

# *Electric Restructuring in New England – A Look Back*

Abstract of white paper released by NESCOE in December 2015<sup>1</sup>

## **Why Restructure?**

In the 1990s, during a period when competitive wholesale power markets were evolving at the federal level, at least half the US states, mostly those with higher-than-national average retail rates, began investigating the potential benefits of opening their retail markets to competition. California, New York, and New England were early leaders in the exploration, although by the late 1990s, the majority of US states, even those with electric rates close to or even below the national average, were also considering the beneficial prospects of deregulating their retail supply markets, particularly given seemingly unrelenting rate increases over the previous few decades.

The US Government Accounting Office in 2002 offered a succinct explanation to Congress for the rationale behind states' interest in pursuing electric restructuring:

“The goal of restructuring the electricity industry is to increase the amount of competition in wholesale and retail electricity markets, which is expected to lead to a range of benefits for electricity consumers, including lower prices and access to a wider array of retail services than were previously available. Increasing the amount of competition requires structural changes within the electricity industry, such as allowing a greater number of sellers and buyers of electricity to enter the market. Competition is expected to produce benefits for consumers by increasing the efficiency of wholesale electricity generation and by encouraging innovations in retail electricity services. Such efficiency gains are expected to occur as a result of improved incentives for electricity suppliers to provide better service at lower prices.<sup>[9]</sup>

It was widely noted in other documents and discussions of the time, including at the state level, that competitive wholesale electric markets were essential for encouraging investment in more efficient generation that might lead to price reforms and many observers saw the need to ultimately open the retail markets, to complete the transformation by offering all end-use customers a choice of competitively-priced supply options, including renewable energy.

State policymakers across the US expressed several rationales in the 1990s to support the adoption of electric retail restructuring, in some cases explicitly stating their goals in the enacting legislation or orders. Among the goals most often cited were:

- Market mechanisms are preferred over regulation to set prices where viable markets exist, and, all else equal, should result in cost savings to consumers.

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<sup>1</sup> Available in full at <http://nescoe.com/resource-center/restructuring-dec2015/>.

- Risks of business decisions should fall on investors rather than consumers.
- Consumers' needs and preferences, including a choice of clean energy options, should be met with the lowest costs.
- Electric industry restructuring should not diminish environmental quality, compromise energy efficiency, or jeopardize reliability.

By the year 2000, five of the six New England states, all but Vermont, had chosen to restructure their retail power markets as well. The characteristics shared by the state restructuring plans included divestiture of the bulk of the investor-owned utilities' generation fleet, recovery of the utilities' stranded costs in rates, and the granting to end-use customers the option of choosing from alternative competitive suppliers.

In the decades since the opening of wholesale competition, the region increasingly relied on additions of new natural-gas fired generation, which led to improvements in overall fleet operating efficiency, as well as lower emissions of both conventional and carbon pollutants. Average consumer power prices in the region generally rose as they did during this time period across the US, in both restructured and non-restructured states.

Several policy and market dynamics issues have arisen in the years since restructuring was enacted in the 1990s that may not have been fully contemplated at the start. These present new challenges and opportunities, especially to state policymakers and others who are responsible for the future of the evolving electric power system. However, much of the original impetus remains the same for the policymakers of today, namely, to serve consumers in a way that is cost effective and reliable while advancing environmental and other objectives.

## **Specific rationale offered by New England state policymakers**

The New England states, including Vermont, were among the first states in the US to explore the potential benefits of retail restructuring. Legislatures and public utility commissions began examining the issue through a variety of initial inquiries and utility pilot programs, by the mid-1990s. In the year 2000, five of the six New England states had partially or fully restructured their electric retail markets.

Specific rationale for adoption of retail-level restructuring was often included in a state's enabling legislation. For example, a 1999 New Hampshire Commission report described its Legislature's intent in opening retail markets, noting "...it has become apparent in industry after industry that the natural monopoly presumption no longer necessarily applies, and that competition is appropriate in areas including local telephone service and electric generation. The Legislature also found that '[m]arket forces can now play the principal role in organizing electricity supply for all customers instead of monopoly regulation' and '[i]t is in the best interests of all the citizens of New Hampshire...to

establish a competitive market for retail access to electric power as soon as it is practicable.”<sup>[13]</sup>

More explicitly, Rhode Island’s legislation stated the following seven goals for opening the retail electric markets in its state:

- “(1) that lower retail electricity rates would promote the state’s economy and the health and general welfare of the citizens of Rhode Island;
- (2) that current research and experience indicates that greater competition in the electricity industry would result in a decrease in electricity rates over time;
- (3) that greater competition in the electricity industry would stimulate economic growth;
- (4) that it is in the public interest to promote competition in the electricity industry and to establish performance-based ratemaking for regulated utilities;
- (5) that in connection with the transition to a more competitive electric utility industry, public utilities should have a reasonable opportunity to recover transitional costs associated with commitments prudently incurred in the past pursuant to their legal obligations to provide reliable electric service at reasonable costs;
- (6) that it shall be the policy of the state to encourage, through all feasible means and measures, states {where fossil-fueled electric generating units producing air emissions affecting Rhode Island air quality are located to reduce such emissions over time to levels that enable cost effective attainment of environmental standards within Rhode Island;
- (7) that in a restructured electrical industry the same protections currently afforded to low income customers shall continue.<sup>[14]</sup>

Likewise, the Connecticut Commission offers the following summary of the rationale on its website explaining restructuring to the public:

- “Overall, the General Assembly concluded that competition among electric generating companies is in the public interest, especially by:
- benefiting the state’s electric consumers by providing both choice and the opportunity for savings,
  - benefiting the state’s economy by creating opportunities to bring in new electric generating companies and new generation technology,
  - benefiting the state’s environment by encouraging generating companies to develop and new technologies which improve air quality,
  - benefits the environment by mandating conservation and renewable resources portfolio.<sup>[15]</sup>

Although the Vermont Public Service Board at the time also recommended moving forward with deregulation, restructuring legislation failed to win support in both chambers for several years. A statewide task force established by Vermont Governor

Dean in 1998 also recommended restructuring but the House ultimately elected not to proceed, and the state currently remains the only one in New England not to have adopted policies in some fashion to restructure its vertically integrated power utilities.

But the rest of the states in the region moved forward quickly. Following the success of several small pilot programs in the region, New Hampshire's legislature in 1996 was the first state in the nation to pass a bill enabling restructuring. Rhode Island followed quickly and was the first state to officially implement restructuring in 1997, with Maine, Massachusetts and Connecticut all moving forward with their restructuring plans before the end of the decade.

In fact, by the year 2000, roughly half of US states had passed restructuring legislation and begun implementation, including California, New York, and most of the mid-Atlantic states, and many of the remaining US states were actively exploring the prospect. The national interest in and activity surrounding expansion of state restructuring came to an end, however, with the California energy crisis of 2000-2001.

## **Elements of retail restructuring**

Although the specific details of the restructuring plans vary by each state and by affected utilities<sup>[18]</sup> within a state, the elements of retail restructuring plans adopted across the country, including New England, are broadly similar. They generally included:

- Divestiture or structural separation of all or a significant portion of the generation fleet held by the formerly vertically integrated electric utility, either as mandated by law or a result of negotiations as part of an overall settlement agreement. The remaining franchise utility would continue to provide delivery service of power to end-use customers as a regulated local transmission and distribution (T&D) company, also referred to colloquially as “the pipes and wires” company;
- Proceeds from the sale or transfer of divested generation assets were typically put towards offsetting the size of the transition charge, also known as “stranded costs” embedded in the utility's rate base; the stranded cost figure represented the amount of regulator-approved but ultimately uneconomic investments in generation, regulatory assets, and above-market Purchased Power Agreements (PPAs) for Qualifying Facilities (QFs) that were still being recovered from customers in rates prior to restructuring;
- A “provider of last resort,” (POLR) “default service,” or “standard offer” provision, in essence, to supply power generation to customers who choose not to migrate to a competitive offer, or who were economically unattractive to competitors and therefore unable to secure alternative supply service;

- Multi-year rate freezes or mandated rate decreases in the first years of restructuring, to provide immediate savings to consumers or, at a minimum, to avoid unexpected rate increases for an initial period;
- Consumer protections in the form of competitive supplier rules and statewide efforts to educate consumers on their option to choose a competitive supplier;
- Unbundling of the bills, so that consumers could clearly see and better understand the disaggregated charges as separate line items that comprised their total electricity charge, which typically included distribution, transmission, system benefits (such as energy efficiency charges), stranded cost or transition charges, and the now-competitive generation component. In many states, competitive suppliers were given the option to have their generation charges appear on the distribution utility's bill, so that customers continued to receive a single monthly bill, to reduce potential confusion among consumers.

The restructuring plans of the New England states generally included most of these elements. For example, of the five restructured states, all but Maine instituted immediate multi-year rate freezes or decreases for the default service retail rate at the start of the plans. Divestiture of most of the utility-owned fossil-fired units in the region was either mandated by law or negotiated as part of the overall restructuring settlement agreements in each state.

*In addition to noting the similar goals of policymakers in other states as well as the expectations of non-policymaker stakeholders, the remainder of the 2015 white paper delved into several key aspects of restructuring, including details of the stranded cost recovery and rate freezes in each state, a note about improvements in natural gas fired generation technology, and a discussion of the early experience of customer “switching” to competitive retail suppliers. This is followed by a brief discussion of some of the policy issues that had emerged which had not necessarily been contemplated by stakeholders in the 1990s, including the growth in distributed generation and energy efficiency, the emergence of state-supported contracts for renewable energy projects, the challenge of increased reliance on natural gas fired generation, the role of demand response, and rising interest in grid modernization.*

*Appendices of the paper included program highlights and events in the New England states related to restructuring activity, as well as an annotated bibliography for further reading on specific topics of interest.*

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