

JERROLD OPPENHEIM, ESQ.  
57 MIDDLE STREET  
GLOUCESTER, MASSACHUSETTS 01930  
+1 (978) 283-0897  
Fax +1 (978) 283-0957  
[JerroldOpp@tgic.net](mailto:JerroldOpp@tgic.net)

CHARLES HARAK, ESQ.  
18 TREMONT STREET, SUITE 400  
BOSTON, MASSACHUSETTS 02108  
(617)-742-5554  
Fax (617) 523-7398  
[charak@nclc.org](mailto:charak@nclc.org)

JOHN HOWAT  
NATIONAL CONSUMER LAW CENTER  
18 TREMONT STREET, SUITE 400  
BOSTON, MASSACHUSETTS 02108  
(617)-523-8010  
Fax (617) 523-7398  
[jhowat@nclc.org](mailto:jhowat@nclc.org)

April 23, 2001

Donald S. Clark  
Office of the Secretary  
Federal Trade Commission  
600 Pennsylvania Ave., N.W.  
Washington, D.C. 20580

RE: V010003 – Comments Regarding Retail Energy Competition

Dear Secretary Clark:

Enclosed, pursuant to arrangements with Michael Wroblewski of the Office of Policy Planning, are six copies of the Comments of the Utility Workers Union of America (UWUA) and the Massachusetts Union of Public Housing Tenants (MUPHT).

If you have any questions, please do not hesitate to contact either of us.

Respectfully,

Jerrold Oppenheim

Copies by e-mail:  
[retailectricity@ftc.gov](mailto:retailectricity@ftc.gov)  
[mwroblewski@ftc.gov](mailto:mwroblewski@ftc.gov)  
[jhilke@ftc.gov](mailto:jhilke@ftc.gov)



Island. Most of the factual information in these Comments is therefore drawn from those states. We address the Commission's questions with a national perspective, rather than one limited to any one particular state.

We do not necessarily endorse retail electricity competition. Indeed UWUA has long been on record as opposing retail competition. States that have not implemented retail competition should at least wait. However, if retail competition is adopted, consumer protections must be adopted at the same time. The needed protections include:

- Vigorous enforcement by the Federal Energy Regulatory Commission (FERC) of the requirement that wholesale rates be "just and reasonable." This enforcement could resolve most of the pricing unfairness that has so far characterized retail electricity competition.
- However, whether or not FERC performs its statutory duties, states have the tools to address the issues that we have identified. No further Congressional action is needed to enable the states to act in their citizens' interests.
- States suffering from volatile prices should build, or order their utilities to build, generating plant to both serve as a benchmark and act as a physical hedge against price-gouging and market gaming. At the same time, states should halt further plant divestitures. Added cost-of-service supply would thus discipline the market.
- Large state-supervised investments in demand management, particularly energy efficiency and inverted rates, will also provide needed market discipline.
- States should also supervise utility portfolio management to assure such practices as hedging and long-term contracting are taken to assure stable prices.
- Low-income customers need relief in the form of payment assistance and protections such as shut-off moratoria.
- The price gap between residential and industrial customers should be rolled back to a reasonable, cost-based level, and frozen (as in Connecticut).
- Service quality standards and inspection and maintenance guidelines must be set to restore service to pre-competition levels. These standards and guidelines should be enforced with meaningful penalties.
- Regulators need new tools to address newly created consumer vulnerabilities, such as slamming, misuse of personal information, and failure to disclose the terms of sale.

The Utility Workers Union of America (UWUA) represents 50,000 working men and women at utilities across the United States. Its members answer customer calls, read meters, operate fossil and nuclear power plants, maintain and repair lines, and carry out load planning and engineering tasks. Since 1996, UWUA has warned that retail competition would lead to higher, more volatile prices; create the risk of more frequent outages; and result in layoffs not only for utility workers but also for workers in energy-intensive industries. UWUA has played an active role in the public debate over retail competition, by: meeting with state and federal legislators; commenting in state and federal proceedings (including written comments on the U.S. Department of Energy's Power Outage Study Team ["POST"] Report and as an invited speaker at follow-up POST hearings); and intervening in key restructuring cases (including a California Public Utilities Commission case in which UWUA convinced the commission not to allow Southern California Edison's proposed sale of the Mohave Generating Station to an unregulated merchant owner). UWUA sees retail competition as a threat to the economic well-being of working families and seniors across America; to energy-intensive businesses such as mining, smelting, and paper-making; and, ultimately, to the overall economy.

The Massachusetts Union of Public Housing Tenants (MUPHT) is the oldest state-wide association of public housing tenants in the United States. Its 13-member board is elected from tenants who live in public or subsidized housing. MUPHT has been formally recognized and funded by the state's housing agency (the Department of Housing and Community Development), and also recognized by the federal Department of Housing and Urban Development as a partner in drafting of regulations and policies. MUPHT has long been active in a range of energy and utility issues, including funding of the Low-Income Home Energy Assistance Program and the setting of public housing utility allowances. The public housing tenants whom MUPHT represents are predominantly senior citizens living on small, fixed incomes and families with low-wage jobs. They can ill-afford any increases in energy prices.<sup>1</sup>

In the next section, we describe how wholesale electricity prices have become higher and more volatile with the introduction of retail competition. We also show that choice is available to residential customers only at very high prices. In section III, we show how the stability and reliability of the electricity system has deteriorated, causing broad disruption as well as job

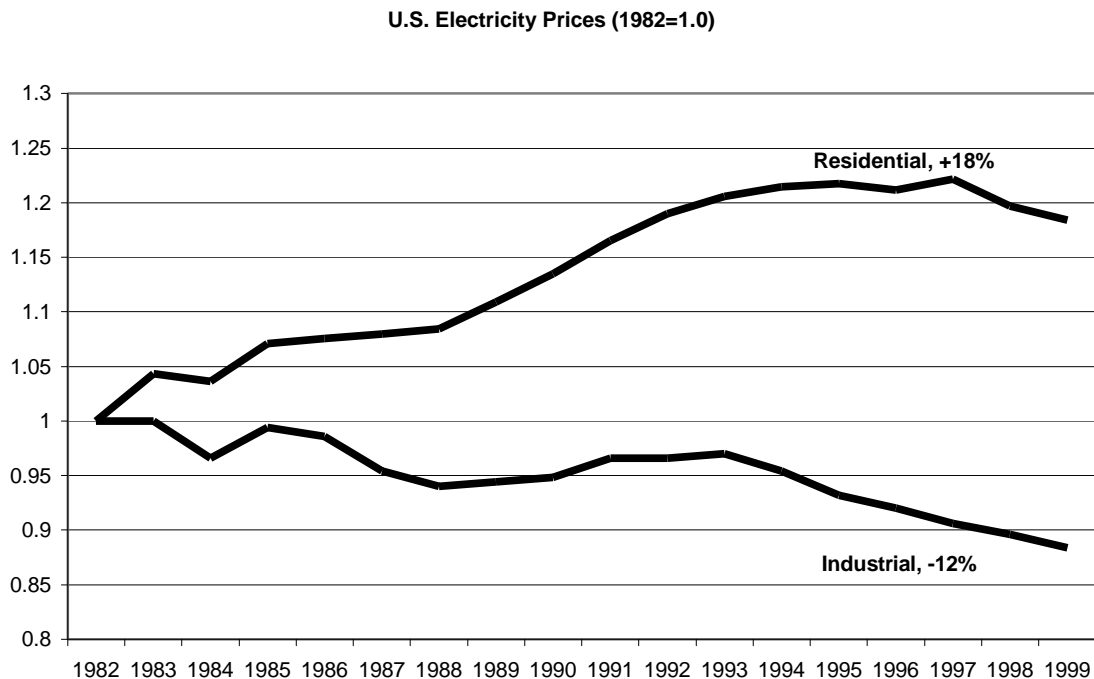
---

<sup>1</sup> MUPHT is represented in this filing by John Howat of National Consumer Law Center (NCLC). NCLC is a non-profit organization dedicated to protecting the rights of low-income Americans in the marketplace. Since its founding in 1969, the Center has addressed consumer issues that affect the poor, including the affordability of basic utility services and utility programs for low-income customers.

losses inside and outside the electricity industry. Each section concludes with a description of remedies for the problems described. Section IV sets out the opportunity for new consumer abuses created by retail competition and briefly describes protections that should be created. Section V, the Conclusion, advises that states take no further action toward retail competition until the current experiments yield more positive information.

**II. Wholesale electricity prices have become higher and more volatile. Choice is available to residential customers only at very high prices.**

The political movement for retail electricity competition began with large industrial customers. Not satisfied with the substantial price reductions they obtained in the regulatory process over the last twenty years, these customers thought they saw an opening to shift even more of the costs of the electricity system to smaller customers. As this chart shows, the 1980s and 1990s brought a series of price drops to electricity utilities' industrial customers while residential prices continued to climb.



Source: U.S. Energy Information Administration

In the debate over retail electricity competition, consumers were offered lower prices as part of the deregulation bargain -- in most cases guaranteed for a period by statute, then promised thereafter as an inevitable

consequence of competition. Consumers were also offered choice, the ability to choose an electricity supplier, though not because any consumer had asked for it. Indeed, after the confusion of telephone deregulation and the proliferation of telemarketed long distance offers, most consumers yearned for fewer utility choices rather than more. Furthermore, with electricity prices already among the lowest in the world and declining slowly, there was little clamor among non-low-income residential consumers for lower prices.

RESIDENTIAL PRICES Country	ELECTRICITY	
	per kWh 1999	compared to U.S.
Argentina	\$0.141	174%
Australia (1997)	\$0.080	99%
Brazil (1998)	\$0.128	158%
Chile	\$0.090	111%
Denmark	\$0.207	256%
France (1998)	\$0.129	159%
Germany	\$0.152	188%
Greece	\$0.090	111%
Ireland	\$0.117	144%
Japan	\$0.212	262%
Netherlands	\$0.132	163%
UK	\$0.117	144%
US	\$0.081	100%

Source: U.S. Energy Information Administration

As it has turned out so far, nearly all consumers have received neither lower prices nor choice as a result of retail competition.

California, of course, is the most dramatic failure of retail electricity competition. Wholesale electricity prices that were as low as 2.1 cents per kilowatthour (kWh) in February 1999 spiked to 31.7 cents per kWh in December 2000<sup>2</sup> and are projected to jump further this summer to 64.5 cents.<sup>3</sup> Blackouts have rolled across the state.<sup>4</sup> Plants have closed all over

<sup>2</sup> California Independent System Operator, Department of Market Analysis, "Report on Real Time Supply Costs Above Single Price Auction Threshold: December 8, 2000-January 31, 2001," Appendix C (Feb. 28, 2001).

<sup>3</sup> NYMEX futures price for August delivery at Palo Verde, at April 20, 2001. At least one University of California economist (Peter Navarro) predicts the spot price will hit \$2.00. Associated Press, "Wholesale cost of power may double," Boston Globe at A15 (April 22, 2001).

the West, putting their employees out of work.<sup>5</sup> Ironically, large industrial customers have been plagued with skyrocketing prices along with everyone else.

But California's experience is not unique. The drama of California's debacle should not cover-up the universal failure of retail competition to date:

- Massachusetts retail default price increases have wiped out the 15% rate cut provided by statute, as New England wholesale prices almost tripled. And there are no alternatives for residential consumers.<sup>6</sup> High and volatile wholesale prices have sent potential competitors packing.<sup>7</sup>
- Con Ed residential customers suffered a 43% rate increase last June. Now the New York ISO predicts summer wholesale prices will rise another 46% by 2005.<sup>8</sup>
- In the first state with retail competition, Rhode Island, competitors entered the market with price increases.<sup>9</sup> They later fled the state altogether.
- Instead of adopting immediate 15% price reductions, as California and Massachusetts did, Pennsylvania left its prices higher than regulation would have set them. For a while this brought competition. But as wholesale prices have risen, low-priced

---

<sup>4</sup> E.g., Lynda Gorce, "Another day in the dark for Californians," Boston Globe at A3 (Jan. 19, 2001); Rebecca Smith et al., "California Power Crisis: Blackouts and Lawsuits and No End in Sight," Wall St. Journal at A1 (Jan. 19, 2001).

<sup>5</sup> E.g., Robert Gavin, "Power Crunch Roils Other Western States," Wall St. Journal at A2 (Jan. 24, 2001); Bloomberg News, "Phelps Dodge Says Energy Costs May Force Layoffs," New York Times at C3 (Jan. 26, 2001).

<sup>6</sup> E.g., Peter Howe, "Mass. Electric to hike rates up to 69%," Boston Globe at C1 (April 3, 2001); Peter Howe, "Few in Mass. switch electric suppliers," Boston Globe at E9 (Jan. 11., 2001); Massachusetts Division of Energy Resources, [www.state.ma.us/pub\\_info/migrate.htm](http://www.state.ma.us/pub_info/migrate.htm).

<sup>7</sup> Bruce Mohl, "Utility.com stops taking customers," Boston Globe at C1 (Dec. 29, 2000).

<sup>8</sup> A. Sullivan and N. Hegedus, "Con Ed Customers Get Tough Lesson on Deregulation," Wall St. Journal at B6 (Aug. 23, 2000); J. Covert, "Mismanagement of NY Power Market Costs Millions – Utilities," Dow Jones Newswire (Oct. 5, 2000); A. Caffrey, "New York Energy Prices May Rise Sharply by '05," Wall St. Journal at A10 (April 18, 2001).

<sup>9</sup> Bob Wyss, "New utilities charge more, not less, for power," Providence Journal-Bulletin, p. A-1 (June 29, 1997). At least one supplier, New Energy Ventures, declined to provide power there. Jeffrey Krasner, "For Real Competition in Energy Market, the Price Isn't Right," Wall St. Journal, p. NE3 (Dec. 31, 1997).

competitors have fled every service territory except the one around Philadelphia.<sup>10</sup>

- According to FERC data, wholesale prices since 1997 have more than doubled in Chicago, the Upper Midwest, New York, and New England; almost tripled in some parts of the South and more than tripled in other parts; and quadrupled in Texas.<sup>11</sup>
- Wholesale prices in the Midwest, usually around two or three cents per kWh, skyrocketed to \$7.50 on June 25, 1998.<sup>12</sup>
- In the place where retail electricity competition originated, the United Kingdom, promised savings of ten percent evaporated. After the first year, the regulator conducted an independent audit and found (in one of the service territories) one competitor offering a price discount of two percent. Two others matched the utility's price. The remaining 12 offered price increases, as high as five percent.<sup>13</sup> Not surprisingly, only six percent of consumers switched suppliers.<sup>14</sup> Wholesale power generation costs have dropped 50 percent but retail prices have barely changed.<sup>15</sup> Furthermore, "Poorer people don't benefit as much from deregulation as the middle class because of poor information and less favourable offers," Richard Hunt, spokesman at Britain's energy regulator Ofgem, told Reuters.<sup>16</sup>

Perhaps the most striking characteristic of the short history of retail electricity competition has been the volatility of prices. As noted above, California is the most dramatic:

---

<sup>10</sup> E.g., Christian Berg, "Only discount power supplier for much of state pulls out," Lehigh Valley Morning Call at A1 (Jan. 23, 2001).

<sup>11</sup> R. Smith and J. Fialka, "Electricity Firms Play Many Power Games That Jolt Consumers," Wall St. Journal at A1 (Aug. 4, 2000).

<sup>12</sup> Staff Report to the Federal Energy Regulatory Commission on the Causes of Wholesale Electricity Pricing Abnormalities in the Midwest During June 1998 at Fig. 3-5 (Sept. 22, 1998).

<sup>13</sup> "Electricity savings compared," OFFER survey published in Utility Week at 22 (June 11, 1999).

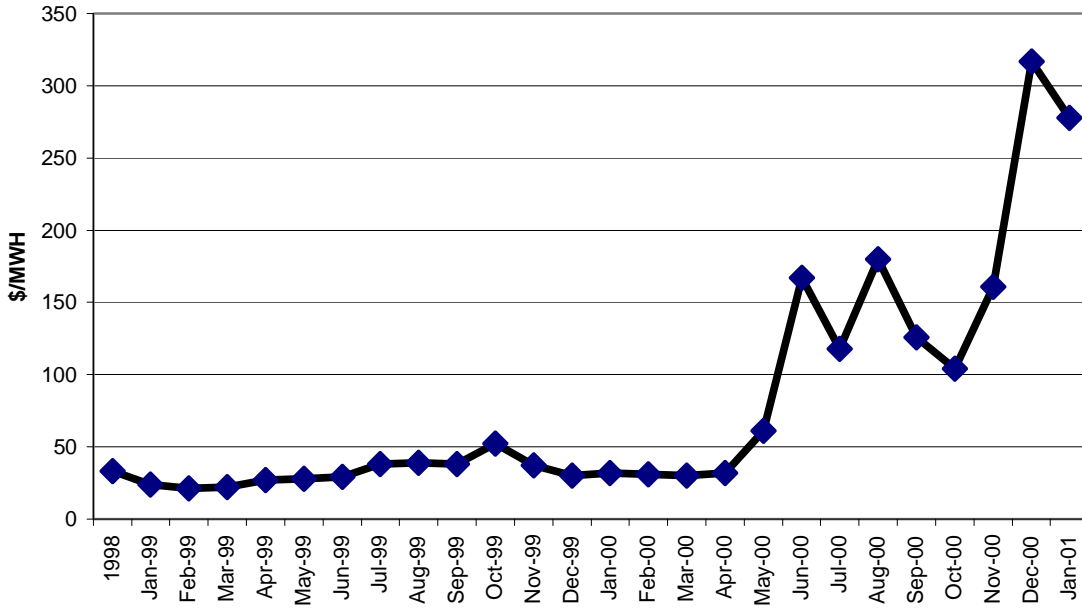
<sup>14</sup> "Electricity Shake Up Leaves Consumers Confused," press release of Consumers' Association, [www.which.net/whatsnew/pr/may99/general/confused.html](http://www.which.net/whatsnew/pr/may99/general/confused.html) (May 24, 1999).

<sup>15</sup> M. Champion, "As Britain Recasts Its Power Markets, Others Take Notes," Wall St. Journal at A13 (Aug. 21, 2000).

<sup>16</sup> "Europe's power deregulation benefits poor least" (Reuters July 17, 2000).

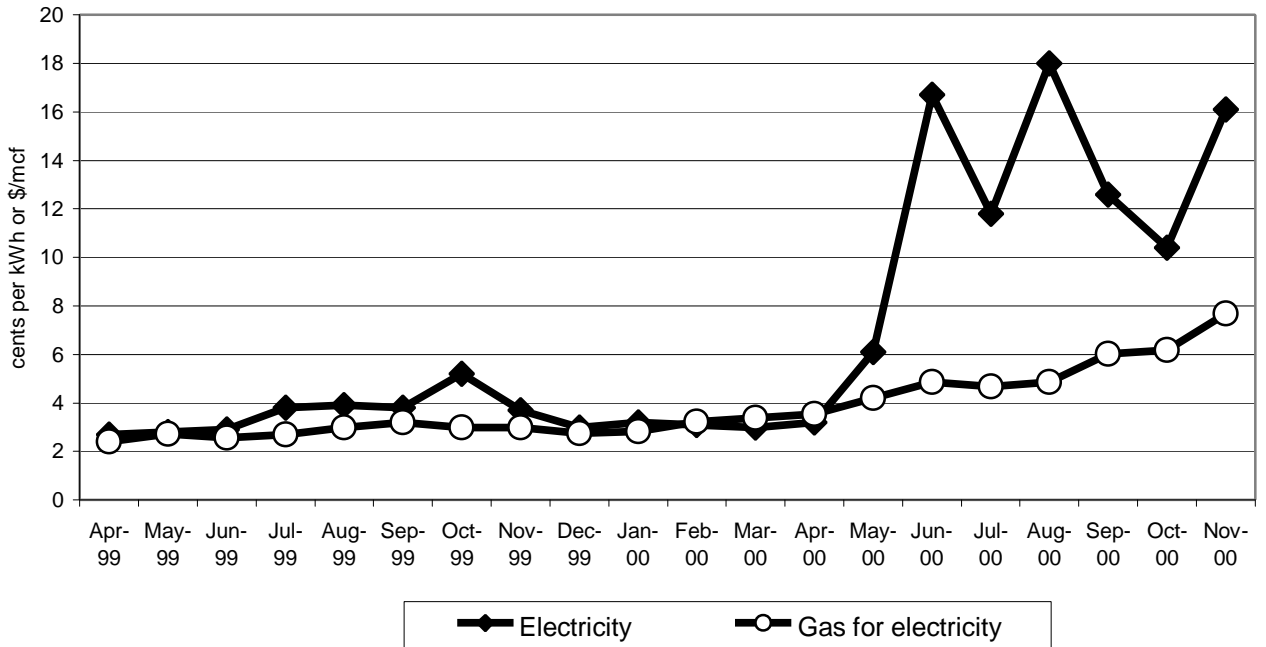


California Wholesale Electricity: 1998-1999 averages \$33, and then ...



Although gas prices have been blamed for this, less than 15% of California generation is gas-fired. In any event, the electricity price spike did not follow gas prices:

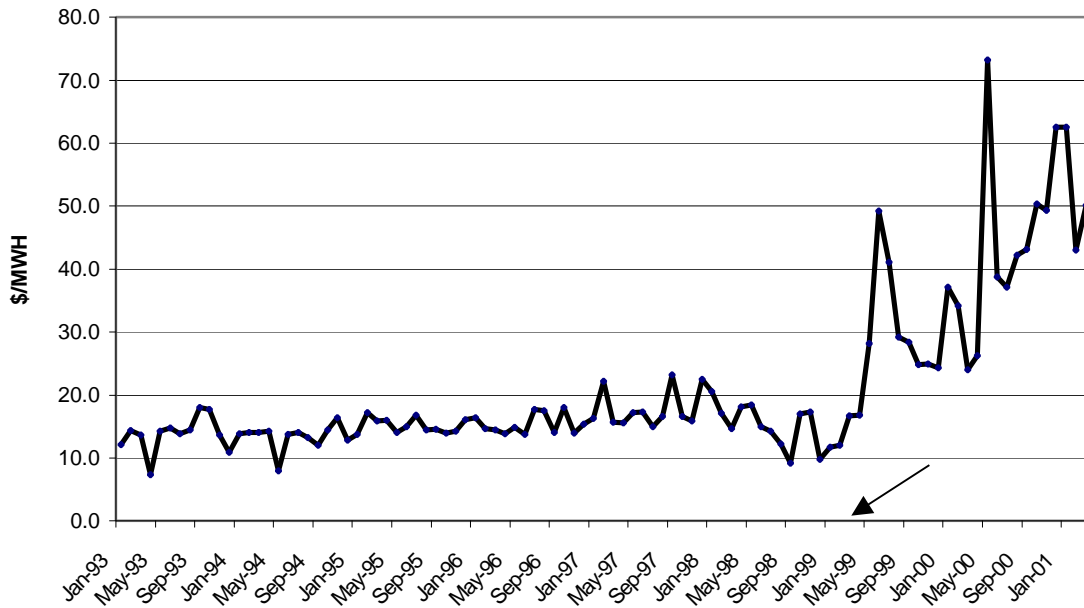
### California Prices



Sources: California ISO, U.S. Energy Information Administration.

Similarly, price volatility in New England increased 50 percent. In the six-and-a-third years before the market opened, high average monthly prices averaged 1.9 times the lows, reflecting cost differentials among plants responding to various demand levels. This has increased to 3.0 times, with no apparent change in cost relationships other than fuel prices. The chart below shows that not only are New England prices thus 56 percent more volatile, but the general price level is also 2.7 times the average price before competition.

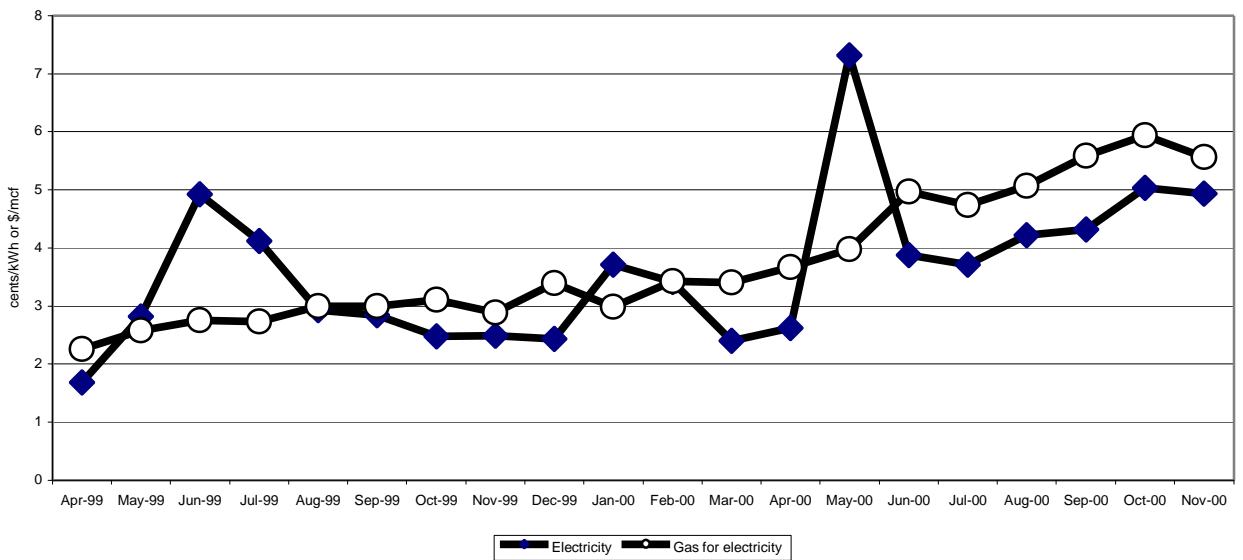
**New England Average Monthly Wholesale Electricity Price**



Source: ISO-New England

Gas and oil account for less than half of New England generation. New England competitive wholesale electricity prices did not track gas prices:

**New England Prices**



Source: ISO-New England, U.S. Energy Information Administration

Rising and more volatile prices are thus not entirely caused by costs such as fuel costs. Furthermore, loads were stable in this period. At least three studies suggest pricing has been controlled by the market players themselves. In New England, power plant operation and maintenance expenses were cut about 40% and power plant outages increased 47%.<sup>17</sup> This suggests the possibility of generation owners withholding power to create a shortage to raise prices. In New York, market power (withholding power from the market) has contributed to rising prices.<sup>18</sup> In California, the excess of generation prices over generation costs in two months alone totaled \$565,000,000.<sup>19</sup> For example, Southern California Edison's Mohave Station in Laughlin, Nevada, produces power for SoCalEd customers at about 3.5 cents per kWh but it would have sold power to Californians at about ten times that amount if AES had been allowed to buy it.<sup>20</sup>

There may nevertheless be some benefits for a few non-residential customers. For the 7% of Massachusetts large commercial and industrial customers that have found an alternative,<sup>21</sup> lower prices seem to be available. But only 0.1% of residential customers have found an alternative and there are no competitors in the residential market right now. Even the internet-based companies that had been marketing almost exclusively to residential customers, Utility.com and Essential.com, have abandoned Massachusetts.<sup>22</sup>

Rising and volatile prices pose a particular burden for low-income consumers, who are already at or beyond the limit of what they can pay for energy. The

---

<sup>17</sup> Synapse Energy Economics, "Generator Outage Increases: A Preliminary Analysis of Outage Trends in the New England Electricity Market" (Union of concerned Scientists, January 2001).

<sup>18</sup> NYDPS Pricing Team, "Interim Pricing Report on New York State's Independent System Operator" (December 2000). Accord, J. Stutz et al., Comments of the Public Utility Law Project on the DPS Staff Interim Pricing Report (January 2001); A. Caffrey, "New York Energy Prices May Rise Sharply by '05," Wall St. Journal at A10 (April 18, 2001); A. Sullivan and N. Hegedus, "Con Ed Customers Get Tough Lesson on Deregulation," Wall St. Journal at B6 (Aug. 23, 2000); J. Covert, "Mismanagement of NY Power Market Costs Millions – Utilities," Dow Jones Newswire (Oct. 5, 2000).

<sup>19</sup> California Independent System Operator, Department of Market Analysis, "Report on Real Time Supply Costs Above Single Price Auction Threshold: December 8, 2000-January 31, 2001," Appendix C (Feb. 28, 2001).

<sup>20</sup> The purchase was rejected by the California Commission in docket 99-10-023 (December 2000).

<sup>21</sup> Massachusetts Division of Energy Resources; see note 6 above.

<sup>22</sup> Id.

average low-income consumer devotes 19% of household income to energy – almost four times the burden on the median American family and 36% more than before the recent spikes in oil and natural gas prices.<sup>23</sup> For the poorest of these families, most of whom are elderly or single-parent households, the burden is a quarter of their income or more. An increase in electricity bills on top of other increased energy bills is simply not manageable without cutting back on food expenditures, falling into arrears on rent, or going without needed medicines. This is made even more difficult by dropping incomes and decreased predictability due to price volatility,

Despite the recent economic boom, low-income family incomes are falling. The inflation-adjusted incomes of the poorest 20% of the American population dropped 7% over the last two decades while the richest 20% have become 33% richer:



Low-income Americans frequently encounter price discrimination and other unfair practices targeted at their communities:

<sup>23</sup> Meg Power, *The Winter Energy Outlook for the Poor: Low-Income Consumers' Energy Bills in the Winter of 2000-2002* (Economic Opportunity Studies, December 2000).

- One study found that supermarkets (when they locate in low-income neighborhoods at all) charge 36 percent more for produce of a quality that would never sell in a middle-class suburb.<sup>24</sup>
- Some vocational schools pay more attention to student loan paperwork than to education.
- Indeed, some industries seem to exist only for the purpose of exploiting low-income consumers, such as with short-term payday loans at 531 percent interest; rent-to-own stores that in effect charge similar credit fees; check cashing agencies that (at two to six percent of the face value of a check) charge more than it would cost to operate a bank account; and used car dealers with warranties such as “five minutes or fifty feet.”
- Pre-paid local telephone service providers offer to re-sell a diluted version of the incumbent’s local phone service for triple the price. In Ohio, for example, pre-paid providers applied to offer service for \$50 a month after a \$50 installation fee; the degraded serviced would include no directory assistance, no operator service, no long distance, and no other service for which payment could only be collected after the service is rendered. The current telephone company in Ohio offers full service to low-income customers for \$15 a month and no installation charge.<sup>25</sup>

Although high and volatile electricity prices coupled with reduced reliability are especially difficult for low-income families, they are unacceptable for all sectors of the society. Alfred E. Kahn, an economist at Cornell University and Chair of the New York State Public Service Commission in the mid-1970's, helped oversee the creation of free markets in the rail, trucking and airline industries as well as the electricity industry. He now says: “I am worried about the uniqueness of the electricity markets. I’ve always been uncertain about eliminating vertical integration.... It may be one industry in which it works reasonably well.” He also said that although he thinks free markets do

---

<sup>24</sup> D. Caplovitz, The Poor Pay More (The Free Press 1967); D. D. Troutt, “The Thin Red Line/How the Poor Still Pay More” (Consumers Union 1993).

<sup>25</sup> Unlike in many other states, the application was rejected in Ohio. NOW Communications, Inc., et al., Public Utilities Commission of Ohio docket 98-1466-TP-ACE et al. (decided Nov. 2, 2000).

a better job managing rail, phone and airline prices, they have yet to match regulators' ability to juggle the complexities of electricity.<sup>26</sup>

The Wall Street Journal sees the current volatility more caustically and recently summed up the situation this way:

It's a market ripe for manipulation: surging demand for an indispensable commodity, weak oversight and a chaotic new set of rules.... The tactics include manipulating wholesale electricity auctions, taking juice from transmission systems when suppliers aren't supposed to and denying weaker competitors access to transmission lines.... In the case of the Midwest where prices in July 1999 hit \$9,000 per megawatt-hour [\$9.00 per kWh], it was as if a \$1.89 gallon of gasoline sold for \$567.<sup>27</sup>

No wonder utilities such as KeySpan and Northeast Utilities say prices must rise for competition to "work." "[C]ertain consumers may have to pay higher prices, before they pay less. ... If residential customers' regulated rates increase, it will give them the incentive to look to marketers for better prices, and marketers would have an opportunity to look to them for profits."<sup>28</sup>

Electricity trader Catherine Flax, Vice President of Morgan Stanley, recently conceded to the Vermont Public Service Board, pointing to airline deregulation price data as an example, that introducing competition raises average prices and makes them more volatile. The advantage she points out is that a few customers can reduce the prices they pay.<sup>29</sup> Dynegy Chairman Chuck Watson frankly sees price volatility as a profit opportunity.<sup>30</sup>

---

<sup>26</sup> J. Kahn, "Economic View: Utility Deregulation: Square Peg, Round Hole?" New York Times (March 4, 2001).

<sup>27</sup> R. Smith et al., "Electricity Firms Play Many Power Games That Jolt Consumers," Wall St Journal at A1 (Aug. 4, 2000).

<sup>28</sup> KeySpan CEO Robert Catell in speech to NEMA conference (April 3, 2001), [www.pulp.tc/NEMAKEYSpan.pdf](http://www.pulp.tc/NEMAKEYSpan.pdf). See "Is deregulation supposed to raise prices?," New Haven Register editorial (March 12, 2001).

<sup>29</sup> Discussion of "Competitiveness of Regional Wholesale Power Market/Evolution of Competition" presentation, New England Wholesale Market Roundtable in docket 6330 (Montpelier, April 12, 2001).

<sup>30</sup> Rebecca Smith, "Power Traders See Profits Rise On High Prices," Wall St Journal at A3 (April 18, 2001).

## Predictable

A little analysis and a review of the experience in other industries might have led policymakers to predict the high and volatile prices that have occurred. Indeed, as noted above, UWUA President Don Wightman did so in 1996.<sup>31</sup>

Competitive long distance telephone carriers incur customer acquisition (marketing) costs of \$75 and up per customer. Such costs would overwhelm any potential generation efficiencies available from competition – the entire average residential electricity generation bill is only about \$200. In fact, in most states currently, electricity marketer margins are negative. Thus almost no competitors in any state are willing to bear the costs and risks of selling electricity to residential consumers. Indeed, competitive supplier Duke Energy warned that retail competition would be limited by costly barriers to entry, including the need for state-of-the-art billing systems, and margins that will be "very low."<sup>32</sup> Another supplier, Enron, warned the Massachusetts Department of Public Utilities<sup>33</sup> not to expect a lot of competition for the residential sector: "safety net responsibility lies with the distribution company. . . it's a very difficult market." Supplier New Energy Ventures made a similar prediction, explaining that "In the competitive marketplace there's choice on both sides."<sup>34</sup>

Thus, once he left the presidency of the California Public Utilities Commission, Daniel Fessler expressed his opinion that it was dishonest to promise electricity price reductions from restructuring: industry has no obligation, he said, to "shield small customers from reality."<sup>35</sup> Current Texas

---

<sup>31</sup> Utility Workers Union of America, "Toward A Utility Industry That Works for Everyone" (March 1996). See also J. Oppenheim, "Potential Costs of Competition: A Customer Perspective -- Brownouts, Death Spirals and Alternatives," in S. Limaye, ed., Utility Opportunities for New Generation (Washington and Palo Alto: Edison Electric Institute and Electric Power Research Institute, 1989).

<sup>32</sup> "Duke Energy planning on retail margin that are [sic]very low'," Restructuring Today, p. 1 (Oct. 10, 1997).

<sup>33</sup> Now the Department of Telecommunications and Energy. Docket 96-100 (1997).

<sup>34</sup> Id.

<sup>35</sup> "Former CPUC president doubts lower prices to come from choice," Restructuring Today, p. 1 (Apr. 7, 1997), quoting Daniel Fessler at a conference sponsored by The Electricity Journal.



Commissioner Perlman confirms this view: “The promise of SB 7 [electric deregulation] is not lower prices; it is about innovation and market prices.”<sup>36</sup>

The economics of the electricity industry made the current volatility easy to predict, too. Electricity cannot be stored, but supply and demand must be kept in instantaneous balance to physically protect the grid. Electricity must therefore be produced on demand from large and costly generation plant. Plant additions cannot be finely tuned to meet demand, either. Economics have dictated relatively large investments. Any investor risking a large sum of capital wants some assurance of its return. Thus the incentive is to not invest until a shortage makes it almost certain that the output from a new investment will be purchased. Such a shortage also increases prices – the price signal to build new plant that some economists find hopeful about the California disaster. Eventually, enough plant is built to fill the demand, a surplus may develop, and prices drop – until the next cycle of shortage and investment attracted by skyrocketing prices. In this way, especially given the lumpiness of generation investment, price volatility is an inevitable component of a market system. “[R]apid deregulation of the ... power sectors have also reduced the incentives for specific businesses to invest in ... excess capacity that can help smooth markets during times of disruption or unexpected volatility in demand growth.”<sup>37</sup>

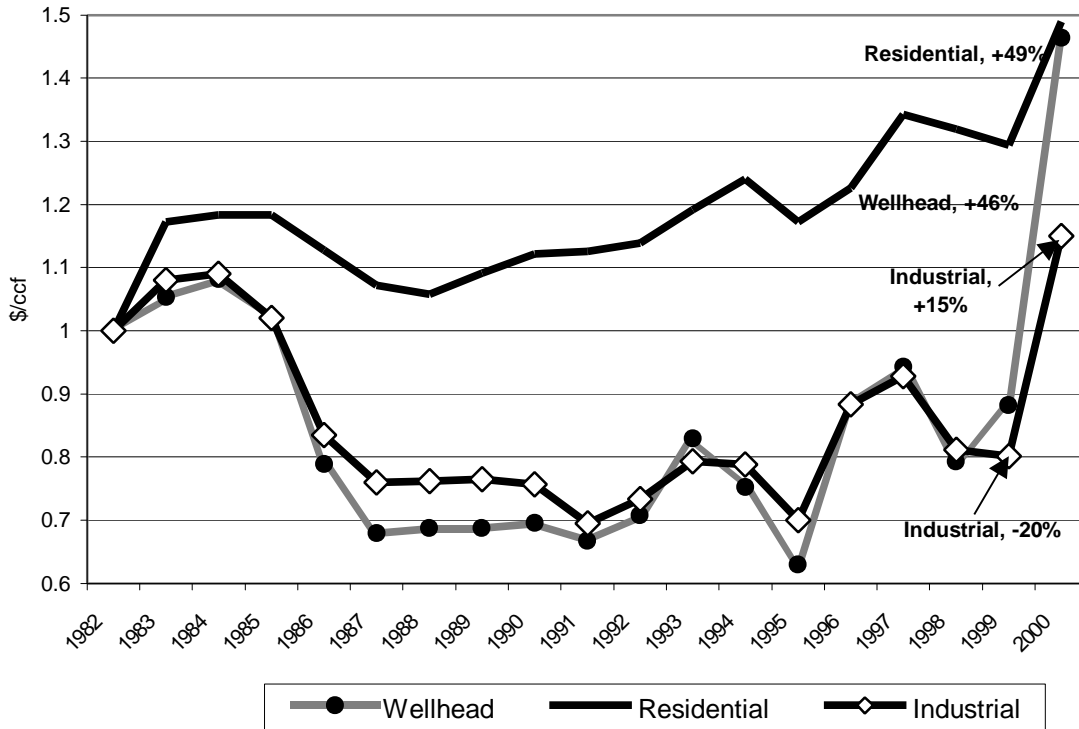
In addition, the history of other deregulated industries demonstrates the risks of market segmentation that raises prices for those with the least power in the marketplace. Most of the benefits of natural gas deregulation, for example, have gone to industrial customers. Residential customer price increases tracked recently spiking wellhead prices, but earlier wellhead price decreases went to industrials:

---

<sup>36</sup> At Gulf Coast Power Association speech (Sept. 19, 2000), quoted in Clark, Thomas & Winters, Electric Update at 12 (Sept. 21, 2000).

<sup>37</sup> Edward Morse, Chair of Independent Task Force, et al., “Strategic Energy Policy Challenges for the 21<sup>st</sup> Century” (Council on Foreign Relations, 2001). While these commenters do not agree with CFR’s overall support for retail competition, CFR makes the key point that an unregulated market has no incentive to build adequate supply (inventory, in CFR’s terms) to assure reliability and minimize price volatility.

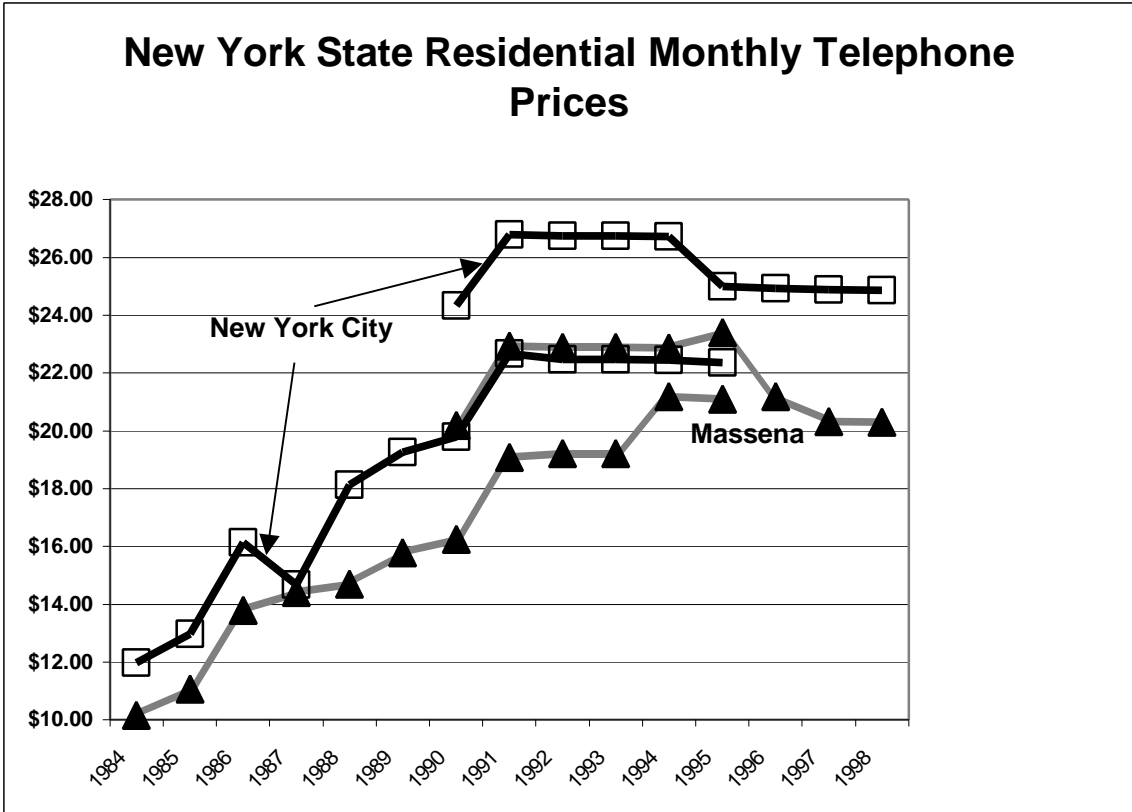
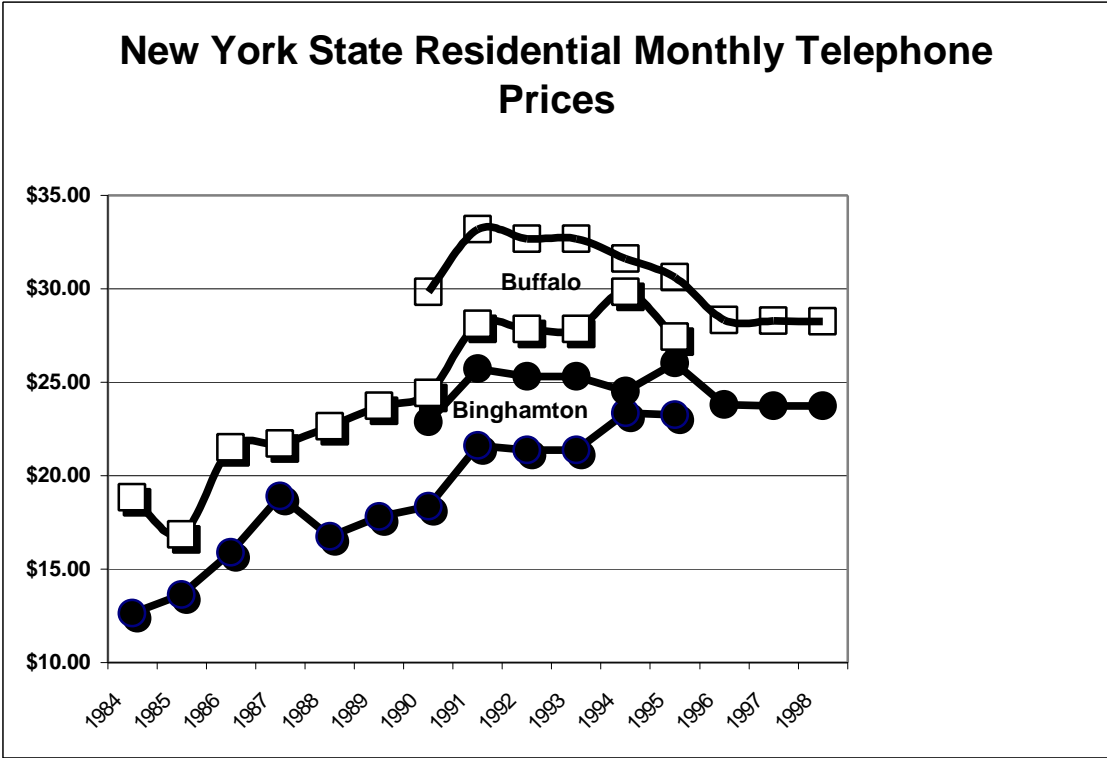
U.S. Natural Gas Prices (1982=1.0)



Source: U.S. Energy Information Administration

Similarly, Federal Communications Commission (FCC) data show that, while deregulation brought sharply falling long distance rates for business customers – 50 percent or more -- local residential prices rose even more sharply. For example, as the next two charts illustrate, local rates in New York State jumped 46 percent in Buffalo, nearly doubled in New York City, and more than doubled in Massena.<sup>38</sup>

<sup>38</sup> Two lines are shown for each city because the FCC changed the way it computes the cost of local residential telephone service. Rates in the period covered by the later line (1990-1998) were relatively stable.



Source: Federal Communications Commission

## Remedies

At the Federal level, the obvious remedy to volatile prices that are vastly in excess of cost is for the FERC to enforce the Federal Power Act's requirement that rates be "just and reasonable." This does not include applying "price caps" of \$1.00 per kWh to plants with running costs of 3.5 cents per kWh.

Fortunately, there are several effective tools available to states in the event that the FERC does not act appropriately. The goal of state policy where wholesale electricity prices are out of control should be to bring them under control by using market tools of demand and supply. Reductions of demand, or increases in supply, can have marked impact on the price of generation.<sup>39</sup> Thus massive state-supervised investments in electric energy efficiency are an important tool;<sup>40</sup> private investment in efficiency can also be encouraged by inverted rate structures that reflect the higher costs associated with greater usage. On the supply side, state investments (or state-ordered utility investments) are needed in generating plant.<sup>41</sup> State- or utility-owned plant can be run on a cost-of-service basis which will control prices directly as well as serve as a price benchmark.<sup>42</sup>

The growing disparity between residential and industrial rates, which is based on power in the marketplace rather than cost differentials, should be rolled back and capped. Connecticut adopted a "Cap The Gap" as part of its electricity restructuring statute in order to limit this unfairness.<sup>43</sup>

---

<sup>39</sup> Massachusetts Division of Energy Resources, 1999 Energy Efficiency Activities at Appendix F (Spring 2001, April 12 Draft).

<sup>40</sup> Id.; Robert Gavin, "States Rediscover Energy Policies/Looming Power Crises Spur a Return to Strategies Fostering Conservation," Wall St. Journal at B13 (March 21, 2001); Edward Morse, Chair of Independent Task Force, et al., "Strategic Energy Policy Challenges for the 21<sup>st</sup> Century" (Council on Foreign Relations, 2001).

<sup>41</sup> California Governor Gray Davis proposed a state power authority to build plant. State of the State Address, (Jan. 8, 2001). Others have suggested eminent domain proceedings. Los Angeles Times (April 3, 2001). The New York Power Authority is already building some plants; a group of Assemblymen have proposed a New York City-Westchester County power authority to take over existing plants in those areas. New York Post (April 19, 2001).

<sup>42</sup> Sufficient "inventory" should be established to prevent dislocations. Edward Morse, Chair of Independent Task Force, et al., "Strategic Energy Policy Challenges for the 21<sup>st</sup> Century" (Council on Foreign Relations, 2001). Such a benchmark should be used, for example, by the FERC in setting wholesale rates.

<sup>43</sup> H.B. 5005, sec. 75; Public Act 98-28 (1998).

States should also require utilities to manage their portfolios in a manner that reduces price and price volatility, such as by hedging and long-term contracts. For example, NYSEG has hedged more than 90% of its expected demands for the next two summers.<sup>44</sup> New York State regulatory policy provides an example of what is needed:

Local [gas] distribution companies have many ways to meet their loads; they should consider all available options ... [which] may include short and longer term fixed price purchases, spot acquisitions, the use of financial hedges ... While we are not directing any particular mix of portfolio options, volatility of customer bills is one of the criteria, along with other factors such as cost and reliability, that LDCs should consider ... Any utility without a diversified pricing strategy will have to meet a heavy burden to demonstrate that its approach is reasonable.<sup>45</sup>

Specific low-income protections against price increases and volatility are needed, including payment assistance (rate discounts, cash assistance, budget programs), targeted efficiency programs, and protections against shut-offs.<sup>46</sup>

### **III. The stability and reliability of the electricity system has deteriorated, causing broad disruption as well as job losses inside and outside the electricity industry.**

Much has been written about how California's frequent blackouts and massive price increases have both disrupted daily life, discouraged business investment, and cost jobs. The true economic costs of retail electricity competition in California may never be fully counted.

As the impact of the California debacle cascaded through the western United States, workers have been laid off at smelters, paper mills and mines. A December 2000 study of industry by the Bureau of Business and Economic Research at the University of Montana found that 19 firms will curtail production due to high energy prices. In Arizona and New Mexico, Phelps Dodge gave notice to 2,000 miners that they face layoffs due to high energy

---

<sup>44</sup> Form 8-K at 2 (Sept. 18, 2000).

<sup>45</sup> Statement of Policy Concerning Gas Purchasing Practices at 4-5, Case 97-G-0600 (April 28, 1998).

<sup>46</sup> E.g., Edward Morse, Chair of Independent Task Force, et al., "Strategic Energy Policy Challenges for the 21<sup>st</sup> Century" (Council on Foreign Relations, 2001).

prices. Washington State predicts that "43,000 jobs could be lost over the next three years."<sup>47</sup> Kaiser Aluminum, at its Mead aluminum plant near Spokane, decided to sell electricity for \$400 million rather than keep production going, idling 600 workers. Montana Resources closed its copper mine in Butte, displacing 325 workers. Georgia Pacific West shut down its paper mill in Bellingham, Washington last year, idling another 600 workers, all due to high energy prices. Bellingham Cold Storage temporarily shut down half its operation and laid off 270 workers. Now Bonneville Power Authority is asking Northwest aluminum smelters – nearly 40% of U.S. capacity – to close for two years.<sup>48</sup>

Furthermore, as noted in section II, the investment cycle desired by generators in a competitive market requires such periods of shortages. From consumers' points of view, shortages not only result in raised prices but they also bring blackouts, both of which have broad adverse economic impacts. For example, the City of Melrose, Massachusetts, predicts that increased energy costs (\$300,000) and increased health insurance costs will eat up the entire year's growth in property tax revenues, eliminating its ability to add new positions in any school or City department.

As described above, merchant plant owners and marketers consciously withhold power until prices spike, leading to rolling blackouts. Merchant plant owners also run their plants without respite if the prices are right, resulting in too many plants being out when prices drop. The plants have often been run too hard, and need longer to be brought back on line. Both Massachusetts and California plants have been out about 50% more than before the advent of retail competition.

The reliability of the grid is also affected by competitive generators' attempts to use it in ways for which it was never designed. A series of wholesale trades nearly caused the Tennessee Valley Authority (TVA) system to collapse in August 1999 as a grid that was built to exchange power among a relatively small number of large monopoly generation utilities was bombarded with unanticipated transmission demands that complicated flows in ways for which the system was not designed. Last summer 180 wholesale transactions were rejected to preserve reliability. The alternative could be blackouts caused by load imbalances.<sup>49</sup>

---

<sup>47</sup> Wall St. Journal (March 13, 2001).

<sup>48</sup> John McKinnon, "Agency Request to Shut Smelters Revives Conflict Issue for O'Neill," Wall St. Journal at A16 (April 20, 2001).

<sup>49</sup> John Fialka, "Electricity Facilities Sprout Near Tiny Tennessee Town," Wall St. Journal at A2 (April 17, 2001).

Another unintended consequence of retail electricity competition has occurred at the distribution level of utilities. As they prepared for competition, many utilities slashed their maintenance budgets by laying off workers. In a recent survey of its locals, the UWUA found that staffing levels across the country are down about 35% compared to 1991. Last year, DOE's Energy Information Administration also found 35% fewer workers over the prior ten years. UWUA members consistently note serious problems connected to these staff cuts:

- utilities perform inspections less frequently;
- necessary but non-emergency repairs are deferred, sometimes indefinitely;
- retiring workers are often not replaced;
- some companies are cutting back on training programs for new employees.

Workers are worried about system reliability, their own safety, and the safety of the public.

The industry infrastructure is aging and in need of continuous maintenance.<sup>50</sup> Distribution system upgrades are needed not only to replace old and defective equipment but also to keep up with increasing loads on pole-top transformers, feeder circuits, and substations.<sup>51</sup> Inspection cycles have doubled or tripled and critical equipment is often in poor condition when eventually inspected. There are neither sufficient numbers of workers nor adequate management systems to follow up on repairs identified through routine inspections. The problems range from poles that are condemned by workers but not replaced; to load tap changers that are inoperable, affecting proper voltage levels; to uninspected transformers that pose a serious risk of exploding. Field workers across the country observe that cables are tested less frequently; that substation and manhole inspection cycles are longer; and that condemned poles are often not replaced. Key system components will not perform as they were designed to perform due to age, lack of repair, or both.

---

<sup>50</sup> A May, 1999 report from the East Central Area Reliability Council notes that electric equipment is often so old that the manufacturers have either gone out of business, or no longer stock spare parts or provide service, threatening the ability to make critical repairs. "How the Aging of Major Equipment Affects Reliability," ECAR report 99-EEP-61 ([www.ecar.org/publications](http://www.ecar.org/publications)). See findings of DOE Power Outage Study Team (POST), "Interim Report: Findings from the Reliability Events of Summer 1999" (January 2000), Table S.1, findings 9, 16).

<sup>51</sup> A recent Electric Power Research Institute report notes that the "current power delivery grid is not designed to meet . . . emerging demands." *Electricity Technology Roadmap: Powering Progress* (EPRI, July 1999).

Utilities may experience lengthy delays in replacing failed critical equipment, but are nevertheless cutting back on their inventories to conserve cash. As one example, a utility drastically reduced the ratio of in-stock to in-service transformers, from 15% (1989 through 1996) to 5% (1997 and 1998). While companies may hope that new arrangements with vendors or suppliers can minimize the need for inventory, transformer and other equipment failures often occur during heat waves, when other companies will also seek to purchase the same equipment. Inventory cutbacks may thus place system reliability at risk.

These widespread practices of cutting back on basic maintenance culminated in the summer of 1999 with outages and disturbances described in a special US Department of Energy (DOE) report<sup>52</sup> and occurring in:

- New York City,
- Long Island,
- New Jersey,
- Delmarva Peninsula,
- South-Central States (Mississippi, Arkansas, Louisiana, Texas),
- Chicago,
- New England, and
- Mid-Atlantic.

Commonwealth Edison's own investigative report illustrates problems that are becoming symptomatic of an industry undergoing extreme cost-cutting pressures:

[W]hile ComEd's inspection programs seemed appropriate, there were only imperfect mechanisms in place to ensure execution [of repairs]. . . It is not clear, from a review of the records, how often inspections were actually performed, and the inspections that were performed may have been too passive, too cursory, to truly maintain the system.

Additionally . . . ComEd needs to ensure better follow-up on maintenance requests. While virtually all T&D emergencies are dealt with immediately, there appear to be altogether too many deficiencies which, had they been identified and addressed sooner, would not have

---

<sup>52</sup> DOE Power Outage Study Team (POST), "Interim Report: Findings from the Reliability Events of Summer 1999" (January 2000).



become critical in the first place. . . . [R]outine maintenance requests ... were rarely tracked to ensure follow-up.<sup>53</sup>

As the DOE Report concluded after its review of the summer of 1999, "The overall effect has been that the infrastructure for reliability assurance has been considerably eroded."<sup>54</sup>

In recognition of this erosion, the California Public Utilities Commission recently "barred PGE [Pacific Gas & Electric] and SoCal Ed [Southern California Edison] from cutting costs by laying off employees involved with service and reliability... [The companies] are ordered to rescind any layoffs of employees that are needed to answer calls, read meters, respond to outages and connect new customers." The utilities had planned to layoff 1400 workers.<sup>55</sup>

Retail competition has had additional direct adverse impacts on reliability. Maintaining reliability has become an increasing challenge as the responsibilities of formerly integrated monopolies are spread among diverse players whose responsibilities are not yet clear. With 35% staffing cuts over the past decade, there are simply fewer workers available during emergencies. More critically, however, retail competition depletes industry capacity to respond to major outages. Few, if any, utilities maintain large enough staffs to respond quickly to major outages without drawing upon workers from neighboring or even fairly distant companies. Many have formal mutual aid agreements through which they try to assure that extra help is available when needed. But as utilities restructure, this ability to provide extra workers to draw on has been eroded. Some companies have spun off their service departments (and associated employees) or sold their generating assets (and transferred the skilled generating workers) to independent entities. As a result, mutual aid forces are now seriously depleted. Worker skills are also now more specialized, making it harder to call in extra staff to make outage repairs. When utilities were integrated generation and distribution companies, workers in the generation department were familiar with the entire system and often had first-hand experience working in the distribution department. Now, generation workers

---

<sup>53</sup> A Blueprint for Change: Executive Summary for the Investigative Report By Commonwealth Edison at A-11 (September 15, 1999).

<sup>54</sup> At S-1.

<sup>55</sup> Draft Decision of Ali Wong, Administrative Law Judge, Opinion Regarding the Emergency Motion Seeking to Prevent the Utilities from Implementing Layoffs in A00-11-038 et al. at 1-2 (Feb. 23, 2001, approved by California PUC March 15, 2001).

may be employed by an unaffiliated company and would not necessarily have the skills to perform distribution repairs even if the generation company was willing to lend its staff.<sup>56</sup>

## Remedies

In addition to the remedies discussed in section II, above, state regulators should establish prescriptive service quality standards to guard against the declines in inspection, maintenance and planning efforts that are occurring around the country. The restructuring statute in Massachusetts, for example, mandates the adoption of service quality standards.<sup>57</sup> The legislation requires the state's Department of Telecommunications and Energy ("DTE") to promulgate service quality measures for "customer satisfaction, service outages, distribution facility upgrades, repairs and maintenance, telephone service, billing service, and public safety." The DTE must also establish "benchmarks for employee staff levels and employee training programs."<sup>58</sup> These service quality measures are meant to "require that quality and reliability are the same as or better than levels that exist on November 1, 1997," the month that the legislature approved the restructuring act.<sup>59</sup> Managers translate these measures into goals for front-line supervisors and into changed maintenance and customer service practices. Companies and customers alike benefit.

States should also adopt routine inspection and maintenance guidelines similar to those adopted by the California Public Utilities Commission.<sup>60</sup> These guidelines set reasonable intervals for inspection of key components of the aboveground and underground transmission and distribution systems

---

<sup>56</sup> Such lending, however, appears unlikely because merchant plant owners cut staffing to the bone. For example, Dennis Bakke of AES notes: "We believe it is socially irresponsible to keep even one extra person employed when he or she cannot help operate the business more effectively." Similarly, Enron's Jeff Skillings states: "You must cut costs ruthlessly by 50% or 60%. Depopulate. Get rid of people. They gum up the works." Journal of Commerce (4/7/97).

<sup>57</sup> Mass. Gen. Laws. c. 164, §§1E, 1F(7).

<sup>58</sup> G.L. c. 164, §1E(a).

<sup>59</sup> G.L. c. 164, §1F(7). See also 1997 Mass. Acts c. 164, §1(p): "[S]ince reliable electricity service depends on conscientious inspection and maintenance of transmission and distribution systems, to continue and enhance the reliability of the delivery of electricity, the regional network and the commonwealth, the department of telecommunications and energy should set stringent and comprehensive inspection, maintenance, repair, replacement, and system service standards."

<sup>60</sup> Decision No. 97-03-070 (1997).

(e.g., annual visual patrols of urban transformers, conductors, capacitors and protective devices; biennial visual patrols of same equipment in rural locations). Routine inspections and maintenance programs help to avert outages, minimize the scope and duration of unavoidable outages, and generally insure greater system reliability.

#### **IV. Regulators should adopt new consumer protections to guard against the new consumer abuses that arise under retail competition.**

Retail competition creates new relationships and new opportunities for consumer abuse. Experience with the introduction of retail competition into other formerly regulated utility industries has taught the need for protections against such abuses. The abuses, and their possible remedies, include:

- Price spikes: In addition to the remedies discussed above, regulators in more states should establish stricter rules against terminating service during seasonal extremes or to households with infants, elderly, or sick members. Utilities should also be required to offer budget billing programs.
- Lack of actual competition: In addition to the remedies discussed above, the local distribution utility should be appointed as provider of last resort, with the requirement to include in its supply portfolio hedging, long-term contracts, and utility-owned (or state-owned) generation.
- Slamming: Regulators should adopt very severe penalties to prevent the repetition of the experience of the telephone industry.
- Invasion of privacy: Rules should require that customers approve in advance any sharing of their information;
- Lack of price information: Regulators should require a simple standard label that allows customers to compare competing offers.
- Lack of environmental information: Regulators should require disclosure of the environmental attributes of every electricity product so customers who wish can purchase on that basis and to encourage efforts at marketing environmentally benign supply.
- Lack of labor information: the labor attributes of every electricity product should be disclosed so customers who wish can purchase on that basis.
- Licensure: There must be a mechanism for weeding out competitors with a history of deceiving or abusing consumers.

Given the very slim retail competition that is actually occurring in the few states with operating markets, it is much too soon to evaluate existing protections.

## **V. Conclusion**

The most significant recent events with respect to retail electricity competition have been the moves away from it. Nevada repealed its retail competition scheme altogether and California is dismantling its scheme piecemeal. New York is considering public ownership of existing generating plants. Several other states that have enacted retail competition policies have delayed or amended them, including:

- Arkansas
- Montana
- New Hampshire
- New Mexico
- Oregon
- West Virginia

Half the states have not adopted retail competition policies. Those recently affirming that decision include:

- Alabama
- Colorado
- Georgia
- Louisiana
- North Carolina
- Mississippi

The best advice the Commission can provide right now about retail electricity competition for states that have not implemented it is: wait to see whether California and the handful of other states experimenting with retail competition survive the experiment.

For those states conducting the experiment, the most important objective is control of wholesale market prices and reliability. This requires focus on:

- State- or utility-built generating plant,
- A halt to further divestiture of generating plant,
- Demand management, particularly energy efficiency and inverted rates,
- Utility portfolio management to assure such practices as hedging and long-term contracting,

- Low-income relief in the form of payment assistance and other protections,
- Capping The Gap between residential and industrial prices,
- Inspection and maintenance guidelines, and
- Service quality standards.

Respectfully submitted,

**Utility Workers Union of America**, by

Jerrold Oppenheim, Esq.  
57 Middle Street  
Gloucester, Mass. 01930  
(978)283-0897  
Fax (978) 283-0957  
JerroldOpp@ tgc. Net

Charles Harak, Esq.  
18 Tremont Street, Suite 400  
Boston, Massachusetts 02108  
(617)-742-5554  
Fax (617) 523-7398  
charak@nclc.org

**Massachusetts Union of Public Housing Tenants**, by

John Howat  
National Consumer Law Center  
18 Tremont Street, Suite 400  
Boston, Massachusetts 02108  
(617)-523-8010  
Fax (617) 523-7398  
jhowat@nclc.org

Dated: April 23, 2001