

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

Senate Bill 521
Finance

(Senators Pipkin and Rosapepe)

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. The bill also establishes the return to such a regulated market as a goal of the State.

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund may increase in FY 2012 and 2013 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, 7 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 United States

Deregulated Electric Markets

Connecticut	New Hampshire
Delaware	New Jersey
District of Columbia	New York
Illinois	Ohio
Maine	Oregon
Maryland	Pennsylvania
Massachusetts	Rhode Island
Michigan	Texas

Suspended Deregulation

Arizona
Arkansas
California
Montana
Nevada
New Mexico
Virginia

Source: U.S. Energy Information Administration

In December 2010 PSC issued a draft request for proposal (RFP) to solicit offers from persons seeking to construct new generating facilities in or around the State. In the draft RFP, respondents may offer energy from any generation capacity resources, not to exceed 1,800 megawatts (MW) on an installed capacity basis. PSC may award one or more contracts to one or more suppliers from new generation and may direct one or more electric companies to construct new generation up to 1,800 MW; however, PSC reserves the right to reject all submissions if proposals are not cost-effective. The draft RFP is the result of Case Number 9214, which was initiated in September 2009 for PSC 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.

Electric Customer Choice

During the initial transition period from July 1, 2000, through June 30, 2004, rate caps were imposed for residential customers in the PEPCO and Delmarva service territories. Rate caps in the BGE and Allegheny Power service territories expired June 30, 2006, and December 31, 2008, respectively. In both the 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, the current price to compare, and the number of offers. Most competitive suppliers offer customers different options on the length of contract, and the generation source (such as 50% wind or 100% wind).

Exhibit 2
Residential Electric Choice
February 2011 Survey

<u>Service Area</u>	<u>SOS Price (per kWh) to Compare</u>	<u>Competitive Suppliers</u>	<u>Number of Offers</u>
BGE	\$0.1003	12	25
Delmarva	0.0952	4	9
PEPCO	0.1035	6	14
Allegheny Power	0.0747	3	8
SMECO	0.0946	0	0
Choptank	0.0891	0	0

Source: Office of the People’s Counsel

Most alternative plans to SOS require a fixed-length contract of at least 12 months and have cancellation fees that range between \$150 and \$200; however, some suppliers are now offering month-to-month supply options. 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
December 2010

<u>Distribution Utility</u>	<u>Customers Served by Competitive Suppliers</u>	<u>Total Accounts</u>	<u>Percent of Total</u>
Allegheny Power	11,763	220,369	5.3%
BGE	179,801	1,114,743	16.1%
Delmarva	12,759	173,752	7.3%
PEPCO	64,335	487,076	13.2%
Total	268,658	1,995,940	13.5%

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 55,024 to 268,658, and the number of nonresidential customers has increased from 57,103 to 87,071. As shown in **Exhibit 4**, the percentage of customers receiving competitive service has increased significantly since December 2006.

Exhibit 4
Percentage of All Customers Served by Electricity Suppliers

<u>Customer Class</u>	<u>December 2006</u>	<u>December 2007</u>	<u>December 2008</u>	<u>December 2009</u>	<u>December 2010</u>
Residential	2.3%	2.8%	2.8%	5.0%	13.5%
Small Commercial & Industrial	21.1%	22.5%	17.3%	23.2%	27.9%
Mid Commercial & Industrial	51.2%	52.8%	47.0%	50.9%	54.4%
Large Commercial & Industrial	87.9%	89.0%	87.0%	88.6%	88.2%
Total	4.7%	5.3%	5.1%	7.6%	15.7%

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

<u>Distribution Utility</u>	<u>December 2008</u>	<u>December 2009</u>	<u>December 2010</u>
Allegheny Power	40	2,743	11,763
BGE	26,944	53,126	179,801
Delmarva	1,039	2,463	12,759
PEPCO	27,001	40,267	64,335
Total	55,024	98,599	268,658

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 Rates in Surrounding States
Average Residential Electric Rates
(\$ per kilowatt-hour)

	<u>1999</u>	<u>2001</u>	<u>2004</u>	<u>2007</u>	<u>2010</u>	<u>Average Annual Increase</u>
Delaware	\$0.092	\$0.086	\$0.088	\$0.132	\$0.138	3.5%
District of Columbia	0.078	0.080	0.099	0.128	0.137	4.6%
Maryland	0.077	0.078	0.097	0.138	0.145	4.6%
New Jersey	0.107	0.112	0.128	0.157	0.166	3.2%
Pennsylvania	0.096	0.096	0.104	0.114	0.128	2.2%
Virginia	0.078	0.080	0.085	0.096	0.106	2.9%
West Virginia	0.062	0.062	0.064	0.071	0.088	2.8%
U.S. Total	\$0.087	\$0.090	\$0.104	\$0.113	\$0.116	2.9%

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 the increased cost of 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, and, 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: SB 807 of 2010 received an unfavorable report from the Senate Finance Committee.

Cross File: None.

Information Source(s): Office of People's Counsel, Public Service Commission, Department of Legislative Services

Fiscal Note History: First Reader - March 11, 2011
mm/lgc

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