

# **Municipal Aggregation for Retail Natural Gas and Electric Service: Potentials, Pitfalls and Policy Implications**

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## **EXECUTIVE SUMMARY**

Proposals to allow municipal aggregation have implications from both the community and consumer perspective. The discussion below looking at those implications is based on research from Massachusetts, Rhode Island, New York, Ohio and California.

### **Community Perspective**

Municipal governments have a limited ability to engage in electric and/or natural gas aggregation without outside assistance. In those instances where aggregation has occurred, municipal aggregation has largely been a consultant-driven response to retail natural gas/electric competition. Towns tend to be approached with a proposal that they aggregate their load (as opposed to deciding to do so and then seeking appropriate assistance). To assist towns in responding to proposals, technical assistance is critical to successful aggregation. Moreover, conflict of interest rules governing aggregation consultants working for competitive service providers are necessary.

The presence of substantial numbers of residential customers aggregated through municipal entities should not be confused with a robust market for aggregated residential electric load. Indeed, the numbers of customers served through a municipal aggregator may mask the lack of retail competition to serve that aggregated load.

Care must be taken to impose sufficient protections to make municipal aggregation work. For example, self-reporting requirements for competitive retail electric suppliers serving municipally aggregated load are insufficient to provide protections to aggregated consumers. Companies that are active in bidding for future contracts from municipal aggregators have no incentive, and substantial disincentive, to self-report internal financial problems, let alone substantial internal financial problems. Without public disclosure of potential financial problems, a local government's choice on whether to place a municipal aggregation proposal before the electorate is uninformed, as is voter choice on whether to approve such a municipal aggregation proposal.

Residents of small communities tend to be excluded from municipal aggregation initiatives. For example, Ohio's municipal aggregation has not succeeded in including the small communities within the state. The exclusion of small communities appears to flow not simply from the lack of municipal resources to participate, but also from the decision of marketers of municipal aggregation not to pursue the smaller loads associated with small communities. Providing

state aggregation assistance to small communities is necessary to ensure a fair opportunity for such communities to participate.

Successful municipal aggregation does not generally involve single communities, but is instead pursued through a regional council of governments. If municipal aggregation is authorized, municipalities should be specifically authorized to pursue such aggregation on their own or in collaboration with other communities. In addition, the state may wish to initiate and/or facilitate a consortium of small communities for purposes of municipal aggregation.

Front-end resources are more critical to municipal aggregators than ongoing administrative resources. Individual communities tend to have neither the resources nor the legal/technical expertise either to negotiate a retail choice procurement or to provide the ongoing necessary services. As a result, nearly universally, management of the ongoing municipal aggregation program occurs through a designated consultant funded by a charge on the energy bill.

Generating front-end money to hire legal and technical assistance before the flow of ongoing money can begin is a big issue with smaller communities. The lack of front-end resources may be evidence of local budget constraints. In addition, resource constraints often drive community priority-setting. It is often difficult for smaller communities to identify the customer savings sufficient to incent the local government to devote municipal human and financial resources to municipal aggregation rather than to school and zoning issues. Front-end assistance from the state devoted to small communities in particular may be necessary to support community aggregation initiatives.

One primary limiting factor in the failure of municipal aggregation to become common throughout the states where it has been authorized is the tendency to shop based on commodity competition, i.e., seeking the short-term benefits provided by lower prices. Individuals in virtually every state in which municipal aggregation is allowed have cited the inability to beat the “price to compare” as the primary limiting factor in preventing aggregation.

One issue presented by “commodity competition” is the allowed length of contracts underlying a municipal aggregation initiative. Through short-term contracts, communities shop based almost entirely on the commodity cost of energy. In contrast, California is allowing municipal aggregators to enter into contracts for up to 10 to 15 years. The impact of this longer-term approach is to allow the municipal aggregator to engage in life-cycle costing (and life-cycle financing) of energy efficiency and renewable resources. Longer-term contracts will allow communities to compete not simply on the commodity cost of energy, but also on industry investment in energy efficiency and renewable energy projects. Technical assistance supporting the interplay of efficiency/renewable investments and municipal aggregation efforts is important as well.

### **Individual Consumer Perspective**

Municipal aggregation is not inherently inclusive of all individuals. Care must be taken to avoid the exclusion of discrete populations. Some participation prerequisites tend to exclude customers for whom aggregation may be most beneficial. One Ohio example involves aggregation rules that exclude customers that are not “current” on their bills. Local aggregation rules tend also to exclude frequently mobile households. In contrast, California’s municipal aggregation structure explicitly requires that municipal aggregation make participation available on an equal basis to all residents of a community. Municipal aggregation initiatives should, by law, require that all residents within the community be included in the initiative on equal terms and conditions.

Residential consumers should have the right to balance the costs of the risks that they are asked to shoulder through municipal aggregation against the benefits that they will potentially pocket through such aggregation efforts. Disclosure only of competing retail prices is insufficient to fully inform consumers of the risks that they are being asked to bear. One of the primary risks borne by retail consumers, for example, is the risk that their potential savings may be offset by an expensive return pricing policy should the municipal aggregation entity return its customers to the local utility before the end of the term of the aggregation contract.

In addition to being informed of this risk, aggregated retail customers should be informed of the track record of the selected municipal aggregator in serving (and, conversely, in abandoning) retail markets before being asked to make decisions on whether to approve or disapprove opt-out aggregation. The abandonment of a particular retail market imposes risks, and costs, on the aggregated customers rather than on the retail supplier (or the aggregating entity). Customers should have the right to be fully informed of the risk to which they are being subjected.

Finally, opt-out aggregation models are uniformly endorsed as the necessary approach to municipal aggregation. Two opt-out models exist for broad-based municipal aggregation. The Ohio model provides for a short opt-out period but relatively recent renewal time periods. The California model provides for substantial notice and an extended opt-out period, after which there is no provision for renewals. The trade-offs are evident. More limited front-end opportunities to opt out are offset by more frequent opportunities to reconsider that decision at a late date. More extended opportunities to opt out are offset by the foreclosure of a cost-free opportunity to reconsider that decision. There appears to be no inherent policy preference for one approach over the other.

### **FULL NARRATIVE DISCUSSION**

Municipal aggregation is not an inevitable market mechanism that will develop in a retail choice electric/natural gas environment even where authorized by state statute. Local government entities will not necessarily, on their own initiative, aggressively pursue municipal<sup>1</sup> aggregation on behalf of their residents. The discussion below identifies certain issues that are raised by municipal aggregation.<sup>2</sup> The discussion is divided into three parts:

- A “finding” is presented, indicating what factual conclusion is being presented for consideration;
- A “substantive discussion” is presented for each finding, summarizing the evidentiary basis that supports each finding; and
- The “policy implications” of each finding and substantive discussion is presented, indicating how the finding and substantive discussion might have implications for a municipal aggregation initiative in Maryland.

In turn, there are two sets of “findings.” The first set considers municipal aggregation from the perspective of the local government. The second considers municipal aggregation from the

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<sup>1</sup> In this memo, the term “municipal” collectively refers to all types of local government entities, including cities, towns, townships, counties and the like.

<sup>2</sup> Information collected for this memo was obtained from the following states: Massachusetts, New York, Rhode Island, New Jersey, Ohio and California.

perspective of the individual consumer. Pricing and migration issues have been excluded as issues for consideration in this analysis.

**THE PERSPECTIVE OF THE COMMUNITY**

The “community perspective” presented in this analysis takes a perspective from that of municipal government. These observations reflect primarily on the ability of a municipal government to participate effectively in municipal aggregation initiatives.

Finding #1

Municipal aggregation is largely a consultant-driven response to retail natural gas/electric competition.

**Substantive Discussion**

Municipal aggregation should be viewed as a product, not a process. Municipal aggregation is “sold,” not “bought.” Five states have authorized municipal aggregation: Massachusetts, Rhode Island, New Jersey, Ohio and California. No significant municipal aggregation has occurred in Massachusetts, California, Rhode Island and New Jersey.<sup>3</sup>

Information presented below indicates that the numbers of residential customers electing to use retail choice for their electric service did not grow dramatically in the four years 2001 through 2004. While the data below is of *all* residential customers taking electric service through a power marketer, those customers for whom shopping is pursued through a municipal government aggregator would be a subset of these figures. It is clear that if total power marketer sales are not expanding, neither are sales through municipal aggregation.

**Residential Customers Served by Power Marketers  
by Year in Selected States (2001 - 2004)**

	2001	2002	2003	2004
<b>Massachusetts</b>	3	12,349	11,561	56,015
<b>Rhode Island</b>	0	0	0	0
<b>California</b>	79,539	49,038	45,584	37,468
<b>Ohio</b>	267,305	727,412	848,253	894,356

U.S. Department of Energy, Energy Information Administration, Form 861 Data (annual: 2001 - 2004).

<sup>3</sup> Because the rules and regulations concerning municipal aggregation in New Jersey are cumbersome and contradictory, no municipal aggregation efforts have occurred. While the Board of Public Utilities is “aware of” the problem, and is considering revisions to the regulations, those revisions have been in limbo for more than a year. New Jersey municipal aggregation will not be considered further in this memo.

Only in Ohio did total power marketer sales expand significantly from 2001 to 2004. That expansion occurred primarily through municipal aggregation efforts. In Ohio, more than 200 communities<sup>4</sup> have agreed to participate in municipal aggregation. The Ohio process involves a local government seeking electoral authorization to pursue aggregation. Once authorized to pursue municipal aggregation, the municipal government must traverse a process that involves preparation of an aggregation implementation plan, preparation of a Request for Proposals (RFP), and negotiation of a “deal” with the competitive service provider. The entire process tends to be consultant-driven. Towns tend to be approached with a proposal that they aggregate their load (as opposed to deciding to do so and then seeking appropriate assistance). The consultants help prepare the resolution to be voted on, help with the public outreach for the electoral approval, and then undertake the legal and technical tasks of soliciting bids and negotiating a bid.

The same process has been true in Massachusetts, New York and California. The most successful municipal aggregation initiative in New York, for example, involves the Municipal Electric and Gas Alliance (MEGA).<sup>5</sup> A consultant (EnergyNext) (formerly Boyd and Salerni) administers the initiative. After the municipal governments adopt appropriate resolutions authorizing municipal aggregation, they contract with EnergyNext to administer the process from top to bottom. The local governments do not have the capacity to do it on their own.

California has the same experience. While some communities have sought municipal aggregation because of a specific grievance with their local utility, most communities considering aggregation have been approached with a specific proposal. Aggregation in other communities has been activist-led (primarily by environmental activists), while a small minority have been administrator-driven, primarily by government administrators interested in meeting their responsibilities under the Kyoto and Toronto accords calling for reduced emissions. (Many California communities belong to the organization, Cities for Climate Protection.)

### **Policy Implications**

- Technical assistance is critical to successful municipal aggregation.
- A state-driven municipal aggregation program would be appropriate. A state-driven program might occur through state agencies such as a department of community development or department of economic development

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<sup>4</sup> These include municipalities, townships and counties.

<sup>5</sup> New York’s MEGA initiative does not involve “municipal aggregation” in the same sense as Ohio and California. MEGA is an organization of six counties (and their associated local governments). The MEGA initiative, involving about 2,500 accounts, focuses on the municipal energy bills themselves. As part of this initiative, residential customers are *allowed* to become a part of the buying group, but they are not –because of their small load and high customer service needs-- “sought-after.” MEGA serves about 500 to 600 residential customer accounts.

## Finding #2

The existence of municipal aggregation should not be confused with robust retail competition.

### **Substantive Discussion**

The presence of substantial numbers of residential customers aggregated through municipal entities should not be confused with a robust market for aggregated residential electric load.<sup>6</sup> Even in Ohio, when the Northeast Ohio Public Energy Council (NOPEC) issued its Request for Proposals (RFP) in 2000, it received only two bids in response.<sup>7</sup> The Northwest Ohio Aggregation Coalition (NOAC), the smaller sibling of NOPEC, serving nine communities and about 133,000 customers, released an RFP for its aggregated load in 2003, receiving only two responses as well. Indeed, one of the responses to NOAC's RFP was FirstEnergy Solutions, the unregulated affiliate of FirstEnergy, the local distribution utility.

NOPEC's competitive electric retail supplier (CRES) was Green Mountain Energy Company (GMEC). In its most recent annual report, NOPEC reported some modest savings on customer electric bills for 2005. According to the NOPEC 2005 annual report, "individual consumers saved an estimated average of \$33 per year on their electricity bill\* \* \*." These electric savings are the same (\$33/customer) as were reported in the 2004 annual report for individual NOPEC customers. The savings are based on a discount of roughly six percent (6%) off the local distribution utility's (FirstEnergy) shopping credit (also known as the "price to beat").

Even as the largest municipal aggregator in the country, NOPEC has lived an insecure life. As recently as late 2004, NOPEC found itself arguing against regulatory policies that threatened its continued existence. In July, 2004, in responding to a Public Utilities Commission of Ohio (PUCO) order approving the Rate Stabilization Plan (RSP) for the FirstEnergy Companies,<sup>8</sup> NOPEC noted "critical errors" in the RSP provisions governing retail shopping in the 2006 - 2008 time period. "If left uncorrected," NOPEC said, "the errors will be fatal to NOPEC and other governmental aggregators and suppliers and will deal a death knell to retail competition in this state." In March

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<sup>6</sup> This conclusion is bolstered by the following statement found on the Public Utilities Commission of Ohio (PUCO) web site regarding its "apples to apples" comparison of retail electric choice prices: "In December 2004, more than 50,000 customers enrolled in a voluntary electric pilot program. The purpose of this program is to find a competitive supplier that can serve customers at an electric rate lower than Dayton Power and Light (DP&L). Unfortunately, due to market conditions, no supplier submitted a bid that could guarantee customers a savings. Therefore, as of August 30, 2005, the first phase of the program ended." A "second phase" of the DP&L pilot program will begin in May 2006, at which time new enrollments will be solicited.

<sup>7</sup> This memo focuses on the electric municipal aggregation program in Ohio. NOPEC did not enter into a retail choice natural gas contract in 2005. According to its 2005 annual report: "Disappointment. . .has dogged our efforts to jumpstart the NOPEC natural gas program. The Board's buying strategy, based on expert analysis, was to lock in a price this autumn, when market experts uniformly predicted wholesale prices would drop. Instead, two devastating hurricanes tore through the Gulf of Mexico, sending prices soaring. We are continuing to monitor the market on a daily basis, and as soon as prices drop sufficiently, we are poised to act. But the Board will not present an offer to our customers that is not advantageous and consumer-friendly. No deal is better than a bad deal."

<sup>8</sup> FirstEnergy's local distribution utilities include Cleveland Electric Illuminating Company, Ohio Edison and Toledo Edison.

2004, after noting “a dearth of potential [competitive retail electric suppliers--CRES] willing to bid on governmentally aggregated retail electric load in the state,”<sup>9</sup> NOPEC noted further that:

The elimination of shopping in FirstEnergy’s service territories during the RSP through radical shopping credit reductions will result in NOPEC’s approximately 455,000 consumers returning to FirstEnergy-provided [Provider of Last Resort--POLR] service. This will be a disaster of epic proportions for the Commission to deal with.

The “disaster,” NOPEC opined, would be the return of the aggregated consumers to a monopoly utility with unregulated generation charges.

That “disaster” came close to occurring in late 2005 when problems plaguing the NOPEC municipal electric aggregation program in Ohio culminated in an organization-threatening crisis. In October 2005, just months after Green Mountain Energy Company (GMEC) renewed its contract with NOPEC<sup>10</sup> to supply electricity to municipally-aggregated customers through the three-year period of 2006 through 2008, GMEC announced that it would instead terminate its relationship with NOPEC as of December 31, 2005.<sup>11</sup>

According to the year-end report by NOPEC’s chairperson, the “immediate problem” posed by the GMEC contract abrogation involved finding another supplier to serve NOPEC’s 450,000 electricity customers. The NOPEC chair asserted in his year-end report that “negotiations were opened with several suppliers, and, in a reaffirmation of the bulk-buying power of public aggregation, a new agreement was reached with FirstEnergy Solutions, Ohio Edison and CEI that will continue customer discounts through 2008. . .” FirstEnergy Solutions, however, is the unregulated affiliate of FirstEnergy, the local distribution utility.

### **Policy Implications**

- The presence of municipally-aggregated load is not necessarily an indicator of robust retail competition for residential electricity. Indeed, the numbers of customers served through a municipal aggregator may mask the lack of retail competition to serve that aggregated load.
- The presence of significant numbers of residential customers served through a municipal aggregator offers no insight into the broader development of retail choice in a state.

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<sup>9</sup> NOPEC observed, also, that “of course, there are *no* suppliers currently offering retail electric to residential customer service on an individual opt-in basis on the Commission’s web site.” (emphasis in original).

<sup>10</sup> The contract renewal had been announced in March 2005.

<sup>11</sup> While the 2005 year-end “chairman’s report” by the Chairman of NOPEC’s governing board put a positive spin on the contract termination, the facts he reported were nonetheless disturbing. That report referenced “an unanticipated crisis that threatened the continued existence of our signature discounted electricity program. . .” He then continued: “The crisis was precipitated when Green Mountain Energy Company, NOPEC’s electricity supplier since 2001, served notice that it intended to terminate its contract at the end of this year. This was clearly unjustified under the contract, in our view, and we have taken legal action against Green Mountain as a result.”

- Moving large numbers of municipally-aggregated residential customers from a regulated local distribution utility to the unregulated power marketing affiliate of that local utility emphasizes the need for substantial oversight to ensure that retail choice has not simply removed regulatory price and service protections for the aggregated customers.

### Finding #3

Regulatory protections designed to ensure the legitimacy of retail power marketers appear to have failed in Ohio.

### **Substantive Discussion**

The regulatory protections incorporated into PUCO aggregation regulations appear to have failed to identify, let alone raise warnings of, the impending collapse of the GMEC multi-year contract with NOPEC. NOPEC and GMEC entered a contract extension in March 2005 under which GMEC agreed to provide competitive generation service to NOPEC communities for the years 2006 through 2008. Under PUCO regulations, a Competitive Retail Electric Supplier (CRES) is to provide extensive documentation in support of the renewal of its CRES certification. In its January 2005 filing with the PUCO for a renewal of its certification as a “retail electric generation provider and power marketer,” however, GMEC chose *not* to provide key information that might have provided insights into its ability (or lack thereof) to meet the obligations it would choose to undertake with respect to providing electric service to NOPEC communities. Additional information was neither required, nor even requested, by Ohio regulators or regulatory staff in the summary recertification proceeding.

**Regulatory risks:** A comparison of GMEC’s 2003 application for a renewal of its certification to its 2005 application for renewal of its certification is instructive. The PUCO application for recertification (Exhibit B-3) calls for a “disclosure of liabilities and investigations,” including “a description of all existing, pending or past rulings, judgments, contingent liabilities, revocation of authority, *regulatory investigations, or any other matter* that could adversely impact the applicant’s financial or operational status or ability to provide the services it is seeking to be certified to provide.” (emphasis added).

- In its 2003 application for renewal, GMEC identified, among other regulatory investigations, an Ohio proceeding through which GMEC sought to require the FirstEnergy companies to purchase accounts receivable from competitive electric retail suppliers. GMEC also identified the Ohio proceeding commenced by the FirstEnergy companies through which those companies sought a reduction of the shopping credits available to customers who switch to competitive retail electric suppliers.
- In contrast, in its January 2005 application for renewal, GMEC reported that “there are no such matters that are reasonably likely to materially adversely affect Green Mountain Energy Company’s financial condition or ability to perform it’s (sic) obligation as a CRES provider.”

In addition, the renewal application contained a standard Affidavit through which Green Mountain was to provide eleven assurances to PUCO. Assurance 11, to which GMEC chief legal officer Robert Thomas attested in the Affidavit attached to GMEC's January 2005 renewal application, provided that "the Applicant herein attests that it will inform the Commission of any material change to the information supplied in the renewal application within 30 days of such material change. . . ." Presumably, therefore, if a regulatory investigation or some other matter arose that "could adversely affect" the company's "financial condition or ability to perform its obligations as a CRES provider," GMEC was under an obligation to disclose that investigation (or other matter) to the PUCO within 30 days of the change.

Despite the statement in its application for a certificate renewal that no regulatory investigations existed as of January 2005 that might adversely affect the company's ability to meet its Ohio obligations, and despite the requirement to inform PUCO of any "material change" in information provided in the application for renewal, GMEC failed to provide notice to PUCO of the projected impacts of the regulatory investigations that the company would later cite as fatally affecting its ability to fulfill its contractual obligations in Ohio. In its October 26, 2005 press release announcing that it would discontinue service to the NOPEC aggregation program as of December 31, 2005, GMEC stated:

Green Mountain Energy Company said it exercised its right to terminate the agreement in response to a series of *adverse regulatory events that prevented it from continuing to supply the NOPEC aggregation program*. Two regulatory events cited by Green Mountain Energy Company were FERC's implementation of the Seams Elimination Charge Adjustment (SECA) and its resulting litigation, in addition to unexpected charges associated with the start of MISO's Day II energy markets.

GMEC Press Release, October 26, 2005 (emphasis added). Green Mountain blamed the expense of the Seams Elimination Charge Adjustment -- FERC's short-term fix to compensate generation owners for lost grid revenues -- and unexpected Midwest ISO Day-2 energy market expenses for its decision.

The issues involving MISO were well-known to GMEC at the time of its January 2005 application for renewal of its CRES certificate. Both the "joint marketers" and the Ohio Office of Consumer Counselor (OCC) had identified MISO as an issue in the PUCO proceeding considering the FirstEnergy Rate Stabilization Plan. OCC stated in September 2004 that: "*As the joint marketers also note*, there has as yet been no decision on the allocation of FTRs [financial transmission rights] under the MISO Day 2 tariffs. Decisions with regard to the allocation of FTRs under the MISO tariffs are not likely to be made under March 1, 2005. . . Absent a decision regarding the proper allocation of FTRs, the Commission cannot know what congestion costs will be avoidable or hedged." (emphasis added). Despite this clear knowledge of the implications of ongoing deliberations about the MISO tariffs, GMEC did not tag those deliberations as being significant to its Ohio operations, let alone being potentially fatal to its ability to maintain its contractual obligations to municipal aggregators.

**Financial risks:** Neither did Green Mountain Energy Company (GMEC) file information with the PUCO about its potentially changing financial conditions in 2005. The tenuous financial condition of GMEC had been reported in documents previously filed with the Public Utilities

Commission of Ohio (PUCO). In the April 12, 2002 “report of independent public accountants” filed in January 2003 as part of GMEC’s “Application for Renewal of Certificate as a Retail Electric Service Provider,”<sup>12</sup> GMEC auditor Arthur Andersen stated:

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and net losses, and it has not generated positive cash flows from operations since its inception. In addition, the Company is dependent on its ability to obtain additional equity and/or debt financing. These matters raise substantial doubt about the Company’s ability to continue as a going concern.<sup>13</sup>

(emphasis added) . The referenced “Note 2” to the financial statements as filed with the PUCO, in turn, stated: “Management estimates that the Company’s working capital will be sufficient to fund its operations and the expansion of its business through the second quarter of 2002. Additional equity and/or debt financing will be required no later than the third quarter of 2002 in order for the Company to continue to execute its current business plan and continue as a going concern, and management is currently in the process of negotiating up to \$20.0 million in additional equity financing from certain of its shareholders. There is no assurance, however, that additional equity or debt financing can be obtained or that it can be obtained on acceptable terms. If additional financing is obtained, there is no assurance that the Company will be able to develop financially viable future operations. These matters raise substantial doubt about the Company’s ability to continue as a going concern.”<sup>14</sup>

Subsequent to this 2003 PUCO filing, information was certainly available that would indicate that Green Mountain was not meeting its sales projections. While GMEC audited data is not publicly available for 2002, data for other years from 2000 through 2004 is available. The table below presents actual audited revenue figures for GMEC, projected financial figures, and revenue figures reported by GMEC to the Energy Information Administration of the U.S. Department of Energy (EIA/DOE).<sup>15</sup>

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<sup>12</sup> Certificates must be renewed on a biannual basis.

<sup>13</sup> GMEC’s January 2003 and January 2001 GMEC financial filings had been held as confidential by the PUCO. They were provided to Fisher, Sheehan & Colton on March 7, 2006, pursuant to a public documents request submitted by Roger Colton. The January 2005 GMEC financial filings with the PUCO are still maintained as confidential records by the PUCO.

<sup>14</sup> Report of Independent Public Accountants (April 12, 2002). Notes to Financial Statements, note 2 (“going concern and liquidity”) (December 31, 2001).

<sup>15</sup> EIA/DOE Form 861 data can be reported as either “observed” or “imputed.” GMEC Form 861 data was reported as “observed.”

**Green Mountain Power Revenues (Actual, Reported, Projected) /a/  
(2000 - 2004) (dollars in millions)**

	2000	2001	2002	2003	2004
<b>EIA 861 reports</b>	\$73.0	\$81.3	\$246.5	\$331.5	\$299.1
<b>GMEC projections /a/</b>	N/A	\$102.4	\$189.4	\$451.3	\$719.7
<b>GMEC audited /b/</b>	\$73.7	\$82.0	N/A	N/A	N/A

NOTES:

/a/ As part of a Competitive Retail Electric Service (CRES) provider's filing with the PUCO to have its certificate to be a CRES renewed, the provider is required to file projected financial statements (Exhibit C-5).

/b/ Audited financial figures are not publicly available for years subsequent to 2001. Financial statements on file with the Public Utilities Commission of Ohio (PUCO) are confidential.

In its early years of operation, Green Mountain operated in six states: California, Connecticut, New Jersey, Ohio, Pennsylvania, and Texas. After 2002, by far, most of the company's revenue was generated in Ohio. In 2003, while GMEC continued to operate in all six states, its sales revenue fell \$120 million short of its projections (\$331.5 million reported to EIA compared to \$451.3 projected to PUCO), and the percentage of total sales generated exclusively from Ohio increased to two-thirds of the company's operations. By 2004, GMEC had abandoned the retail markets in California, Connecticut and Texas. Its actual sales revenues fell more than \$420 million short of the projections it had filed with the PUCO (\$299.1 reported to EIA compared to \$719.7 projected to PUCO). The proportion of sales generated exclusively from Ohio increased to more than 90% of its total.

**Source of Green Mountain Power Revenues (Reported)  
(2000 - 2004)**

	2001	2002	2003	2004
<b>EIA 861 reports</b>	\$81.3	\$246.5	\$331.5	\$299.1
<b>Ohio revenue (EIA 861)</b>	\$16.6	\$147.4	\$221.9	\$272.2
<b>Percent from Ohio</b>	20.4%	59.8%	66.9%	91.0%

Despite GMEC's attestation in its application to renew its CRES certification that it "will inform the Commission of any material change to the information supplied in the renewal application within 30 days of such material change," and PUCO regulations mandating such reports, no filing of material changes were submitted to the PUCO. A February 1, 2006 request submitted to the staff of the PUCO asked "Before Green Mountain Power abrogated its contract with NOPEC, did it file any notice of material change pursuant to Rule 4901:1-24-10?" In response, PUCO staff<sup>16</sup> reported that "... we are not aware of any such filings."

<sup>16</sup> The February 1, 2006, response was provided by Chuck Stockhausen, with a copy to Tammy Turkenton.

The decision of GMEC to abrogate its contract with NOPEC and cease operations in Ohio<sup>17</sup> could not have come without significant deliberation. In arguing its position relative to the proposed shopping credits proposed by FirstEnergy in that utility's Rate Stabilization Plan (RSP) proceeding (March 2004), GMEC urged that the unreasonably low credits contained in the RSP would result in "the loss of NOPEC." GMEC continued on to discuss the impact of GMEC ceasing operations in Ohio:

Of course, the end of NOPEC would mean the operations of Green Mountain, FirstEnergy's largest independent competitor and the public's primary source of retail electric competition, would be stranded. And unlike the billions that FirstEnergy collected in stranded costs, there would no transition charges for the investments and risks of suppliers such as GMEC that came invited to this state by Senate Bill 3 and the PUCO's rules. Green Mountain has made sizeable investments and taken significant risks to participate in the Northern Ohio markets, all of which are at stake and vulnerable to FirstEnergy's proposal that is one-dimensionally focused on its own financial advantage. (emphasis added).

The "sizeable investments" and "significant risks" referenced by GMEC certainly did not decrease between March 2004 (when it submitted the above argument to PUCO) and October 2005 (when the company terminated its NOPEC contract).

It is reasonable to conclude that:

- Long before GMEC announced in October 2005 that it intended to terminate its NOPEC contract as of December 31, 2005, that company must have recognized that there were material changes resulting from "regulatory events" that could "materially adversely affect [its] ability to perform its obligations as a CRES provider."
- Long before GMEC recognized that the SEAMS proceeding, and the MISO Day 2 energy deliberations, would generate results that would adversely affect the company, it must have identified those proceedings as ones that could materially adversely affect the company's ability to perform its obligations as a CRES provider.
- Long before GMEC announced in October 2005 that it intended to abrogate its NOPEC contract as of December 31, 2005, that company must have recognized that it was not meeting the financial projections that it had submitted to the PUCO as part of its previously submitted CRES recertification applications.<sup>18</sup>

It is reasonable to conclude that these "regulatory events" and financial shortfalls did not sneak up on GMEC. Despite this forewarning, despite the PUCO regulations, and despite the explicit agreement provided in its application for certification renewal, GMEC provided none of the information that

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<sup>17</sup> GMEC did not choose to abandon its certificate in Ohio. It merely chose to terminate its contract with NOPEC to provide electric generation service from 2006 through 2008.

<sup>18</sup> Again, new financial information was submitted as part of its January 2005 CRES recertification application. That information, however, was filed with the PUCO under seal and remains confidential.

would have allowed NOPEC, or Ohio regulators, to prepare for GMEC’s decision to terminate its NOPEC contract.

### **Policy Implications**

- Self-reporting requirements for competitive retail electric suppliers serving municipally aggregated load are insufficient to provide protections to aggregated consumers. Companies that are active in bidding for future contracts from municipal aggregators have no incentive, and substantial disincentive, to self-report internal financial problems, let alone substantial internal financial problems.
- Without public disclosure of potential financial problems, a local government’s choice on whether to place a municipal aggregation proposal before the electorate is uninformed, as is voter choice on whether to approve such a municipal aggregation proposal.<sup>19</sup>
- Self-reporting requirements for competitive retail electric suppliers serving municipally aggregated loads are insufficient to protect individual customers from the adverse impacts of undisclosed internal financial risks and problems facing a potential competitive retail electric supplier. The risks facing individual consumers in Ohio are discussed in more detail below.<sup>20</sup>
- Summary regulatory proceedings through which competitive retail electric suppliers are certified (or recertified) should be discouraged.

#### Finding #4

Residents of small communities tend to be excluded from municipal aggregation initiatives.

### **Substantive Discussion**

Small communities tend to be excluded from municipal aggregation proposals. The largest residential aggregation initiative in the country, for example, is undertaken through the Northeast Ohio Public Energy Council (NOPEC). NOPEC is a council of governments,<sup>21</sup> organized pursuant to Ohio state law, that pursues electric and natural gas aggregation behalf of the residents of its member communities. Akin to NOPEC is the Northwest Ohio Aggregation Coalition (NOAC) another regional local government consortium.

<sup>19</sup> While, on paper, the local government choice is not of a specific competitive retail electric supplier, nor the voter choice to approve municipal aggregation an approval of a specific retail electric supplier, in cases such as NOPEC and NOAC, where the council of governments is served by a single provider, the approval process is, in effect, to approve that specific provider.

<sup>20</sup> This conclusion is based on the assumption that an individual consumer could not avoid the higher “return pricing” rates charged to consumers for whom the municipal aggregation contract had been abrogated by arguing that “had I known the risks I was taking on, I would have selected not to be a party to such risks.”

<sup>21</sup> The term “council of government” is not used here in any specific legal sense. It is used as a generic term to refer to groupings of local government that have joined together to pursue one or more joint interests.

Despite the perceived success of municipal aggregation in Ohio, that municipal aggregation has not succeeded in including the small communities within the state through consortiums such as NOPEC and NOAC. The Ohio Consumer Counsel lists 207 communities that have decided to pursue municipal aggregation in that state. These communities were compared to the total list of “places” in Ohio as reported by the U.S. Census Bureau (there are 1,054).<sup>22</sup> The list of total communities was divided into deciles by size (number of households). By definition, each decile has the same number of communities (one-tenth the total number in the state). The smallest communities are in the first decile and the largest are in the 10<sup>th</sup> decile. Each decile was examined to see how many of the communities in that decile participated in community aggregation. The results are as follows:

Ohio Places with Municipal Aggregation /b/			Ohio Places with Municipal Aggregation /b/		
Size by Decile /a/	Number	Percent	Size by Decile /a/	Number	Percent
1	3	2.8%	6	15	14.3%
2	2	1.9%	7	22	21.0%
3	8	7.5%	8	27	25.7%
4	8	7.5%	9	39	37.1%
5	19	18.1%	10	64	61.0%

NOTE:

/a/ Size determined by number of households. 1= smallest communities. 10=largest communities.

/b/ The word “places” is a term-of-art used by the U.S. Census Bureau.

As can be seen, while the communities falling in the bottom four deciles (by size as measured by number of households) had municipal aggregation in fewer than 10% of the cases (with the bottom two deciles, or roughly 210 communities, having only two to three percent), the communities falling in the top four deciles (by size) had 20% or more participating in municipal aggregation (with the top decile having 61% participation).

The exclusion of small communities from municipal aggregation initiatives appears to flow not simply from the lack of resources to participate but rather from the decision of marketers of municipal aggregation not to pursue the smaller loads associated with small communities.

**Policy Implications**

The policy implications of the substantive discussion above flow from the observations immediately above combined with the observation that municipal aggregation tends to be consultant-driven. It would not seem to be feasible (or desirable) to “require” consultants promoting municipal aggregation to include small communities within their marketing.

<sup>22</sup> Where the aggregated entity was a township, the central community in the township was used for analysis.

- Special attention must be paid to smaller communities that do not have the ability to respond to consultant-based proposals. State actions providing community aggregation technical assistance to small communities is necessary to ensure a fair opportunity for such communities to participate.
- A state authority should be created, or a state agency designated, and should be charged with the responsibility of bringing community aggregation to small communities.

#### Finding #5

Where it does occur, successful municipal aggregation does not generally involve single communities.

#### **Substantive discussion**

Municipal aggregation does not frequently occur by single communities. Almost always, municipal aggregation, where it has occurred, has been pursued through the structure of a regional council of governments. The Ohio communities aggregating on a municipal basis do so primarily through regional associations. Of the roughly 200 Ohio communities that have aggregated, at least three-quarters have done so through regional councils.

A similar phenomenon is reported to exist in California. While several large communities (e.g., San Francisco, Los Angeles and San Diego counties) are pursuing aggregation on their own initiative, small towns are pursuing aggregation to a much lesser degree. The general impression in California is that the smaller cities tend to be suspicious of whether the larger jurisdictions will appropriately protect small town interests in joint power authorities, but do not have the resources to pursue it on their own. The efforts thus generally occur through regional power authorities and regional power compacts. One example of such a regional initiative is the Southern California Cities Joint Power Consortium, a consortium of 15 cities representing roughly 450,000 customers in the Los Angeles area.

New York's MEGA, as well as the Cape Light Compact in Massachusetts, also represent examples of where smaller communities have aggregated into councils of government in order to pursue a municipal aggregation agenda.<sup>23</sup>

Municipal consortiums are commonly used for the purchase of other commodities. In particular, the purchase of health insurance through government consortiums was cited as analogous to the potential to use consortiums for electric and natural gas purchasing. Existing entities that provide bulk purchasing of insurance could be led, through consultant-driven initiatives, to move into the bulk purchasing of electricity as well.

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<sup>23</sup> As discussed above, MEGA does not involve community aggregation in its true sense. MEGA is a consortium of governments aggregating their governmental loads, not aggregating the loads of their residents. The Cape Light Compact has not yet been successful in its efforts to aggregate residential load for electric or natural gas purchases.

## **Policy Implications**

- To the extent that municipal aggregation is authorized, municipalities should also be specifically authorized to pursue through such aggregation on their own or in collaboration with other communities.
- Consistent with the discussions relating to the exclusion of small communities from community aggregation, the state may wish to initiate and/or facilitate a consortium of small communities for purposes of municipal aggregation.

### Finding #6

Front-end resources are more critical to municipal aggregators than administrative resources.

## **Substantive discussion**

The ongoing administration of municipal aggregation programs does not impose significant financial impacts on communities. Nearly universally, management of the ongoing municipal aggregation program occurs through the designated consultant. In Ohio, NOPEC and NOAC provide the exclusive management oversight of the municipal aggregation initiative. Management fees are paid through the collection of a per unit-of-energy (kWh or therm) charge collected on each unit of energy delivered to aggregated consumers.<sup>24</sup>

The regional councils of government (NOPEC and NOAC in Ohio; the Cape Light Compact in Massachusetts; MEGA in New York) that tend to be the instrumentality used for municipal aggregation tend to be structured in the same way. Boards of directors are comprised of individuals from each community. The board is charged with providing overall policy oversight. Day-to-day operations, however, are managed through the retained consultant.

In California, generating front-end money was considered to be a “big issue” with smaller communities. One consultant indicated that communities would need to devote “from tens to hundreds of thousands of dollars” in front-end money, depending on the size of the community. The consultant indicated that this requirement was appropriate. Communities seeking to participate in municipal aggregation need to demonstrate a “certain seriousness” about the process, as evidenced by the willingness to commit front-end resources.

The fact that ongoing administrative resources are not a limiting factor assumes a consultant-driven process. The general consensus is that individual communities have neither the resources nor the legal/technical expertise either to negotiate a retail choice procurement or to provide the ongoing necessary services.<sup>25</sup>

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<sup>24</sup> In one instance in Ohio, annual management fees were imposed on participating jurisdictions that were responsible for those fees out of appropriations. This, however, was the clear exception to funding for ongoing administration.

<sup>25</sup> See, however, the discussion of the different types of energy ownership below to more fully understand the need for “customer service.”

The lack of front-end resources may not be evidence of a lack of “seriousness” on the part of a community as much as it is evidence simply of local budget constraints. One strong opinion in Massachusetts was that resource constraints often drive community priority-setting. Particularly in smaller communities, the “critical mass” necessary to generate sufficient customer savings must be sufficient to incent the local government to devote human and financial resources to municipal aggregation rather than to school and zoning issues.

### **Policy Implications**

- Front-end resources devoted to small communities in particular may be necessary to support community aggregation initiatives. Use of Community Development Block Grants (CDBG) or other economic development/community development funds on either a grant or loan basis may be appropriate to assist entry of the small community into a municipal aggregation process.

#### Finding #7

The potential for conflict of interest must be carefully monitored.

### **Substantive discussion**

One implication of the consultant-driven nature of municipal aggregation, particularly in a budget-constrained environment, is the potential for conflict of interest situations to arise. A conflict of interest arises when a competitive service provider organizes its own consulting group to assist municipalities in the aggregation process. A municipality may accept service from such a consultant to develop aggregation documents, to prepare Requests for Proposals (RFPs), and to negotiate with respondents to those RFPs. One analyst indicated that these situations have sometimes led to “disaster.” At some point in the process, the municipality realizes that the consultant is not operating exclusively on behalf of the interests of the municipal aggregation pool, but rather also on behalf of the parent competitive supplier. The switch from providing front-end assistance to facilitate the aggregation effort to providing marketing services to “steer” the community to the underlying competitive supplier can be subtle and undisclosed.

### **Policy Implications**

- Disclosure of commercial relationships within the consultant community is important. While it is critical for communities to engage in their own “due diligence” when retaining consultants, it is reasonable for communities to expect a disclosure of vested commercial interests that may not be readily evident.
- While perhaps not needing to be placed on a strict fiduciary relationship, the special relationship between consultant and community should be recognized and the consultant’s exclusive responsibility to his/her client (rather than to any third party) emphasized.

## Finding #8

Municipal aggregation based on commodity competition is not likely to generate the same level of benefits as aggregation based on competition on other bases.

### **Substantive discussion**

Municipal aggregation has not become a pervasive phenomenon in any state in which it has been permitted. In Massachusetts, while the Cape Light Compact is often cited as a successful municipal aggregation effort, that Compact has still not yet successfully purchased power (or natural gas) for community residents generally. No community aggregation has occurred in Rhode Island or New Jersey. Limited community aggregation has occurred in New York.<sup>26</sup>

One primary limiting factor in this failure of municipal aggregation to become common throughout the states where it has been authorized is the tendency to shop based on the short-term benefits provided by lower prices. While residential electric and/or natural gas bills in Ohio have been reduced between five and six percent, one natural gas aggregation project in New York has generated reductions of between eight and nine percent.<sup>27</sup>

Individuals in virtually every state in which municipal aggregation is allowed has cited the inability to beat the “price to compare” as the primary limiting factor in preventing aggregation.

Even Ohio, which has the greatest penetration of municipal aggregation, is not evidence to the contrary. In northern Ohio, home of NOPEC, the process of municipal aggregation was primed by First Energy, which made available a certain block of low-cost generation to help “kick-start” municipal aggregation. Indeed, outside the area in which that low-cost generation was made available, little municipal aggregation has occurred.

One issue presented by what has been referred to as “commodity competition” is the allowed length of contracts underlying a municipal aggregation initiative. Ohio limits municipal aggregation contracts to two years. New York and Massachusetts also tend to shop for contracts of two years or less. Short-term contracts push communities to shop based almost entirely on the commodity cost of energy. When existing commodity costs are difficult to beat (as they have been in Massachusetts, Rhode Island, and New Jersey), municipal aggregation does not occur.

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<sup>26</sup> In addition, remember that New York’s “community aggregation” differs from that in other states. The New York MEGA model, as well as the model of the “PACE Project” involving National Fuel Gas, involves municipal governments buying power (and/or natural gas) for municipal facilities and allowing residential customers to tag along. MEGA allows, but does not seek out, residential participants. The PACE Project actively includes all public assistance recipients (about 4,300 to 4,600 each year) receiving directly vouchered assistance as part of the county loads that have been aggregated.

<sup>27</sup> These bill reductions, however, may not have been entirely the result of price reductions, but rather due in part to some state-specific, and unique, tax advantages generated by the aggregation project.

The reason municipal aggregation has not taken off in Massachusetts, for example, is that it has “focused on cheaper rates.” This focus on cheaper short-term rates is the wrong way to frame the issue, according to one analyst. The “commodity competition for electricity is simply not strong.”

In contrast, while of too recent vintage to determine its success or failure,<sup>28</sup> California appears to be taking a somewhat different approach. California is allowing municipal aggregators to enter into contracts for up to 10 to 15 years. The impact of this longer-term approach is to allow the municipal aggregator to engage in life-cycle costing (and life-cycle financing) of energy efficiency and renewable resources.

California has sought to distinguish its municipal aggregation efforts from those of Massachusetts and Ohio by “redefining the opportunity.” The opportunity presented by community aggregation is not simply “to get cheaper electricity,” but rather also to generate long-term savings. Municipal aggregation in California is designed to improve community load profiles over the next decade, to generate independence from price volatility, and to generate environmental benefits. The goal, according to one analyst, is “to meet or beat the current rate with vastly superior service” as defined by community improvements in efficiency and independence.<sup>29</sup>

### **Policy Implications**

- Defining the basis upon which municipal competition will occur will drive (and be driven by) the allowable length of contracts by municipal aggregators. Short-term contracts will tend to support only commodity competition, which is not strong enough at present to generate substantial municipal aggregation initiatives. Longer-term contracts will allow communities to compete not simply on the commodity cost of energy, but also on industry investment in energy efficiency and renewable energy projects.
- Technical assistance supporting the interplay of efficiency/renewable investments and municipal aggregation efforts is important.

### **INDIVIDUAL CONSUMER PERSPECTIVE**

Aside from the implications of municipal aggregation from a community perspective, there are a variety of impacts that can be identified from the perspective of individual consumers as well. These impacts involve not only the ability of individual consumers to participate in the municipal aggregation altogether, but also involve price and service issues.

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<sup>28</sup> Final municipal aggregation rules in California have just been recently adopted by the California Public Utility Commission (CPUC).

<sup>29</sup> One impact of longer-term contracts is to allow municipalities to issue bonds in support of efficiency or renewable investments, with a life-cycle cost analysis in support of such bonds.

## Finding #9

The failure of power marketers serving municipal aggregators to fulfill the terms of their contracts places significant numbers of residential customers at financial risk.

### **Substantive Discussion**

The risks presented to GMEC by the MISO deliberations and FERC SEAMs proceeding could have had substantial adverse impacts on the residential customers served through Ohio municipal aggregators (including NOPEC).<sup>30</sup> Had NOPEC been unable to find an alternative supplier for its 455,000 customers, those customers would have been subject to the return pricing policy recently adopted by PUCO.

The Green Mountain decision to leave the Ohio market was *not* driven by the PUCO's approval of the FirstEnergy Companies' Rate Stabilization Plan (RSP).<sup>31</sup> In opposing the RSP opposition expressed by the Ohio Office of Consumer Counsel (OCC), which had argued that the RSP was anti-competitive and unlawful, Green Mountain responded that: "the fixed rate pricing that the Commission approved is not anti-competitive as it approximates the pricing that would be obtained at auction and provides the certainty necessary for customers to make an informed decision to shop."

In its approval of the FirstEnergy rate, the PUCO "adopted a return price for residential customers, comprised of the rate stabilization plan's fixed rate standard service offer, plus an additional percentage equal to 5% of the RSP's SSO<sup>32</sup> rate." Green Mountain "generally supported this pricing policy." Green Mountain argued that the OCC simply had a "preference for a lower price for residential customers returned to the electric distribution utility."

The return pricing issue involved what the local distribution utility could charge customers that returned to the utility's Provider of Last Resort (POLR) before the supplier contract expired. The PUCO had determined that the local distribution utility could impose the RSP cost plus 5%. In addition, however, the PUCO determined that the local distribution utility could, upon application to and approval by PUCO, impose a surcharge "to recoup the costs not otherwise recovered in serving returned customers." Under the surcharge approach, not only will the distribution company receive the 5% premium over the SSO rate, but it will receive "any of the operating company's unrecovered costs of serving those customers" through a surcharge "assessed to returning customers."

NOPEC's comments on the return pricing policy appropriately captured the circumstances under which these higher prices would be charged:

...upon expiration of a qualifying contract and the end of its contract term, NOPEC's customers shall be entitled to receive FirstEnergy's fixed standard service offer (SSO). For example, if NOPEC's qualifying contract is for calendar year 2006 and it expires

<sup>30</sup> Those risks were discussed in detail under Findings #2 and #3, *supra*.

<sup>31</sup> PUCO Docket No. 03-2144-EL-ATA.

<sup>32</sup> SSO is Standard Service Offer.

by its own terms on December 31, 2006 and is not replaced with another qualifying contract for calendar year 2007, NOPEC's customers would receive service beginning January 1, 2007 at FirstEnergy's fixed SSO. Only in a circumstance where NOPEC's customers would be returned to FirstEnergy's generation service during the term of the contract (emphasis in original), e.g., in this case, during calendar year 2006 if a qualifying contract for calendar year 2006 is in effect, would NOPEC's customers be subject to a higher "return pricing" mechanism

Avoiding the need to implement this "return pricing" was one of the benefits generated by NOPEC's ability to enter into a substitute contract with FirstEnergy Solutions for the 2006 - 2008 time period that GMEC had been signed to supply. By arranging a substitute competitive retail electric supplier, NOPEC helped its customers avoid the need to pay the return pricing electric rates approved by PUCO.

In debating the appropriate level of the return pricing policy, government aggregators such as NOPEC, along with GMEC, had urged that the return pricing policy would encourage a "fear factor" on the part of customers potentially interested in pursuing retail choice. This "fear factor" would be based on consumer concerns that any savings potential from participating in the retail choice market would be overshadowed by the fear that, in the event of supplier default, the returned customers could pay a price far in excess of the customers that had stayed with the local utility with which to begin.<sup>33</sup>

The OCC had also recognized the implications of the return pricing policy, even though Ohio had not yet been subjected to GMEC's withdrawal from the market. In opposing the assignment of market rates to returning customers, the OCC had argued:

It is unlikely that customers will be comfortable shopping if they are told that, upon return to the standard service, they must pay potentially volatile and higher market prices. Correspondingly, there will be little shopping if shoppers are compelled to pay an RSC [rate stabilization charge] in order to return to the standard service offer. In fact, it is possible that such a provision would completely halt the development of a competitive retail market in Ohio.

NOPEC, too, observed that:

Unpredictable return pricing has very significant negative implications. . . on customers' willingness to take service other than under the EDU's [electric distribution utility's] fixed SSO. . . Further, such unpredictable pricing would have a chilling effect on customers --and aggregators-- willing to take any risk in pursuing shopping when the potential consequences of a supplier problem could have

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<sup>33</sup> Concerns over a "fear factor" are well-founded. Competitive electric prices obtained by NOPEC generated roughly a 6% savings on electric bills compared to the Standard Service Offer (SSO). The return pricing policy would charge the SSO plus 5%, plus any approved surcharge (uncapped) necessary for the utility to recoup any additional unrecovered costs.

unpredictably disastrous financial effects on customers when savings from shopping may be modest.<sup>34</sup>

While the PUCO had taken a middle ground between the competing return pricing proposals of FirstEnergy<sup>35</sup> and the OCC,<sup>36</sup> the PUCO decision still subjects customers returned to POLR to an uncapped price for return service. In its January 19, 2005 order adopting a return pricing policy, the PUCO observed that “although residential customers should not be relieved of the risk of shopping, they deserve to know what the risk entails. We find that the return price for residential customers should be the SSO plus five percent, with any unrecovered costs assessed to returning customers through a surcharge. FirstEnergy’s costs related to the returning customers would only be subject to review if the company filed for a surcharge.”<sup>37</sup>

The OCC objected to the PUCO’s allowance of a surcharge on top of the SSO-plus-5% return pricing policy. “The Commission’s new plan permits an unknown and unknowable surcharge that does not inform residential customers about the risk of shopping.” While the SSO-plus-5% creates a floor, OCC argued, the return price “is not restricted on the upside because of the permitted surcharge.” The PUCO’s order, OCC concluded, “would result in placing a floor on FirstEnergy’s pricing that has no ceiling, further threatening residential customers with a higher cost to shop and return to FirstEnergy service.”

The risks presented by the PUCO’s return pricing policy were nearly recognized by the default of GMEC on its contract with NOPEC. Just ten months after the PUCO adopted its SSO-plus-5% return pricing policy, GMEC exited the marketplace rather than honor its contract to supply generation service to NOPEC’s 455,000 customers.<sup>38</sup> Had these 455,000 customers been returned to FirstEnergy companies, they would have paid the SSO-plus-5% price for the remainder of the term of the RSP (the full three years of 2006 through 2008 in this particular situation).<sup>39</sup> These increased prices would need to be compared to the 6% annual savings (\$33) generated by the GMEC contract with which to begin. Remember, it was NOPEC, itself, that had earlier referenced how the return pricing policy might have “unpredictably disastrous financial effects on customers when savings from shopping may be modest” with which to begin.

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<sup>34</sup> OCC had earlier argued that the return pricing policy “presents a serious obstacle to competition. Shoppers are placed at a distinct disadvantage in the event that they return to FirstEnergy’s POLR service. They do not return to the standard service offer. Customers will not know what prices they may encounter under the price plan. When customers are informed of this stark alternative, they may find it reasonable to quit shopping before the pricing plan for returning customers takes effect.”

<sup>35</sup> The utilities had argued that pricing for return customers should be at full market rates. “The Operating Companies’ SSO is market based, and so are rates that reflect the costs of purchasing generation to serve returning customers, even if those rates are different from the SSO. The price to returning customers, who have committed to a multi-year contract (and have received an enhanced shopping credit as a result) and who return to POLR service *before the expiration of that contract*, (emphasis in original), must reflect the market price of generation at the time the Operating Companies go to the market to purchase supply for those customers.”

<sup>36</sup> The OCC had argued that the pricing for return customers should be at POLR prices.

<sup>37</sup> Any “unrecovered costs” imposed on the local distribution utility from returning customers and sought to be recovered through a surcharge, in other words, would need to be presented to the PUCO and approved after hearing.

<sup>38</sup> I offer no opinion on whether GMEC was legally entitled to terminate its contract or on any other legal implication with respect to the GMEC decision.

<sup>39</sup> Again, this SSO-plus-5% can be supplemented by a surcharge to cover “unrecovered costs” as determined by the PUCO.

## **Policy Implications**

- Residential consumers should have the right to balance the costs of the risks that they are asked to shoulder through municipal aggregation against the benefits that they will potentially pocket through such aggregation efforts. Disclosure only of competing retail prices is insufficient to fully inform consumers of the risks that they are being asked to bear.<sup>40</sup> In the case of NOPEC, for example, retail consumers should be informed that their potential 6% savings may be offset by a return pricing policy of the SSO-plus-5%, plus a surcharge for any remaining unrecovered costs.
- Aggregated retail customers should be informed of the track record of the selected municipal aggregator in serving (and, conversely, in abandoning) retail markets before being asked to make decisions on whether to approve or disapprove opt-out aggregation. The abandonment of a particular retail market imposes risks, and costs, on the aggregated customers rather than on the retail supplier (or the aggregating entity). Customers should have the right to be fully informed of the risk to which they are being subjected.
- Significant financial penalties should be imposed upon competitive retail electric suppliers that provide false or misleading information in certification applications, or in *recertification* applications, or that fail to provide updated information when required to do so by statute or regulation. The efficacy of municipal aggregation depends upon aggregators being able to make fully-informed choices. The provision of false or misleading information, or the failure to provide updated information when required, places the entire efficacy of the process of informed selection of competitive providers in question.

### Finding #10

Municipal aggregation is not inherently inclusive of all individuals.

## **Substantive Discussion**

While municipal aggregation is generally viewed as involving a municipal government negotiating prices for all residents of the community, care must be taken to avoid the exclusion of discrete populations. Some Ohio municipal aggregation efforts, for example, have participation prerequisites that would tend to exclude customers for whom aggregation may be most beneficial.<sup>41</sup>

Some Ohio municipal aggregation initiatives have participation criteria that exclude customers that are not “current” on their bills. Definitions of “current” are not provided in the aggregation plan that have

<sup>40</sup> In the case of GMEC, for example, had NOPEC been unable to find a substitute competitive retail electric supplier, the return pricing costs of GMEC’s contract abrogation would have been borne by the retail customers rather than by GMEC, the entity that abrogated its contract.

<sup>41</sup> Due to the unique structure of Ohio’s percentage of income payment (PIP) program, PIP customers are not eligible for participation in municipal aggregation efforts. PIP customers are separately aggregated, on a statewide level, through a state initiative. This separate aggregation is not the exclusion to which reference is made.

been filed with the Public Utilities Commission of Ohio (PUCO). The strong relationship between income and payment-troubled status, however, has been repeatedly documented over the years. Exclusion of payment-troubled customers may well make non-participants of the very customers who would most benefit from aggregation efforts.

The mobility of residential customers is an additional way in which residential customers might be excluded from gaining the benefits of municipal aggregation. Ohio is the state where residential mobility has been specifically addressed in municipal aggregation contracts. No Ohio municipal aggregation plan reviewed to date *excludes* the household changing addresses within the community from the municipal aggregation pool. If a household changes addresses, but stays within the territory of the municipality, the household retains the right to be a member of the pool without fees. In contrast, however, when a household moves *into* a community after the initial opt out period, the household must apply to become a member of the aggregation pool. The community will allow the new customer to become a member of the pool, but does not guarantee that the new customer will receive service at the same price, and on the same terms, as members of the pool that have been a part of the pool since its inception.

As with payment-troubled status, this treatment of mobile households disproportionately affects low-income customers.<sup>42</sup> It has long been recognized that low-income households, which include a disproportionate number of tenants, have disproportionate mobility. While more than three-in-ten of all low-income households change residences in any given year, fewer than one-in-six non-low-income households do so.

In contrast to these Ohio requirements, California's municipal aggregation structure explicitly requires that municipal aggregation make participation available to all residents of a community.<sup>43</sup>

Even within the communities participating in Ohio's municipal aggregation, low-income communities are not well-served. Similar to the analysis of community-size presented above, an analysis of communities by income was performed. Ohio's 1,054 "places" (as identified by the 2000 Census) were ranked by per capita income. Each decile of community was examined to assess how many of the communities in that decile engage in municipal aggregation. The results are as follows:

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<sup>42</sup> This recognizes that Ohio PIP customers are separately aggregated by the state, and are thus not subject to municipal aggregation participation regulations.

<sup>43</sup> Both of these models differ from the Pace Project of New York and the existing aggregation by the Cape Light Compact. The New York and Massachusetts initiatives separate out specific low-income populations for participation in a municipal aggregation effort.

Income by Decile	Ohio Places with Municipal Aggregation			Income by Decile	Ohio Places with Municipal Aggregation	
	Number	Percent			Number	Percent
1	3	2.8%		6	18	17.1%
2	4	3.8%		7	23	21.9%
3	7	6.6%		8	36	34.3%
4	11	10.4%		9	43	41.0%
5	13	12.4%		10	49	46.7%

NOTE: Income determined by per capita income. 1 = lowest income. 10 = highest income.

As can be seen, lower-income communities (as measured by per capita income) are underrepresented in aggregated communities. While each decile has roughly the same number of communities (the lower deciles have been assigned the “extra” communities),<sup>44</sup> the three lowest income deciles have the smallest number of municipal aggregation initiatives, while the three highest income communities have (by far) the largest penetration of municipal aggregation initiatives.<sup>45</sup>

### **Policy Implications**

The policy implications of various findings are heightened by the overlap between various findings. The fact that municipal aggregation is consultant-driven (including contracting out for the ongoing administration of the aggregation) may tend to exclude lower income communities. Because of payment troubles in these communities, for example, additional customer service work can be expected. Cream-skimming potential communities in which to pursue aggregation would thus push aggregators away from these lower income communities. The need for front-end resources may well exclude lower income communities because of the smaller local tax base supporting municipal services (with local governments thus having fewer discretionary resources for municipal services).

- State financial and technical assistance to lower-income communities is needed to promote and support municipal aggregation.
- Municipal aggregation initiatives should, by law, require that all residents within the community be included in the initiative on equal terms and conditions.

<sup>44</sup> All deciles have either 105 or 106 communities.

<sup>45</sup> No effort has been made to identify the precise factors driving the presence or absence of municipal aggregation. Factors appearing to contribute include the size of the community, the per capita income, and the geographic location of the community. Those factors are likely to have substantial overlap, however.

## Finding #11

Opt-out and provider-switching processes have different and offsetting “costs” and consequences.

### **Substantive Discussion**

Opt-out aggregation models are uniformly endorsed as the necessary approach to municipal aggregation (in contrast to opt-in models).<sup>46</sup>

Within the general opt-out approach, two opt-out models appear to exist for broad-based municipal aggregation: the Ohio model and the California model. The Ohio model provides for a short opt-out period but relatively recent renewal time periods. The California model provides for substantial notice and an extended opt-out period, after which there is no provision for renewals.

The Ohio opt-out model provides for a short opt-out period and frequent renewals. Once a community approves a specific competitive energy provider, consumers are notified of the choice along with the terms of the new energy supplier. Consumers are provided a one-time opportunity to opt out of that contract. Once the consumer receives their respective notice, they have between 14 and 21 days to opt out of the new competitive supply. In addition, once they receive confirmation of their switch to the new supplier, all consumers in an Ohio opt-out community have the opportunity to rescind their switch. It appears that this is, effectively, a second opportunity to opt-out of the program. After the opt-out period, customers may switch to an energy provider other than that selected by the municipal aggregator, but the customer would be subject to a switching fee. While the opt out period seems short, Ohio municipal aggregators are required to provide all their residents a new opportunity to opt out of the municipal aggregation program every two years. In addition, of course, an opt out program can not proceed in the first place unless there has been an affirmative majority vote approving the opt out process in a municipal election.

California’s opt out process stands in contrast to this Ohio procedure. California’s municipal aggregation may proceed upon adoption of the appropriate resolution by the local governing body. No municipal election is required. California law requires that all residents of a community be notified twice within a sixty (60) period before the switch to the competitive service provider, and twice again in the sixty day period subsequent to the switch, with an opportunity to opt out of the municipal aggregation initiative at each of those points.<sup>47</sup> After these more extended opt out opportunities, however, no further opportunity is provided for a customer to switch to a different service provider without being assessed a switching fee.

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<sup>46</sup> The Cape Light aggregation for low-income customers and the PACE Project in New York have even different models. These are not applicable, however, since they are tied to specific programs rather than being true municipal aggregation efforts. They are not further discussed in this section.

<sup>47</sup> The R.W. Beck municipal aggregation feasibility study for San Francisco estimated that no more than 10% of the total residential customer base would opt out of the aggregation initiative.

## **Policy Implications**

The trade-offs between the Ohio and California models seem evident. In Ohio, more limited front-end opportunities to opt out are offset by more frequent opportunities to reconsider that decision at a late date. In California, more extended opportunities to opt out are offset by the foreclosure of a cost-free opportunity to reconsider that decision. There appears to be no inherent policy preference for one approach over the other.

### Finding #12

Municipal aggregators approach the ownership of energy in different fashions, with some operating simply as a middleman and others taking ownership and reselling energy.

## **Substantive Discussion**

Two distinct approaches exist to the municipal aggregation of electricity and natural gas purchases. On the one hand is the Ohio approach. Ohio municipalities engaging in aggregation have no role in the ownership and sale of the energy requirements made subject to the aggregation pool. While all residents of the community that do not opt out of the municipal aggregation pool become members of the pool, Ohio communities emphasize that the actual contractual relationship with respect to the energy supply is between the individual customer and the energy supplier. The municipal aggregation pool arranges for the competitive supplier to provide service, but has no role in the actual provision of service.

One impact has been to limit the competition for energy service amongst Ohio's municipal aggregators to commodity competition. Although many municipal aggregators indicate that they will bargain not only for price, but for service benefits and "other community benefits," no evidence of additional non-price based benefits, let alone community-specific non-price benefits, appears in the aggregation plans and contracts filed with the Public Utilities Commission of Ohio (PUCO).

While no specific conversation has occurred with anyone in California about this issue, California appears to have adopted an approach where the municipality, itself, takes on the responsibility of providing energy to its residents. This conclusion is based on the emphasis which California's municipal aggregators place on the ability to reshape load curves, promote renewable portfolios, and increase investments in efficiency measures to reduce load. The entire California approach seems based on the ability of the municipal aggregator to pursue these options as lesser cost (and more environmentally benign) supply options than procuring competitive power supplies.

## **Policy Implications**

- While it may be administratively simpler to have municipal aggregators serve only the function of the "arranger" of service with a competitive service provider, this limited municipal role eliminates the incentive (and opportunity) for municipal aggregators to

negotiate for longer-term cost savings (and energy independence) through investments in efficiency and renewable energy supplies.