Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 638 (Senators Pipkin and Rosapepe)
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. The bill also establishes the return to such a regulated market as a goal of the State.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: Special fund expenditures from the Public Utility Regulation Fund may increase in FY 2013 and 2014 for consulting expenses to assist PSC in developing a transition plan for returning to a regulated electricity market. Special fund revenues increase correspondingly from assessments imposed on public service companies. State expenditures could increase minimally beginning in FY 2013 as public service companies pass on the cost of assessments to all customer classes.

Local Effect: Minimal or none.

Small Business Effect: Minimal or 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. The resulting system of customer choice allows the customer to purchase electricity from a competitive supplier or continue receiving electricity under standard offer service (SOS). Default SOS electric service is provided by a customer's *electric company*. Competitive electric supply is provided by competitive *electricity suppliers*.

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 23 states (including the District of Columbia) 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 – September 2010

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

Source: U.S. Energy Information Administration

In December 2010, PSC issued a draft request for proposals (RFP) for new generation facilities and asked interested persons to review the draft RFP and provide comments, suggestions, and revisions. Through that process, PSC decided a formal RFP issuance was in the best interest of the State, and in September 2011, PSC required that each of the State's regulated electric distribution companies issue an RFP inviting interested persons to submit proposals to PSC to construct new generation facilities that would produce and sell electricity to the electric distribution companies. Through a series of questions and comments pertaining to the RFP, PSC modified several aspects of the RFP, including extending the proposal due date to January 20, 2012. An updated RFP was issued in December 2011, and PSC will decide which bids to accept (if any) on April 6, 2012.

The current RFP requires that a proposal for new generation facilities (1) must include the sale of capacity and energy; (2) must be for a new natural gas-fired unit, not exceeding 1,500 megawatts in nameplate capacity; and (3) must be located inside the Southwestern Mid-Atlantic Area Council Locational Deliverability Area, which includes the PJM BGE Zone and PJM PEPCO Zone. Further, the RFP requires responses to include a description of other reliability, economic, socioeconomic, and environmental benefits that are likely to be realized in the State as a result of the new generation facility.

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 selected service territories, 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 2012 Survey

Service Area	SOS Price (per kWh) to Compare	Competitive Suppliers	Number of Offers
BGE	$0.0922	25	58
Delmarva	0.0867	10	21
PEPCO	0.0877	16	48
Potomac Edison	0.0781	8	12

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 2011

Distribution Utility	Customers Served by Competitive Suppliers	Total Accounts	Percent of Total
Allegheny Power	16,200	221,288	7.3%
BGE	260,911	1,116,401	23.4%
Delmarva	17,459	173,650	10.1%
PEPCO	100,798	487,642	20.7%
Total	**395,368**	**1,998,981**	**19.8%**

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 395,368, and the number of nonresidential customers has increased from 57,103 to 92,636. As shown in **Exhibit 4**, the percentage of customers receiving competitive service has increased significantly since December 2007.

Exhibit 4
Percentage of All Customers Served by Electricity Suppliers

Customer Class	December 2007	December 2008	December 2009	December 2010	December 2011
Residential	2.8%	2.8%	5.0%	13.5%	19.8%
Small Commercial & Industrial	22.5%	17.3%	23.2%	27.9%	33.1%
Mid Commercial & Industrial	52.8%	47.0%	50.9%	54.4%	56.8%
Large Commercial & Industrial	89.0%	87.0%	88.6%	88.2%	91.5%
Total	**5.3%**	**5.1%**	**7.6%**	**15.7%**	**21.8%**

Source: Public Service Commission

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

Exhibit 5
Residential Electric Customers
Receiving Competitive Electric Supply

Distribution Utility	December 2009	December 2010	December 2011
Allegheny Power	2,743	11,763	16,200
BGE	53,126	179,801	260,911
Delmarva	2,463	12,759	17,459
PEPCO	40,267	64,335	100,798
Total	**98,599**	**268,658**	**395,368**

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.

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, and constrained transmission facilities coupled with little growth in transmission capacity, have contributed to the increased cost of electricity in the State.

Exhibit 6
Comparison of Annual Electricity Rates in Surrounding States
Average Residential Electric Rates
($ per kilowatt-hour)

	1999	2001	2004	2007	2010	2011	Constant Annual Growth Rate
Delaware*	$0.092	$0.086	$0.088	$0.132	$0.138	$0.138	3.4%
District of Columbia*	0.078	0.080	0.099	0.128	0.137	0.135	4.7%
Maryland*	0.077	0.078	0.097	0.138	0.145	0.135	4.8%
New Jersey*	0.107	0.112	0.128	0.157	0.166	0.163	3.6%
Pennsylvania*	0.096	0.096	0.104	0.114	0.128	0.134	2.8%
Virginia	0.078	0.080	0.085	0.096	0.106	0.107	2.7%
West Virginia	0.062	0.062	0.064	0.071	0.088	0.094	3.5%
U.S. Total	**$0.087**	**$0.090**	**$0.104**	**$0.113**	**$0.116**	**$0.118**	**2.6%**

* = Deregulated State
Source: U.S. Energy Information Administration

State Fiscal Effect: PSC advises that the bill can be handled with 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.

If PSC costs increase to hire consultants, PSC would recoup any such costs through its assessment on public service companies as authorized under current law. Thus, special fund revenues to the Public Utility Regulation Fund increase commensurately with special fund expenditures.

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 521 of 2011 and SB 807 of 2010 received unfavorable reports from the Senate Finance Committee.

Cross File: None.

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

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