

D.T.E. 99-60-C

Investigation by the Department of Telecommunications and Energy on its own Motion into the Pricing and Procurement of Default Service Pursuant to G.L. c. 164, § 1B(d).

ORDER ADDRESSING RECOMMENDATION OF THE WORKING GROUP ON
DEFAULT SERVICE ISSUES

I. INTRODUCTION

In Pricing and Procurement of Default Service, D.T.E. 99-60-B, the Department directed interested participants to set up a working group to: 1) develop processes for providing customers information that would educate them about changes in default service prices; and 2) develop standards, protocols, and schedules for information exchange between the distribution companies and their customers regarding changes in default service prices. Pricing and Procurement of Default Service, D.T.E. 99-60-B at 22-23 (2000). The Department directed the default service working group ("Working Group") to submit its recommendations within 60 days of the issuance of this Order. Id. On August 30, 2000, the Working Group submitted its recommendations to the Department ("Working Group Report").

The Working Group consisted of Associated Industries of Massachusetts ("AIM"), the Office of the Attorney General ("Attorney General"); the Division of Energy Resources ("DOER"); Energyguide.com; Essential.com; Fitchburg Gas and Electric Light Company ("Fitchburg"); Green Mountain Energy Company ("Green Mountain"); MHI, Inc. ("MHI"); Massachusetts Electric Company and Nantucket Electric Company (together "MECo"); NewEnergy East L.L.C. ("NewEnergy"); Boston Edison Company, Cambridge Electric Light Company and Commonwealth Electric Company, (together "NSTAR"); PG&E National Energy Group; Smartenergy.com; and Western Massachusetts Electric Company ("WMECo") (Working Group Report at 1-2). In order to develop the recommendations, the Working Group met at the Department's offices on July 27, August 3, August 10, August 17, and August 24, 2000 (id. at 2).

The Working Group addressed the following issues: 1) the development of an implementation plan to notify customers of the available default service pricing options and pending rate changes; 2) the process and timing of Department review of the results of a distribution company's default service solicitation; 3) the manner by which customers' bills will be calculated; 4) reconciliation of default service costs and revenues; and 5) the process and timing of customers switching between pricing options. The Working Group reached consensus on all issues except the reconciliation of default service costs and the process and timing of customers switching between pricing options. In addition, Working Group participants were permitted to file individual comments regarding the Working Group Report.⁽¹⁾ Each of the issues addressed by the Working Group is discussed below. Although not bound by the results of the process, the Department and the Commission thank the Working Group not only for its efforts but also for its generally sound and thoughtful recommendations.

II. THE WORKING GROUP REPORT

A. Customer Notification of Default Service Pricing Issues

1. Description

a. Introduction

The Working Group reached a consensus recommendation on the process by which customers will be notified of the upcoming changes in default service pricing (id. at 4-8). The Working Group established separate notification processes for: 1) the initial change in pricing (i.e., the prices that will be in effect during the first six-month default service term in which market-based prices are used), 2) the subsequent change in pricing (i.e., the prices that will be in effect during the second six-month default service term), and 3) future price changes.

b. Notification for Initial Default Service Term

The Working Group proposes a three-step process⁽²⁾ to notify customers regarding the changes in default service pricing that will take effect (both the move to market-based prices and the availability of two pricing options) during the first six-month default service term (id. at 5-7):

(1) An initial notification will be directed to all customers providing general information on the restructured electric industry. This initial notification has been approved by the Department to be included in customers' September bills (id. at 5-6, ¶1).

(2) A second notification will be directed only to default service customers, providing these customers with information on the specific changes that will be taking place for default service pricing. The Working Group seeks approval of this second notification, which is included as Attachment B to the Working Group Report (id. at 6, ¶2).

(3) A third notification will be directed only to default service customers, providing these customers with the actual prices that will be in effect for each distribution company. The third notification will be timed so that all customers will receive it at least 30 days before the new default service prices take effect. In addition, each distribution company will make its default service prices available on its Website and through a toll-free telephone number at least 45 days before the prices take effect (id. at 6, ¶4).

Under the Working Group consensus recommendation, the timing of these notifications and the manner in which they will be provided to customers (i.e., through a bill insert or direct mailing) may differ for each distribution company, depending on the company's specific circumstances. For example, a company that seeks to change its default service prices before January 1, 2001, may propose to combine two of the notifications and provide the combined notification to default service customers through a direct mailing in order to effectuate an early change in their prices (id. at 5, 6, ¶4).

c. Notification for Second Default Service Term

The Working Group proposes the following customer notification process for the change in default service prices that will take effect at the beginning of each distribution company's second six-month default service term:

(1) Beginning 60 days before the price change takes effect, each distribution company will place a message on customers' bills that will inform customers that a change in default service prices is upcoming and that the new prices will be made available on the company's Website and through a toll-free telephone number at least 30 days before the new prices take effect. The effective date of the price change will also be identified. (id. at 7, ¶¶6-8).

(2) During the bill cycle preceding the price change, each distribution company will place a message on customers' bills listing the new prices and the effective date. In addition, each company will include a bill insert that provides customers with information on the two default service pricing options (id. at ¶¶6-8).

d. Notification for Subsequent Default Service Terms

The Working Group proposes the following customer notification process for the change in default service prices that will take effect at the beginning of all subsequent default service terms:

(1) Beginning 60 days before the price change takes effect, each distribution company will place a message on customers' bills that will inform customers that a change in default service prices is upcoming and that the new prices will be made available on the company's Website and through a toll-free telephone number a certain number of days before the new prices take effect (id. at 8, ¶¶10-11). The Working Group states that it "did not reach agreement as to the period of time that would be reasonable and/or appropriate on a going forward basis for advance notice of price changes" and will continue to discuss this issue (id. at n.6).

(2) During the bill cycle preceding the price change, each distribution company will include a bill insert that provides customers with information on the default service pricing options (id. at ¶12).

2. Discussion

In addressing these customer notification issues, it is necessary to balance between two competing objectives: 1) providing customers with sufficient notice of upcoming changes in default service prices; and 2) minimizing the time between when suppliers commit to their bid prices (i.e., when default service supply contracts are finalized) and when the prices take effect.⁽³⁾ For the initial change in default service pricing, the Working Group proposed a 45-day notification period via electronic means (i.e., via Websites and toll-free

telephone numbers), and 30-day notification via written means. For the second default term, the notification period is reduced to 30 days via electronic means. Written notification would range between zero and 30 days, depending on a customer's billing date.⁽⁴⁾ For subsequent terms, customer notification would occur only electronically, which means that customers would have to visit the Websites or call the toll-free telephone numbers in order to identify the new default service prices before they go into effect. For the subsequent terms, the Working Group was unable to reach a consensus agreement on how far in advance of the effective date the new default service prices should be made available to ratepayers.

Customer notification and education issues were the primary focus of the Working Group. The fact that the Working Group, whose members represented a broad range of interests, was able to reach consensus on this issue (at least for the first and second default service terms) demonstrates that the members consider the recommendation to be an appropriate balance of the two objectives described above. The Working Group recommendations appropriately take into account the need for significant advance notice to customers during the initial transition to market-based default service prices. The recommendations also recognize that the need for advance notice lessens as customers become more accustomed to market-based prices. Therefore, for the initial period of transition to market-based prices, the Department accepts the recommendation of the Working Group for a 45-day notification period via electronic means, saving its discretion to shorten this period if, in its judgment, circumstances so warrant. For the initial period, the Department also accepts the recommendations of the Working Group for a 30-day notification via written means.

The Working Group report leaves to the discretion of the distribution company the manner in which the initial notice will be provided to customers (*i.e.*, through a bill insert or direct mailing). Bill inserts are the typical method distribution companies use to inform customers of changes in rates and other services. For the initial transition period to

market-based prices it is important to ensure that customers receive timely and effective notice of the upcoming changes in pricing options and pending rate changes. Direct mail signifies to the customer that the company has something important to say. Direct mail also insures that all customers receive notice at approximately the same time. For these reasons, we conclude that direct mail is a better method of gaining consumers' attention. While the Department accepts the consensus customer notification recommendations of the Working Group for the first and second default service terms, we further require distribution companies to use direct mail for all notices sent for the first default service term.

The Department is concerned about the lack of resolution of notification issues on an on-going basis, in particular, the period of time in advance of default service price changes that new prices would be made available electronically (*i.e.*, on companies' Websites and

toll-free telephone numbers) to customers. Although the Department recognizes that this issue may not need to be resolved immediately, it is important to establish a policy that will be in effect after the second default service term. Therefore, we will apply the 30-day advance electronic notice established for the second default service term to subsequent terms, unless events warrant a different approach. The Department will consider modifying this policy if further consensus agreement is reached on how far in advance of the effective date the new default service prices should be made available to ratepayers.

Finally, the Department notes that the Working Group is developing a fourth notification, which will be provided to customers with their first bill that includes the new default service price. The Department directs the Working Group to submit this notification for Department review within 30 days of the date of issuance

of this Order.

B. Department Review Of Default Service Solicitation Results

1. Description

Distribution companies must file the results of their default service solicitations with the Department. D.T.E. 99-60-B at 22. The Department will then determine whether any additional investigation is necessary. Id. The Working Group reached a consensus recommendation that the Department institute a five business-day review period within which to initiate an investigation of the proposed price that results from the default-service solicitation (Working Group Report at 9). Under this recommendation, if no action is taken by the Department within the five business days, the propose default service price would be allowed to go into effect (id.).

2. Discussion

Similar to the discussion above, the two competing objectives that must be balanced are: 1) allowing the Department sufficient time to review the results of default service solicitations, and 2) minimizing the time between when suppliers commit to their bid prices and when the prices take effect (in this regard, Department responsiveness is essential to making markets work). It is important to note that the length of any Department review must be added to the customer advance notification period to determine the total length of time between the supply contract finalization date and the price change effective date. A five-day review period is an appropriate balance of the two objectives. Therefore, the Department accepts the consensus recommendation of the Working Group.

C. Proration of Customer Bills

1. Description

The Working Group reached a consensus recommendation that a customer's bill be prorated when the customer's billing period encompasses a period of time during which two different default service prices are in effect (id. at 9-10). For example, for a customer whose billing period runs from January 15 through February 15, the applicable default service price for usage during the second half of January would be the price in effect during January, while the applicable default service price for usage during the first half of February would be the price in effect during February.⁽⁵⁾ For customers on the variable (i.e., monthly) default service pricing option, proration would occur monthly. For customers on the fixed (i.e., six-month) default service pricing option, proration would only occur every six months, when the fixed price changes.

The Working Group states that prorated rate changes: 1) minimize customer confusion because these types of changes are familiar and understandable to customers, and 2) allow customers to match wholesale market prices (as reflected in the default service prices) with their retail energy consumption (id. at 10).

2. Discussion

An underlying goal of the Department's default service pricing policies is to ensure that, to the extent

possible, default service customers pay the full costs of providing that service. See D.T.E. 99-60-A at 10. The proration approach to calculating customers' bills accomplishes this goal. The alternative to proration is the "fuel charge model," in which all of a customer's usage is billed at the rate that is in effect during the month that the bill is received.⁽⁶⁾ The proration approach will produce better estimates of default service costs, thus more closely matching default service costs with default service revenue and ensuring that customers receive appropriate signals regarding the underlying costs of their usage. Therefore, the Department accepts the Working Group's consensus recommendation.

D. Reconciliation of Default Service Costs

1. Description

The precise level of a distribution company's default-service costs each month may not equal its default service revenues collected each month because some level of estimation will be involved in determining the default-service price. For example, in order to determine the six-month fixed price, the distribution company estimates its default-service load for the

six-month period. This estimation may also depend in part on the specific contractual terms of the procurement contract(s) and the mix of resources used. As a result, the Working Group agreed that distribution companies will face the need to reconcile default service costs and revenues on a periodic basis (id. at 11).

The Working Group recognized that two issues were involved in establishing a reconciliation mechanism: 1) whether reconciliation should occur on an annual, semi-annual, or monthly basis; and 2) whether the reconciliation amount would be collected from or refunded to all customers of the distribution company or only default-service customers (id.). The Working Group was unable to reach a consensus recommendation regarding the manner in which default service cost under- and over- recoveries would be collected from or refunded to customers (id.).

With regard to the timing of the reconciliation, AIM, Fitchburg, MECo, MHI⁽⁷⁾ and NSTAR argue that the default service reconciliation should be governed by the companies' default service adjustment factor tariffs which provide for a reconciliation on an annual basis (AIM Comments at 1, MECo Comments at 1, MHI Comments at 1, Fitchburg Comments at 1, NSTAR Comments at 1-2). With regard to whom the reconciliation amount should be collected from or refunded to, these same companies argue that the default service reconciliation should also be governed by the companies' default service adjustment factor tariffs which provide that any under- or over-recovery be collected from (or refunded to) all customers of the distribution companies (id.). As further support, AIM, the Attorney General, MECo, MHI, NSTAR, and Fitchburg argue that default service acts as insurance for all customers who enter the competitive market and it assures all customers who move to a new service territory that they will be provided service. Accordingly, these commenters assert that this obligation benefits all customers, and therefore, should be spread among all customers (AIM Comments at 1, Attorney General Comments at 1-2, MECo Comments at 1, MHI Comments at 1, Fitchburg Comments at 1-2, NSTAR Comments at 2). Further, the Attorney General and NSTAR argue that any reconciliation surcharge assessed solely against default service customers would result in default service rates in excess of the market average and, thus, would violate the requirements of G.L. c. 164, § 1B(b) (Attorney General Comments

at 2, NSTAR Comments at 2).

Alternatively, DOER argues that the default service reconciliation amount should be collected from or refunded to only default service customers because this amount is a part of the costs of providing default service (DOER Comments at 1-3). In support of its position, DOER notes that the Department had previously stated that "default service prices must take into account the full costs of providing the service in order to encourage the development of robust competitive retail markets" (id. citing D.T.E. 99-60-A at 10). While DOER recognizes that all customers of the distribution company benefit from the availability of default service, it argues that the costs for over and under recovery that would be subject to reconciliation are directly related to generation and are distinguishable from other administrative or marketing costs (DOER Comments at 2).

2. Discussion

The default service reconciliation is part of the cost of providing default service. That cost ideally should be recovered from or refunded to the customers that cause the cost. However, default service is intended to act as a safety net for all customers even if they do not currently receive generation supply from a default service provider. Further, the number of customers on default service at one time may constantly change. Who, then, causes these costs to be incurred? Cost causation may be ascribed both to customers actually partaking of default service and, to some extent, the mass of customers who are eligible to do so (even if, in fact, they do not so partake) and on whose behalf an electric company secures the insurance fallback of default service eligibility. Consequently, collecting or refunding the default service reconciliation costs from or to default service customers may not collect or refund the costs from the actual customers that caused the cost, and may result in large swings in the default service price since the load may vary significantly from one month to the next month. Therefore, it is not practical to collect or refund the default service reconciliation costs from or to only actual default service customers.

Default service does act as insurance for all customers who enter the competitive market; and it does assure all customers who move to a new service territory that they will be provided service. Accordingly, this obligation benefits all customers, and therefore, the

over- or under-recovery should be spread among all customers. Consistent with the language of the companies' default service adjustment tariffs, it is appropriate to reconcile these costs annually.

E. Customers' Ability to Switch Pricing Options

1. Description

In D.T.E. 99-60-B, the Department established two default service pricing options: 1) a variable option, in which prices would change monthly; and 2) a fixed option, in which prices would remain constant for six-month periods. D.T.E. 99-60-B at 6. Residential and small commercial and industrial ("C&I") customers would automatically be placed on the fixed option, while medium and large C&I customers would automatically be placed on the variable option. Id. A customer could switch between pricing options only once during an uninterrupted stay on default service. Id. The Department placed no limitations on when a customer could make the switch in pricing options.

The Working Group Report includes two proposed modifications to the policy established in D.T.E. 99-60-

B. Under the first modification, customers would be allowed to switch pricing options only at the beginning of each six-month default service term, thus ensuring that customers would remain on the same pricing option for each month of the term (Working Group Report at 14-15). All members of the Working Group except Green Mountain and NewEnergy support this modification, stating that it is necessary to eliminate the incentive for customers to switch pricing options (from the variable to the fixed option) in the middle of a six-month term solely to avoid paying their fair share of default service costs (Working Group Report at 12, n.7, 15). The proposed modification would not apply to residential and small C&I customers until each distribution company's second default service term,⁽⁸⁾ in order to minimize customer confusion during the transition to the new default service pricing policies (*id.*). Green Mountain and NewEnergy object to the modification, stating that it falls outside the scope of issues assigned to the Working Group by the Department (Green Mountain and NewEnergy joint Comments at 1-2).

Under the second proposed modification, residential and small C&I customers participating in municipal aggregation programs would automatically be placed on the variable, rather than the fixed, pricing option (Working Group Report at 18). These customers could change to the fixed option at the start of the subsequent six-month service term (*id.*). All members of the Working Group support this modification, stating that it is necessary to eliminate the incentive for municipal aggregation suppliers to switch residential and small C&I customers to default service under the fixed pricing option during high-cost periods (*i.e.*, when market prices exceed the fixed default service price) (*id.* at 18-19). In addition, while the Attorney General does support the recommendations of the Working Group designed to minimize uneconomic gaming, he encourages the Department to undertake a more comprehensive examination of mechanisms that should be adopted to minimize the adverse effect that gaming opportunities can have on the cost of default service (Attorney General Comments at 2).

2. Discussion

The manner in which customers are able to switch between pricing options is established in D.T.E. 99-60-B. See D.T.E. 99-60-B at 6-10. Modifying the Department's order to place additional limits on the ability of customers to switch between pricing options, is outside of the scope of tasks assigned to the Working Group, however thoughtful the Working Group's recommendations may be. See *Id.* at 22-23.

The Department acknowledges that a potential exists for customers (or their suppliers) to "game" the system by switching pricing options. By way of example, assume that in each six-month default service term, the first two months are low-cost months, the middle two months are high-cost months, and the final two are low-cost months. Under the guidelines established in D.T.E. 99-60-B, a residential or small C&I customer could be enrolled with a competitive supplier during the first two months (when market prices are low), could move to default service under the fixed price option for the next two months (when market prices are high and exceed the fixed default service price), and then switch to the variable pricing option for the final two months (when market prices are low). The customer could repeat this pattern for each default service term. Precluding customers from switching pricing options in the middle of the six-month term would mitigate this potential problem. In addition, requiring that municipal aggregation customers who move to default service in the middle of a term be initially placed on the variable pricing option would mitigate "gaming" by these customers and their suppliers.

However, if the proposed modifications are adopted, the ability of customers to switch pricing options would

be substantially restricted. Customers who contact distribution companies to state that they wanted to switch pricing options in the middle of a default service term would be informed that: 1) they could not switch pricing options at the present time, and 2) they can request a switch in pricing options only during the last month of the present six-month term (see Working Group Report at 16). In terms of the modification targeted at residential and small C&I customers participating in municipal aggregation programs, this modification would result in these customers operating under different rules than apply to other residential and small C&I customers, who would automatically be placed on the fixed pricing option.

The Department concludes that the proponents of the modifications have not sufficiently demonstrated that the modifications are necessary at this time. Although the proponents establish that the potential exists for certain "gaming" activities, the Department does not have enough information to evaluate whether these activities are likely to occur. Therefore, the Department will not adopt the proposed modifications at this time. Electric restructuring is, however, an evolving process. Certainty is essential to an evolving market, but suppleness in the face of emergent situations is also essential. As stated in D.T.E.

99-60-A, the Department intends "to review periodically the effectiveness of our policies and to make necessary modifications as circumstances dictate." D.T.E. 99-60-A, at 6. The Department will monitor events as they unfold to determine if this type of "gaming" occurs as predicted and will revise our policy in the future, as appropriate.

As a final matter, the Department notes that the default service tariffs currently on file with the Department need to be revised to accurately describe the terms and conditions under which each distribution company will provide default service to its customers. The Department directs each distribution company to submit new default service tariffs, within 30 days of the issuance of this Order, consistent with the pricing and procurement directives contained in D.T.E. 99-60-A, D.T.E. 99-60-B, and D.T.E. 99-60-C.

III. DEFAULT SERVICE AND THE COMPETITIVE MARKET

As a closing point, we note that under the 1997 Electric Restructuring Act, default service is so named for a good reason. It will be the ultimate fallback for electric service after February 2005. Default service cannot artificially undercut the competitive market, but must, if that competitive market is to function well for the benefit of all consumers, derive from and be governed by those same market forces. The sooner default service finds its proper role sending an efficient price signal, the smoother and sounder the remaining path to competitive wholesale and retail markets will be.

IV. ORDER

After due notice and consideration, it is

ORDERED: That all electric distribution companies comply with the final guidelines for the pricing and procurement of default service contained herein.

By Order of the Department,

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr. Commissioner

Deirdre K. Manning, Commissioner

1. AIM, the Attorney General, DOER, Fitchburg, Green Mountain, MHI, MECo, NewEnergy and NSTAR filed individual comments regarding the Working Group Report.
2. A fourth notification will be provided to customers with their first bill that includes the new default service price. The notification is still under development and will be submitted for Department review at a later date (Working Group Report at 6, ¶5).
3. Minimizing the period of time between when suppliers commit to their bid prices and when the prices take effect minimizes the risk that suppliers must bear, which should result in lower bid prices.
4. This range in the number of days for written notification is because such notification would be provided in customers' bills during the month preceding the price change. Customers whose billing date is early in a month would receive the notification close to 30 days before the price change, while customers whose billing date is late in a month would receive the notification close to zero days before the price change.
5. The proration approach assumes that a customer's usage over a billing period occurs equally each day (Working Group Report at 9-10).
6. For example, for a customer whose billing period runs from January 15 through February 15, the applicable default service price for usage during the whole billing period would be the price in effect during February.
7. MHI states that the rate treatment of these costs "is or should be covered" by the default service adjustment factor tariffs. However, to the extent that this issue is not adequately addressed in the tariffs, MHI recommends that the default service reconciliation be performed monthly (MHI Comments at 1).
8. That is, residential and small commercial customers would be able to switch from the fixed to the variable at any time during the initial default service term.

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