedding the retail costs of energy-related services in its distribution rate, a competitive marketplace cannot occur. Indeed, permitting utilities to maintain default service and offer false price signals in the process not only distorts energy price signals, but establishes a significant barrier to effective price competition by forcing customers who switch to competitive suppliers to pay twice for retail energy services. Under these circumstances fewer customers will choose competitive energy service providers, the utility's market share will be maintained, consumers will not benefit to the degree they should, and competitive markets simply won't develop.

All suppliers providing generation service to customers at retail, including default service and competitive suppliers, incur costs to do so in addition to the wholesale cost of the energy commodity. These costs include transmission charges, scheduling and control area services, and distribution system line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care. Default service pricing mechanisms that hide the true costs of providing retail energy services, showing instead the wholesale power costs alone as the "price to compare," do not benefit default service customers,

1 Order at page 6.
2 Id.

who are getting a false price signal and are still paying the other costs to provide generation service in the distribution component of the bill. They do, however, penalize customers who switch to competitive suppliers since those customers are paying for the retail costs of energy supply services twice. They also have a devastating effect on the competitive market, since competitive suppliers are unable to compete effectively on the basis of price with the subsidized default service option.

A. Administrative and Marketing Costs Must Be Included in the Default Service Price

When the Department examined the issue of default service pricing in Decision 99-60-A, it found that, "[t]he inclusion of the distribution company's administrative costs will ensure that all costs of providing default service are included in the default service price 'seen' by retail customers. With the administrative costs, the default service component of a customer's bill will provide an appropriate price signal to customers and allow competitive suppliers a fair and reasonable opportunity to compete for default service customers." However, the Department later found in Decision 99-60-B that, "[w[hile the inclusion of administrative costs in the price of default service sends the right price signal to customers, we conclude that the relatively small magnitude of the administrative costs does not warrant the imposition of this additional administrative burden." In Decision 99-60-A, the Department also noted commenters' suggestion that, "a third cost component be included in default service prices - an adder to represent marketing costs incurred by retail suppliers, but not by the default service suppliers or distribution companies." The Department did not adopt the recommendation finding that, "[w]hile it is critical that all costs of providing default service be included in the retail price to provide an accurate price signal, it is inappropriate to include artificial costs for the purpose of spurring competition." NEM urges the Department to reconsider the treatment of administrative and marketing costs.

As recommended above, default service prices should not be set artificially low as it will stunt the development of the competitive market. More importantly, if the utilities' full energy supply and commercial costs of providing default service remain hidden in distribution rates then migrated customers will unfairly be forced to pay these costs twice - once to the competitive supplier that is currently providing service to the customer and once to the utility that is no longer providing the service. The Department did acknowledge in previous Orders that inclusion of administrative costs would send proper price signals but rejected the approach because of the purported administrative burden and certain parties estimates that the adders would be relatively small. NEM submits that this is an insufficient reason for rejection of inclusion of these costs in default service prices. The Department also rejected the inclusion of marketing costs in default service prices finding that it would constitute an "artificial cost." NEM submits that the utility incurs a number of energy supply and commercial costs, as discussed above, associated with default service that must be included in default service pricing to send consumers accurate price signals.

NEM submits that other Commissions have instituted adders that partially reflect these costs. For instance, the Maryland Public Service Commission has approved default service for non-residential customers in the BGE service territory that includes the PJM locational market price for energy for the BGE zone, the PJM market capacity price, transmission, ancillary services, line losses, appropriate taxes, and a fixed retail adder of 7 mills per kWh. (See BGE Electric Schedule DS).

Similarly, the New York Public Service Commission approved retail access program credits of 2 mills for large C&I customers and 4 mills for small customers in the NYSEG,[3] Niagara Mohawk[4] and Central Hudson[5] service territories. The NYPSC also approved retail access program credits of 1 mill for demand billed customers and 2 mills for non-demand billed customers in the ConEd service territory.[6] These retail access program credits were instituted pending the NYPSC's completion of its statewide, embedded cost-based unbundled rate proceedings.

B. Default Service Pricing Should Be Differentiated By Customer Class

In Decision 99-60-A the Department recognized that, "to the extent that the costs and risks associated with providing default service differ significantly among customer classes, a single default service price for all customers could result in poor price signals to customers and cost subsidization among customer classes." Subsequently, in Decision 99-60-B, the Department found that, "there are insufficient facts to indicate the magnitude or direction of the cost differences of providing default service to the various customer classes," but allowed for default service bid proposals to set forth separate bid prices for residential, commercial and industrial customers. NEM asserts that the costs to provide default service do vary by customer group. NEM recommends that

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3 Under the NYPSC-approved terms of NYSEG's Price Protection Plan settlement, "[c]ustomers who choose the ERO rate will receive a credit of 2 mills (Large Customers) and 4 mills (Small Customers) unless and until replaced by the Commission in the Unbundling Track." Joint Proposal at page 31. Customers that elect retail access through a market-based backout, "will receive an adder of 3 mills for Large Customers and 5 mills for Small Customers." Joint Proposal at page 30. See Case 01-E-0359, Petition of New York State Electric & Gas Corporation for Approval of its Electric Price Protection Plan and Case 01-M-0404 - Joint Petition of Energy East Corporation, RGS Energy Group, Inc. New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation and Eagle Merger Corp. for Approval of Merger and Stock Acquisition, Order Adopting Provisions of Joint Proposal with Modifications, issued February 27, 2002.

4 The NYPSC-approved NIMO settlement provides that,

> "Customers selecting an alternative supplier shall be credited with a Customer Service Backout Credit of $0.004 per kilowatthour for residential customers served under SC-1, SC-1B, SC-1C, and non-demand metered commercial customers served under SC-2, and of $0.002 per kilowatthour for all other demand metered customer classes and customers served under PSC-214 as described in existing Rule 42."

Joint Proposal at pages 45-46 approved in Case 01-M-0075, Joint Petition of Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corporation, National Grid Group plc and National Grid USA for Approval of Merger and Stock Acquisition, Opinion No. 01-6, issued December 3, 2001.

5 The NYPSC approved the following credits set forth in the Central Hudson settlement,

> "Electric Back Out Credits: Credit levels would be set at 0.5 mills per kWh for S.C. 13 customers; 2.0 mills per kWh for S.C. 3 customers; 3.0 mills per kWh for S.C. 2 demand customers; and 4 mills per kWh for S.C. 2 non-demand, S.C. 6 and S.C. 1 customers pending the outcome of the Unbundling Proceeding."

Central Hudson Joint Proposal at page 38 approved in Cases 00-E-1273 and 00-G-1274, Proceeding on Motion of the Commission as to the Rates, Charges, Rules, and Regulations of Central Hudson Gas & Electric Corporation for Electric and Gas Service, Order Establishing Rates, issued October 25, 2001, at page 16.

6 See Cases 96-E-0897 et al., Order Approving Phase 5 Retail Choice Program, issued April 29, 2002, page 7 (extending credits previously approved in Cases 96-E-0897 et al., Order Adopting Terms of Joint Proposal, Subject to Modifications, issued April 9, 2001).

properly designed default service prices should reflect these real price differences to encourage competition for all customer classes.

II. Competitive Provision of Default Service

NEM submits that in a restructured environment the utilities' historical obligation to serve should be converted into an obligation to connect and deliver. Therefore, while the utilities should and will continue to provide transportation or distribution service for all customers, it is not necessary or desirable to establish the utilities, on a long-term basis at least, as the default provider of energy supply services. Indeed, the sooner the competitive market can super-aggregate small customers the sooner true price competition can begin. Retaining the utility as the default provider of energy supply services long-term in a restructured environment will have a negative impact on the development of competitive markets. When states mandate the selection of incumbent utilities for all consumers who fail to make timely supplier elections and set a non-competitive price for default service, it perpetuates the same non-competitive energy services that restructuring is designed to replace.

III. Conclusion

For the foregoing reasons, NEM urges the Department to adopt default service policies consistent with the recommendations set forth above.

Sincerely,

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