

COMMONWEALTH OF MASSACHUSETTS  
**MASSACHUSETTS SENATE**

STATE HOUSE, BOSTON 02133-1053

SENATOR MARK MONTIGNY  
SECOND BRISTOL DISTRICT  
ROOM 413D  
TEL 617 722 1440  
FAX 617 722 1068  
DIST 508 984 1474

PAUL FENN  
ENERGY CONSULTANT  
OFF 617 722 1440  
TEL 510 204 9125  
FAX 510 204 9125

PAULFENN@IX.NETCOM.COM

## Restructuring and the Competitive Franchise November 8, 1995

Restructuring the electricity industry is good public policy only to the extent that it benefits the citizens of the Commonwealth. The benefits of competition must be tangible. This proposal reflects a concerted effort to achieve three basic goals for a restructured electric system: (1) to create and capture the economic savings of competition equitably among all customer classes; (2) to protect the environment and social programs, and; (3) to ensure public accountability.

We must remember that energy is not just another commodity; like food, water and shelter, it is necessary for one's survival. For this reason, there are enormous dangers inherent in deregulating the system under conditions of urgency, or for purposes of ideological purity to embrace direct access. We may find we are actually opening a door that may not be equitable for all classes of consumers; discrimination and inequity in the marketplace is not merely possible; it is probable under direct access proposals.

Electricity is also unlike other commodities in its widespread impacts on the economy and the environment. Anyone who is familiar with the strip-mining, drilling for gas and oil, and the storage of nuclear wastes knows that the process by which we make decisions about power has a profound impact on our health and safety; an impact that is long-term and difficult or impossible to reverse once it has been struck. Direct access proposals do no justice to this very tangible concern, which is a cornerstone of the competitive franchising bill. Anyone who has witnessed the history of Seabrook knows what a severe impact poor decision-making in the production of this commodity can have on every rate payer and tax payer: and on an economy that is saddled with its billion-dollar consequences.

Nor are direct access proposals adequately concerned with the negative impacts that a deregulated marketplace could have on the average consumer, otherwise

*Commonwealth of Massachusetts*  
DEPARTMENT OF PUBLIC UTILITIES

DPU Investigation )

Into Electric Industry )

Restructuring )

DPU 95-30

INITIAL COMMENTS OF SENATOR MARK MONTIGNY

*Respectfully Submitted*

**Senator Mark Montigny**  
**Member, Joint Committee on Energy**  
**Member, Joint Committee on Government Regulations**  
**Vice Chairman, Steering Committee,**  
**National Council on Competition and the Electric Industry**

**State House, Room 413C**  
**Boston, Massachusetts 02133**  
**March 31, 1995**

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**MASSACHUSETTS SENATE**  
STATE HOUSE BOSTON 02133-1053

**SENATOR MARK C. W. MONTIGNY**

SECOND BRISTOL DISTRICT  
ROOM 413C  
TEL. (617) 722-1440  
FAX (617) 722-1068

DISTRICT OFFICE:  
888 PURCHASE STREET  
ROOM 304  
NEW BEDFORD, MA 02740  
TEL. (508) 984-1474  
FAX (508) 984-1590

COMMITTEE

INSURANCE (CHAIRMAN)  
POST AUDIT  
ENERGY  
GOVERNMENT REGULATIONS  
HUMAN SERVICES AND  
ELDERLY AFFAIRS

**March 31, 1995**

**Mary Cottrell**  
**Secretary**  
**Department of Public Utilities**  
**100 Cambridge Street, 12th floor**  
**Boston, Massachusetts 02202**

**Re: DPU 95-30, Investigation by the Department of Public Utilities on its own motion into electric industry restructuring.**

Dear Ms. Cottrell:

Enclosed please find my initial comments submitted in response to the Department's inquiry, DPU 95-30, on its motion into electric industry restructuring. Attached are 15 copies of this testimony for purposes of its distribution.

Sincerely yours,

  
**Mark Montigny**  
**SENATOR**

## **Introduction**

The electric utility industry is now undergoing a change nationally, the likes of which have not been seen in sixty years. Amid this restructuring, the federal Energy Policy Act of 1992 encouraged states to work out systems of competition for electric utilities. The Massachusetts Legislature is considering various proposals for introducing competition into the industry, and will continue to play an essential role in the final determination of what kind of restructuring will come to fruition in coming months. It is critical to the promise of a more competitive system that the Department work cooperatively with the Legislature in defining the terms of a restructured industry.<sup>1</sup>

In my work as chairman of the Legislative Joint Committee on Energy from January 1992 until January 1995, as a member of last year's Electric Utility Market Reform Task Force, and as current Vice Chairman of the National Council on Competition and the Electric Industry sponsored by the National Conference of State Legislatures and the National Association of Regulatory Utility Commissioners, I have devoted the bulk of my resources to the agenda of electricity industry restructuring. Now that this agenda is gaining momentum in Massachusetts, I am no less determined to ensure that restructuring is implemented in the public interest, creating healthy competition on the supply side, and offering meaningful choices to consumers. To this end, I have attempted to achieve three basic goals for a structured electric system: (1) to capture the economic savings of competition equitably for all customer classes; (2) to protect the environment and future efficiency of our economy; and (3) to assure public accountability as an inherent part of the new system. It is in that spirit that I am writing to submit initial comments on the Department's docket on restructuring the electric utility industry.

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<sup>1</sup> The proposal outlined in the following pages corresponds directly to legislation filed under my name in December, 1994, Senate Bill 447, *An Act to Establish Guidelines for Competition in the Electric Utility Industry*, which will be heard by the Joint Legislative Committee on Government Regulations on April 5, 1995, at 1:00pm in the State House, Room A-1.

I recognize that the Department has carefully outlined a series of questions for its deliberations on restructuring. At this time, however, I will limit my initial comments to describing the mechanisms of the competitive franchise. I do intend to take up other concerns of the Department in later testimony.

### **Conditions in Massachusetts**

There is no question that a restructuring of the electricity industry is essential for economic recovery in the Commonwealth. The recent threats of our largest employer, Raytheon, to move jobs out of state unless its electricity rates are dramatically reduced is just the latest chapter in the rapid economic decline of manufacturing in the Commonwealth in recent years, to which high electricity rates have contributed significantly. The most recent national rate indices highlight the fact that Massachusetts' most exorbitantly priced electric companies are unresponsive to widespread public demand for rate relief, and even to political momentum toward restructuring. In September, 1994 Boston Edison was reported to have the third highest industrial rates of any investor-owned electric utility in the United States. In the following month, Commonwealth Electric had the ninth highest commercial rates in the nation. In November, the same source listed Commonwealth Electric as charging the fourth highest industrial rates, Western Massachusetts Electric following at number twelve.<sup>2</sup> These conditions require comprehensive change that is focused not only on generation and transmission, but also, and perhaps most importantly, on the retail level.

### **The Concept**

It is imperative that the retail, or distribution level be prioritized in the discussion of restructuring. While the discussion of restructuring electric generation and transmission has

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<sup>2</sup>*Energy User News*, January, February, and March, 1995.

been prolific in recent years, the distribution level, which is paramount in any restructuring scenario, particularly for consumers, has been relatively neglected. The assumption that the retail level will automatically adjust to a market system could have disastrous consequences for consumers. The competitive franchise outlined in the legislation that I have submitted is specifically concerned with the distribution level of a competitive system, and offers a model that will be useful for comprehensive restructuring.

This legislation relies on traditional franchise law. The concept of competitive franchising for electricity is similar to municipal franchising for other services, such as cable television. Half of the states in the nation currently allow municipal franchising for electric service. These franchises are currently limited to monopoly suppliers, but with transmission access opening up, this limitation is likely to change. The next logical step for cities using limited franchises for electric service, *e.g.*, Houston, Miami, and Chicago, will be to consider competitive bidding for their franchises. This legislation provides rules and guidelines that could be used in a competitive framework, and would allow cities and towns in the Commonwealth to utilize the franchise in such a framework.

The legislation proposes that any Massachusetts municipality be empowered, by a two-thirds vote of its municipal governing body, to create a new retail market for electric service within its municipal boundaries, called a "Consumer Service District.," and to make joint efforts with contiguous Consumer Service Districts in issuing Requests For Proposals, negotiating contracts, and conducting operations. The Consumer Service District would be available as a retail-level market for electric service to any investor-owned or municipal utility through a competitive bidding process, resulting in the negotiation of an exclusive franchise contract for a limited term.<sup>3</sup> The private utility company winning a contract would provide all services

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<sup>3</sup>While no specific term is mandated in the legislative proposal, a ten year term is suggested (Senate 447, section 4, subsection vii). It is anticipated that municipal franchises would have terms of ten to twenty years.

from billing and metering to power supply. The contract would contain generic provisions for environmental, energy efficiency, demand side management, and consumer protection, defined according to prevailing state standards, and subject to the final approval of the state for its compliance with those standards.

### **Creating Consumer Service Districts**

A municipality, by two-thirds vote of its municipal governing body,<sup>4</sup> would be empowered to create a Consumer Service District,<sup>5</sup> notifying the Department of this vote within ninety days.<sup>6</sup> Within thirty days of its receipt of this vote, the Department would inform the municipality's current service provider of this vote, notifying it of the municipality's intention to offer the newly created Consumer Service District for competitive bidding, and instructing the current service provider to deliver the following to the municipality within sixty days; (1) a complete inventory of the current service provider's facilities and equipment within the Consumer Service District; (2) a list of planned upgrades and facility retirements within the Consumer Service District; (3) the current service provider's demand forecast for the Consumer Service District; (4) the current service provider's demand forecast for residential commercial, and industrial customers within the Consumer Service District; (5) a complete statement of planned conservation or load management programs within the Consumer Service District; (6) any other information deemed pertinent and requested by the municipality, excluding any information that the Department deems of a proprietary nature.

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<sup>4</sup>Any duly elected City Council or Board of Selectmen. In cities or towns where municipal utilities exist, the municipal governing body authorized to create Consumer Service Districts is the municipal light commission. (Senate 447, Section 1, lines 48-50).

<sup>5</sup>The vote would simultaneously create an Office of the Consumer Service District manager, operating at the discretion of and overseen by the municipal governing body, and performing the following duties; (a) assist the municipal governing body during the bidding process; (b) negotiate a contract with the new service provider; (c) represent the municipal governing body during transfer of services between the current service provider and the new service provider; (d) oversee the new service provider's forecasting duties for the new consumer service district; and (e) carry out administrative and business operations, including the review of the new service provider's compliance with the terms of the contract as well as any other duties deemed appropriate by the municipal governing body for purposes of establishing a Consumer Service District (Senate 447, section 3, section 12).

<sup>6</sup>It is anticipated that a municipality considering the exercise of this power would first conduct a feasibility study to identify potential benefits and impacts.

## Issuing a Request for Proposals

The municipal governing body would use this information to prepare a Request For Proposals, notifying interested electric companies of the municipality's intention to accept bids for electric service.<sup>7</sup> The Request For Proposals would include the following items; (1) a profile of the Consumer Service District compiled from information obtained from the current service provider; (2) provisions for demand side management; (3) provisions for integrated resource management; (4) provisions for environmental protection;<sup>8</sup> (5) generic provisions provided by the Department; (6) the term of any ensuing contract, which shall be ten years unless some other term is deemed appropriate; (7) provisions for low-income service and rates; (8) a provision which requires the new service provider to conduct demand forecasting, subject to the oversight of the Consumer Service District Manager and approval of the Department; and; (9) a description of the standard contract provisions.<sup>9</sup>

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<sup>7</sup>It is expected that the municipality would begin an initial process of negotiation with its current service provider before issuing a Request For Proposals to other interested electric companies for competitive bidding. A good indication of the substantiality of such negotiation can be found in Albuquerque, New Mexico's recent efforts to initiate competitive franchising, which resulted in a preemptive settlement with its current service provider, Public Service Company of New Mexico, for a \$30 million, 6.5% rate decrease agreement spread across all rate payer classes. Statutory Competitive Franchising offers informal downward pressure on rates simply by giving municipalities the option to take their business elsewhere.

<sup>8</sup>An addition measure is applied in the legislation; "An electric company affected, directly or indirectly, by this chapter, shall comply with air pollution standards pursuant to chapter 111, chapter 164, and all other applicable federal and state laws regarding air emissions and the protection of environmental resources." (Senate 447, section 15).

<sup>9</sup>Standard franchise contract provisions drawn from existing electric franchises in other states. These provisions include: (a) grant of authority; (b) the temporal term of franchise; (c) termination provisions, describing the power of municipality and/or new service provider to terminate the franchise; (d) regulation provisions, citing the state laws and regulations the electric company must obey in fulfilling its obligations under the contract; (e) construction and maintenance provisions, outlining construction and maintenance standards with which the utility must comply; (f) provisions for the restoration of streets, requiring the utility to restore streets to good condition pursuant to section 70 of Chapter 164 of the General Laws, after erecting or maintaining lines or equipment in the Consumer Service District; (g) municipal services provisions, identifying services which the electric company must provide to the Consumer Services District; (h) quality of services provisions, specifying the quality of service the electric company must provide to the Consumer Service District; (i) provisions for the use of public ways, detailing purposes for which the utilities may use the public rights of way; (j) provisions for reports, identifying and describing the reports an electric company must submit, as well as frequency and contents of these reports (k) provisions for inspections, identifying the municipality's right to audit and inspect an electric company's financial records and facilities; (l) franchise fee provisions, outlining an amount equal to six per cent of annual gross revenues from kilowatt hour sales to the Consumer Service District, or an amount deemed appropriate by the municipal governing body, according to a schedule of fees payable on a monthly basis



## **Choosing the Winner**

The municipal governing body would have authority to accept a bid.<sup>10</sup> After the bidding process ends, the municipality would negotiate a contract directly with the current service provider, or negotiate with a prospective new service provider based on its response to the Request for Proposals.<sup>11</sup> While a negotiated agreement with the current service provider would clearly be the simplest course of action for both parties, failed negotiations would result in the municipal governing body's selection of another prospective new service provider's bid.

## **Methods of Transition of Distribution System to New Service Provider**

Three alternative methods of transition to a new distribution system would apply; (1) it could be rented from the previous utility provider; (2) the new provider could purchase it, or; (3) the municipality could take it by eminent domain under a proscribed evaluation formula and arbitration process. Given that the eminent domain formula specifies replacement value minus depreciation, there is a strong incentive for the disenfranchised utility to rent, or sell, its distribution system. In the event that an eminent domain taking is necessary, the legislation provides for an administrative process.

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to the municipality; (m) non-waiver provisions, describing terms of compliance with the provisions of the contract, including a statement that each party must comply with current or future law, regulation or other contractual agreements; (n) assignment provisions, providing that the municipality's express consent must be obtained before assignment of any or all of the electric company's equipment, operations, or holdings within the municipality's Consumer Service District to another entity; (o) indemnity provisions, requiring an electric company to hold the municipality harmless for damages to persons or property which result from an electric company's activities under the contract; (p) forfeiture provisions, stating conditions under which a municipality may revoke the contract, and outlining methods and procedures for these actions and for the electric company's redress; (q) provisions for notices, stating the person or persons either party shall contact regarding routine and extraordinary contract issues, and stating the proper methods of notice and the length of notice required; (r) provisions for amendments, describing conditions which can trigger amendments to the contract, and outlining the process for the creation and acceptance of these amendments; (s) provisions for acceptance, defining the action the electric company must take to formally accept the contract; (t) undergrounding provisions, describing the conversion of above-ground equipment to underground/burial conversions (Senate 447, Section 2).

<sup>10</sup>Senate 447, sections 6 and 9.

<sup>11</sup>Senate 447, section 7.

### **Evaluation and Arbitration for Eminent Domain**

The municipality would have authority to take by eminent domain the previous service provider's facilities within the Consumer Service District. Accordingly, the municipal governing body would have authority to request that an arbitration board be formed to determine the valuation of any transferred or taken facility or property. The arbitration board would consist of three members; one member appointed by the current service provider; one appointed by the new service provider; and one appointed by the Department. This board would conduct hearings to specify the valuation, schedule of payment, and schedule for transition in ownership of taken facilities and service according to the following formula of valuation; (1) replacement value less depreciation on a straight line basis, and/or consideration of obsolescence; (2) the costs associated with inventory and appraisal of facilities to be transferred; and (3) the costs of reintegrating the system, if any. The arbitration board would issue a decision on the proposed valuation within six months of appointment, and would have authority to make other findings of fact and award damages. At the request of the municipality, the arbitration board could also conduct hearings to determine whether the current service provider created unreasonable delays in the arbitration process, determine the amount of, and award damages. The arbitration board's decisions would be binding on all parties. The arbitration board's expenses and service charges would be included in the final cost of the acquisition. In cases where the arbitration board is convened to hear charges of delay, the losing party would pay those charges.<sup>12</sup>

### **Stranded Investment**

The legislation includes provisions for the recognition of stranded investment, which are necessary both to prevent the creation of Consumer Service Districts from having an impact on the rates of surrounding communities in the same service territory, and to ensure that all

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<sup>12</sup>Senate 447, sections 2 and 11.

franchise contracts are truly competitive with all costs internalized..

The current service provider may claim that establishment of the Consumer Service District renders certain of its facilities or contracts no longer used and useful. In this case, the current service provider may request, within sixty days after the recognition of the Consumer Service District, that the department designate these facilities or contracts as stranded investment.. The request must include; (1) a full description and valuation of the facilities or contracts the current service provider claims as stranded investment; and (2) a brief including (a) the current service provider's rationale for the requested designation; (b) a complete list of the alternatives the current service provider has pursued to market its capacity and energy; and (c) a complete list of the steps the current service provider has taken to maintain these facilities or contracts as used and useful.

The Department would have authority to determine whether a facility, portion of a facility, or contract, is stranded investment, and would make this determination prior to the approval of the municipality's contract with the new service provider, based on the following criteria: (1) the facilities or contracts are no longer used and useful due to the creation of the Consumer Service District, and resultant loss of franchise territory; (2) the current service provider has made reasonable efforts to market its capacity and/or energy; (3) the current service provider has no reasonable alternatives to maintain the facilities as used and useful. The department shall also determine, if appropriate, the time period for which a facility or contract remains a stranded investment.

If a facility or contract is determined by the Department to be stranded investment, the Department may instruct that the facility's or contract's energy and/or capacity be sold at prevailing market rates, and may allow the current service provider to sell the entire assets of a facility deemed stranded investment. The purpose of such a sale would be to let the market

establish a valuation which may be difficult to establish administratively.

Any resulting loss from such a sale would be shared between the Consumer Service District's rate payers and the current service provider. The loss would be the original cost minus depreciation (or a cost determined prudent in a prior proceeding) minus the sale price of the contract or facilities. Rate payers would be responsible for no greater than thirty-three and one third per cent of the resulting loss; the current service provider would be responsible for no less than sixty-six and two-thirds per cent of the resulting loss. In the unlikely case that the current service provider is a municipal electric system, the department would make appropriate determinations recognizing that municipal electric systems have no stockholders to share any resulting losses.<sup>13</sup>

#### **Departmental Review of the Proposed Contract**

Once the costs of transition and/or stranded investment are determined, the municipal governing body would then forward the proposed contract to the Department. The Department would have final authority of approval over the proposed contract, reviewing the proposed contract to assure that it complies with the Department's generic provisions and standards, and notifying the parties in writing of the reasons for disapproval if applicable. The parties would have the opportunity to correct any defects designated by the Department in order to secure its approval.<sup>14</sup> The municipal governing body would have authority of final acceptance of a negotiated contract, provided that the contract has already been approved by the Department.<sup>15</sup>

In recognition of the validity of the contract, the Department would amend the current

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<sup>13</sup>Senate 447, section 8.i

<sup>14</sup>*ibid.*

<sup>15</sup>Senate 447, sections 7 and 9.

service provider's franchise to specifically exclude the new Consumer Service District.<sup>16</sup>

### **Annual Reports and Franchise Fee**

The new service provider would be required to file annual reports showing compliance with the terms of the proposed contract. The new service provider would also conduct demand forecasting with oversight from the local governmental body and final approval by state regulators, and the new service provider would be required to pay a franchise fee<sup>17</sup> to the municipal governing body based upon gross annual revenue.

### **Summary**

Restructuring the electricity industry is good public policy only to the extent that it benefits the citizens of the Commonwealth. The benefits of competition must be tangible. This proposal reflects a concerted effort to achieve three basic goals for a restructured electric system: (1) to create and capture the economic savings of competition equitably among all customer classes; (2) to protect the environment and social programs, and; (3) to ensure public accountability.

We must remember that energy is not just another commodity; like food, water and shelter, it is necessary for one's survival. For this reason, there are enormous dangers inherent in deregulating the system under conditions of urgency, or for purposes of ideological purity to embrace retail wheeling. We may find we are actually opening a door that may not be equitable for all classes of consumers; discrimination and inequity in the marketplace is not merely possible; it is probable under retail wheeling proposals..

Electricity is also unlike other commodities in its widespread impacts on the economy and the

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<sup>16</sup>Senate 447, section 9.

<sup>17</sup>Standard franchise fees for electric service traditionally range from between two and six per cent of gross annual revenues; payment on a monthly or quarterly basis is preferable for the local government.

environment. Anyone who is familiar with the strip-mining, drilling for gas and oil, and the storage of nuclear wastes knows that the process by which we make decisions about power has a profound impact on our health and safety; an impact that is long-term and difficult or impossible to reverse once it has been struck. Retail wheeling proposals do no justice to this very tangible concern, which is a cornerstone of the competitive franchising bill. Anyone who has witnessed the history of Seabrook knows what a severe impact poor decision-making in the production of this commodity can have on every rate payer and tax payer: and on an economy that is saddled with its billion-dollar consequences.

Nor are retail wheeling proposals adequately concerned with the negative impacts that a deregulated marketplace could have on the average consumer, otherwise known as the citizens of the Commonwealth. It will not do to assume, as many have, that consumers will organize themselves into aggregate buyers with meaningful bargaining power in the market place. By beginning with the aggregation of consumers on the retail level, the competitive franchising bill ensures that consumers are powerfully organized wherever competition prevails.

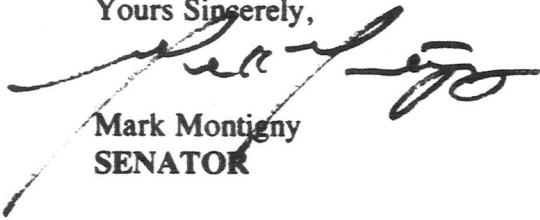
The competitive franchise is targeted to take all of these elements into consideration and achieve the three goals outlined above - to reflect these costs as part of the marketplace - and provide for ongoing public accountability through mixed systems of state and local regulation that offer a stable structure for the marketplace in the long term. For consumers, competitive franchising offers communities the advantage of a strong bargaining position that will otherwise be the exclusive privilege of the few; it means power companies will compete for their business, rather than vice versa.<sup>18</sup> For municipalities, this proposal offers a new source

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<sup>18</sup>It is distressing - and telling - to see many proposals for "competition" coming forward that set industrial consumers against commercial consumers, small businesses, and residents, or that force manufacturers to bid against each other to win direct access from their current service providers. The benefits of competition are a direct result of competition among suppliers, not consumers.

of needed revenues, and a powerful planning tool. For the state, competitive franchising offers stability and public accountability at the distribution level that will reinforce state energy goals, policy and regulation. For well-run, competitive electric companies this proposal offers a very strong incentive and reward in the opportunity to market capacity and acquire new service territories: the freedom to compete. For the quality of life in Massachusetts, competitive franchising offers downward pressure on electric rates combined with a system of rules to ensure environmental protection, to expand the role of energy efficiency, and to shelter low and fixed income families from harm in an increasingly competitive market for electricity.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'Mark Montigny', written over a horizontal line.

Mark Montigny  
SENATOR

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