

COMMONWEALTH OF PENNSYLVANIA

Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, Pennsylvania 17101

William R. Lloyd, Jr.
Small Business Advocate

(717) 783-2525
(717) 783-2831 (fax)

November 17, 2010

**TESTIMONY BEFORE THE
HOUSE CONSUMER AFFAIRS COMMITTEE
ON MUNICIPAL AGGREGATION LEGISLATION**

Chairman Preston and members of the Committee, thank you for the opportunity to comment on possible changes in House Bill 2619 before its introduction in the next legislative session.

HB 2619 would authorize a municipality to purchase generation service for small business customers with a maximum peak load of less than 50 kilowatts ("kW"). To a large extent, customers in this category are the type of restaurants and retail establishments sometimes called "Mom and Pop" businesses.

The premise underlying the legislation is that "Mom and Pop" businesses would benefit from "shopping" for generation service but that it is too costly for electric generation suppliers ("EGSs") to market to those customers on an individual basis. However, "Mom and Pop" businesses *are* likely to have at least some shopping opportunities without the legislation. First, local chambers of commerce are already aggregating their members on a voluntary basis in the hope of getting better generation rates. Second, some chain fast food restaurants and gas

stations/convenience stores that fall into the category covered by the legislation will probably buy generation as part of their chain.

The legislation aims to provide another shopping alternative. Specifically, an EGS would be authorized to enroll “Mom and Pop” businesses on a collective basis through their municipality rather than to incur the cost of soliciting those customers individually.

Under the current draft of HB 2619, the municipality could choose either an “opt-out” or an “opt-in” aggregation program.¹ However, as a practical matter, municipalities are likely to select opt-out because EGSs are likely to offer better rates under opt-out than under opt-in.

Opt-out municipal aggregation will assign “Mom and Pop” businesses to an EGS that elected officials have chosen for them. Those businesses will be forced to take affirmative steps to continue receiving “default” service.

Unfortunately, opt-out municipal aggregation will destroy the default service model the General Assembly and the Commission have spent years to create. To understand why the OSBA has reached that conclusion, I will discuss some of the major pitfalls of opt-out aggregation.

Problems with Opt-Out Aggregation

1. Illusory “Discounts” for Participants

The EGSs supporting municipal aggregation will be quick to point out that opt-out aggregation will provide “Mom and Pop” businesses with “discounts” off the default service rate. That sounds enticing. However, the problem is that opt-out aggregation will increase the cost of default service. Therefore, any “discount” provided to these small business customers through aggregation is likely to be a discount from an *inflated* default service rate. As a result,

¹ See House Bill 2619, Printer’s Number 4406, page 6, line 24, through page 7, line 4.

municipal aggregation customers may not receive a discount at all; instead, they may pay higher prices for generation than they would have if municipal aggregation had never been authorized.

2. Higher Rates in Non-Participating Municipalities

An inflated default service rate will also mean higher electric rates for “Mom and Pop” businesses located in municipalities that are *not* participating in aggregation.

Default service rates will increase primarily because of the way the major electric distribution companies (“EDCs”) are purchasing electricity for their default service customers for the period from January 1, 2011, through May 31, 2013. Specifically, these EDCs are competitively acquiring electricity through full-requirements, load-following contracts to serve those small business customers that remain on default service. Under full-requirements, load-following contracts, wholesale suppliers absorb the risk that customers will switch into and out of default service during the term of the contract. To compensate for this switching risk, the suppliers include an adder, or “risk premium,” in their bids. Opt-out municipal aggregation will substantially increase that risk premium because of greater uncertainty about the load the wholesale suppliers will be serving. As a result, default service rates will increase for small business customers that continue to receive default service.

The increased switching risk created by opt-out municipal aggregation may also cause fewer suppliers to submit bids in default service procurements. Having fewer bidders is likely to mean higher winning bids and, as a result, further upward pressure on default service rates.

Over time, customers in the non-participating municipalities are likely to pressure their local elected officials to enter aggregation contracts in the hope of getting “discounts.” Unfortunately, as the number of customers left on default service continues to decline, default service rates are likely to continue spiraling upward.

3. Inadequate Mitigation of Higher Default Service Rates

The current version of the legislation attempts to mitigate the problem of higher default service rates by requiring the coordination of municipal aggregation with default service bidding.² However, the current draft provides no details as to how that coordination is to be done, thereby presumably requiring the matter to be litigated before the Commission.

Furthermore, the draft would empower the Commission to allow EGSs to initiate opt-out municipal aggregation before June 1, 2013. That means increased uncertainty and increased risk during the period for which EDCs are already buying default service electricity. Therefore, regardless of the eventual Commission decision on the timing questions, the mere fact that there will be litigation will be enough uncertainty to cause default service rates to go up.

Given the potential rate increases for small business customers not in a municipal aggregation program, the OSBA is opposed to the enactment of opt-out legislation. However, if the General Assembly decides to move forward, the OSBA recommends that municipal aggregation not take effect until the default service period beginning June 1, 2013. With that change in the legislation, the EDCs could design their next default service plans in a way that would avoid, or at least mitigate, the adverse effect on default service rates.

For example, EDCs could ask the Commission to require that municipalities decide, prior to default service bidding, whether the municipalities will, or will not, be participating in aggregation during the default service period. Having that information prior to bidding would provide prospective suppliers with greater certainty of the default service load they would be bidding to serve, thereby at least leading to a smaller risk premium.

² See House Bill 2619, Printer's Number 4406, page 22, lines 1-13.

4. Inter-Class Subsidization

In addition to increasing default service rates for small business customers, HB 2619 would undermine another key feature of the current default service design, *i.e.*, the ban on inter-class subsidization. Under the Commission's default service regulations, EDCs are required to avoid inter-class subsidization through procurement of electricity by rate class. Bidding by rate class allows the market, rather than the regulatory process, to determine relative costs of service. Consistent with the Commission's requirement, Section 2807(e)(7) of the Public Utility Code, 66 Pa. C.S. §2807(e)(7), specifies that "[a]ll default service rates shall be reviewed by the commission to ensure that the costs of providing service to each customer class are not subsidized by any other class." Unfortunately, HB 2619 would allow local elected officials to provide larger discounts to residential customers than to small business customers.³ Such a decision would amount to just the kind of rate discrimination the Commission and the General Assembly have sought to avoid.

5. Absence of Commission Oversight

As a practical matter, opt-out municipal aggregation will result in a substantial number of "Mom and Pop" businesses paying a generation rate that is neither regulated by the Commission nor determined in accordance with a procurement plan approved by the Commission. In theory, market forces will prevent an EGS from overcharging small business customers. However, in practice, market discipline will be effective in preventing overcharging only if ratepayers are willing and able to devote time and attention to understanding and exercising their options. Unfortunately, "status quo bias" is likely to keep most municipal aggregation customers from returning to default service or switching to another EGS.

³ See House Bill 2619, Printer's Number 4406, page 12, line 28, through page 13, line 1; and page 14, lines 19-23.

Furthermore, because of the marketing costs cited as justification for this legislation, it is possible that a significant number of “Mom and Pop” businesses will be unable to find offers from other EGSs even if these businesses want to leave the aggregation program.

Consequently, market forces are likely to provide little price discipline other than to prevent relatively extreme differences between rates under opt-out aggregation and prices available from competitive alternatives.

Conclusion

There is no reason to mandate major changes in default service at this time. The General Assembly and the Commission have spent considerable time designing a default service model that is aimed at keeping rates as low as possible, especially in the first few years after the expiration of rate caps. Over the next several years, the Commission will be able to gather data about whether one approach to competitive procurement produces consistently lower default service rates than another and about the level of shopping among customers with different load profiles. With that data, the Commission and the General Assembly will be better able to assess the need for any further changes in the design of default service.

In view of the foregoing, the OSBA recommends that the General Assembly defer action on a successor to HB 2619. However, if the General Assembly decides to press forward, the OSBA recommends that opt-out aggregation be allowed only during default service periods beginning on or after June 1, 2013.

Thank you for the opportunity to testify. I will be happy to answer any questions you may have.