A LOW-INCOME ADVOCATE'S INTRODUCTION TO ELECTRIC INDUSTRY RESTRUCTURING AND RETAIL WHEELING

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Washington, D.C. 20002
202-543-6060

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A LOW-INCOME ADVOCATE'S INTRODUCTION
TO
ELECTRIC INDUSTRY RESTRUCTURING AND RETAIL WHEELING

Nancy Brockway
National Consumer Law Center
11 Beacon Street
Boston, MA 02108
617-523-8010

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A LOW-INCOME ADVOCATE'S INTRODUCTION

TO

ELECTRIC INDUSTRY RESTRUCTURING AND RETAIL WHEELING

Industrial customers,¹ some independent power producers, and "Chicago-
school" academics² have been pressing lately for what is called "electric industry
restructuring" and "retail wheeling." Electric industry restructuring will have a major
impact on the rates and the quality of service for low-income residential customers.
Proposals are under consideration or being tested at the Federal level and in a
number of states, including California,³ Michigan,⁴ Massachusetts, New York⁵ and
Wisconsin.

This paper is intended to give low-income advocates an introduction to the
issues, so that they can better participate in the debate on these topics. First, we
review the jargon being used to describe different positions in the debate. Second, we
discuss the impact the proposed retail competition will have on low-income residential

⁵ Re. Niagara Mohawk Power Corporation, Case 93-R-0272, 150 P.U.R. 4th 438 (N.Y. P.S.C. April 19, 1994)(relaxed regulation for PURPA-qualifying cogeneration facility contract sale to retail customers; monopoly utility bears heavy burden to demonstrate transaction will adversely affect utility's captive customers.)
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customers. Third, we review some of the options that are available to low-income customers as a response to the proposals for industry restructuring.

Industry restructuring is not inevitable, despite the claims\(^6\) of some participants in the debate.\(^7\) However, there is mounting pressure for the electricity market to follow in the footsteps of the airline, gas and long-distance telecommunications markets, where competition at the retail level has been established. Industry restructuring would probably lead to higher rates for low-income electric customers, and poorer service, especially if it is accomplished along the plans favored by large industrial customers.

Some of the considerations in the electric industry retail competition debate parallel those in these other industries: small users will likely be at a relative disadvantage to large users in exerting market power in the new competitive environment. As a corollary, electric utility activities (such as energy conservation investments and discounted rates) that are supported by rates averaged across

\(\text{Remarks of Peter A. Bradford, Chairman, New York Public Service Commission, to annual meeting of National Low Income Energy Conference, Buffalo, New York, June 1993.}\)

\(\text{See, Ralph Cavanagh, The Great "Retail Wheeling" Illusion - And More Productive Energy Futures, E-Source, Inc., Strategic Issues Paper (March 1994). Note that Rhode Island recently rejected a quasi-retail wheeling proposal to wheel in power from Hydro-Quebec for industrial customers. See, Written Comments Submitted by the Coalition for Consumer Justice, Direct Action for Rights and Equality, and Parents for Progress, Rhode Island Legal Services, September 22, 1993, in Re: Offer by Hydro-Quebec to Sell Hydroelectric Power, before the Rhode Island Public Utilities Commission and Department of Economic Development.}\)
customers and customer classes will not survive in the most likely formulations of the
retail competition regime.

However, the gravest risk for low-income customers is that restructuring will
lead to a scenario in which large customers abandoning the uneconomic costs of failed
supply investments of the recent past,\(^8\) leaving low-use customers and the old
monopoly electricity utilities to fight over who will pay these costs. The ideal outcome
would be a fair apportionment of these costs among ratepayers and utility
stockholders, and then a fair apportionment among ratepayers of costs society assigns
to them and not the utilities. Theoretically this is possible under restructuring, and
theoretically it is possible if restructuring is repulsed. It may be more or less likely
under either scenario. But it will only happen if consumer advocates enter the debate
and press for protections for low-income ratepayers.

I. DEFINITIONS OF TERMS

"Electric industry restructuring" is the more general term. It does not have one
fixed meaning. Generally, proponents use it to describe any one of a number of ways
of introducing competition between independent power producers and existing,

\(^8\) Steven C. Anderson, John G. Graham, William W. Hogan, *Electricity Transition Costs*, prepared for the
Harvard Electricity Policy Group (Draft, October 22, 1993).

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monopoly, utilities to sell power to retail customers. The key, then, is the concept of retail competition.

As the electric industry has evolved since the turn of the century, in most areas of the country a single entity has a monopoly on sales to retail customers. That entity might be an investor-owned utility ("IOU") or a municipal utility, or a co-op.\(^9\) Retail sales are sales to customers for the customer's use, and not for resale to others.

The monopoly utilities historically generated almost all of their power themselves. Thus, they are often described as "vertically integrated" entities: they directly produce the "product" they sell at resale. Starting in the late 1970's, federal and state policies\(^10\) have demanded that utilities open their wholesale power supply operations to competition. Now, alternative wholesale power producers may sell power to utilities, who in turn resell it to their retail customers, along with power the utilities generate themselves or buy from other utilities.

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\(^9\) For convenience, we will call the monopoly provider a "utility." We will call someone who wants to sell power to that utility's retail customers an "alternative power provider."

\(^10\) The Public Utility Regulatory Policy Act of 1978 requires utilities to buy wholesale power at the utility's "avoided cost." A large number of states have enacted legislation or promulgated regulations giving life to these provisions, and requiring that utilities buy wholesale power from entities qualifying for the PURPA rules ("qualifying facilities," or "QFs"), or extending the concept to other power producers, variously known as non-utility generators ("NUGs"), or independent power producers ("IPPs"). See, e.g. *Investigation of the Commission on Its Own Motion*, D.P.U. 89-239 (Mass. D.P.U. November 1990). The National Energy Policy Act of 1992 requires states to consider mandating an integrated resource planning ("IRP") process under which all potential resources (including non-utility generation) are considered in the development of a least-cost plan.
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Typically, however, no other entity may sell power directly to the retail customers in a given utility's service territory. Proponents of retail wheeling and industry restructuring want to change that rule. They want to permit alternative power producers11 to sell directly to the retail customers of a utility, instead of selling power to the utility, for resale to its customers.

Retail wheeling is a term that refers to the process of transmitting ("wheeling") the APP's source of power across the utility's transmission and distribution system to the retail customer. It is important because, practically speaking, retail competition will require use of the utilities' T&D systems in order to work.

If retail competition is permitted, and customers may buy directly from APPs, they must find some way of getting the power from the APP's plant to their own premises. It would be prohibitively expensive in most cases to build a duplicate transmission and distribution (T&D)12 system to "wheel" that power to the retail

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11 The EPACT refers to "exempt wholesale generators," entities who sell to a utility in one service area, and are not subject to rate-of-return jurisdiction in those sales. These EWGs may be utilities franchised to serve at retail in a different geographic area (next door or across the country). I use the term Alternative Power Producer as a catch-all for any provider of power to a retail customer other than the utility that has (had) the monopoly franchise in the geographic area where the customer is located. Thus, I include NUGs, PURPA-qualifying facilities, IPPs, municipal or other public power producers, and EWGs, if they are selling at retail in the (former) franchise territory of a utility.

12 Edison Electric Institute, The Case Against Retail Wheeling, Transmissions Issues Monograph No. 5 (July 1992). Transmission of power takes place at high voltages, transmitting large amounts of power from the generating plants, over long distances, to the distribution network. Distribution refers to transmission of smaller amounts of power, at lower voltages, from the transmission system to the retail customers.
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premises. So most industry restructuring proposals envision new rules under which utilities would be required to "wheel" the power from an APP to the retail premises over the utility's T&D system.

Much of the debate over industry restructuring focusses on how much the APP and retail customer should pay the utility for the use of the T&D system, and who should bear the risk that the system does not have enough capacity to deliver all the power that the utility and the APPs wish to wheel.

II. IMPACT ON LOW-INCOME CUSTOMERS

A. Typical Wheeling Proposals

The typical retail wheeling or industry restructuring proposal would allow customers to buy power directly from APPs, and require a utility to wheel that power to the retail buyer at rates no higher than the utility pays to wheel its own power\(^\text{13}\) to its own customers. Some proposals would follow the British example, in which customers would have the right to contract separately for power in order of their size, with the very largest customers (the industrials) being allowed to leave the system first, and on down a ranking of customer sizes until eventually all customers would have the legal right to contract for power from someone other than the existing monopoly.

\(^{13}\) Including power it buys "off-system" but uses to meet its retail customers' needs for power.
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customer.\textsuperscript{14} Other plans would limit the option to the largest customers,\textsuperscript{15} on the one hand, or immediately open up the entire load of a utility to competition for retail sales, no matter the size of the customer.\textsuperscript{16}

What is likely to happen in these cases? The most important impact is created by the decision of very large (industrial) customers to take their power needs directly from an APP. The industrials wish to have the right to do this without paying for the costs of the existing power generation system that historically were incurred to meet their retail demand for power, thus "stranding" this investment.\textsuperscript{17} Nor do they wish to have responsibility for supporting system-wide costs that exceed the bare cost of supplying them with the commodity (electricity) they want to buy.\textsuperscript{18} Such system-wide costs include the costs of maintaining rates across classes of customers at

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\textsuperscript{14} Tim Woolf, Retail Competition in the Electricity Industry: Lessons from the United Kingdom. Tellus Institute (Boston, February 11, 1994). The California Commission proposes such a phase-in.

\textsuperscript{15} The Michigan experiment is limited to large industrial customers. See, Re: ABATE, 150 P.U.R.4th 409.

\textsuperscript{16} John Stutz and Neil Talbot, Retail Wheeling Without Captive Customers, Tellus Institute (February 1994).

\textsuperscript{17} John Anderson, spokesperson for ELCON, a national organization of large industrial customers, argues that such stranded investment does not exist, and that to the extent it does, any exiting customer's responsibilities to support it can be fulfilled by requiring an advance notice of intent to leave the system (no more than 5 years). Anderson, op. cit., supra, note 1.

\textsuperscript{18} Ibid.

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reasonable levels, considering historic trends.\textsuperscript{19} In some states, system-wide costs include support for any shortfall in revenues from low-income rates.\textsuperscript{20} System-wide costs would also include the costs of environmental clean-up or pilot programs to test new renewable forms of power.

The customers seeking wheeling rights would also like to be able to come back on the system at any time, without paying for to reserve that option. And they would like the most favorable wheeling rates possible.

Giving large customers these rights would result in the shift of costs to the smaller users, including the residential customers. To understand the dynamics driving these results, it is useful to explore the forces driving current utility rates.

B. Current Utility Planning Described

Utilities have for decades operated with an "obligation to serve." That means they must anticipate their customers's need for power, and build (or buy) enough

\textsuperscript{19} Many analysts believe that industrial customers pay a rate of return to the utility that is higher than average, while residential customers pay a below-average rate of return. A contrary view holds that, if there were a proper allocation of plant costs and a proper, risk-adjusted, class-by-class calculation of rates of returns, it would turn out that industrial customers are being subsidized by residential customers. Without getting into this debate, it is worth noting that even where Commissions accept this argument, they have found sufficient reason to keep residential rates, or at least rate increases, at a moderate level.

\textsuperscript{20} Note that there should be a net benefit to the utility from bringing rates to affordable levels, by reducing avoidable credit and collection costs. NCLC, \textit{Identifying Savings Arising from Low Income Programs}, (Boston 1993). However, it remains common to speak in terms of a revenue shortfall from low-income discounts.
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power so that they can meet those needs as they arise. Many utilities around the
country made mistakes in estimating what the demand for power would be, or
otherwise invested in power plants that became overly expensive, or are not needed to
meet the needs of today or the next several years. Paying for this investment raises
rates above what they would be if ratepayers only had to pay for a system that was
perfectly efficient. 21

Some of the costs of this unneeded or expensive capacity have been excluded
from rates by regulators, on various grounds. 22 But even after the exclusions, utility
rates reflect costs that are higher than they would be if this uneconomic "sunk"
investment could be avoided. Industrial customers want to buy power from APPs in
large part because the APPs do not need to recover the costs of such "sunk"
investments in uneconomic plant, so their rates can reflect the lowest cost power
available today.

If industrial customers were to leave the utility's system (i.e., no longer buy
their power from the utility, but instead from an APP), without being required to pay

21 Steven C. Anderson, John G. Graham, William W. Hogan, Electricity Transition Costs, Harvard Electricity
Policy Group (Cambridge, October 22, 1993).

22 For example, many millions of dollars of costs for unneeded and uneconomic nuclear power plants were
disallowed in the late 1970's and early 1980's, in part on the grounds that the utility was imprudent in
building the plants behind schedule and over budget.

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any portion of the utility's "sunk" costs, they would escape responsibility for costs that were incurred to date to serve them.

C. Paying for Stranded Investment: Utilities vs. Ratepayers

We may well ask what would be so bad about that outcome, assuming all customers could also leave the system. In such a world, only the utility whose plans had gone awry would be left holding the responsibility for these excessive costs. The question becomes how realistic it is to imagine that utilities will in fact be forced to shoulder these sunk costs. To the extent that there are any genuinely "captive" customers, the utility will be able to shift at least some of the burden to these remaining customers.

It may be possible to insist that the utility take on more of the burden for the failed investments of the past, in the context of the debate about whether to permit retail competition. For example, an effort is underway in California by consumer advocates and industrial customers to force the utilities to write down major portions of their sunk nuclear plant costs. The industrial customers may not spearhead the drive to institute retail competition if such a combined effort with other customer groups is successful. The outcome of this battle will be instructive for the chances consumers in other states will be able band together to force similar concessions by the utilities as a price of maintaining their monopoly status.
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D. Impact on Customer Service

As we have seen, utilities react to the threat of competition by cutting services and features that they do not think industrial ratepayers will pay for in a competitive market. Customer service features, such as widely-available customer service offices, plenty of customer service personnel, opportunities for carefully crafted payment arrangements and follow-up in the event of missed payments, all are under pressure as utilities seek to reduce staff and costs.

Some utilities may be panicking as their stock value is declining with the threat of losing their monopoly. Little thought is being given to the long view. Under a longer view, a utility might want to make sure its remaining customers had sufficient avenues to make tailored payment arrangements, for example, rather than be forced off the system altogether. If customers are forced off the system, the utility loses their

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23 As retail competition comes to residential customers, utilities consider as well what the bulk of residential customers are willing to support in rates. And, since rate deaveraging will tend to drive up residential rates no matter what the utility offers for special programs, there is all the more pressure to eliminate any program or feature that is non-essential.

24 Risks to utility stockholders from retail competition proposals are discussed in a research report by Prudential Securities, Electric Utilities: Competitive-Risk Study, (December 1993). Florida Power and Light Company recently sent shivers through the stock market when it announced it would cut its dividend by 30% (Electricity Daily, May 12, 1994). Ironically, FP&L is in a power deficit position (Public Utilities Fortnightly, March 15, 1994), and thus does not face the same stranded investment dilemma facing other areas.

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contribution to common costs, and incurs expenses for disconnection (and reconnection) that are unlikely to be covered.\textsuperscript{25}

E. Impact on Percentage of Income Payment Plans, Discounts, Arrears Forgiveness.

It is widely recognized that a casualty of retail competition could well be discounted rates designed to make service affordable for low-income households. In the traditional view, such discounts reduce the revenue to be collected from the low-income customer below the revenue fairly allocated to that customer. In other words, traditional utility thinkers regard such rates as a cross-subsidy from other ratepayers. Under the pressure to reduce rates for the customers with market power to the lowest possible cost\textsuperscript{26} utilities are likely to try to eliminate such price reductions for low-income customers.\textsuperscript{27}

Such an approach would be "penny wise but pound foolish." Reducing rates to an affordable level, via PIPPs or even straight line discounts, reduces system costs. On

\textsuperscript{25} See, generally, NCLC, Identifying Savings Arising From Low-Income Programs, (1994).

\textsuperscript{26} The short run marginal cost of producing the power, with the smallest possible contribution to the fixed costs of the system, leaving these fixed costs to be recovered from the more captive customers, who do not have the practical choices to take power from a competitor.

\textsuperscript{27} Steven J. Remen, Massachusetts State Director of Energy Resources, an advocate of retail bidding, acknowledged the need to resolve the need to support low-income affordability rates so that low-income customers "don't go without heat." "The Balance of Power," Boston Globe, May 31, 1994, p. 44.
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net, the utility should be no worse off. While its revenue is intentionally reduced, so are its costs.

Unless a renewed effort is made to explain the benefits of bringing low-income rates to affordable levels, it will be hard to stave off a wholesale movement to eliminate low-income affordability programs.

F. Impact on Integrated Planning/DSM

A strong case has been made that retail wheeling will make it very difficult to conduct integrated resource planning. Customers of utilities will demand the cheapest kilowatthours and kilowatts. They will not want the utility to engage in long-range planning if the effect is to drive up costs today; rather, the customer will rely on the expectation that if this supplier makes a mistake and overbuilds or underbuilds, the market will force it to keep its prices down, or some other supplier will come in to take the business. This view sees electricity under retail wheeling as a "commodity," like bushels of wheat or tons of pig iron.

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Similarly, Demand Side Management\textsuperscript{29} is under pressure. DSM fully funded through utility rates tends to raise rates in many situations.\textsuperscript{30} To cut non-essential costs\textsuperscript{31}, utilities have begun to announce that they will take a less aggressive posture in trying to control demand. They will cut back on DSM expenditures. Rather, as Niagara Mohawk has stated,\textsuperscript{32} they will seek to provide DSM as a customer service, paid for by the individual customer.\textsuperscript{33}

It is well known that low-income customers face unique market barriers that make it unlikely they will be able to take advantage of most DSM programs that require copayments.\textsuperscript{34} While it is not only possible, but desirable, for low-income and non-low-income customers to pay ongoing fees to "lease" conservation equipment, in

\textsuperscript{29} Utility investments to increase the efficiency of energy use, managing the demand for energy, rather than merely the supply. DSM investments would include, for example, a program to install water heater blankets and low-flow fixtures in electric-water-heat homes.


\textsuperscript{31} Or perhaps to cut the DSM by using the excuse of retail competition: utilities traditionally have resisted DSM among other reasons because it reduces sales and, under traditional regulation, thus reduces profits.

\textsuperscript{32} Niagara Mohawk Corporate Strategic Planning, Demand Side Management in Niagara Mohawk's 1995-96 Rate Case (May 6, 1994).

\textsuperscript{33} The pursuit of equity between participants and non-participants suggests that DSM planners put more effort into developing ways to encourage DSM activities without producing adverse rate impacts. But this is wholly separate from the impetus to open retail electricity markets to competition.

\textsuperscript{34} Re: Texas Utilities Electric Company, No. 11735, Order (Texas Public Utilities Commission, December 20, 1993).

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some cases, major investments in insulation, weatherstripping and the like should be provided to low-income households through "direct install" programs, such as Weatherization Assistance Program piggy-back programs.

Efforts to restrict DSM to programs that pay for themselves out of customer co-payments, likely under increasing competitive pressure, will result in programs that fail to serve low-income customers, unless some mechanism is found for saving low-income direct install protocols out from the general trend. The rationale for continuing aggressive low-income DSM even when other DSM efforts are scaled back is compelling: if DSM helps low-income customers reduce bills to a manageable level, low-income participants will pay their bills on time, lowering the utilities avoidable delinquent payment costs.

G. Pressure to Institute So-Called Incentive Regulation

Electric utilities have begun calling for what they call "incentive regulation," as they face the prospect of retail competition. The California Commission has itself proposed that, during the transition to a fully competitive retail market, electric

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utilities' regulated sales be subject to this different form of regulation. The main argument given is that utilities need incentives to keep rates down, and the current system does not provide them. Secondary arguments include supposedly greater administrative simplicity, and lower litigation costs. However, the main point of such proposals may be the argument that "performance-based regulation can assist the utilities in developing the tools necessary to make the successful transition from [existing rate of return regulation] to [a world in which] consumers, the rules of competition, and market forces dictate."

Performance-based regulation or incentive regulation, so-called, involves a system in which commissions do not set specific utility rates, but rather set caps on rates, and permit the utilities flexibility to adjust rates within the cap. Similarly, typical proposals allow utilities to retain any profits they make, over the allowed rate of return, at least up to some threshold. Similar proposals have been instituted in a number of jurisdictions for selected telephone services, and for large gas customers.

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38 Ibid, at 36.

39 (At least downward).

40 In some versions, utilities must "share" such excess earnings with ratepayers, by reducing rates to lower the earnings, prospectively and sometimes retrospectively, to the prescribed level of sharing.
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The idea that such mechanisms provide incentives to good performance where none exist today is without merit. As Peter Bradford, chairman of the New York Public Service Commission, says, all regulation is incentive regulation.\textsuperscript{41} Traditional rate of return regulation contains incentives to keep costs down, because between rate cases, utilities lost profits if expenses went up,\textsuperscript{42} and earned more if they kept expenses down. Most incentive regulation plans in the telecommunications industry have been introduced and maintained via regulatory proceedings that are every bit as expensive and contentious as traditional rate cases.

The real charm of incentive regulation for the utility is the ability to shift costs from one group of customers to another, without coming to the regulatory commission to explain the merits of the proposal.\textsuperscript{43} It is this "flexibility" and ability to "develop the tools necessary" to live in a world of retail competition that utilities are after. Indeed, most industrial proponents of retail wheeking would probably be satisfied without the genuine article of retail competition if they could have the benefits of such pricing flexibility.

\textsuperscript{41} Peter A. Bradford, What Happens to the Rat After it Bites the Cheese? Or Do I have to Hear the Phrase "Regulatory Compact" Ever Again? (discussion paper) (July 16, 1993).

\textsuperscript{42} All else being equal.

\textsuperscript{43} Eugene P. Coyle, Remarks to Los Angeles City Council, Toward Utility Rate Normalization (March 10, 1994).
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Again, it will be the customers with market power who benefit from pricing flexibility. To the extent residential customers are captive customers, lacking unified bargaining power (in the absence of regulatory pricing oversight), they will face higher costs. Indeed, without retail competition, performance-based ratemaking will result in higher rates for residential customers.

H. Summary of Dangers of Retail Competition

To the extent residential customers remain "captive" customers on the old utility's system, they will likely face much higher rates. The existing utility will be forced to raise its rates as it loses load to new competitors. The utility will still have to recover the costs it incurred in the past to serve the customers who are now taking power from retail competitors. If this results in more customers leaving to take service from the new aggregators, the result may be a death spiral, in which the existing utility gradually prices itself out of the market entirely in a vain effort to recover its stranded investment.

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44 Under most price cap regimes, the prices seen by low-market-power customers will not go up between revisits to the price cap structure; rather, they will not go down, as the prices seen by larger customers do go down. And these relative differences will likely not be corrected, and will persist, through later revisions of the price cap structure.

45 (In which residential customers could band together in coops for aggregating purchasing power.)

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Rates are a function of the costs to be recovered divided by the kilowatthours and/or kilowatts provided\(^{46}\). So long as any customers remain on the system who have no competitive alternative, and who can afford to purchase power at the increasingly high rates, the utility will shift costs from the customers who have left the system to the customers who remain. The existing utility, too, will cut low-income programs, conservation investments, and all other activities that raise rates, as it struggles to keep rates down.

III. WHAT OPTIONS DO LOW-INCOME CUSTOMERS HAVE?

The question arises, is it possible to restructure the electric industry in a fair way, and in a workable way? A fair restructuring would not leave some customers to cover the costs of sunk excess investment while others got out from under their share of these costs. A workable competitive structure would capture the benefits of competition without leaving some customers uniquely vulnerable to the downside.

A. Can the Little Guy Jump Ship Too?

One option for low-income customers can be characterized as "if you can't beat 'em, join 'em." Under this option, low-income customers would seek to be able to buy from competitors themselves. They might in fact work for the development of

\(^{46}\) And/or numbers of customers served.
such an approach.  This approach is somewhat like shooting the moon in the card game "Hearts." It is a high-risk gamble.

If it worked, low-income customers would join industrial and other customers in getting out from under the overhang of stranded investment. However, if it didn't work, low-income customers would have promoted the very retail competition that would leave them the most vulnerable in the new market. In addition, the "commodity" features of the new market will still leave low-income customers at a relative disadvantage to larger customers, customers with more market power, even if they share in the freedom from the investment mistakes of the past.

There are risks in leaving a utility's system. Large customers may be better able to protect themselves against these risks, as by negotiating back-up arrangements, for example. In addition, small customers cannot practically buy directly from an APP. Under retail competition, they will only be served if brokering, aggregating entities emerge.

It is not clear that any MCI-Energy Company or Sprint Energy Company will step forward to sell power at retail to small customers, such as low-income residential customers. New entities would have to set up costly billing systems and marketing and

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47 John Stutz and Neil Talbot, Retail Wheeling Without Captive Customers, Tellus Institute (Boston February 1994).
sales divisions, for one thing. Stutz and Talbot point to the possibility of expanding
such entities as Energy Purchasing Cooperatives, Municipal Utilities, Rural
Cooperatives, and Power Districts. They suggest that Power Authorities, and certain
state and federal agencies, could buy power and resell it to residential customers.
Finally, they suggest that power brokerage firms would emerge.

Similarly, customers could band together in "power clubs" to buy power for
their members, in the way fuel purchasing coop work. The author of this idea,
Bobbi Bennett, notes that a penny spent in a low-income community is worth more
than a penny spent outside the community, in terms of the empowerment of the
community to exercise its market power.

All these options could exist. In order for these entities to serve the loads of
low-income customers at just and reasonable rates and under fair terms and
conditions, retail competition will have to include a number of preconditions.

FIRST, competition in the residential sector would have to be opened up no
later than competition in other sectors. Indeed, because it takes longer for the
aggregating entities to be formed and/or organized to serve this sector, residential
customers should have the right to take power from APPs before other, larger
customers. Failure to grant low-use customers this "head start" will result in industrial

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48 The "power club" concept was coined by Bobbi Bennett, of the ABC Foundation, Chicago, Illinois.

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customers obtaining the benefits of retail wheeling and locking up the best sources of alternative power, while residential customers are left to struggle with the existing utility over who has to pay for the stranded investments. There is no reason why large customers should go first, as is often assumed in the discussion of retail competition.

SECOND, the regulatory body will have to continue to regulate, charged among other things with ensuring that all providers of power observe customer service safeguards (e.g. offering fair payment arrangements, protections from extreme-weather disconnection, etc.). Electricity will continue to be a life-sustaining necessity, and the history of consumer rights shows that the "invisible hand" of the market does not produce procedural safeguards without societal oversight. It only makes sense for the historical experts, the Commissions, to continue in this role.

THIRD, democracy in the control of public power entities must be strengthened and ensured. Some public power organizations, such as some rural electric cooperatives, have self-perpetuating boards which tend to exclude minorities and others, and thus function without meaningful checks and balances by the full complement of their membership.

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49 Vl, the experience in Great Britain. Tim Woolf, Retail Competition in the Electric Industry: The Experience from the United Kingdom, Tellus Institute (Boston, February 1994).

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FOURTH, the right of existing agencies to serve outside their traditional service areas would have to be expanded. Municipalities, power districts, cooperatives and the like tend to be restricted, legally or practically,\(^{51}\) to areas less than the size of most investor-owned utilities.

FIFTH, the state commissions and the Federal Energy Regulatory Commission would have to police the transmission access practices of the existing utilities. Transmission will remain a bottleneck, and existing utilities will have no incentive to open the system up to free flows of transactions absent tough regulatory oversight. As it stands now, the states have the authority to order a utility to wheel power, the FERC can condition a merger on the new entity's willingness to wheel, and the FERC has exclusive jurisdiction to set the rates.

Without the rates being set, no amount of ordering will cause electrons to flow. FERC is currently having a difficult time balancing the rights of customers of the existing utility with customers of the APPs, and has been unable to achieve a consensus behind pricing principles, in voluntary negotiations ongoing presently concerning so-called Regional Transmission Groups.\(^{52}\)

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\(^{51}\) Whitfield A. Russell, *Retail Competition and Wheeling*, Comments presented to APPA Retail Competition/Retail Wheeling Workshops (1994).

\(^{52}\) "FERC's Transmission Pricing Docket May Redefine Discrimination," *The Electricity Journal* (June 1994)
SIXTH, a mechanism would have to be found to continue the support for activities and goods important to society as a whole, more so than to any customer or customer group. Examples would be development of new renewable resources, integrated resource planning from a societal perspective, provision of conservation assistance to low-income customers, and the like.

The risk to low-income customers is that these preconditions will not be met, or that no alternative providers will step forward to serve them. To the extent competitors do not offer service at attractive rates to the low-income customers, those customers will be forced to continue to take their power from the existing utility. They will be "captive" customers.

If new competitors are allowed and do offer to serve the residential customers, it is unclear that they would be able to continue to provide lower prices to residential customers than the existing monopoly utility, over the long run. For example they would not be able to average the cost of serving different size loads in their price structure, because the inexpensive-to-serve loads would demand a cheaper rate and threaten to go to a competitor who would give them such a rate. They would not be able to provide discounts, programs or other consideration for low-income customers.
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unless such programs were clearly the profit-maximizing approach, and also were less expensive to the APP than deciding simply not to serve those customers at all. They will have difficulty coordinating their system resource planning with the myriad other providers, to achieve a least-cost mix of resources.

And perhaps most importantly, the APPs will have little incentive to keep their rates much below those of the existing utility - their incentive is to keep them just enough lower to lure customers away from the utility. As with MCI and Sprint, once the new division of market share has stabilized, rates for upstart profit-making entities can be expected to become closer to those of the existing utility.

Thus, competition, even if it were available to residential customers, would not guarantee or perhaps even promise lower rates.

53 Again, reducing low-income bills to affordable levels is a tool for avoiding delinquent payment costs such as working capital on delayed payments, disconnection/reconnection costs, the cost of making payment arrangements, etc.

54 Looking more closely at the telecommunications competition to date, note also that most residential customers saw an important component of their overall bill, their long-distance charges, drop as the result of "deregulation." Most residential customers were able to pay a higher basic rate, and enjoy the reduced calls for usage-sensitive calling. The shift in costs in the telephone industry was largely from long-distance to local, and residential customers take service in both modes. Thus, there was not a huge customer outcry to stop deregulation in its tracks. By contrast, in the electric industry, a residential customer will not be taking service in the deregulated market for some purposes and in the captive-customer market for others. The residential customer will be in or out of the retail wheeling transactions, and will lose or win accordingly.
B. Divestiture of Generation from Transmission and Distribution

A plan for a workable competitive environment would, ideally, involve the complete divestiture of the power generation business from the business of transmission and distribution.\(^55\) In such a world, wholesale power competition could flourish, without fear that the vertically integrated utility would try to distort the resource selection process in its own favor. No elaborate and cumbersome administrative procedures would be required to ensure an honest wholesale market.

The T&D companies would have every incentive to choose the least-cost supplier who met the desired reliability and other non-price criteria for the T&D company's service area. The T&D company would continue to function as the natural monopoly that it is, and social functions and price averaging that were considered beneficial by regulatory bodies could be carried out through retail pricing via the T&D companies.

This idea was floated during the debate on the National Energy Policy Act of 1992, and rejected in favor of the encouragement of wholesale competition within territories where existing monopoly utilities hold a retail franchise and are vertically integrated. Most analysts consider that it is unlikely we could develop a national

\(^{55}\) For an excellent discussion of the merits of such divestiture, see, Report of the Senate Committee on Post Audit and Oversight, "The Clean Air Act and Electric Generation Competition: A Win-Win Situation," Commonwealth of Massachusetts, Senate Doc. No. 1716 (June 1994).

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consensus for eliminating vertical integration, having so recently considered it and related topics.\textsuperscript{56}

C. Set Transmission Access Fees to Recapture Contribution from Bypassers.

A realistic question is how retail competition might be made palatable if vertical integration is to remain, but low-use customers were not unable to obtain the benefits of leaving the existing monopolies' systems. If one wanted to introduce retail competition in the present environment, steps must be taken to make sure that it is not merely a device for some customers to escape their responsibilities. Those who wish to leave the system should pay their fair share of the system's cost for the privilege of continuing to use the T&D network. To accomplish this, the price for the use of the T&D network should be set according to the following formula:\textsuperscript{57}

\[
\text{Wheeling Rate} = \text{Price utility would charge retail customer for same amount of power,} \\
\text{Less} \quad \text{utility's long-run avoided cost of supplying the same amount of power.}
\]

\textsuperscript{56} In addition, there are some land use policy questions associated with deregulating generation. And existing owners of generation would undoubtedly claim that some compensation was due for being forced to subject their wholesale transactions to the new fully competitive market, although similar suggestions have not held sway as competition was introduced starting with PURPA in the late 1970s.

\textsuperscript{57} See, Regulatory Assistance Project, \textit{IRP and Competition}, issuesletter (Gardiner, Maine February 1994).

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This formula is very much like the formula for pricing naccess charges to be paid by interexchange carriers who compete with the Bell Operating Company in the state of Maine. It permits new competitors to take business away if their long-run avoided costs are lower than the utility’s comparable costs.

That is, new competitors will have the advantage and be able to sell at retail if, and only if, they can promise to supply power at a cost lower than what the utility would charge if it were selling power on similar terms: forward-looking only, priced for that specific customer or class of customers. At the same time, those customers would make the same contribution to defray sunk costs, or support system-wide investments, as customers who stay on the system. They do not gain any unfair advantage merely from leaving the system.

Meanwhile, properly priced back-up and stand-by charges must be fashioned. If a retail customer wishes to leave the system, it must not reserve the right to return to the system for its power supply without paying for that right. It costs money to maintain sufficient reserves be able to add back customers whenever they choose to return, and if a former retail customer wishes that option, they should pay for it. A

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58 Re: Competitive Provision of Interexchange Services, 97 P.U.R. 4th (Maine P.U.C. October 24, 1989). The Commission has recently issued a notice that it wishes to revisit this formula, as it considers introducing competition for local exchange service in Maine. Re: Inquiry into the Provision of Competitive Telecommunications Services (Chapter 280), No. 94-114, Notice of Inquiry (Me. P.U.C. April 5, 1994).

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similar effect is accomplished by the use of agreements not to return to the system for "X" number of years, although these assume that later regulators and policy makers will not reverse the rule and permit a restoration of service without payment by the customer.

This option has the benefit of retaining the equal contribution of all customers to system costs. It has the disadvantage that it removes the cost-cutting incentive existing monopoly utilities have, under the threat of retail competition, to write down assets and reduce costs in an effort to save their customer base. As we have seen above, that incentive is itself a two-edged sword for low-income customers, as utilities threaten to drop services and rate programs beneficial to low-income ratepayers.

D. Other Options

Among the other options that have been discussed are a periodic auction of franchising rights for any given area, using tax revenues to buy out the liability for uneconomic plant, and a bargain between low-income and industrial customers that "the industrials can have their retail wheeling if the low-income keep their discount rates."\textsuperscript{59} As to the first, the concept of periodically subjecting the entire franchise to competition has intuitive appeal, and deserves further study. As to the second, shifting cost responsibility from rates to the tax base may or may not be a better bargain for

\textsuperscript{59} Paraphrase of remarks of Peter A. Bradford before the NCIEC conference, Buffalo, New York, June 1993.
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low-income customers, but it is hard to see what the rationale for such a transfer is. Great Britain's government had to retain its interests in the nation's nuclear power plants when it privatized generation, and the state of Maine is providing a form of state-backed guarantee for certain high-cost cogeneration contracts with Central Maine Power Company. However, these are admissions of failure, rather than formulae for a successful future.

With respect to the the third alternative mentioned, a "Faustian" bargain between the very largest customers and the most vulnerable customers, the merits of such an approach are less than clear at this writing. To the extent the objective is to leave both the utility shareholders and all the other customers (small business, commercial, and non-low-income residential) to shoulder any "uneconomic" costs of the system, it is not likely to be a successful strategy. As noted above, electric restructuring will not go down as smoothly as long distance telephone restructuring, or for that matter gas industry restructuring.61

60 Supra, note 54.

61 And introducing competition in the local telephone service area will not be as easy as it was with long-distance. Local telephone service is closer to electric service in the cost structure and identification of likely winners and losers from competition.

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IV. CONCLUSION

Retail competition is not inevitable. Many of the versions of retail wheeling that are being promoted today would produce higher rates and a poorer quality of service for low-income customers. It may be possible to construct a retail competition structure under which low-income customers do not suffer. But to do so, protections would be needed to ensure that all customers receive fair treatment, and societal purposes in electricity generation and distribution are preserved. If these protections are put in place, it is unlikely that the proponents of retail wheeling will continue to express the same level of enthusiasm for this dramatic restructuring of the way electricity is sold.