



National Energy Marketers Association

BEFORE THE FEDERAL TRADE COMMISSION
Comments on Retail Electricity Competition Plans-V010003

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION ON RETAIL ELECTRICITY COMPETITION

The National Energy Marketers Association (NEM) hereby submits Comments pursuant to the March 6, 2001, Federal Register Notice Requesting Comments on Retail Electricity Competition Plans.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing both wholesale and retail marketers of energy and energy-related products, services, information and technologies throughout the United States. NEM's membership includes: small regional marketers, large international wholesale and retail energy suppliers, billing and metering firms, Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, and information technology providers. Our membership has both affiliated and unaffiliated companies.

True price competition and lower energy prices require competitive suppliers to achieve national, or at least, regional economies of scale. Competitive suppliers can only succeed in winning customers away from incumbent utilities if they can offer lower prices, better services, more novel products, services and technologies or all three.

Affiliated and independent marketers have come together under the NEM auspices to forge consensus and to help eliminate as many issues as possible that would impede competition. Attached hereto and incorporated herein by reference are NEM's Testimony submitted to the Senate Energy Committee and National Policy Guidelines developed by NEM members entitled, "*National Guidelines for Restructuring the Electric Generation, Transmission and Distribution Industries*," "*National Guidelines for Designing and Pricing Default Energy and Related Services*," "*Uniform Code of Conduct for Regulated and Unregulated Suppliers of Energy and Related Services and Technologies*," and "*National Energy Technology Policy*." NEM is committed to working with representatives of state and federal governments, large and small consumer groups and utilities to devise fair and effective ways to implement the competitive restructuring of retail electric markets.

A. History and Overview

1. Why did the state implement retail electricity competition? What problems of the previous regulatory regime was it trying to solve?

2. What were the expected benefits of retail competition? Were price reductions expected in absolute terms or in relation to what price levels would be absent retail competition? Were the benefits of retail competition expected to be available to consumers in urban, suburban, and rural areas? Were the benefits expected to be available for residential, commercial, and industrial customers? Were the benefits expected to be comparable for each group of customers?

The consolidated U.S. market for energy and related services and technologies is one of the largest such markets in the world, with a size estimated as much as \$830 billion per year. Federal and state governments are among the nation's largest consumers of energy. Consequently, even modest cost savings or efficiency gains could result in tens of billions of dollars in savings to U.S. consumers and billions more in federal and state tax and budget relief. Simply stated, each year of energy cost savings has the economic effect of a major tax reduction.

As outlined in the attached testimony, if the three policies made therein are implemented, effective energy price competition can occur to the benefit of the smallest residential consumer. It is NEM's position that true price competition can and will produce the lowest possible price for energy in the same way that it has for long distance telecommunication services.

3. What factors or measures should the Commission examine in viewing the success of a state's retail electricity competition program? How should these measures be evaluated?

The best measure of a competitive market is the number of customers that, in fact, exercise choice. All customers should be given meaningful competitive choices at the earliest possible date. Customer choice must be easy to execute. NEM asserts that the right to switch energy suppliers is the ultimate consumer protection. Choice must exist in order to serve the public interest and it should not be complicated or expensive.

4. What are the most successful and least successful elements in the state's retail competition program? Has the state taken steps to modify the least successful elements?

B. Consumer Protection Issues

1. What efforts were made to educate consumers about retail competition? How was the success of these efforts measured? Were the programs successful? Who funded these efforts? Who implemented the programs?

It is imperative that customer understanding of energy deregulation be increased in order to ensure the success of the nation's retail energy market. Customers switching should occur in the context of understanding and choosing from among the offers that marketers present. Accordingly, customer education programs should be adequately funded up front. Furthermore, education programs should be implemented by state PUCs or by an independent party, not by the utilities.

2. Do consumers have enough information to readily make informed choices among competing suppliers? Did the state coordinate its labeling requirements about the attributes of a supplier's product, if any, with neighboring states? Is there a need for federal assistance to provide standardized supplier labeling? If so, what would be the most useful federal role?

3. Have consumers complained about unauthorized switching of their accounts to alternative suppliers ("slamming") or the placement of unauthorized charges on their electric bills ("cramming")? Were rules adopted to prevent these practices? Has the state taken enforcement action under its new authority against slamming and cramming? Have these actions been effective to curb the alleged abuses? Is there a need for federal assistance with slamming and cramming issues? If so, what would be the most useful federal role?

NEM urges the incorporation of the procedures set forth in the Uniform Business Practices¹ document in finalized Section IV: Customer Enrollment and Switching to determine whether a valid consumer enrollment and switch has been effectuated. The procedures set forth in Section IV of the UBP represent an effective safeguard of consumer interests. A marketer's compliance with Section IV procedures should constitute prima facie evidence that the marketer has not engaged in slamming or cramming activity and that the marketer has adequately addressed consumer protection concerns. In particular, Section IV(C)(6) of the UBP on Supplier Obligations provides that:

The Supplier shall provide the Customer within 3 days, a statement of the Supplier's terms and conditions that detail the Customer's rights and responsibilities, as well as the particulars of

¹ Uniform Business Practices for the Retail Energy Market, Sponsored by EEI, NEM, CUBR, and EPSA, accessible at www.eei.org [hereinafter "UBP"].

their contract with the Supplier (such as price, term, and services to be provided).

Furthermore, NEM asserts that if a marketer has enrolled and switched a consumer in conformance with the procedures set forth in Section IV of the UBP that the marketer should not be subject to penalties or other sanctions for slamming and/or cramming.

NEM also asserts that the Uniform Commercial Code, state privacy laws and local laws against unfair trade practices imbue the marketplace with meaningful and enforceable guidelines to implement the restructuring of electric industry. Incorporating these laws and the years of court cases interpreting these laws protects all energy consumers without imposing new and costly regulations, licensing requirements, paperwork and administrative burdens. NEM also endorses standards of conduct and self-policing rules to protect consumers against unwanted sales tactics. NEM asserts that any marketer found to be in violation of anti-slamming or anti-cramming prohibitions should be required to devise an internal action plan to correct such violations.

NEM asserts that consumer protection laws that are targeted specifically at energy marketers will negatively impact electricity restructuring. Such laws have the effect of a regressive tax on competition. This is because if marketers are forced to incur the expense of developing separate systems to comply with energy-specific consumer protection laws in addition to systems for pre-existing consumer protection laws, many of the costs will be passed on to consumers in the form of higher energy prices. Additionally, investments, productivity, competition and innovation will be negatively impacted. Resources that would have been directed into developing new products and services to enhance competition will have to be diverted into resources dedicated to compliance with the market specific consumer protection laws.

4. How did the state facilitate the ability of customers to switch to a new supplier? Have these efforts been successful? Does the state allow consumers to aggregate their electricity demand? If so, has aggregation enabled consumers to benefit from retail electricity competition? If not, why not?

5. Has the state established licensing or certification requirements for new suppliers to provide electricity to customers? Why? Which licensing provisions are designed to protect consumers? How do they operate? Has the state taken enforcement action against unlicensed firms? Have these actions been effective to curb unlicensed activity? Have these requirements acted as an entry barrier for new suppliers?

As noted above, every state has anti-fraud and a myriad of consumer protection laws already on the books which if properly enforced can protect energy

consumers as they do consumers of any other product or service. Increased requirements, such as special licensing or onerous certification requirements, result in increased costs to suppliers which in turn are passed on to customers. To the extent that increased costs are placed on aggregators of small customers, the costs will be passed on to small customers, who are least able to pay for them. Increased costs will not foster the development of a competitive market. Often, such costs have the impact of regressive energy taxes.

6. Did the state place any restrictions on the ability of a utility's unregulated affiliate(s) to use a similar name and/or logo as its parent utility, in order to avoid consumer confusion when the affiliate offered unregulated generation services? Why or why not? What has been the experience to date with the use of these restrictions? Are consumers knowledgeable about who their suppliers are?

NEM's Uniform Code of Conduct addresses this issue in some depth. However, the principle issue in affiliate transactions is competitive neutrality and the prohibition of favoritism in business dealings. NEM asserts that a utility and its unregulated affiliate should not trade upon, promote or suggest to any customer, supplier or third party that they may receive preferential treatment as a result of the affiliation. A utility should not speak on behalf of its unregulated affiliate or give the appearance that it is speaking on behalf of its unregulated affiliate. By the same token, utilities should not provide negative information about affiliated or non-affiliated competitors.

7. Did the state place any restrictions on third-party or affiliate use of a utility's customer information (e.g., customer usage statistics, financial information, etc.)? What were the reasons for enacting the restrictions? What has been the effect of these restrictions on new marketing activity?

NEM asserts that information should be available and disseminated on a non-discriminatory, competitively neutral basis. NEM urges all jurisdictions to require that customer energy usage and billing data be provided to all competitors at a reasonable cost-based fee, in a timely manner and without preference. Specific customer information requested by one non-regulated party must be confidential to all other parties unless similarly requested by such parties. Utilities should keep written records of such information requests and stand ready to demonstrate that information requested by one competitor was not shared improperly with other competing suppliers.

It is very important that marketers have access to as much customer information as possible. It is also important to make access as easy as possible, particularly for smaller customers. Internet-based electronic access to information in a format that is easily readable and useable is preferable and will lower the costs of energy. Many suppliers need usage information in order to aggregate supplies efficiently and to customize services for prospective customers, but getting the information

can be expensive. Some utilities offer the information via a web portal, and some through real-time EDI CRM access; others only offer the information via repeated faxing back and forth. Seamless, low-cost, efficient and competitively neutral data and information exchange is key to lowering the cost of energy and related services as well as enhancing reliability.

8. Has the state adopted any other measures intended to protect consumers (e.g., length of consumer contracts, automatic renewal provisions, etc.) as it implemented retail competition? What has been the effect of these measures?

9. To what extent have suppliers engaged in advertising to sell their product(s)? Do some suppliers claim that their product is differentiated (e.g., that it has environmental benefits)? Has there been any enforcement or attempts to verify these advertising claims? Do any certification organizations, such as Green-e, operate in the state? Are they used by (or at least available to) a substantial portion of consumers?

C. Retail Supply Issues

1. What difficulties have suppliers encountered in entering the market? What conditions/incentives attract suppliers to retail markets? Have suppliers exited the market after beginning to provide retail service? If so, why?

In order to create conditions to attract suppliers to retail markets, utilities should exit the merchant function and consumers should be provided shopping credits equal to current monopoly prices to shop for competitive services. Utilities should be encouraged to "exit" competitive businesses and focus all ratepayer dollars on performing services that can only be performed by a natural monopoly. In the process, consumers should be given "shopping credits" on their utility bills equal to the utility's fully embedded costs of providing competitive services that historically have been bundled with traditional monopoly services. Currently, captive utility customers pay monopoly prices for a bundle of services that include many products and services that can and should be provided by competitive suppliers at competitive prices. Failure to give consumers credits that reflect the full costs historically associated with these services will send erroneous pricing signals to consumers and cause consumers to pay twice for the same services. Shopping credits which "back out" the proper amounts from utility rates will permit consumers to shop for competitive services, encourage price competition among suppliers, improve efficiency and stimulate innovation. Until consumers are given the full monopoly prices they are currently paying for competitive services to shop for alternative energy services, price competition and lower energy costs will be difficult to achieve.

NEM urges that back-out credits should be structured to reflect the full supply costs and full commercial costs of serving retail customers currently included in utilities fully bundled rates. The full energy supply costs associated with serving retail customers include: the wholesale price of energy for delivery into the utility's service territory; installed capacity (on kWh basis); transmission and ancillary services; retail load shape factor costs; risk management; scheduling and control area costs; and pool operating costs plus transmission and distribution system line losses. The full commercial costs associated with serving retail customers include: the costs of load forecasting; environmental disclosure; and the costs of negotiating and managing supply contracts and the associated costs of regulatory compliance and litigation; taxes; administrative and general costs; customer service; billing; bad debt; collections; marketing; and an appropriate return on equity and debt.

Additionally, NEM urges that back-outs credit should be flexible. Back-out credits should be structured to reflect movements in market prices to prevent serious misalignment. Fixed back-out credits put great pressure on competitive suppliers during times of wholesale price volatility. Back-out credits that are shaped or structured to adjust in response to wholesale market conditions provide better price signals to the market and help level the competitive playing field.

NEM also asserts that back-out credits should be structured to reflect the cost differentials of serving customers in different customer classes. Costs of serving customers can vary significantly by customer class. This is because different classes have different load shapes that result in different energy costs. Additionally, different classes have different load factors that result in different capacity costs per kilowatt-hour of energy. Finally, different classes have different line loss factors as well.

Additionally, states should establish a date certain by which to complete the transition to a competitive market. The maximum consumer benefits of open access and competition take place when markets make a complete transition to competition. All classes of consumers must be free to purchase as many or as few competitive services as they wish, as soon as possible, without fear of losing quality or reliability. Each PUC should apply cost-of-service regulation only to those specific functions that remain natural monopoly services, based on true "economies of scale" and declining average costs. These functions do not include competitive commodity supply functions. Additionally, as regulated utilities unbundle energy supply and service functions, the provider-of-last-resort functions can be provided by qualified competitive suppliers, and the obligation-to-serve can be modified into an obligation to connect and deliver.

Additional and related factors which effect market entry include artificial constraints on prices offered by the incumbents, the liquidity of wholesale markets and availability of supply, and the cost of backroom operations and processes

(discussed *infra*). The bottom line is that adequate profit margins for marketers are the key incentive.

2. What are the customer acquisition costs and operational costs to service retail customers? How do acquisition and operational costs compare to profit margins for electric power generation services? Do retail margins affect entry? If so, how? Did the state harmonize the procedures suppliers use to attract and switch customers with other states' procedures, in order to reduce suppliers' costs?

Typically it is more expensive to serve small customers than large customers because the energy supply and commercial costs of serving small customers are much higher on a per kilowatt basis for said customers (see response to Question C.1. above).

A competitive return on risk capital invested is the key to market entry. Regulatory delays, defective market structures, utility cross subsidies and failure to give consumers back monopoly rents in credits to shop for competitive energy and related products, services, information and technology undermine the competitiveness of state restructuring efforts. At a minimum, it is essential to establish standard business processes and practices within a state and in alignment with other state and federal jurisdictions to allow marketers to attain national, or at least regional, economies of scale. The development of a standardized language describing these processes and practices is also needed (see response to Question F.3 below). When coupled with properly designed shopping credits a state restructuring effort has a chance of success with resulting price competition to the smallest consumer.

3. Have customers switched to new suppliers? Why or why not? Are there greater incentives for certain customer classes (*i.e.*, industrial, commercial, residential) than for others to switch suppliers? Why or why not? Are penalties or different rates applied to customers that switch back to the supplier of last resort? Are there other measures to determine whether customers are actively considering switching suppliers? If so, do these indicators show different patterns than the switching rate data?

4. Have suppliers offered new types of products and services (*e.g.*, time of day pricing, interruptible contracts, green power, etc.) in states where retail competition has been implemented? If so, describe the products and what customer response has been.

If the proper regulatory structure is implemented, members of the National Energy Marketers Association are prepared to offer an array of new and innovative energy related products services, information technology and distributed generation. Many marketers cannot afford to offer new products and services yet, due largely

to the failure of state restructuring programs to properly design back out credits and uniform business practices and information transfer protocols.

5. What are the benefits or drawbacks of the different approaches to handling the supplier of last resort obligation for customers who do not choose a new supplier (e.g., allow incumbent utility to retain the obligation to provide generation services to non-choosing customers, auction the obligation, or assign the obligation to non-utility parties). What has been consumer reaction to these approaches? Is provider of last resort service necessary?

The availability of default service (for those who do not choose) will help make the transition to a competitive market smoother (there will be less negative consumer reaction and suppliers will be able to adjust to increases in their customer base gradually). However, default service should be for a limited transition period and should be priced at the full cost of serving no-notice retail load. Note that, as described more fully in our attached position paper, NEM distinguishes between default service (which primarily services non-choosers during a transition period) and true provider of last resort service, which may be needed even after the transition period to provide emergency service on a short-term basis to customers who have lost their supplier and are seeking a new one in the competitive market. It is NEM's position that this POLR service should be competitively procured and reflect the full costs of providing the service.

Options for approaching default service fall into four general models and may be used in varying combinations and permutations, preferably for a brief interim period of time before all customers make the transition to a competitive market.

a) Utility retains default customers - From a default service customer's perspective, competition has changed nothing. Customers continue to deal with the utility for all aspects of service. As indicated above, this approach is not a long-term solution. When it is employed on a transitional basis, Commissions should insure that the transition plan: 1) maximizes appropriate incentives for customers to choose competitive suppliers by allocating retail costs appropriately between the distribution rate and the energy supply service (i.e., default service) rate, thereby preventing customers from paying the retail cost component twice; 2) minimizes incentives for utilities to retain default service customers by ensuring that revenues in excess of commodity costs benefit all customers via lower stranded costs or distribution rates; and 3) educates consumers on the benefits of competitive energy supply service options, including the potential for: innovative product offerings, including flexible pricing, billing and delivery options, and cleaner and renewable energy resources; multiple supply and purchase alternatives; and lower costs as the result of competitive price pressure among suppliers.

b) Default customers transferred to another supplier - Under this approach default service is granted to an entity other than the utility, such as an affiliate or the buyer of the utility's generation assets. An automatic non-competitive transfer of customers to any other single entity (affiliated or unaffiliated) grants a substantial and unfair competitive advantage to one market participant and violates the concept of competitive neutrality. In addition, automatic transfer to a utility affiliate offers few, if any, advantages to the competitive market over leaving customers with the incumbent utility itself.

c) Default service awarded based on revenue bids. This option puts the responsibility on the Commission to set the default service price. Suppliers then bid a dollar amount for the right to serve default customers at the price established by the commission. This revenue bid amount is then available to reduce stranded costs or offer other benefits to all distribution customers. While there are a number of benefits to this approach, an inherent problem with this option is the difficulty and risk of forecasting prices into the future. From a competitive market perspective, the greatest risk is that the price will be set too low, presenting substantial risk to potential default service providers and limiting opportunities for the competitive market to offer pricing benefits to customers. If this approach is utilized, it is important that these dynamics are considered and that Commissions provide themselves with opportunities to reset the default service price (and rebid the service) periodically.

d) Default service awarded based on price bids - This approach can represent significant progress toward establishing default service charges that reflect the competitive market for energy supply services. If it is utilized, however, it is important to ensure that the default service provider is responsible to the maximum extent possible for all of the retail functions and costs that impact competitive suppliers. Since a default service provider can avoid certain costs (such as marketing costs) and enjoy certain advantages (such as instant economies of scale), it is important to neutralize these advantages in order to allow a competitive market to flourish.

D. Retail Pricing Issues

1. How is entry affected by the price for the provider of last resort service (for customers who do not choose) or for default service (for customer whose supplier exits the market)? How does the price for the provider of last resort or default service compare to prices offered by alternative suppliers? Is the price for provider of last resort service or default service capped? If so, for how long?

There are four basic models that have been tried or considered for the pricing of default service. They are described below, beginning with the most competitive method and ending with the least competitive.

a) Wholesale Prices Adjusted to Reflect Retail Service Costs - This approach starts with either a periodic rate or an index rate to determine a wholesale price and then includes the additional costs of providing retail energy services. For the electric industry, the costs associated with retail services include transmission charges, scheduling and control area services, losses and pool operating expenses and the costs of risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, and taxes, as well as costs for administrative and general expenses, metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care.

b) Periodic Rate – A periodic rate is a pricing mechanism that relies on regulators, auctions or market mechanisms to set prices (either wholesale or retail) annually or at some other interval that allows for changes in market conditions. This is the approach taken in Arizona, Nevada, and Maine.

c) Fixed Rate – Under a fixed rate mechanism the default service rate schedule is administratively determined for some period of years. The rate, which usually escalates over time, may be based on the embedded cost of utility generation, a speculative forecast of wholesale or retail prices over time, stranded cost recovery considerations and other factors. This is the approach taken in Massachusetts, Rhode Island, New Jersey and initially in Pennsylvania. Initial default service rates established in several utility service territories in Pennsylvania have helped to develop a competitive market in that state to date because the pricing structure has more realistically reflected the costs of providing retail services. However, escalating wholesale power costs are now presenting a challenge to suppliers competing with fixed default service prices. In contrast, default service rates in Massachusetts and Rhode Island were initially set at unrealistically low levels, thereby precluding any significant competitive activity in those states.

d) Index Rate - The index rate relies on the wholesale marketplace to set the price of default service. Customers generally pay a monthly or billing period average of the spot market price. As applied in markets like California, customers do not avoid the overall higher costs associated with being served by a monopoly because the retail service component remains embedded within the distribution rate.

NEM asserts that Commissions should design default service pricing mechanisms that reflect retail prices, and do not produce artificial or cross-subsidized price

signals. All suppliers providing generation to customers at retail, including default service and competitive suppliers, incur costs to do so in addition to the wholesale cost of the energy commodity. These costs include a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care. Default service pricing mechanisms that hide the true costs of providing retail energy services, showing instead the wholesale power costs alone as the “price to compare,” do not benefit default service customers, who are getting a false price signal and are still paying the other costs to provide generation or gas sales service in the distribution component of the bill. They do, however, penalize customers who switch to competitive suppliers since those customers are paying for the retail costs of energy supply services twice. They also have a devastating effect on the competitive market, since competitive suppliers are unable to compete effectively on the basis of price with the subsidized default service option.

Furthermore, the costs to provide default service varies by customer group. Properly designed default service prices should reflect these real price differences to encourage competition for all customer classes.

Default service pricing mechanisms must also be designed to account for changing market conditions. While it is early in the development of competitive markets to have much concrete experience with this, there is a huge inherent risk for the retail market in a “price to compare” that does not change over time in response to changes in the wholesale markets. Such set prices put tremendous pressure on retail suppliers during periods of wholesale price volatility, and provide opportunity and motivation for generation owners, comprised largely of utilities, to “game” the wholesale market for competitive advantage. Default service pricing mechanisms that allow prices to change over time in response to wholesale market conditions better reflect real competitive markets, provide more accurate price signals, and help level the competitive retail playing field.

2. Has the state required retail rate reductions prior to the start of retail competition? What is the rationale for these reductions? How have state-mandated rate reductions prior to the start of retail competition affected retail competition?

State-mandated rate reductions (price controls) are primarily a political compromise that distort energy economics to the long term detriment of the consumer, as exemplified during the 1970s energy crisis² and more recently in

² During the 1970's, prompted by an OPEC Boycott, the U.S. government implemented the most comprehensive form of energy price and allocation controls since World War II. As a result, crude oil prices rose from a price of \$2/barrel to more than of \$40/barrel. On

California. State-mandated reductions, particularly improperly designed back out credits or POLR prices undermine the possibility of true price competition to the smallest consumer. Utilities should not be proposing a long-term basic service charge that is discounted in order to assure legislative and regulatory support for implementing the utility brand of deregulation as has occurred in Massachusetts with the “standard offer.”

3. Do any seasonal fluctuations in the price of wholesale generation cause some suppliers to enter the market only at certain times of the year? How have these suppliers fared?

Seasonal fluctuations in price are a reality that many members of NEM are prepared to offset with cost effective risk management. The best solution is to let risk capital manage energy risks as soon as possible. In fact, restructuring will fail if government remains the risk manager for the new energy marketplace on the one hand, and, on the other, attempts to control the responsive activities of marketers with additional regulations.

4. How has the state addressed public benefit programs (e.g., universal service requirements, low income assistance, conservation education, etc.) as it has implemented retail competition? Which of these programs are necessary as competition is introduced and why? Are public benefits available to all customers or are they restricted to customers of the supplier of last resort? How does this affect retail competition?

NEM supports the proposition that market-based solutions such as aggregation should be utilized to the maximum extent possible to address the needs of low-income consumers effectively and to allow low-income customers access to lower prices in the competitive market. In fact, states could experiment with pilot programs that bid out aggregated low income groups either as part of POLR service or a separate service. It is important, however, that POLR service, as a whole, not be designated as a subsidized rate in order to address low income concerns. A subsidized POLR service available to all would both undermine the competitive market and unnecessarily increase the cost of providing assistance to low income individuals.

January 21, 1981, President Reagan decontrolled the price of crude oil and prices fell to a low of \$9/barrel by the late 1980s. Natural gas sold for many years for less than 50 cents/Mcf. Responding to calls that the country was running out of natural gas, the U.S. government implemented a complex form of natural gas price regulations. Predictably, natural gas prices climbed to as high as \$10/McF in some markets. Predictable also, after natural gas price decontrol, prices fell to as low as 50 cents/McF in some markets. Similar price reductions were experienced in the airline, trucking and long distance telecommunication markets.

E. Market Structure Issues

1. How has the development of Regional Transmission Organizations (RTOs) affected retail competition in the state?

NEM urges that FERC should regionalize the U.S. electric grid under independent management and operational control, with incentives to optimize throughput. A key element in linking geographically separate electricity markets is the integrity of the transmission network. This network facilitates the movement of bulk power transactions to ensure reliability, economic efficiency and market liquidity. Unlike generation, transmission remains a “natural monopoly” function. Given the current commercial bottlenecks (constraints) in transmission service, the owners of such service must be scrupulously monitored to avoid use of these constraints unfairly as market power to its own financial advantage or to the disadvantage of competitors.

FERC endorsed the independent control of transmission access as a means of achieving regional operation of transmission grids with some measure of separation from generation ownership. Unfortunately, the current management structure of ISOs, is neither sufficiently independent nor free from conflicts of interest, to implement Orders 888 and 889. It is not sufficiently accountable to transmission customers. There are no incentives to optimize transmission, nor are there meaningful penalties for failure to comply with rules established for fair and non-discriminatory operations. Independent grid managers should have incentives to optimize transmission throughput and service reliability, and be held accountable for their operational decisions.

Sound public policy mandates that the transmission network be operated regionally under independent management, without financial conflicts of interest among the owners of affected transmission, distribution and generation assets. Independence means that operational decisions will be made solely upon operational considerations and that commercial protocols will be uniformly applied in a non-discriminatory fashion regardless of corporate affiliation. Additionally, in emergencies, no direct or indirect financial benefit should be derived by the operator of the transmission network.

The lack of development of RTO’s has significantly harmed competition in many areas, particularly those areas that do not already have an established tight power pool. The provision of equal access to transmission and distribution systems is essential.

2. Did the state require the divestiture of generation assets (or impose other regulatory conditions on the use of these assets) when retail competition was introduced? To what extent was divestiture of generation assets a component of the state’s handling of a utility’s stranded costs? Was divestiture used to remedy a high concentration of generation assets serving the state? Was there

appreciable voluntary divestiture of generation assets? Has the state examined whether there has been appreciable consolidation of ownership of generation serving the state since the start of retail competition?

The current ownership of generation assets creates potential opportunities for a generation owner to exercise market power. Vertically, the owner may work in conjunction with transmission and/or distribution assets; horizontally, an owner may utilize a concentration of assets in a particular region. Regulators must prevent the exercise of such market power. NEM supports the divestiture of generation assets to non-affiliated entities to the extent it is necessary to fully mitigate residual horizontal and vertical market power. In accomplishing this objective, valid stranded costs associated with generation assets should be collected to the extent that market values for such assets have been determined by reference to legitimate arm's-length sales offerings. Further, such stranded costs should be measured on an aggregated basis (i.e. market values that are greater than net book values should be netted against negative market values). In addition, to the extent any company is or becomes an owner of generation and transmission and/or distribution facilities, these functions should operate independently, consistent with NEM's Uniform Code of Conduct (attached hereto).

3. If a utility no longer owns generation assets to meet its obligations as the supplier of last resort or default service provider, what market mechanism (e.g., spot market purchases, buy back or output contracts, etc.) does it use to obtain generation services to fulfill these obligations? What share of a utility's load is obtained via the different mechanisms? How are these shares trending? Is the market mechanism transparent? Is it necessary to monitor these market mechanisms? Why or why not? If so, what should the monitor examine?

4. Explain the state's role in overseeing operation of the transmission grid in the state and the extent to which public power or municipal power transmission systems are integrated into this effort. What is the relationship between the state's role and the Federal Energy Regulatory Commission's role in transmission system operation in the state?

5. Do firms that have provider of last resort or default service obligations (formerly "native load" obligations in the regulated environment) receive preferential transmission treatment? If so, how does this affect wholesale electric power competition? How and by whom should retail sales of bundled transmission services (i.e., retail sales of both energy and transmission services) and retail sales of unbundled transmission be regulated? If by more than one entity, how should regulation be coordinated? What should the state's role be in overseeing wholesale transmission reliability?

Congress should resolve that competition in the sale of electricity is in the best interests of consumers and direct FERC to take significant steps toward encouraging such competition. FERC should act in a timely fashion to create fully functional, efficient electricity markets as soon as possible. Toward that end, Congress needs to ensure that FERC has the requisite authority to require all owners of transmission facilities to provide all transmission services on a comparable, non-discriminatory basis. This authority should include the ability to mandate participation in regional transmission organizations. FERC's actions should provide owners and/or operators of transmission facilities with a heightened sense of accountability through a meaningful and balanced system of incentives and penalties that is aggressively administered by FERC.

Reliable "real time" information is vital to commercial transactions, the operation of a competitive marketplace, and is the linchpin of Order 888. In many instances, transmission providers are either inaccurately posting "Available Transmission Capacity" (ATC) or not posting it at all. Transmission operators tend to overestimate native load and reserve "margins," thereby underestimating the level of transmission service that is available for use by competing suppliers. Specifically, FERC should require, under strict and enforceable penalties for non-compliance, that all transactions (including those involving captive, preexisting or "grand-fathered" transmission customers) be reported and available to the marketplace in "real time" on the Open Access Same Time Information System ("OASIS").

6. To what extent did the state identify transmission constraints affecting access to out-of-state or in-state generation prior to the start of retail competition? Is the state capable of remedying these transmission constraints, or is federal jurisdiction necessary? How do the rationales for federal jurisdiction over electric power transmission siting compare to the reasons underlying federal jurisdiction over the siting of natural gas pipelines?

It is important that the wrangling over state vs. federal jurisdiction over transmission be resolved and that federal jurisdiction be asserted. If incumbent utilities are allowed to enjoy a "native load priority" for their regulated sales, the market will continue to be inhibited from functioning efficiently. Federal jurisdiction over electric transmission siting is essential if RTOs are to function as truly regional entities (see response to Question E.7 below).

7. How have state siting regulations for new generation and transmission facilities been affected by the onset of retail competition? Has new generation siting kept pace with demand growth in the state? If not, why not? Is federal jurisdiction necessary for siting of electric power generation facilities? Has the state actively monitored and reported the relationship between in-state capacity and peak demand in the state? What incentives do suppliers have to maintain adequate reserve capacity? What are the ways to value capacity in competitive markets? Is reserve sharing still important in competitive

markets? Do other institutions/market processes provide a reasonable substitute for reserve sharing?

The United States has entered the digital age with an energy infrastructure constructed for the industrial revolution. The United States is operating on a level of reliability that cannot support digital power quality needs. A flicker of the lights in Silicon Valley has global impacts. One of the lowest cost, highest yield policy solutions is to create targeted tax incentives to encourage all forms of new energy supply, technology and conservation investments. This includes investments in new pipes and wires to reduce congestion, advanced metering systems, new computer systems, new energy supplies, investments to conserve energy as well as distributed generation. Both the state and federal governments have powerful and effective tools to encourage new investments in energy supply and conservation. The federal tax code already contains a myriad of targeted energy, environmental and efficiency tax credits that should be updated to increase the supply of electricity and natural gas and reduce consumption. Either or both the existing energy tax credits contained in Section 48 of the Internal Revenue Code (IRC), or the existing credit for research contained in Section 41 of the IRC, could be expanded to include "qualified energy restructuring investments."

NEM recommends that the definition of "qualified restructuring investments" include, at a minimum, expenses incurred to modernize and upgrade computer and information systems, metering systems, billing systems and customer care facilities to facilitate competitive restructuring. The credit should be available to both regulated and unregulated entities. To ensure that restructuring tax credits and regulatory incentives are targeted and effective, investments that are not "qualified" should also not qualify for stranded cost recovery.

NEM asserts that there must be better recognition in local siting decisions of the regional economic impacts of inadequate energy supplies. For example, California is one of the world's largest economies, the epicenter of a worldwide technology revolution, and built around an electricity system that is in need of significant new investments to deliver "digital power quality." Strong population growth with no new power supplies added in a decade made shortages and price spikes a certainty. The direct and indirect impact to California, the western United States and the global economy of local decisions that stall construction of needed supplies is astronomical.

8. Since the start of retail competition, what has been the rate of generation plant outages (scheduled and unscheduled)? To what extent has the state monitored these outages and examined their causes?

F. Other Issues

1. What measures has the state taken to make customer demand responsive to changes in available supply? Has the state provided utilities incentives to make customers more price responsive? Has the state moved away from average cost pricing? What effect have these measures had on demand and on demand elasticity?

It is essential that customer demand become more responsive to changes in available supply even if the retail market is not open. The wholesale market is open, and if it is to function effectively, customer demand must be allowed to respond to change in price (i.e. available supply).

The timely, accurate dissemination of critical energy usage information is vital to the efficient management of both energy supply and energy demand. Historically, the installation, maintenance and reading of energy meters have been part of a utility's responsibility. Increasingly, however, metering has become a competitive market, particularly for larger commercial and industrial users. However, for the true benefits of competition to be enjoyed by all consumers of energy, investments to upgrade existing meters are long overdue and must be made.

Investments made to upgrade existing meters and to install advanced meters will permit more accurate forecasting to meet customer demand. Statistical load profiles, which can vary significantly from actual customer usage, are currently used to forecast power needs. Advanced meters will permit suppliers to more accurately match supplies to meet demand and to minimize imbalance, standby, storage, injection and withdrawal costs. In this way, consumers can save millions of dollars in unnecessary costs.

NEM supports the expansion of existing tax credits and expedited prudency reviews for "qualified energy restructuring investments." To qualify for the new restructuring tax credit or expedited prudency review, new metering investments should permit open, non-discriminatory access to accurate, reliable, real-time energy consumption information in a standardized protocol. Such investments will permit consumers to reduce demand during peak times and permit energy providers to lower the costs and risks of managing supply and demand. Qualified investments must contain open architecture and must be capable of being read and used by different entities to facilitate customers unfettered decision to switch. New metering investments should produce data in a standard format that all market participants can use and understand. It is recommended that "behind-the-meter" smart devices that see and respond to price signals should also be qualified investments.

2. Has the state provided mechanisms and incentives for owners of co-generation capacity to offer power during peak demand periods? Has the

state identified, reported, and facilitated development of pumped storage facilities or other approaches to arbitraging between peak and off-peak wholesale electricity prices?

3. What issues have arisen under retail competition that have required cooperation or coordination with other states? What approach was taken to securing this cooperation or coordination? Are there other issues requiring cooperation that have not yet been addressed? Which of these issues are the most significant?

There are a significant number of rules, procedures, processes and business practices, which, if established fairly, efficiently, and uniformly across the country could bring significant cost savings in a very short period of time. If market participants are forced to divert scarce resources to customize billing, back-office, and customer care facilities, and to develop and maintain non-standardized information protocols or develop specialized knowledge of different business rules in each jurisdiction, it drives energy prices higher nationwide.

The industry has come together in an unprecedented collaboration on a series of recommendations for Uniform Business Practices (UBP), the implementation of which can have an immediate and favorable impact on the delivery of energy services. NEM urges all states to implement the consensus positions set forth in the finalized sections of the UBP applicable to customer information, enrollment and switching, billing and payment processing and load profiling at the earliest possible date. This body of standardized business processes should also be updated continuously to reflect the latest developments in technology and the competitive marketplace.

The challenge to maximizing the public benefit of implementing Uniform Business Practices is the fact that there are currently different information protocols and processes being used to transfer data. NEM strongly recommends that these protocols and processes be standardized immediately and efficiently migrated to the Internet as soon as possible.

To implement Uniform Business Practices, it is critical to also establish energy industry specific "Standardized Information Protocols" (SIPs). To minimize costs, standardized energy information protocols must integrate Internet-based technology at the earliest possible date. It is vital that the energy industry be permitted to rely on both a consistent set of business practices and a consistent set of information standards that will reduce the risk of implementing new technology as markets open from state to state. SIPs will reduce the costs of developing data systems, increase understandability and comparability of data and create and encourage a competitive environment to handle both information and data. In turn, state implementation of UBPs will lower the costs to deliver energy and related products, services and technologies.

Uniform business processes and standard information protocols will levelize the playing field for marketers. Currently, marketers are trying to participate in multiple forums with limited resources on these issues. The utilities have more resources to devote to representation and advocacy of their positions. Uniformity would also permit all parties, regulated and unregulated, to put their resources to their best and most efficient uses.

4. How prevalent is the use of distributed resources (e.g., distributed generation) within the state? What barriers do customers face to implementing distributed resources?

It is important that national standards relating to interconnection of distributed resources be developed to encourage appropriate use of such resources including standard interconnection contracts, standard interconnection requirements and standardized approval processes for interconnection.

Standard interconnection contracts are necessary to give developers and potential owners of distributed generation plants the ability to make the long-term investment these plants require. No power-plant owner would reasonably make an investment in generation equipment unless it was assured that the equipment would be allowed to connect and stay connected to the grid. A properly constructed standard interconnection contract would provide for this.

Standard interconnection requirements are critical to the economics of distributed generation. The small size of most distributed generation plants means that the cost per kilowatt for engineering and testing is very high relative to that of central plants. The cost of corresponding with the utility, doing the required studies, producing the drawings and testing the system can vary widely and can be prohibitive. Standard interconnection requirements save time and money for the utility as well as the plant owner. Standard interconnection requirements allow prospective plant owners and developers to make informed decisions based on costs of interconnection equipment and engineering. Making the process predictable allows costs to be estimated reliably and encourages participation in distributed generation projects.

Standardized approval processes for distributed generation interconnection should be instituted in all ISO/RTOs and electric utilities should be required to adopt them. The approval processes should have time limits for each step of the process. Standardized approval processes allow informed decision-making and good planning by the prospective plant owner and developer. Making the process predictable allows costs to be estimated properly and encourages participation in distributed generation projects. It promotes good faith between the prospective plant owner, developer and utility.

5. Which specific jurisdictional issues prevent state retail competition programs from being as successful as they might be?

True price competition and lower energy prices require competitive suppliers to achieve national, or at least, regional economies of scale. Competitive suppliers can only succeed in winning customers away from incumbent utilities if they can offer lower prices, better services, more novel products, services and technologies or all three.

Currently, there are 50 different states with different rules in multiple utility service territories, different data protocols and transaction sets, different operating rules, different switching, scheduling and customer protection rules, even different units of measurements. As long as market participants are forced to divert scarce resources to customize computer systems, billing, back-office, and customer care facilities, and to develop and maintain non-standardized information protocols or develop specialized knowledge of different business rules in each jurisdiction, it drives energy prices higher nationwide. Add to this the fact that one marked failure like California can have a devastating impact on consumers, taxpayers, financial markets and regional ecosystems.

Energy is the lifeblood of the world economy. It is time to coordinate and implement relative uniformity among the states, in rules, processes, procedures, scheduling delivery, and even information technologies. There are a significant number of business rules, consumer protection laws, technology platforms and comparable operating rules and scheduling processes which, if established fairly, efficiently, and uniformly across the country could bring significant cost savings and have a profound impact on the country and the reliability of energy supplies.

Many utilities do not have state of the art information systems which limits their capability to cooperate with competitive retailers that want to offer leading edge products and services. A good example is the state of consolidated billing in Ohio. It will be offered but it was not able to be offered when competition started in Ohio because of the inability of some utilities to accommodate it on their systems.

6. Which specific technological developments are likely to substantially affect retail or wholesale competition in the electric power industry that may alter the manner in which states structure retail competition plans? Why? What time frame is associated with these developments?

Technology is the enabler that will allow national economies of scale to be realized quickly. The goals of deregulation are to lower costs, improve the quality of service and provide value-added services to consumers. These goals are attainable if the state and federal governments implement policies that encourage the prompt implementation of uniform, consistent standards, processes, contract terms, and information protocols that allow competitive suppliers to effectively

compete in multiple jurisdictions at the lowest cost to consumers. Indeed, the new energy industry has already embraced the power of the Internet to provide consumers a full array of energy products and services as well as a novel array of bundled home automation, risk management, telecommunications, broadband access and Internet-related services. The next step is to standardize the business processes as well as the electronic transfer of vital information by which energy services are delivered.

Over the last five years, it has become clear that the Internet will play an increasingly vital role in the growth of the energy industry as well as the U.S. and global economies. The Internet will likely become a significant, perhaps dominant vehicle to aggregate the supply and demand for energy as well as to facilitate the delivery of energy-related products, services and information. It is equally clear that the Internet can lower operating costs, facilitate a wide array of value-added products and services, lower barriers to entry and provide an ideal platform for true price competition.

E-commerce transactions in the U.S. alone are forecasted to grow from \$27 billion dollars in 2000 to \$266 billion dollars by 2004. As Internet commerce explodes, a restructured energy industry must coalesce around a uniform set of business practices and Standardized Information Protocols to facilitate the delivery of lower cost energy services. The retail energy industry does not have a bricks and mortar base (i.e. an energy store on every corner) that will strand prior investments or impede the speed with which restructuring can occur. However, there are and will be considerable investments necessary in information systems, billing, metering, back-office and customer care networks that must be encouraged and must facilitate the lowest cost delivery of energy services to consumers.

Seamless, low-cost, efficient data and information exchange is the key to lowering the cost of energy and related services as well as enhancing reliability.³ The passage of the Electronic Signatures in Global and National Commerce Act⁴ provides that e-contracts are as binding as paper contracts. Congress deliberately pre-empted state governments in the development and implementation of e-standards to facilitate e-commerce. Clearly, the impact and import of global Internet commerce on the U.S. economy and the competitiveness of U.S. businesses is and will continue to be too important to risk the potential incompatibility of 50 different e-standards for e-commerce.

While the federal government clearly has the authority to establish national standards for information exchange over the Internet, states can and should help lead in the development and implementation of both Uniform Business Practices (UBP) and Standardized Information Protocols (SIPs). Indeed, it was state

³ Real-time energy usage information allows consumers to reduce demand and allows suppliers to more accurately match supply and demand thereby both lowering costs and enhancing reliability.

⁴ Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001.

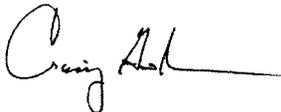
leadership that culminated in the model code entitled, "Uniform Electronic Transactions Act"⁵ that led to enactment of the federal Electronic Signature law in the first place.

7. What are the lessons to be learned from the retail electricity competition efforts of other countries? Are there other formerly-regulated industries in the U.S. (e.g., natural gas) that allow customer choice and provide useful comparisons to retail electricity competition? If so, what are the relevant insights or lessons to be learned?

The exit of the utilities from the merchant function is best demonstrated through the telephone company. Only by separating these retail customers from the utility, as AT&T was forced to do, do you begin to get deregulation. Good examples of this coming to fruition in the utility industry are Texas and segments of PA, and Georgia gas customers.

NEM reiterates our commitment to working with the Commission and the other stakeholders to devise fair and effective ways to implement the competitive restructuring of retail electric markets.

Respectfully submitted,



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⁵ Over 40 states have adopted electronic transaction legislation in response to the National Conference of Commissioners on Uniform State Laws initiative for development of a model code entitled, "Uniform Electronic Transactions Act." The full text of the Uniform Electronic Transactions Act is available on the NEM Website, www.energymarketers.com.