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Division of Energy Resources

Commonwealth of Massachusetts

Office of Consumer Affairs and Business Regulation

2000 Market Monitor: Electric Industry Restructuring

Executive Summary

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INTRODUCTION

With the passage of the Electric Industry Restructuring Act (the Act) in 1997, Massachusetts set out on an historic mission to use competitive market forces to reduce prices and provide customers with choice of their retail electricity supplier. The year 2000 marked the third year of electric industry restructuring in Massachusetts. Thus far, the results have been positive, though issues and challenges remain. For example, Massachusetts' electric customers have saved $1.7 billion through the transitional rate reductions mandated by the Act. However, wholesale market price volatility and uncertainty about market rule changes left retail competitive suppliers unsure of what strategies to pursue in Massachusetts. Several market initiatives need to be implemented to overcome market barriers and alleviate problems preventing a more competitive, robust wholesale and retail market. In this Executive Summary, the Division of Energy Resources outlines the highlights and significant events of 2000.

The Act requires the Division of Energy Resources (DOER) to monitor the changes in the electric industry each year. As prescribed by the Legislature, DOER reports on electricity prices and price disparities, competitive market developments, and electric system reliability (M.G.L. c 25A §§ 7, 11D, 11E). Below are the major findings for calendar year 2000.

2000 HIGHLIGHTS

1. Consumers Saved $775 Million in 2000.

As mandated by the Act, each local distribution company met the required fifteen percent rate reduction by September 1999. These reductions provided continuing savings to Massachusetts customers in 2000, even with inflation pressures. In 2000, customers saved $775 million over pre-restructuring rates. Residential customers saved $292 million, commercial customers $362 million, industrial customers $112 million, and other customers saved $9 million. When added to savings realized since March 1998, total savings are almost $1.7 billion.

2. Cape Light Compact Became First Approved Municipal Aggregation.

The Act allows municipalities to aggregate electricity purchases for their public buildings and interested electricity customers, including residential, commercial, and industrial customers. In 2000, the Cape Light Compact's plan was the first municipal aggregation plan approved by the Department of Telecommunication and Energy. The Cape Light Compact consists of 21 towns on Cape Cod, Barnstable County and Martha's Vineyard, representing approximately 185,000 customers. Using an aggregation approach to consolidate energy purchases into larger buying blocks will help many small consumers obtain lower prices and help suppliers reduce marketing and education costs.

3. New England Increased Power Capacity.

New England's electric generation capacity increased significantly in 2000, adding 1,466 megawatts at six new power plants. In Massachusetts, power plant development has been vibrant, in part, driven by a liberalization of power plant siting procedures. The

restructuring legislation made it easier for merchant generation companies to enter the state. Maintaining sufficient generation capacity is critical for the electric system's reliability.

4. Massachusetts Avoided California's Electricity Problems.
During 2000, California confronted unprecedented electricity shortages, wholesale price spikes and a financial crisis among its electric distribution companies. Despite years of dramatically increasing demand for electricity, no new power plants were built in California after 1990. Instead, the state relied on electricity imports from adjacent states. New England avoided similar problems for several reasons. New England states, particularly Massachusetts, fostered a more stable and competitive electric marketplace, which encouraged developers to build new power plants and the natural gas pipelines necessary to supply fuel to the plants. Furthermore, Massachusetts encouraged utilities to divest generation assets and allowed its utilities to determine how best to buy power for their standard offer and default service consumers.

5. Wholesale Prices Exceeded Retail Prices.
The nationwide increase in the cost of natural gas in 2000 contributed to higher wholesale electricity prices. In New England, the monthly weighted-average price of wholesale electricity was $46.15 per megawatt-hour in 2000, a 37 percent rise over the 1999 monthly average price of $33.78. At the same time generation prices rose in the wholesale market, retail market generation prices for standard offer and default services barely increased. For most of 2000, the weighted-average of these prices was $41 per megawatt-hour.

6. Competitive Suppliers Withdrew From the Market.
During the first two years of restructuring, Massachusetts experienced an immature yet promising retail competitive market with a handful of retail competitive suppliers selling electricity. The number of competitive choices declined in 2000, although a few competitive suppliers continued doing business in the state. Contributing substantially to the contraction of the retail market was the fact that regulated generation prices (in retail rates) were lower than wholesale electricity generation prices.

7. Default Service Customers and Consumption Grew Substantially.
As competitive suppliers withdrew from the market or curtailed enrollment of new customers, the number of competitive supply customers fell from 9,471 to 5,682, during 2000. Default service customers represented 19.6 percent of total customers at the start of 2000, and 13 percent of electricity consumption. However, the number of default service customers grew each month. By December 2000, their number grew to 25 percent of total customers and their consumption grew to 20 percent of total demand.

8. Standard Offer and Default Service Rates Were Uncoupled.
During 2000, the utilities' costs for default service contracts increased, due to higher electric generation prices. As a result, default service was priced below cost. Under this condition, competitive suppliers could not sustain their retail offerings to beat default service prices. To compound the problem, the utilities saw the number of default service

customers increase. As a result, utilities deferred the cost difference (known as deferrals) for default service and the deferrals grew. In 2000, the Department of Telecommunications and Energy allowed utilities to uncouple standard offer and default service rates and base the default service price on market-based costs. (Default service had been priced the same as standard offer service.)

9. New England Forms A Regional Transmission Organization (RTO) Plan.
In 2000, the Federal Energy Regulatory Commission (FERC) called for the creation of Regional Transmission Organizations (RTOs) in FERC Order 2000. They believed that large RTOs would foster wholesale market development, provide increased reliability and ultimately result in lower wholesale electricity prices. Even before Order 2000 was issued, New England already met many of the required characteristics and functions of a RTO. New England has the only competitive power pool in the United States with the characteristics of an interstate power pool where incumbent utilities have ceded control over the energy markets. Nonetheless, New England electric industry participants collaborated throughout the year to propose changes needed to satisfy all of FERC's RTO required characteristics and functions.

2000 MARKET MONITOR REPORT FOCUS

This is DOER's third annual assessment of electric restructuring progress in Massachusetts. It includes a discussion of electricity price and price disparities for each customer sector in Massachusetts. DOER closely examines the retail effects of high wholesale prices and low retail prices, and provides an overview of the resulting changes in customer migration on standard offer, default service, and competitive supply. The report highlights initiatives and regulatory actions taken to address and eliminate market barriers to competition at both the retail and wholesale levels. In addition, DOER presents an analysis of electricity demand in Massachusetts, New England, and the United States.

REPORT OUTLINE

Chapter I introduces the restructuring success stories that occurred during this year's transition toward more competitive markets.

Chapter II includes a review of wholesale electricity prices, overall retail prices, and regulated standard offer and default service generation prices. Price information shows that the companies continued to meet the mandated rate reductions and retail prices rose less than the rate of inflation. This chapter also places the Massachusetts retail prices within the context of the United States.

Chapter III provides a review of the retail customer migration in 2000. Data collected by DOER is presented to show how customers moved among standard offer, default service and competitive supply. This chapter provides an account of competitive suppliers' withdrawal from the market in 2000.

Chapter IV identifies retail and wholesale market barriers, and initiatives undertaken to overcome them. In this chapter, attention is given to changes in the acquisition and price of default service. Another section focuses on the need to examine whether or not some electric distribution companies' services such as metering and billing should be provided through the competitive market. Other issues include reducing distribution companies' cost while maintaining reliability; changes in wholesale market rules and design; and New England's proposal to create a Regional Transmission Organization.

Chapter V presents, for the first time in DOER's Market Monitor reports, an analysis of electricity demand. This evaluation presents the differences between the Massachusetts, New England and United States electricity markets. It also highlights the variations in electricity consumption among various sectors –residential, commercial, and industrial. The demand analysis illustrates what load profiles are attractive to marketers

OUTLOOK FOR 2001

The events during the third year of restructured electric markets in Massachusetts delivered several benefits for consumers. However, one of the significant challenges is the development of a robust retail competitive market. Despite some setbacks, several initiatives were implemented to overcome market barriers and alleviate problems preventing more competitive wholesale and retail markets.

The *Market Monitor 2001* will continue DOER's examination of the progress of electric industry restructuring. Specific events and topics to be addressed in the 2001 report include the following:

Short Term Market Pricing for Default Service
At the end of 2000, the DTE separated standard offer and default service, establishing new guidelines for default service pricing and procurement, based on market-based costs. In 2001, utility prices for default service will better reflect market forces. (It is also expected that natural gas prices and thus wholesale electricity prices should fall in 2001.) Thus, competitive retail suppliers should be able to start offering competitive choices to default service customers.

Retail Competitive Market Initiatives
By December 2000, the number of default service customers swelled to 25 percent of total customers and their consumption grew from 13 percent to 20 percent over the year. Many, interested market participants and regulatory decision-makers began discussions on the necessity to expand the range of competitive options available to consumers. The *Market Monitor 2001* will highlight steps taken.

Advanced Metering Services and Competitive Billing
DOER will review the DTE proceedings to establish terms and conditions for distribution companies to offer advanced metering services and DTE's proceeding on competitive billing.

Renewable Portfolio Standards
In 2001, DOER will begin the public review process for the Renewable Portfolio Standards (RPS). The Act directs DOER to establish a RPS for all retail electricity suppliers selling electricity to end-use consumers in Massachusetts. Beginning in 2003, each supplier must obtain at least 1 percent of its supply from qualified new renewable generation units. Each year thereafter, the standard increases by one-half percent (0.5%) through 2009 when it reaches 4 percent of each supplier's sales in that year. After 2009, the standard may increase by one percent per year until DOER modifies or suspends it. In the next Market Monitor, DOER will report on the regulatory developments.

Regional Transmission Organization
On January 16, 2001, ISO-NE and the New England Transmission Owners filed with FERC a Joint Petition for Declaratory Order To Form the New England Regional Transmission Organization (RTO). DOER's *Market Monitor 2001* will focus on FERC's decisions on RTO proposals and the impacts on the New England wholesale market.