Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 807 (Senator Pipkin, *et al.*)
Finance

Electricity Market - Goal of the State - Best Possible Price for Ratepayers Through Reregulation

This bill requires the Public Service Commission (PSC) to develop a transition plan to return to a regulated electricity market for residential and small commercial customer classes that results in a reliable electricity system at the best possible price for ratepayers. It also establishes the return to such a regulated market as a goal of the State.

The bill takes effect July 1, 2010.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund may increase in FY 2011 and 2012 for consulting expenses to assist PSC in developing a transition plan for returning to a regulated electricity market. Revenues are not affected.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: The Electric Customer Choice and Competition Act of 1999 (Chapters 3 and 4) facilitated the restructuring of the electric utility industry in Maryland. The Act required electric companies to divest themselves of generating facilities or to create a structural separation between the unregulated generation of electricity and the regulated distribution and transmission of electricity. Some electric companies created separate entities to operate unregulated and regulated businesses under a single holding company structure and other companies divested generation facilities. With the elimination of the generation functions from regulation, PSC no longer determines the need for additional supply sources as was the case prior to implementation of restructuring.

The resulting system of customer choice allows the customer to purchase electricity from a competitive supplier or continue receiving electricity from an electric company under standard offer service (SOS).

Background:

Efforts to Return to a Regulated Electricity Market

In response to the concern that deregulation had not served the public interest, the General Assembly has taken steps to consider the ideal structure of electricity markets in the State. Chapter 5 of the 2006 special session (SB 1) granted PSC authority to require or allow an investor-owned electric company to construct, acquire or lease, and operate its own generating facilities and transmission facilities necessary in order to meet long-term anticipated demand in the State for SOS and other electricity supply.

Chapter 549 of 2007, required PSC to conduct studies and complete reports on electric industry reregulation and to assess the availability of adequate transmission and generation facilities to serve the electrical load demands of all customers in the State. PSC, at a cost of approximately $2 million, completed a study of the efforts for new generation and possibilities for reregulation. In the report, PSC outlined various options for “reregulation” considering tradeoffs among direct costs, risks, and benefits. PSC concluded that it would not recommend that the legislature seek to return the existing generation fleet to full cost-of-service regulation (where the ratepayers bear all prudently incurred costs to own and operate a generation plant, plus a rate of return) given the costs, risks, and likely disruptions that may result from acquiring the plants. The study valued only the impact of the cost of purchasing the assets under fair market value relative to ratepayer benefits and did not attempt to quantify complexities and risks that may result in added costs.

Instead, PSC recommended incremental, forward-looking reregulation when appropriate. Other options involve measures to mitigate price volatility for residential consumers that include directing utilities to enter into long-term contracts for new generation, establishing a State power authority to initiate power projects, adopting integrated resource planning to coordinate a variety of efforts, and aggressively intervening in Federal Energy Regulatory Commission proceedings to shape PJM wholesale market policies.

Of the 22 states that have deregulated electricity markets to allow for customer choice, 8 have since suspended deregulation and have signaled the intention to return to a regulated market. **Exhibit 1** lists these states.

Exhibit 1
Status of Electric Restructuring in the U.S.

Deregulated Electric Markets		Suspended Deregulation
Connecticut	New Hampshire	Arizona
Delaware	New Jersey	Arkansas
Illinois	New York	California
Maine	Ohio	Montana
Maryland	Pennsylvania	Nevada
Massachusetts	Rhode Island	New Mexico
Michigan	Texas	Oregon
		Virginia

Source: U.S. Energy Information Administration

PSC is currently considering Case Number 9214 to investigate whether it should exercise its authority to order electric companies to enter into long-term contracts to attract new generation or to construct, acquire, or lease and operate new generation facilities in the State. In the proceeding, PSC is examining the broad policy areas surrounding SOS procurement. PSC has received comments on the scope of proposals for new generation to be submitted by interested parties and expects to set a deadline to receive proposals sometime in 2010. In the case, PSC is expected to examine location, generation technology, capacity, terms of long-term contracts, and other factors.

Electric Customer Choice

During the initial transition period from July 1, 2000 through June 30, 2004, rate caps were imposed for residential customers in PEPCO and Delmarva service territories. Rate caps in BGE and Allegheny Power expired June 30, 2006 and December 31, 2008, respectively. In both BGE and Allegheny Power service territories, PSC allowed many customers to mitigate the increases through a rate stabilization plan.

The rate caps, which aimed to give the electric industry time to switch to a competitive market, resulted in electricity suppliers being unable to compete with the below-market SOS rates in effect under the residential rate caps. Prior to the expiration of rate caps, the potential savings for residential customers offered by customer choice were limited as few competitive suppliers had offered rates lower than SOS. Since the expiration of rate caps, competitive electricity suppliers are offering retail electric at rates lower than SOS in the State's largest service territories. **Exhibit 2** shows the number of competitive electricity suppliers in each service territory and the current price to compare. In this exhibit, it should be noted that not all electricity suppliers in each service territory are currently allowing new customer enrollment.

Exhibit 2
Residential Electric Choice
March 2010 Survey

Service Area	SOS Price (per kWh) To Compare	Competitive Suppliers	Suppliers With Current Offers Lower Than SOS
BGE	$0.1197	7	5
Delmarva	0.1111	3	1
PEPCO	0.1251	4	2
Allegheny Power	0.0854	2	2
SMECO	0.0946	0	0
Choptank	0.0891	0	0

Source: Office of the People's Counsel

Nearly all alternative plans to SOS require a fixed-length contract of at least 12 months and have cancellation fees that range between $75 to $200. The majority of these alternative plans also include a portion of renewable energy, which may add additional cost. **Exhibit 3** illustrates the number of residential customers that are currently served by competitive electricity suppliers in each service territory.

Exhibit 3
Residential Customers Served by Competitive Suppliers
January 2010

Distribution Utility	Customers Served by Competitive Suppliers	Total Accounts	Percent of Total
Allegheny Power	2,957	219,147	1.3%
BGE	55,075	1,112,815	4.9%
Delmarva	2,478	173,482	1.4%
PEPCO	41,217	483,855	8.5%
Total	**101,727**	**1,989,299**	**5.1%**

Source: Public Service Commission

Since the removal of rate caps for residential customers, the number of residential customers receiving competitive service has increased; however, the majority of residential customers still procure electricity from SOS. Since 2006, the number of residential customers receiving competitive service has increased from 27,768 to 101,727 and the number of nonresidential customers has increased from 10,688 to 71,778. As shown in **Exhibit 4**, the percentage of customers receiving competitive service has increased significantly since 2006.

Exhibit 4
Percentage of All Customers Served by Electricity Suppliers

Customer Class	January 2006	January 2007	January 2008	January 2009	January 2010
Residential	1.4%	2.4%	2.8%	2.8%	5.1%
Small Commercial & Industrial	2.7%	22.3%	22.4%	17.0%	23.4%
Mid Commercial & Industrial	15.9%	51.8%	53.0%	47.3%	51.0%
Large Commercial & Industrial	78.9%	88.4%	89.3%	86.7%	87.9%
Total	**1.8%**	**4.9%**	**5.3%**	**5.1%**	**7.8%**

Source: Public Service Commission

Exhibit 5 shows the recent increase in the number of residential electric customers receiving competitive electric service in the major distribution territories.

Exhibit 5
Residential Electric Customers
Receiving Competitive Electric Supply

Distribution Utility	January 2009	January 2010
Allegheny Power	42	2,957
BGE	26,291	55,075
Delmarva	984	2,478
PEPCO	27,221	41,217
Total	**54,538**	**101,727**

Source: Public Service Commission

Electricity Rates

For residential customers who have not chosen competitive supply, the price of electricity depends on the results of SOS wholesale electric supply auctions. SOS supply auctions procure supply by purchasing wholesale power contracts, typically of two-year lengths, through sealed bid procurements. Since the end of residential price freezes in July 2004, SOS rates have increased to such an extent that the average annual residential electricity cost has increased significantly over the pre-restructuring cost. **Exhibit 6** shows the changes in the average annual residential electricity cost in Maryland and surrounding states.

Exhibit 6
Comparison of Annual Electricity Cost in Surrounding States
Average Annual Residential Cost

	1999	2001	2003	2005	2007	2009	Avg. Annual Increase *Nominal Change*	Avg. Annual Increase *Inflation Adjusted*
Delaware	$1,133	$1,064	$1,062	$1,114	$1,627	$1,745	4.41%	1.67%
District of Columbia	989	963	969	1,125	1,382	1,676	5.42%	2.65%
Maryland	1,037	948	955	1,046	1,470	1,874	6.09%	3.31%
New Jersey	1,409	1,262	1,319	1,451	1,748	2,046	3.80%	1.07%
Pennsylvania	1,095	1,196	1,185	1,219	1,353	1,450	2.85%	0.15%
Virginia	925	963	959	1,009	1,080	1,330	3.70%	0.98%
West Virginia	775	774	771	768	832	967	2.23%	-0.45%
U.S. Average	**$1,009**	**$1,060**	**$1,078**	**$1,168**	**$1,316**	**$1,444**	**3.65%**	**0.93%**

Note: Annual residential cost is based on the usage of 1,030 kWh per month.
Source: U.S. Energy Information Administration

At the inception of electric restructuring, many expected acceleration in the development of competitive power plants not tied to a traditional distribution facility, so-called merchant plants. The construction of additional merchant generation was expected to increase the supply of electricity, thereby lowering electricity prices. Growth in demand, coupled with the lack of any substantial new generating capacity in the State, constrained transmission facilities, and little growth in transmission capacity have contributed to an increased cost for electricity in the State.

State Fiscal Effect: PSC advises that since the bill does not specify a timeline for the transition plan or establish specific requirements, the bill can be implemented with existing budgeted resources. PSC states that some consulting expenditures may be required in the future, but that any additional costs can be absorbed within existing budgeted resources.

However, Legislative Services advises that, based on past experience with studying options to return to a regulated electricity market, PSC may incur additional costs to hire consultants to conduct economic modeling and analysis of options for reregulation. *For illustrative purposes*, the analysis performed under Chapter 549 of 2007 to study the adequacy of existing generation, options for new generation, and possibilities for reregulation, was completed at a cost of approximately $2.0 million. The scope of any further analysis performed under this bill, therefore the cost, would be determined by PSC. While Legislative Services does not necessarily anticipate consulting expenses to be of the same magnitude as the costs incurred pursuant to Chapter 549 of 2007, it is not unreasonable to assume that some expenses may be incurred. However, to the extent PSC is able to reallocate resources from customer choice-related functions to reregulation efforts, such costs may be absorbable within existing budgeted resources.

Additional Comments: In the long run it is unclear whether electricity purchased by residential and small commercial customers under a regulated market will be less expensive than electricity purchased in a competitive market. In any event, this bill only requires PSC to develop a transition plan. It is assumed that any such plan would require future legislative approval.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Office of People's Counsel, Public Service Commission, U.S. Energy Information Administration, Department of Legislative Services

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