

Promoting Competitive Electricity Markets Through Community Purchasing: The Role of Municipal Aggregation

by

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Any errors are the responsibility of the authors.

Promoting Competitive Electricity Markets Through Community Purchasing

Part I

Introduction

A. Municipal Aggregation: A Means Of Bringing The Benefits Of Retail Competition To All Customer Groups

After decades of dependence on electric utility monopolies, many states are considering introducing retail competition. Creating a competitive market is more easily said than done, however, especially for residential and small commercial consumers. In those states that have introduced retail competition, few small consumers are shopping relative to large industrial consumers. Greater participation by small consumers is necessary to attract new suppliers, and new suppliers in large numbers are necessary to create real competition. The success of retail competition in the small-consumer market, therefore, depends on finding some way to increase the participation of small consumers.

One promising means of encouraging participation by small consumers is to establish their right to be represented in the market as a group by their local governments — a process called “municipal aggregation.” Municipal aggregation refers to a municipality procuring electric power and related services on behalf of the residents of their community. The most effective form is likely to be “opt out” aggregation, wherein consumers are automatically enrolled into the program by their municipality unless they choose not to participate. A municipal aggregator need not own physical facilities, such as distribution, generation, or transmission assets.

A municipal aggregator can serve in two different roles:

- (a) As a *buying agent*, acting as a broker for electricity and related services for the consumers in its jurisdiction; or
- (b) As a *retail seller*, buying wholesale power and reselling it at retail to the consumers in its jurisdiction.

Properly structured, aggregation can reduce the cost barriers associated with a small consumer acting alone. Acting alone, most consumers lack the resources and bargaining power necessary to participate effectively in the market. The savings available to an individual small consumer are easily outweighed by the consumer’s cost of making sense of the choices

available to them. Allowing municipalities to negotiate on behalf of consumers in their community reduces these costs. Suppliers also benefit from municipal aggregation because, from the supplier's viewpoint, the cost of educating small consumers and motivating them to switch can exceed any generation cost savings or service benefits they can provide.

Aggregation can also create the group efficiencies and purchasing power necessary to secure better arrangements for consumers and to make electric service more responsive to community needs. In addition to obtaining significantly lower prices, benefits may include nonprice benefits such as supporting the local economy, obtaining electricity service with less environmental impact, serving all consumers within the municipality's jurisdiction — not just those most attractive to suppliers, and providing packages of products.

The byproduct of providing these benefits to small consumers through municipal aggregation is a major one: increased efficiency and greater competition in the market overall.

In addition to saving transaction costs, overall competitive benefits are achieved by getting competition “off the ground” sooner, by creating customer groups that are strong enough to balance the power of a concentrated industry, by complementing the benefits provided by private aggregators, and by creating a competing form of supplier.

Evidence of the benefits of joint action already exists among large business and institutional consumers, many of whom are shopping the retail electricity markets in groups. For a municipal aggregator to provide comparable benefits to the small-customer community, the municipality must be similarly free to act in the marketplace, and it must be able to avoid the high transaction costs of individually signing up each consumer. State laws authorizing municipal aggregation should allow local decisionmakers the flexibility to determine the most effective ways of enrolling and serving their residents, including the ability to enroll them automatically upon a majority vote of the local legislative body.

Opponents of municipal aggregation see a conflict between giving individual consumers a “right to shop” and allowing municipalities to represent consumers in a group. There is no necessary conflict. Opt-out aggregation provides individuals an opportunity to shop if they choose while allowing the rest of the community to maximize benefits from the marketplace.

In contrast, “opt in” aggregation, where no consumer is served by the municipality unless the municipality signs consumers up individually, does create a conflict between shopping individually and shopping with the community. It imposes on the municipal aggregator a costly entry barrier: the cost of overcoming inevitable consumer inertia by having to sign up each customer. The effect of this barrier is that many, if not most, consumers who fail to make a shopping decision will end up with the state government-mandated default service provider, instead of being enrolled into the service of the most competitive supplier identified by their municipality.

State legislators need not determine which particular form of municipal aggregation is “best.” They need decide only whether to enable or disable municipalities to serve their residents using structures they deem to be most effective. To enable such actions, constrained by a set of reasonable safeguards, is to allow in the market a player that is at once pro-competitive, community-responsive, accountable, sophisticated, and longstanding. These features of municipal aggregation can do much to establish and maintain the standards necessary for competition to succeed.

B. Municipal Aggregation In Context

Municipal representation of electricity consumers can take a number of forms. This report focuses on municipal aggregation, several versions of which are described. Two more traditional (and still vibrant) methods of municipal intervention in the electric industry are the formation of municipal utilities and the granting of distribution rights-of-way. We describe these options briefly here, to help the reader distinguish among various forms of municipal involvement in the electricity business.

1. Municipal Utilities

“Municipal utilities” have existed since the early days of the electricity industry. They are local governments that own the physical facilities that distribute electricity (poles, wires, and substations) and that provide electricity on an exclusive basis to consumers within their jurisdiction. Municipal utilities may also own other assets, such as transmission or generation facilities, or they may purchase services from the owners of these facilities. Many municipal utilities both own and purchase transmission and generation, in amounts necessary to serve their entire load.

While most municipal utilities existing today were formed in the early days of the electric industry, some towns have chosen this option more recently. To form a municipal utility in an area presently served by an investor-owned utility, the municipality offers to purchase the distribution facilities of the existing utility or, if the utility is unwilling to sell, the community can, depending on state law, condemn the utility’s facilities and pay their cost. Alternatively, the municipality can construct a separate distribution system.¹ Once the municipality acquires the distribution assets, it can itself operate the distribution system and provide electricity and related services, or it can outsource any number of the components of these services to one or more private companies through competitive bidding. In this way, the municipality can provide for all of its residents while taking advantage of competitive markets where better prices and services can be found. For example, municipal utilities now routinely provide electricity by acquiring it in the competitive wholesale market. But municipal utilities can also acquire any number of other services from competitive suppliers.²

¹ For more on this topic, see “Municipal Electric Utility Formation” in *Competition and Restructuring in the Electric Utility Industry* (notebook). American Public Power Association. Washington, D.C., 1996.

² For example, in 1999, the city of Long Beach, California, explored a combination of municipalization and outsourcing of electric services. The city sought assistance in many areas, including the following: Distribution System Design/Construction, System Operations/Maintenance, Development of Service Standards, Power Supply, “Green” Power, Power Marketing, Scheduling/Dispatch, Rate/Revenue

Note that a municipal aggregator that acquired distribution assets would resemble a municipal utility.

2. Distribution Rights-Of-Way

Municipalities usually control the public right-of-way that third parties must acquire to own and operate physical electricity-distribution facilities. This right (or “franchise”) can either be granted to the municipality itself, in order to establish a municipal utility, or be awarded to a private (investor-owned) utility for a fee. In both cases, the operator of the distribution franchise has historically provided integrated utility service (generation, transmission, and distribution).

Municipalities whose distribution franchise grants to private utilities are expiring³ have the opportunity to separate distribution functions from energy supply or to bargain for both together. The municipality can:

- (a) Buy the distribution facilities and create a municipal utility;
- (b) Select a new distribution franchisee through competitive bidding,⁴ where the franchisee provides distribution service and the municipality provides electricity service through an aggregation program; or
- (c) Select a new distribution franchisee through competitive bidding, where the franchisee also provides electricity services for the municipality’s aggregation program.

(footnote continued from previous page)

Projections, Meter Installation/Maintenance, Public Relations, System Billing and Collections, and Economic Development. “Solicitation of Interest,” Long Beach Gas and Electric Department, posted at www.ci.long-beach.ca.us/gas/soi.htm, June 23, 1999.

³ Some existing franchise agreements may have renegotiation clauses that may allow new arrangements.

⁴ Competitive bidding for the franchise is essential to determine a fair market price, and to enable the municipality to control the process and establish the terms that will govern the franchisee.

C. Overview of the Report

We have written this report for decisionmakers interested in municipal aggregation. Readers, which we hope will include state legislators, municipal officials, large and small consumers and their representatives and advisors, will learn of the methods of aggregating consumers through local government and the advantages and costs of these methods. The report also describes the essential elements of state legislation necessary to facilitate opt-out aggregation, as well as legislative provisions that can undermine aggregation efforts. Last but not least, the document discusses the importance of the overall market structure in enabling municipal aggregation, for this tool alone is not powerful enough to overcome laws and regulations that fail to promote a competitive market.

This report has six additional parts:

- **Part II** describes the benefits to be gained from municipal aggregation, including lower costs to small consumers, greater responsiveness to community needs and interests, more competitive markets overall, and environmental improvements derived from community resource preferences.
- **Part III** describes and compares the different types of aggregation programs that municipalities can administer, from “all inclusive” programs to individual “opt in” programs. A discussion of “opt out” aggregation explains why this method is required to capture most of the benefits of aggregation while still enabling individuals to shop on their own in the marketplace.
- **Part IV** reviews the features of legislation that are necessary to enable effective municipal aggregation. These include establishing the authority of local governments to effectively administer opt-out aggregation programs, establishing appropriate regulatory oversight of municipal aggregators, modifying laws that govern local government contracting, and establishing the ability of local citizens to authorize aggregation programs through local initiatives.
- **Part V** discusses the legislative provisions that can undermine municipal aggregation, including failing, in general, to structure the market for real competition.

- **Part VI** describes and responds to various arguments commonly used to oppose municipal aggregation legislation.
- The **Conclusion** presents some closing thoughts about the steps that may be required to foster municipal aggregation once legislation is passed.

Promoting Competitive Electricity Markets Through Community Purchasing

Part II

The Benefits Of Municipal
Aggregation: Cost Reductions,
Community Responsiveness,
Competitive Markets, And
Environmental Gains

The many potential benefits of municipal aggregation can be grouped into four main categories: cost reductions, community responsiveness, competitive markets, and environmental gains. We discuss each in turn.

A. Municipal Aggregation Can Produce Cost Reductions

Savings of between three percent and 22 percent of total electric bills are available to [large consumers] who shop around.

In the states that have authorized competition, larger customers are proving by their actions that experience, skill, and size can make electricity shopping rewarding. But for many small customers, after decades of accepting a monopoly product, competition does not come naturally. The knowledge necessary to shop wisely is costly to obtain, and the risks are unknown. Many small customers are opting not to try.

Large-customer experience suggests that if smaller customers can use aggregation to achieve similar size and skill levels, similar benefits could flow. After reviewing the contrasting experiences of larger and smaller customers, we describe how municipal aggregation can unite both types of customers in efforts to reduce total electricity costs.

1. Many Large Consumers Are Obtaining Significant Economic Benefits In The Competitive Market

Although data are scarce on the specific economic benefits of retail competition,⁵ a glimpse of the savings that are available to large customers can be found in the few agreements whose benefits have been publicly revealed. Those agreements tend to be between suppliers and aggregated groups of medium-sized customers, which tend to be public entities. The examples below indicate that savings of between three percent and 22 percent of total electric bills are

⁵ No comprehensive surveys on the economic benefits of newly deregulated markets have yet been completed. Complete information may never become available, since large consumers and electricity suppliers are reluctant to reveal the prices they are paying for electric service.

available to those who shop around rather than stay with the default service provider.⁶

A review of the information below suggests two significant conclusions: a significant portion of the savings achieved by large consumers could be available to similarly sized groups of aggregated small consumers;⁷ and large consumers themselves benefit from aggregation.

a. California

- According to the Electric Power Research Institute, large commercial and industrial consumers in California that have switched suppliers are averaging savings of three percent to five percent.⁸
- The city of Long Beach switched from Southern California Edison to New West Energy (a subsidiary of Arizona’s Salt River Project) and obtained a 2.75 percent discount off of its total electric bill. The city saves \$275,000 annually as compared to the municipal and commercial service rates it would be paying under default utility service.⁹ According to a city official, these savings “could be dwarfed by a citywide contract” that extended to all Long Beachers, which would be almost 30 times the size of the government’s purchase.¹⁰

⁶ Default service is provided automatically to consumers who do not select a competitive provider or cannot obtain service from competitive suppliers. In the states discussed below, default service is currently provided by the incumbent utilities. In some states, default service will be provided by a supplier selected by the state commission after a competitive bid.

⁷ Aggregated residential and small business consumers would probably not capture all of the savings available to larger customers, due to higher associated administrative overhead costs such as for billing and metering.

⁸ “Power Rates Slow to Cool,” *Los Angeles Times*, August 29, 1999.

⁹ Conversation with Chris Garner, gas department general manager, city of Long Beach, August 16, 1999.

¹⁰ *Ibid.* and statement of Chris Garner in “Long Beach Public Power Revival,” *Local Power News* (www.local.org), March 1999.

- New West Energy has also guaranteed savings of between 2.75 percent and three percent of the electric bills of a group of about 80 food processors in and around Oakland, California, that were previously paying the default utility provider's commercial rate.^{11,12} The processors, which annually consume 55 million kilowatthours (kWh), were organized by the Oakland Commerce Corporation, a business retention group that works on behalf of the city of Oakland. The Corporation expended considerable resources to organize the food processing industry, and the director believes it would be far more difficult to organize a disparate set of businesses. Given limited available savings and high transaction costs, the director believes that opt-out municipal aggregation could be very beneficial to its members in comparison to renegotiating the next deal.¹³
- Eighty public agencies are participating in the San Diego Association of Governments' (SANDAG) aggregation program, under which savings of 2.5 percent off of the default utility's total charges are available from Commonwealth Energy Corporation.¹⁴ Participants may also select Commonwealth's "green energy" option and obtain three percent to five percent total-bill savings as long as a large state renewable energy marketing subsidy remains available.¹⁵ Commonwealth offers its residential "green" customers total-bill savings of only about one percent.¹⁶ Thus,

¹¹ New West also provides meters and metering services despite the fact that the local utility, PG&E, does not provide a credit of its metering service costs.

¹² Conversation with Dave Johnson, Executive Director, Oakland Commerce Corporation, June 28, 1999.

¹³ *Ibid.*

¹⁴ Conversation with Steve Sachs, SANDAG, July 12, 1999.

¹⁵ The subsidy began at 1.5¢/kWh, but has been reduced by the state as total eligible renewable energy sales increase. According to Steve Sachs of SANDAG, Commonwealth has agreed to pass through to SANDAG customers any renewable energy marketing subsidy it receives above 1¢/kWh.

¹⁶ According to Commonwealth's website (www.greensmart.com, June 28, 1999), the company offers residential consumers savings of five percent

Commonwealth is passing through a significantly larger portion of the renewable-energy marketing subsidy to its larger, aggregated customers than to its residential customers. Larger customers are able to negotiate for a larger share of the marketing subsidy likely because the marketer incurs lower per-kWh marketing and overhead costs in making the sale.

b. Massachusetts

- A consortium of 600 small and large nonprofit institutions has been able to collectively save an average of 18.2 percent on the electricity-supply component of their bills, as compared to Standard Offer service provided by their local utility.¹⁷ The consortium, clients of the Massachusetts Health and Educational Facilities Authority (HEFA),¹⁸ collectively purchases approximately \$175 million in electricity annually, representing over 245 megawatts — a size equivalent to that of a large city.¹⁹

(footnote continued from previous page)

off of the electricity (PX) portion of their bill, which is equivalent to about one percent off of total default service rates.

- ¹⁷ PECO Energy, which HEFA selected from a group of 27 bidders, has signed contracts with nearly 300 of those members. To date, HEFA's PowerOptions members signing electricity supply contracts with Exelon Energy, a unit of PECO Energy, Inc., have saved a combined \$7.25 million, with life-of-contract savings of over \$27 million, according to HEFA. In addition to the savings received under the supply contracts, members will receive access to energy conservation services. Conversation with Janice Hayes, HEFA, June 28, 1999, and HEFA's PowerOptions website, www.poweroptions.org/electric.htm, June 28, 1999.
- ¹⁸ HEFA is an independent public authority that provides access to capital markets, as well as other services and financial products, at the lowest cost to eligible nonprofit institutions, including hospitals, public and private colleges and universities, museums, cultural and scientific institutions, HMOs, community health centers, nursing facilities, and agencies serving adults and children with disabilities.
- ¹⁹ For example, Long Beach, California, with 440,000 residents and a significant industrial base, generates \$250 million annually in electric revenue. "Long Beach Public Power Revival," *American Local Power News* (www.local.org), March 1999.

- The Massachusetts High Technology Council has successfully aggregated the load of up to 75 of its high technology business members, representing up to 200 megawatts (1 billion kilowatthours).²⁰ The program has saved its members \$2 million annually as compared to Standard Offer service.²¹ According to the MHTC, its load aggregation program will provide participating members with the most efficient process to achieve maximum savings “that cannot be achieved individually.”²²

c. Pennsylvania

- The Pennsylvania Energy Consortium (PENCON), which coordinates the purchase of electricity for 242 of the state’s school districts, 42 municipalities and 29 other nonprofit organizations in 50 counties, is saving participants between nine percent and 22 percent (14-15 percent on average) of the regulated utility rates previously paid.²³ According to the program coordinator, some participants attempted to shop for service on their own, but got no responses to their requests-for-proposals (RFPs) — that is, forming a consortium was often essential for these medium-sized consumers to participate in the competitive market.²⁴
- The Harrisburg-based Pennsylvania Food Merchants Association and its sister group, the Pennsylvania Convenience Store Council, have negotiated electricity service on behalf of their members. Because their members are located in numerous utility service

²⁰ Website of the Massachusetts High Technology Council, www.mhtc.org, July 7, 1999.

²¹ Conversation with Chris Anderson, Massachusetts High Technology Council, June 30, 1999.

²² *Supra* note 20.

²³ Conversation with Jeff Kimball, PENCON coordinator (housed at the Central Susquehanna Intermediate Unit), August 30, 1999, and “Energy Consortia Taking Advantage of Pennsylvania Electric Choice Program,” news release of the Pennsylvania Public Utility Commission (<http://puc.paonline.com>), April 19, 1999.

²⁴ *Ibid.*

territories, comparisons are difficult and no overall savings figures are available. However, according to an association representative, savings were “substantial” as compared to utility service rates and to the prices available to members shopping on their own.²⁵

As stated by the chairman of the state’s Public Utility Commission, “By working together and leveraging their size, the [aggregated] groups are bringing greater savings to all of their members.”²⁶

2. Municipal Aggregation Can Replicate Many Of These Benefits For All Consumers

The benefits obtained by large electricity consumers can be made available to small consumers through aggregation.

The benefits obtained by large electricity consumers can be made available to small consumers through aggregation. At present, small consumers are not receiving many benefits from competition, either because marketers are not serving them aggressively, or the customers are choosing not to shop, or both. After discussing these factors, we explain how municipal aggregation can overcome the barriers that seem to be keeping small consumers from benefiting.

a. Small Consumers Are Not Presently Receiving The Potential Benefits Of Retail Competition

For two significant and related reasons, small customers are not presently receiving the potential benefits of retail competition. The market is not offering them very many attractive products at attractive prices, and in large numbers they are not actively shopping. Each point is discussed briefly below.

i. The Market Is Not Offering Small Consumers Many Attractive Products At Attractive Prices

In contrast to the large price discounts offered to groups of large customers discussed in the preceding sections, prices to small customers do not yet reflect aggressive marketing interest in this market segment. We look below at the states of California, Massachusetts and Pennsylvania, whose larger customers have achieved higher savings through aggregation.

²⁵ Conversation with Randy St. John, Jr., Vice President of Membership Development, Pennsylvania Food Merchants Association, August 30, 1999.

²⁶ Note 23 *supra* (PA PUC 4/19/99).

- **California:** According to a state price survey,²⁷ the only products available to residential consumers in California that are priced below utility-provided default service rates are certain renewable-energy products, the marketers of which benefit from a subsidy of up to 1.5¢/kWh.^{28,29} Most of the products offered by these marketers provide residential customers total-bill savings of two percent or less,³⁰ as compared to the larger discounts for large customers described above.

- **Massachusetts:** Twenty-one months after the start of “competition,” virtually all residential consumers remained on Standard Offer service,³¹ a clear indication of the lack of perceived value to be obtained from shopping, as compared to the examples of savings for larger customers described above. The lack of competition in that state (as well as in California) has been attributed by some observers to the fact that suppliers are unable to match the price of the “Standard Offer” (default) service provided by the incumbent utility, in part because the competitive portion of that

²⁷ “Shopper’s Guide for Residential and Small Commercial Customers,” California Public Utilities Commission’s Office of Ratepayer Advocates (<http://162.15.5.2/SB477/ShoppersGuide.htm>), updated October 7, 1999.

²⁸ One product in one service territory offers one week of free electricity generation after one year with the company which, when incorporated into the average price for the year, results in a price slightly lower than the default service rate.

²⁹ Some renewable energy producers receive subsidies that are in addition. The marketers’ subsidy is intended to spur demand for renewable energy by reducing retail product costs. (See website of the California Energy Commission, www.energy.ca.gov/renewables/). The lower-priced renewables products sell power that is largely or exclusively generated by existing renewable resources. Higher-cost renewables and non-renewables products are also available.

³⁰ Note 27 *supra*.

³¹ Some customers are on “Default” service, *e.g.*, those customers who do not choose a provider when service is initiated for a new account.

service does not include the cost of marketing, customer service, billing, and metering.³²

- **Pennsylvania:** Depending on their service territory, residential consumers who shop around are able to save between one percent and nine percent of their overall electric bill by switching to a competitive provider.³³ As noted above, the savings for aggregated groups of large customers have been much larger.

ii. Most Small Consumers, When Left Unaggregated, Are Not Participating In Newly Deregulated Markets

The fact that most small consumers are not switching indicates that benefits are not available to them, or that the cost of seeking out and understanding those benefits exceeds their perceived worth.

Residential and individual commercial customers are participating in competitive electric markets to a much lesser extent than industrial customers. Presumably, consumers switch from their default utility provider to a competitive supplier because they are able to obtain better rates or service, or both, from the competitive market. The fact that most small consumers are not switching indicates that benefits are not available to them, or that the cost of seeking out and understanding those benefits exceeds their perceived worth. The fact that large consumers are benefiting does not necessarily mean that small consumers are worse off relative to the regulated utility service they previously received. Nor does it necessarily mean that they are not receiving “trickle down” benefits from industrial savings. But it does mean that they are not obtaining equal direct benefits from the competitive electricity market.

Statistics on the number of customers in each customer class that have switched suppliers in California, Massachusetts, and Pennsylvania reveal that relatively few residential customers are participating in electricity competition:

- Twenty months after California’s retail markets were opened to competition, 20 percent of industrial customers representing 32 percent of industrial load had switched to a competitive

³² “Setting Rates for Default Service: The Basics,” *Issuesletter*. The Regulatory Assistance Project. January 1999.

³³ “Statistics Released by Consumer Advocate On Pennsylvania Electric Choice Program” (press release), Pennsylvania Office of Consumer Advocate, March 10, 1999.

provider, while less than two percent of residential consumers representing two percent of residential load had switched. The rest remained on default service provided by the incumbent utility.

- In Massachusetts, 21 months after retail markets opened, very few residential consumers had switched to a competitive supplier because few competitive providers were offering service to them.³⁴ Almost 12 percent of industrial customers, representing almost 21 percent of industrial load, had switched suppliers.
- In Pennsylvania, after 12 months of competition, almost 29 percent of industrial customers representing over 48 percent of industrial load had switched to a competitive provider, while less than nine percent of residential consumers representing less than nine percent of residential load had switched. The rate of switching varies considerably across service territories, due to the greater savings that are available in territories with higher default service rates. As of July, 1999, the rate of residential switches was highest in PECO's service territory, where almost 15 percent had switched, while industrial switching in that territory was almost 58 percent. The lowest residential switching rate was in Allegheny's territory, where 1.4 percent of consumers had switched, as compared to almost 32 percent of industrial customers.³⁵

These statistics are presented in the chart on the next page.

³⁴ Conversation with Dan Sardo, Massachusetts Department of Energy Resources, June 21, 1999.

³⁵ Note 33 *supra*.

Who's Switching And Who's Not In Retail Electricity Markets			
<i>Percent of Customers Switched to Competitive Supplier</i>			
State	Residential	Commercial	Industrial
California	1.7%	3.95%	20.1%
Massachusetts	0.09%	1.99%	11.8%
Pennsylvania	8.72%	16.07%	28.76%
<i>Percent of Load Switched to Competitive Supplier</i>			
State	Residential	Commercial	Industrial
California	2.0%	12.3%	32.0%
Massachusetts	0.17%	3.95%	20.78%
Pennsylvania	8.52%	38.71%	48.53%
Notes:			
<p>California: Data current as of 11/30/99 (reflecting 20 months of competition). Source: “Supplemental Direct Access Implementation Activities Report, Statewide Summary,” California Public Utilities Commission, December 15, 1999 (www.cpuc.ca.gov/divisions/energy/Direct_Access/DASR.htm). Commercial category includes CPUC’s small and large commercial.</p> <p>Massachusetts: Data current as of 11/30/99 (representing 21 months of competition). Source: Massachusetts Division of Energy Resources (www.state.ma.us/doer/pub_info/migrate.htm). Residential category includes DOER’s three residential categories; commercial category includes DOER’s “small” and “medium” commercial and industrial categories.</p> <p>Pennsylvania: Data current as of 1/1/00 (representing 12 months of competition). Source: Pennsylvania Office of Consumer Advocate (www.oca.state.pa.us/).</p> <p>States do not necessarily use the same account sizes to categorize customers into sectors.</p>			

Some argue that opportunities will unfold for small consumers as default service prices begin to reflect the true costs associated with that service, as markets mature, and as consumers become more accustomed to shopping for electricity.³⁶ Some cite Pennsylvania as an example of how a default service price that is set close to actual

³⁶ States that allow suppliers other than the incumbent utility to provide default service on a competitive basis will also foster participation in the competitive market.

There are indications that small-consumer participation in electricity markets will remain low.

retail prices leads to more small-consumer participation, while in California and Massachusetts — where default service prices reflect wholesale power costs rather than the full cost of providing retail service — consumer participation is lower.³⁷ There is little reason to question these arguments. However, there are countervailing indications that small-consumer participation in electricity markets — and the capture of related benefits — will remain low as compared to large-consumer participation. These indicators include:

- (a) Most importantly, the persistence of market barriers — *e.g.*, the high retail transaction costs and other factors discussed in the following subsection — that will disproportionately affect small consumers unless they are overcome through aggregation;
- (b) The expiration of initial policies intended to spur retail competition. For example:
 - (i) In Pennsylvania, the Public Utility Commission deliberately set the utility-provided default service rate above anticipated market prices in order to encourage competition. Rates were set at a level that is likely to result in over-earning by the utility.³⁸ As a result, default consumers are actually penalized if they stay with the default provider, while customers who choose a competitive supplier pay an artificially lower rate. Moreover, while residential participation in Pennsylvania is far higher than in California and Massachusetts, it is still very low relative to industrial participation.
 - (ii) In California, all but one supplier offering residential electricity service at a cost lower than default utility service are supported by a marketing “customer credit” of up to 1.5¢ per kWh.³⁹ Because this large subsidy is available only

³⁷ See, *e.g.*, “It’s the Market, Stupid!,” *Green Power Newsletter*, Regulatory Assistance Project, April 1999.

³⁸ Note 32 *supra*.

³⁹ The renewable energy marketing subsidy is available from the California Energy Commission, which administers the state’s public benefits charge for renewable energy programs (see the CEC’s website, www.energy.ca.gov/renewables/).

to marketers of electricity generated by qualifying renewable resources, these products are virtually the only ones that can be found at a price lower than default utility service.⁴⁰ The subsidy expires at the end of 2001.⁴¹

- (iii) State-sponsored consumer education programs, which are intended to educate consumers and encourage shopping, and general media interest exist primarily at the onset of retail competition.
- (c) As indicated by the Pennsylvania switching data discussed above, residential consumers tend to shop less where smaller savings are available. Although there is less at risk economically, this tendency does not bode well for efforts to encourage shopping in low-cost states — generally those that have not yet opened their markets to competition but that are now considering doing so.
- (d) Early participation in the residential market by suppliers may not be sustained, since many suppliers are losing money in the hope that the market will eventually be profitable for them.⁴²

b. Aggregation Can Bring Cost Reductions To Small Consumers

In this section, we describe five types of benefits that aggregation can bring to small consumers. These benefits are: lower transaction

⁴⁰ Note 27 *supra*.

⁴¹ Since the total subsidy fund is fixed, the size of the per-kWh subsidy will be reduced by the state as total eligible renewable energy sales rise above a certain level.

⁴² For example, Enron Energy Services withdrew from the California market after a few weeks of its opening, having spent \$10 million in marketing and advertising costs to sign up just 30,000 customers. (See “Enron Out of Home Electricity Market,” *San Francisco Chronicle*, April 23, 1998, p. D1.) One of the leading marketers remaining in the California market as well as in Pennsylvania, Green Mountain Energy Resources, reported a loss of \$46 million in 1998 on revenues of \$1.5 million. (See “Green Power Next for Huge IPO,” *The Industry Standard*, www.thestandard.com, April 26, 1999.)

costs; greater bargaining power; ability to enter into long-term agreements; more desirable load profile; and greater sophistication.

I. Lower Transaction Costs

Opt-out municipal aggregation programs can lower costs chiefly because they are able to bypass some of the transaction costs that suppliers incur when they participate in small-consumer retail markets. These transaction costs include:

Opt-out municipal aggregation programs can lower costs chiefly because they are able to bypass ... marketing and advertising [costs].

- (a) Costs associated with the marketing and advertising that suppliers must carry out in order to educate consumers, win their trust, and motivate each individual to actually carry out their preference; and
- (b) Administrative costs, such as billing, metering, and customer service costs associated with each account.

While the latter set of costs are not avoided by aggregating small accounts, the avoidable costs of the former are significant, as indicated by the following:

- In California, a group of electricity marketers estimated that the advertising and marketing cost to acquire one electricity customer is \$100 — the same as other consumer-marketing industries such as long-distance telephone, credit cards, and Internet service.⁴³

⁴³ “Comments of the Renewable Marketers on Power Purchase Eligibility for the Customer Credit Subaccount,” presented on behalf of PG&E Energy Services, Edison Source, Green Mountain Energy Resources, Enron Capital and Trade Resources, Friendly Power, Preferred Energy Services (dba clean ‘n green energy), Utilisys, PowerUSA, Electric Clearinghouse, Inc., PacifiCorp, Automated Power Exchange, Foresight Energy Company, and the Natural Resources Defense Council, pp. 2, 4 and 38. CEC Docket No. 96-REN-1890, April 6, 1998.

- Before pulling out of the California residential market less than a month after it opened, Enron Energy Services spent over \$300 to acquire each of the 30,000 customers it signed up.⁴⁴
- In 1998, Green Mountain Energy Resources spent \$33 million in sales and marketing while it acquired a total of only 57,100 customers in California and Pennsylvania — representing nearly \$600 per customer.⁴⁵
- While the upper end of marketing costs reflected in the previous three data points reflects the high start-up costs associated with entering a new market, the indicated range of \$100-\$600 in per-customer marketing costs is roughly equivalent to 15-90 percent of a California residential consumer's total annual electricity bill.⁴⁶
- Of California's 1.5¢/kWh renewable energy marketing "customer credit," about 0.12¢/kWh is passed through to residential customers⁴⁷ and 0.1¢-0.6¢/kWh is paid to renewable energy producers.⁴⁸ Much, if not all, of the balance —

⁴⁴ "Enron Out of Home Electricity Market," *San Francisco Chronicle*, April 23, 1998, p. D1. Enron spent \$10 million in marketing and advertising costs to sign up 30,000 customers.

⁴⁵ Securities and Exchange Commission Form S-1 filing of the Greenmountain.com Company, March 29, 1999 (available at www.sec.gov/edaux/formlynx.htm).

⁴⁶ Assumes 6,000 kWh annual household electricity consumption at 11¢/kWh. Since California's four-year fixed charge to consumers for the uneconomic past investments of utilities accounts for approximately 45 percent of customer bills, marketing costs will account for a far greater portion of customer bills once the charge expires in 2002.

⁴⁷ According to price surveys conducted by the California Public Utilities Commission's Office of Ratepayer Advocates (see note 27 *supra*), the leading green marketers, Commonwealth Energy and Green Mountain Energy Resources, offer green power at rates 0.12¢/kWh below default utility service rates.

⁴⁸ According to the Automated Power Exchange (www.apx.com), renewable energy producers selling through the APX's Green Power Market received an hourly average on-peak premium averaging \$0.0037/kWh above the California PX price from July 1998 through April 1999, and an hourly average off-peak premium averaging

0.8¢/kWh to 1.3¢/kWh — goes toward marketing costs.⁴⁹ As noted previously, virtually all products currently available to California residential consumers at a lower cost than default service are renewable energy products that are supported by this marketing subsidy.

As these data indicate, marketers entering a new market in which consumers are not used to choosing among service providers must spend considerable sums to establish themselves in that market.⁵⁰ Most consumers will understand these marketing transaction costs as constant, confusing solicitations and advertisements. Suppliers may understand them as large losses that keep them from participating in the market altogether. Municipal aggregation allows both consumers and suppliers to avoid these high initial costs, which is especially important in encouraging infant markets. There is no sacrifice to competition, since those suppliers unable for cost reasons to solicit individual customers can still compete to serve the municipal aggregators. As the market matures and marketing costs decline, municipal aggregation will continue to enable consumers and marketers to avoid significant costs.

(footnote continued from previous page)

\$0.0058/kWh for the same time period. Other sources of renewable power may be available for premiums as low as \$0.001/kWh, according to *Green Buyers Beware: A Critical Review of Green Electricity Products*, Public Citizen, October 1998.

⁴⁹ This is apparent from a Securities and Exchange Commission filing of one of the leading “green marketers,” Green Mountain Energy Resources, which, in 1998, generated revenues of \$1.5 million, incurred wholesale electricity costs of \$1.1 million, spent \$33 million on sales and marketing, and incurred net losses of \$46 million. SEC Form S-1, filing of Greenmountain.com Company, March 29, 1999 (available at www.sec.gov/edaux/formlynx.htm).

⁵⁰ In addition, the initial rules governing those markets may be unfavorable to new entrants. For example, new entrants may not be able to avoid paying the incumbent utility’s billing and metering costs, even if they provide those services themselves.

The primary goal of municipal aggregation is to provide small consumers with enough market weight to capture significant benefits from the competitive marketplace.

ii. Greater Bargaining Power

A generally accepted tenet of the new electricity marketplace is: when it comes to bargaining for the price and terms of service, bigger is usually better. While regulated utility service also provided lower rates to larger customer accounts (increasingly so in recent years), in the new market there is no regulatory oversight of the cost-apportionment balance between small and large consumers. Thus, large customers or aggregated groups can obtain the lower-cost resources, leaving higher-cost resources for smaller customers. Conversely, to secure large-customer accounts, generating companies will allocate their lowest-cost resources to those accounts, and assign the higher-cost resources to smaller accounts.

The primary goal of municipal aggregation, therefore, is to provide small consumers with enough market weight to capture significant benefits from the competitive marketplace. As the examples in **Part II.A.1** show, even relatively large accounts can obtain better deals by banding together with other customers through aggregation, as compared to buying alone.

iii. More Desirable Load Profile

Also important to potential suppliers are the pattern of usage and the compatibility of that pattern with a supplier's portfolio of resources. Combining the load shapes of commercial, residential, industrial, and municipal accounts into one larger load shape often results in usage patterns that are more attractive to suppliers.

Prices in competitive markets are likely to be based on usage patterns because it costs different amounts to provide electricity at different times of day and different times of the year and because, to provide the electricity needed for any one customer at each hour of the day, suppliers have to consider the total demand of all customers.

The pattern of usage for an individual customer is called a load profile. For example:

- An office building will open for business in the early morning, at which point lights, computers, and air circulation systems are turned on. As occupants arrive, more demand is placed on the heating and cooling systems, and electricity use increases. A lull in electricity

demand may occur around lunchtime. The highest usage of electricity might occur in the afternoon, when office-equipment use is combined with peak use of air-conditioning systems.

- A 24-hour industrial facility will have a high, constant pattern of usage.
- Homes will use more power during mornings, evenings, and weekend days.
- Towns and cities use power at night for street lighting.

Combining the load shapes of commercial, residential, industrial, and municipal accounts into one larger load shape often results in usage patterns that are more attractive to suppliers.

The ratio of peak electricity usage to average usage is referred to as the load factor. Suppliers generally (but not always) prefer a high load factor, or an even pattern of use, to usage patterns that fluctuate significantly during the day. Since it is expensive to serve peak loads that coincide with system peaks (because the most expensive sources of electricity must be used), flatter load profiles are generally cheaper to serve. However, flatter load profiles are not always necessary to attract the lowest prices. It is also possible to find suppliers whose available resources coincide with the usage pattern of the aggregated group.⁵¹ In any case, having a municipality shop on behalf of a large, aggregated load will allow the group to find the best-matched supplier, which will result in serving the load at the lowest available cost. Moreover, municipalities who join their loads together can achieve more load-curve benefits.

iv. Ability To Enter Into Long-Term Agreements

Individual residential and small commercial customers have little or no ability to enter into long-term agreements — nor do suppliers usually seek such agreements with small consumers — due to their lack of locational permanence and insufficient market knowledge on which to base a long-term commitment. Long-term⁵² agreements do, however, offer significant advantages because they create a more

⁵¹ See Lynn K. Goldfarb and Douglas Stevenson, “Aggregation: An Anti-Aggravation Pill for New-Millennium Consumers,” *The Electricity Journal*. July 1999.

⁵² In this early stage of the new market, “long term” means up to three years.

Municipal aggregation can deliver to small consumers the benefits associated with long-term agreements.

dependable revenue stream for generators and marketers, who are willing to lower costs in exchange for long-term income security. Long-term contracts also decrease the risk of making investments in new or repowered generating facilities. Lower risk allows lenders and investors to reduce financing costs, which can be a significant factor in the cost of new generating facilities. This factor is especially important for renewable energy plants, which have higher capital costs and longer debt repayment periods relative to natural gas-fired plants, which makes finding affordable financing difficult.⁵³ Because municipalities are able to enter into long-term contracts on behalf of the entire community, municipal aggregation can deliver to small consumers the benefits associated with long-term agreements.

Long-term contracts also allow suppliers to undertake better planning, which in turn can increase their ability to provide reliable service. Thus, municipal aggregation can help lead to an electricity system that is less chaotic and more reliable.

Municipal aggregation transforms small, relatively uninformed consumers with little time and few resources into sophisticated buyers.

v. Greater Sophistication

In addition to creating bigger, more attractive customers that can enter into longer-term agreements, municipal aggregation transforms small, relatively uninformed consumers with little time and few resources into sophisticated buyers. Municipalities routinely negotiate contracts for city services, such as garbage collection, cable TV, and water systems. They are equipped with resources and negotiating skills and can acquire the industry expertise necessary to negotiate favorable terms and conditions for electricity service on behalf of their citizenry.

B. Municipal Aggregation Can Make Electric Service More Responsive To Community Needs

The second major benefit of municipal aggregation, in addition to its potential to reduce costs, is its responsiveness to community needs. Electric service provided through municipal aggregation programs is likely to reflect the needs and interests of the local citizenry because:

⁵³ See Nancy A. Rader and William P. Short, “Competitive Retail Markets: Tenuous Ground For Renewable Energy,” *The Electricity Journal*. April 1998.

Electric service provided through municipal aggregation programs is likely to reflect the needs and interests of the local citizenry.

(a) the programs will be structured under open, democratic decisionmaking processes; (b) the programs are likely to be widely recognized in the community; and (c) municipal officials are accountable to their constituent voters.

Although there will be many examples of community responsiveness, we discuss two below: (1) assuring that low-use and low-income customers are included within the beneficiaries of electricity competition; and (2) fashioning packages of products that respond to the community's product needs and interests.

1. Aggregated Communities Can Bring Low-Load And Low-Income Customers Within The Beneficiaries Of Competition

Certain types of customers are less likely to be served through private aggregation programs. Low-use and low-income customers will not be attractive to suppliers and may be excluded from general marketing efforts and from private aggregation programs. Municipal aggregation programs are likely to serve all customers within the municipality's geographical boundary.⁵⁴ Not only does this factor reduce the possibility of "redlining" or otherwise excluding low-use or low-income customers from the program, but aggregation includes otherwise undesirable consumers within a larger, more attractive group. Thus, the economic and other benefits gained through aggregation will be shared equitably across the entire community.

2. Aggregated Communities Can Identify Local Preferences And Fulfill Them By Fashioning Product Packages

As described above, municipal aggregators are likely to be responsive to the local community. Because of this local responsiveness, municipal aggregators will take into account the citizenry's interests in the type of service they seek, such as possible preferences for renewable resources and electricity conservation programs ("green" resources), resources that support the local economy, and packages

⁵⁴ If there is any doubt, aggregation legislation can require universal coverage within the municipality.

of consumer goods and services. Municipal aggregators are also more likely to capture these benefits, as compared to individuals shopping alone, because they have greater bargaining power and a load that suppliers are more interested in serving.

a. Renewable Resources

The public has indicated strong and consistent support for electricity resources with reduced environmental impacts, including renewable resources and energy efficiency, in polls over the past 15 years.⁵⁵ More to the point, dozens of municipalities have demonstrated an interest in reducing the environmental impacts associated with resource consumption in their communities.

For example, approximately 300 cities, towns, and counties around the world are members of The International Council for Local Environmental Initiatives (ICLEI), whose mission is to “build and support a worldwide movement of local governments to achieve tangible improvements in global environmental conditions through the cumulative impact of local actions.”⁵⁶ Fifty-five U.S. cities are participating in ICLEI’s Cities for Climate Protection Campaign “to slow the Earth’s warming trend and to improve local air quality and urban livability.” Worldwide, 26 campaign participants reported expending or committing a total of \$3.2 billion on local measures from 1990 to 1996 (\$22 per capita annually).⁵⁷ Many participants achieved at least a portion of these savings from energy-efficiency investments.⁵⁸

Because many local communities are interested in reducing their environmental impacts, these communities are likely to be interested in aggregating their electricity loads at least in part because of the

⁵⁵ See, e.g., Barbara Farhar, *Trends in Public Perceptions and Preferences on Energy and Environmental Policy* (and more recent, related works), National Renewable Energy Laboratory. NREL/TP-461-4857. February 1993.

⁵⁶ Website of The International Council for Local Environmental Initiatives (www.iclei.org), September 8, 1999.

⁵⁷ “Local Government Implementation of Climate Protection: Report to the United Nations,” International Council for Local Environmental Initiatives (www.iclei.org). December 1997.

⁵⁸ *Ibid.*

[Local] communities are likely to be interested in aggregating their electricity loads [to obtain] power from resources that have lower environmental impacts.

possibility of obtaining power from resources that have lower environmental impacts. Several California cities, including Santa Monica and cities in the San Diego area, are already purchasing renewable energy for their governments' own electricity use. Cities will also be interested in incorporating energy-efficiency efforts into their aggregation programs because: **(a)** investments in energy efficiency can more than pay for themselves; and **(b)** energy dollars saved through energy-efficiency programs are dollars that can be spent in the community.

A municipal aggregator could incorporate community preferences for green resources in a number of ways, such as: **(a)** the aggregator could require bidders to obtain some or all of their power from renewable energy resources or to provide energy-efficiency services to consumers in the community, or both; **(b)** the aggregator could acquire energy-efficiency services from a separate provider but incorporate the services into the aggregation program; and **(c)** the aggregator could give extra scoring points to bidders who provide these types of resources.

b. Local Power Resources

Local power resources support the local economy through jobs, taxes, and increased reliability. This fact will be important to the municipality that is shopping for electricity service, but largely irrelevant to private suppliers and aggregators that are marketing their services to a much larger geographic area. For the same reasons, distributed resources, such as fuel cells and solar arrays, will be more attractive to municipal aggregators than to suppliers with investments in large, centralized resources. A municipal aggregator can give extra scoring points to bidders who pledge to obtain some or all of their power from local resources, or require all bidders to include some amount of power from local resources.

c. Packaging Power With Other Services

Two recent trends in the electricity industry, in addition to competition in the sale of electric power, include: **(1)** the competitive sale of other “unbundled services,” such as metering, billing, and customer service that the regulated utility traditionally provided; and **(2)** the packaging of electricity services with diverse products and services, such as gas, home

security, Internet access, and cable. The municipal aggregator has the opportunity to package power with these other services, providing community leaders with one more way to provide municipal services in a manner that lowers costs and reflects the community’s preferences. Following are the specific types of services that municipal aggregators could package with electric power.

i. Unbundled Services

Electricity customers require metering, billing, and other customer services in conjunction with their purchase of electric power. In some states that have passed restructuring statutes, the distribution company will continue, at least initially, to provide these services. More states, however, require the distribution company to unbundle these services and allow customers to purchase these services from competitive suppliers.

a. Metering

The market is creating an increasing number of advanced metering-service options that use communications technologies to help consumers access lower electricity prices and nonelectric services. Consumers may have some difficulty understanding and comparing these metering options. Advanced metering systems presently carry a cost that may be prohibitive in some communities. The municipal aggregator will have the expertise to determine the metering services best suited to the needs of the community. The increased bargaining power and lower transaction costs associated with municipal aggregation also may make the difference in making advanced metering services affordable for consumers.

There may be instances where the municipal aggregator can provide services at lower costs because it represents customers in a specific locale. Some advanced metering-services technologies using “dedicated networks” require a high density of customers within a geographic area. The aggregator that represents customers in a discrete geographic area may be able to offer these services, which today cost less than other advanced metering systems. Dedicated networks may not support a wide range of “value added” services, and may not be the best systems to promote metering competition generally, but the aggregator may determine that these systems best serve the needs of the community.

The increased bargaining power and lower transaction costs associated with municipal aggregation also may make the difference in making advanced metering services affordable for consumers.

b. Billing And Customer Services

The municipal aggregator may provide for billing and customer-service options that reflect the preferences of the community. For example, citizens of a community may value foreign-language billing and customer-service options. Internet services and electronic-billing options may be more important to customers in some communities than others. The municipal aggregator can help identify and negotiate with providers for these services.

ii. Non-Electricity Services

Electricity suppliers, including municipals, are offering packages that include: communications services, including telephone, Internet access and cable; appliance services, including programming, energy efficiency and warranties; home security; and financial services, including credit cards and insurance.

For example, Tacoma Power, a Washington municipal utility, is offering its customers cable and Internet services.⁵⁹ A Kansas municipal utility will be selling satellite television dishes, surge protectors, energy management services, backup power and, possibly, appliance warranties.⁶⁰ In light of the slim profit margins in the competitive retail electricity market, competitors are likely to increase the range of packaged product offerings to consumers.

If electricity products are difficult to compare, packaged products introduce additional complexities for consumers trying to comparison shop. There are an infinite number of possible product combinations and pricing schemes. The municipal aggregator can assume the responsibility for distilling this information, identifying the product packages that best reflect the community's needs, and comparing prices on behalf of its customers.

⁵⁹ *Electric Light & Power*, May 1999.

⁶⁰ "Kansas City muni expands service offerings," *Megawatt Daily*, January 5, 1999.

C. Municipal Aggregation Can Make Competition More Effective

The third benefit of aggregation is that, in addition to the reduced costs and other benefits provided for aggregated consumers, municipal aggregation can increase the chances that the introduction of competition into retail electric sales will succeed, with benefits flowing not just to the aggregated load, but to the market as a whole. Municipal aggregation can get competition off to a quicker start, it can counterbalance an increasingly consolidated industry, and it can attract diverse suppliers willing and able to market to these organized groups. All of these factors can assist the evolution of retail competition.

1. Aggregation Can Jumpstart Competition

Municipal aggregation can foster small-consumer participation in the crucial early days.

Municipal aggregation can foster small-consumer participation in the crucial early days. This initial period is a time of confusion when few choices may be made, when those choices may be poor and uninformed, when competitors are in a vulnerable state of infancy, when the lowest-cost resources are not yet committed to large consumers, and when the incumbents are poised to take advantage of these factors. Injecting a respected, accountable, and well-known entrant, in the form of the municipal aggregator, can ensure a serious competitive alternative from the outset. Otherwise, customers may make choices early on that they do not revisit for many years, ensuring that incumbents retain a large market share much longer than true competition would permit.

2. Aggregation Can Offset The Risks Of Industry Consolidation

A market is only competitive if it has a sufficient number of buyers and sellers, each negotiating to maximize its own welfare. Small consumers are not equally matched in their ability to negotiate with multi-billion-dollar electric service providers. By increasing the number of buyers with bargaining power (or even latent bargaining power), the competitiveness of the overall market is improved.

The electricity industry is becoming increasingly consolidated through utility mergers, especially those involving adjacent geo-

Municipal aggregation can help counterbalance a concentrated industry.

graphic territory. Where industry concentration is high, collusion and other forms of market power⁶¹ become more likely.⁶² The result of market power is that the concentrated industry, rather than consumers, will capture any economic gains from competition, if those gains are realized at all. While municipal aggregation is no substitute for deterring market power through structural means and eliminating it through antitrust enforcement, it can help create a strong consumer presence that may partially counterbalance a concentrated industry.

3. Public Aggregation Complements Private Aggregation

Municipal aggregators function similarly to private-sector aggregators, which also may act either as buying agents or retail sellers (usually the former). Private aggregation programs may be run by trade groups, membership organizations, buying clubs, cooperatively owned businesses, and by companies for their employees. Public aggregation is an important complement to private aggregation.⁶³ As a direct competitor to private aggregation efforts (provided individuals can opt out of the municipality and buy from a private aggregator), municipal aggregation provides a benchmark for cost and customer responsiveness. As a co-venturer with private aggregation efforts, municipal aggregation can team up with private companies to serve varied needs in the community with the diversity of products appropriate to the diversity of the market. Finally, whether in competition or collaboration, these two forms of service will complement each other. For example:

- The membership of private aggregators is usually either relatively small or geographically dispersed. Municipal aggregation has the advantage of geographic compactness, which yields uniform market conditions, potentially lower billing and metering costs, and lower costs of disseminating public information (which may

⁶¹ Market power is the ability of a supplier to raise its prices above the competitive level on a sustained basis.

⁶² See, e.g., Albert A. Foer, “Institutional Contexts of Market Power in the Electricity Industry,” *The Electricity Journal*. May 1999.

⁶³ See note 51 *supra*.

be needed to promote various services as well as the aggregation program itself).

- Municipally aggregated electric loads are likely to be more attractive to potential suppliers due to the combination of the diverse usage patterns of residential, commercial, industrial, and municipal loads, which may lead to lower service costs (see **Part II.A.2.b.iii** above).
- Low-use and low-income customers are less likely to be served by private aggregation programs. Municipal aggregation involves an obligation to serve all customers within the municipality's geographical boundary.
- Municipalities are publicly accountable institutions, subject to open-meeting and ethics laws, that have a track record of providing a variety of services to the community (in some cases electric service).
- Due a lack of democratically derived authority, private aggregators cannot automatically enroll their members into the aggregation program, which raises transaction costs. Thus, the offered price must factor in the cost of marketing to each member, and reflect greater uncertainty over the participation rate.⁶⁴
- Municipalities are durable institutions, which, compared to some aggregators, may represent to suppliers more reliable and creditworthy business partners that are better able to enter into long-term contracts.
- Municipalities have a stake in the health of the local economy and will therefore seek to maximize local benefits, including low rates and local energy-conservation efforts (both of which leave more dollars to be spent inside the community), support of local resources, and investing in and packaging electricity with other local services.

Municipalities are durable institutions, which ... may represent to suppliers more reliable and creditworthy business partners.

⁶⁴ Contracts between suppliers and membership groups, where the members are individuals or smaller organizations, are often for the opportunity to market to members at a price discount.

4. Aggregation Can Create A Diversity Of Suppliers

Just as public power has fostered competition among forms of electric utilities, so can municipal aggregation create competition among forms of electricity suppliers.

In assessing the effects of competitive pressure from public power systems, the preeminent regulatory economist Alfred E. Kahn wrote, “competition by example or by threat of displacement by public enterprise has greatly improved the performance of [the electric] industry.”⁶⁵ Just as public power has fostered competition among forms of electric utilities, so can municipal aggregation create competition among forms of electricity suppliers. A diversity of providers also promotes experimentation and new thinking. For example, municipal aggregators (particularly if they implement their share of statewide energy-efficiency and resource-diversity policies) are well positioned to promote a growing trend toward distributed generation, such as fuel cells, solar systems, and other types of small scale generation, which can decrease transmission needs and environmental impacts.

D. Municipal Aggregation Can Produce Environmental Benefits

The fourth category of benefit potentially provided by municipal aggregation is reduced environmental impacts associated with electricity production. As discussed in **Part II.B.2.a**, many local communities will be interested in aggregating their electricity loads because they are interested in reducing the impact on the environment caused by the community’s electricity consumption. Interest in obtaining low-impact electricity resources is not enough, however. Most “green products” available to interested *individual* customers in restructured states make little if any difference to the environment:

- Some products merely resell renewable electricity that is already under long-term contract and would operate regardless of the resale.⁶⁶ The resale of this power into “green markets” does not

⁶⁵ Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, vol. 2, pp. 104-106, 1976.

⁶⁶ Many renewable resources developed pursuant to the Public Utility Regulatory Policies Act (PURPA) are currently operating under long-term contract to utilities at above-market rates. The costs are billed to

Most “green products” available to interested individual customers in restructured states make little if any difference to the environment.

cause any additional power generation from existing renewable energy power plants, does not support any existing renewable energy plants that face market risk, and does not cause the development of any new renewable resources.⁶⁷

- Other products merely package existing hydropower or geothermal supplies that are economic without any additional support from the green market. These resources exist in quantities that are unlikely to be fully subscribed by green consumers, so that demand for them is unlikely to push toward existing or new resource supplies that require support.⁶⁸
- Natural gas is marketed as “green” even though there are tens of thousands of megawatts of gas-fired generation currently being developed without the support of green customers.⁶⁹
- The “new” energy content in some products is limited to a relatively small percentage that is often already supported by state subsidies.⁷⁰

While marketing “green” energy supplies is proving to be an important means of differentiating (and charging more for) an

(footnote continued from previous page)

the utility’s ratepayers whether or not these utilities’ service territories have been opened to competition.

⁶⁷ Note 48 *supra* (Public Citizen).

⁶⁸ For a review of product content in California and Pennsylvania, see Wiser, Fang, Porter and Houston, *Green Power Marketing in Retail Competition: An Early Assessment* (Appendix A), National Renewable Energy Laboratory, February 1999. [Since the publication of this document, a leading green marketer in California, Commonwealth Energy, signed an agreement with Calpine Corp. to purchase power from its geothermal plants at The Geysers, which Calpine recently purchased from Pacific Gas & Electric. The Geysers operate economically without premiums from the green market (see note 48 *supra*, Public Citizen, section II.B.5).]

⁶⁹ See *Ibid.* (Wiser *et al.*) and note 53 *supra*.

⁷⁰ Note 48 *supra* (Public Citizen).

Obtaining products that truly make a difference to the environment is likely to require a consumer who ... is large enough to avoid high marketing costs.

intangible, commodity product in new retail electricity markets,⁷¹ obtaining products that truly make a difference to the environment is likely to require a consumer, like a municipal aggregator, who: **(a)** has the sophistication and resources to differentiate environmentally meaningful from unmeaningful products; **(b)** is large enough to avoid high marketing costs associated with products aimed at the residential sector; and **(c)** is able to enter longer-term contracts at fixed, above-market rates. These characteristics will allow municipal aggregators to obtain electricity products and services that truly make a difference to the environment. Municipal aggregation can, therefore, help produce environmental benefits not only for their communities and their region, but, through carbon emission reductions, for the world.

⁷¹ In California, this is in part due to marketing subsidies that are available for sellers of renewable energy. (See **Part II.A.2.a.**)

Promoting Competitive Electricity Markets Through Community Purchasing

Part III

Making Municipal Aggregation Effective: The Importance Of The “Opt-Out” Model

Municipal aggregation efforts have focused on three different approaches: “all inclusive,” “opt out,” and “opt in.” **Subsection A** in this Part describes and compares these three approaches, illuminating the important advantages of the opt-out model. **Subsection B** explains why the “opt out” model is the approach most likely to make retail competition work for consumers.

A. Comparing Three Forms Of Municipal Aggregation

1. All-Inclusive Aggregation

Under an all-inclusive aggregation program, a local government would negotiate for electricity services on behalf of all residences and businesses in the community and automatically enroll all of them into the program. Just as a resident obtains waste collection, water service, and police and fire protection from the municipality, so would the resident take electric service. In today’s electric industry, the most familiar analog for automatic aggregation is the traditional municipal utility, whose residents do not shop on their own for electricity. (Municipal utilities own their own distribution assets, and often transmission and generation assets, while the aggregator would not own these assets.) Municipal utilities have been successfully procuring power from the competitive wholesale market on behalf of their communities for most of this century.

The process of majority vote is a useful way to balance the costs and benefits of individual shopping vs. community procurement.

Opponents of all-inclusive aggregation have argued it conflicts with an individual’s “right” to choose an electricity supplier. There are several possible responses. *First*, it is not unusual for a majority vote to determine the methods of resource procurement in a community. In every community there is a mix of resources provided exclusively by the municipality and resources procured by the individual. It is the majority vote that determines which resources receive which treatment. *Second*, the process of majority vote is a useful way to balance the costs and benefits of individual shopping vs. community procurement. The community can reasonably conclude, based on facts and after hearings and votes, that procurement for the whole will reduce costs to the whole, even if some individual consumers pay more. Allowing the community’s most attractive customers to opt out of the program could raise costs for the majority of consumers, including those with low

incomes, by reducing bargaining power and increasing program implementation costs because of the need to accommodate opt-outs. Communities make this type of tradeoff constantly.

Third, even where the majority has determined the type of service for the entire community, individuals often have means of supplementing or modifying the service. Prominent examples are supplementing public education through private tutoring, public police service through private security systems, and public fire-protection service through private sprinkler systems. In the electric industry, individuals can modify the majority’s decision through conservation or, in some cases, on-site generation systems. Where many individuals express a desire for particular products or services (such as rate-design packages, payment plans, and particular fuel sources), the all-inclusive approach can accommodate by providing for a package of options. “All inclusive” does not mean one-size-fits-all, provided citizens have a means of having their expressed interests reflected in the implementation decisions and provided that the marketers selected by the municipality can offer a menu of options.

2. Opt-Out Aggregation

With opt-out aggregation, the municipality’s local governing body, after public hearings: (1) votes by majority to become an aggregator; (2) selects one or more competitive electricity providers; and then (3) enrolls its residents into the service of these providers. Like representative democracy generally, the costly step of asking each customer for his or her opinion of this action is avoided. The municipality might enroll all consumers, or only those consumers receiving default service. The “opt out” feature gives consumers the option of not participating in the program by opting out prior to, or soon after, enrollment.

The “opt-out” feature gives consumers the option of not participating in the program by opting out prior to, or soon after, enrollment.

A customer’s “opt out” option can be conditional or unconditional. Unconditional opt-out would allow consumers to leave and rejoin the program at any time, without bearing any costs associated with these decisions. This coming and going can shift costs to those customers who stay, reducing the efficiency of the program as a whole. For example, competitive suppliers bidding to serve a community would have to increase their prices to reflect the risks and uncertainties

associated with an unpredictable customer base. Consequently, some opt-out programs would contain conditions that commit participants to a certain term of service, limit the time periods during which opt-outs would be allowed (*e.g.*, one designated month per year), or impose a cost-based fee for opting out (or opting back in), or all three. By making the size of the customer base more predictable and by requiring those who cause costs to bear them, these conditional opt-out rules can encourage efficient behavior and lower costs for all, while preserving individuals’ opportunity to opt out.

There are several benefits of an opt-out program structure:

[The opt-out] approach avoids delay-inducing opposition that all-inclusive aggregation might provoke.

- (a) The opt-out structure enables effective competitive choice while allowing individuals to remain with, or select, their own provider. The structure is therefore “superdemocratic” because, unlike most other decisions made by elected representatives in a democracy, the minority is not constrained by the vote of the majority.
- (b) By allowing customers to opt out, the approach avoids delay-inducing opposition that all-inclusive aggregation might provoke.
- (c) Allowing some opportunity to opt out places greater pressure on the municipality and its supplier(s) to remain as efficient and competitive as possible, since they have no permanent ability to keep customers.

Opt-out aggregation also has important complications, as compared to all-inclusive aggregation:

- (a) Bidding and contracting procedures would be more complicated, because bidders would likely make their offers contingent on there being a certain minimum number of customers. If the actual number of customers who do not opt out is below that minimum, the winning bidders might seek an opportunity to revise their bids. Since those bids establish the prices that influence a consumer’s decision whether to opt out, a “Catch 22” situation can develop. Bidders need to know how many consumers they will be serving in order to cast a bid, but consumers need to know the bid price before deciding whether to opt out. An unconditional opt-out program would compound this sort of problem.

Opt-out aggregation can enable communities to achieve significant benefits, while allowing individual consumers to shop on their own if they wish.

- (b) The opt-out process imposes program-related transaction costs that all-inclusive aggregation avoids. Both all-inclusive aggregation and opt-out aggregation would require initial notification procedures. But after that, the opt-out process would need to include: (i) a public information campaign designed to educate and retain consumers; and (ii) establishment and management of the opt-out procedures.

As long as state legislation does not unreasonably constrain municipalities in their ability to shape opt-out aggregation programs (see **Part IV**), opt-out aggregation can enable communities to achieve significant benefits from the electricity marketplace, while allowing individual consumers to shop on their own if they wish.

3. Opt-In Aggregation

The opt-in aggregation structure differs crucially from the previous two program structures. Even with a majority vote of its governing body, the local government cannot enroll individuals unless they choose the municipal option affirmatively. The municipality would have to obtain a signature or other means of individual authorization prior to enrollment. While the *opt-out* structure imposes some transaction costs on the municipality, the most significant transaction cost — overcoming inertia — does not fall on the municipality. Under the opt-in structure, it does.

As the data in **Part II.A.2.a** indicate, experience in retail electricity markets so far is that the savings available to consumers is frequently under five percent. A single customer’s cost of comparison shopping — whether this cost is perceived or actual — easily could outweigh the savings achieved. But when the municipality signs all consumers up at once, the savings are achieved at a significantly lower per-capita transaction cost. If, on the other hand, the municipality has to convince each consumer to sign up one by one, the gains will be diminished by the transaction costs involved.

In addition to increasing the cost of aggregation, opt-in will decrease the benefits. It will do so by discouraging bidders. Competitors hoping to sell electricity to municipalities need to know the size and shape of the customer base. The more uncertain the base, the less willing the bidder is to offer attractive products and attractive prices.

Under opt-in [aggregation], customers are likely to stay with the state-appointed default supplier.

Under opt-in, customers are likely to stay with the state-appointed default supplier rather than affirmatively select the municipal aggregator. By simultaneously increasing the cost and decreasing the attractiveness of municipal electric service, opt-in creates a vicious circle wherein less attractive service draws fewer customers, and fewer customers make it difficult to obtain more attractive service.

As of mid-1999, there was one example of a successful opt-in aggregation program, that of the Township of Hampton, located 14 miles north of Pittsburgh, Pennsylvania:

- Almost 2,900 of the 6,185 customer accounts that lie within Hampton Township’s boundaries — nearly 47 percent — have been enrolled in the Township’s electricity aggregation program. The township negotiated with Allegheny Energy for a 12-month contract providing consumers a rate of 4.0¢/kWh if the township could subscribe at least 500 customers, an 11 percent savings compared to Duquesne Light Company’s 4.5¢/kWh default service rate.⁷² The rate would have dropped another 1.3 percent (to 3.95¢/kWh) if over 3,000 customers had subscribed.

The township manager admitted the township’s surprise at the high sign-up rate, and attributed it to good timing, keeping in regular communication with constituents who had initially expressed interest in the program, and to a high level of community awareness and trust in the small town’s⁷³ local government.⁷⁴ The township also built upon Allegheny’s existing public service program, in which computers are donated to schools in relation to dollars spent with the company. Hampton’s campaign parlayed this program into a local benefit, by encouraging township residents to sign up with the aggregation program and designating Hampton local schools as the recipient

⁷² Customers that opt-out of the program after subscribing must pay a \$20 exit fee.

⁷³ Hampton’s population is just 18,000.

⁷⁴ Conversation with Chris Lochner, Hampton Township manager, September 1, 1999.

of the computers. In addition to increasing interest in the program, the school district itself will be signing up.⁷⁵

While Hampton Township demonstrates that opt-in aggregation programs can be successful, it also demonstrates that greater savings could have been achieved through opt-out aggregation, which would have raised subscribership over Allegheny’s 3,000-customer price tier. Moreover, Hampton Township’s program is so far the exception to the rule. The success of other municipal opt-in aggregation programs has been very limited, as illustrated by the following example of the City of Palm Springs, California:

- Palm Springs ran a campaign for its opt-in aggregation program for residents as a means of lowering the cost of living in the city. Although 30 percent of 29,000 city residents and businesses expressed interest in an initial mailing, only 8.5 percent actually signed up. The low sign-up rate is attributed by city staff to customer inertia combined with what some argued was insufficient marketing by the program’s initial supplier, Enron Energy Services.⁷⁶ Because the city could not meet the 25 percent sign-up rate required by Enron, Enron withdrew. An opt-out aggregation program would have allowed the city to meet the goal and capture substantial savings. Instead, the city found a new supplier, New West Energy, which provides much lower savings of 2 percent off of the default utility’s total rate (exclusive of taxes).⁷⁷ The city’s contract does not require New West to conduct any marketing, because the costs would offset the price discount. Program enrollment is therefore static. Still, city staff are quick to point out that the program offers the greatest savings currently available to residential consumers in the California market.

⁷⁵ *Ibid.*

⁷⁶ Conversation with Harold Good, Procurement Manager, City of Palm Springs, September 1, 1999.

⁷⁷ Savings of three percent are available to customers who sign up for electronic billing.

B. Opt-Out Aggregation Is Consistent With Effective Retail Competition

The choice between opt-in and opt-out will affect market outcomes dramatically. At bottom, the question is whether the many small consumers who do not actively choose will become customers of the aggregator selected by a majority vote of their local governing body or of the state-appointed default provider. Opt-out increases the likelihood of the former; opt-in increases the likelihood of the latter. If state law permits a municipality to enroll residents into its aggregation program automatically, subject to opt-out provisions, and that right is exercised, it is likely that a majority of consumers will remain with the provider selected by the municipality rather than with the default provider. *The results are reversed if the state places the burden on municipalities through an opt-in requirement.*

Opt-out programs save the municipality the transaction cost of inducing consumers to make affirmative choices *in favor of the most competitive supplier.*

Obtaining the initial right to serve consumers thus carries with it tremendous value. Reflecting this value is the intense conflict between utilities and new marketers over the chance to be, or to compete to be, the default provider in each state. Opt-out programs save the municipality the transaction cost of inducing consumers to make affirmative choices *in favor of the most competitive supplier*. This cost, which manifests itself in the form of marketing and advertising, is the greatest burden faced by suppliers competing against the default service provider (often the incumbent utility⁷⁸). Because the cost of overcoming consumer inertia is so high (see **Part II.A.2.b**), the allocation of this transaction cost burden will strongly influence whether or not a competitive market for small consumers materializes.

Consumers remain passive for a number of reasons that may include trust in the current provider, unfamiliarity with new competitors, and the cost and inconvenience of obtaining enough information to make a sensible choice among confusing options. The choice to

⁷⁸ Even if the default provider is not the incumbent utility, and is selected through competitive means, most consumers are likely to remain with the default provider, rather than shopping around, as municipalities will do, which will support a larger number of suppliers participating in the market and thus lead to more robust competition.

remain passive may be an entirely rational one if the cost of educating oneself is higher than the real or perceived potential

The savings may not be large enough to justify the transaction costs inherent in individual shopping, but shopping is worthwhile if undertaken on individuals’ behalf by municipalities.

savings. Opt-out aggregation can capture those available savings for consumers — and thereby increase overall market efficiency. The savings may not be large enough to justify the transaction costs inherent in individual shopping, but shopping is worthwhile if undertaken on individuals’ behalf by municipalities. The cumulative savings are dollars that remain in the community to be saved or spent on other goods and services.

Promoting Competitive Electricity Markets Through Community Purchasing

Part IV

Key Features Of Effective Municipal Aggregation Legislation

This Part discusses the key legislative provisions necessary to enable opt-out municipal aggregation.⁷⁹ The focus is on opt-out aggregation because, as discussed in **Part III**, this method preserves the ability of the majority to gain the benefits of shopping as a community while allowing the minority to shop on their own.⁸⁰ Nevertheless, many of the features suggested here will also apply to other forms of municipal aggregation.⁸¹

We have placed the key provisions in four main categories: **(a)** authority to aggregate on an “opt-out” basis; **(b)** regulatory oversight of municipal aggregators and their suppliers; **(c)** modifications to sunshine laws and municipal contracting laws; and **(d)** aggregation by initiative.

Part V then discusses the types of provisions that can undermine municipal aggregation. Unfortunately, a substantial number of these provisions have made their way into state statutes. **Part V** also notes that, even with a solid legislative foundation authorizing municipal aggregation, aggregation efforts will not be successful within an overall market structure that fails to promote competition, and provides suggestions for state legislation that can facilitate the evolution toward such a market structure.

⁷⁹ The opt-out municipal aggregation provisions that were included in the restructuring bills in Massachusetts and Ohio, while useful to review, should not be used as a model. In particular, the Massachusetts provision contains numerous unnecessary requirements and vague language that present barriers, such as those discussed in **Part V**.

⁸⁰ Because local governments are best positioned to determine, in light of actual market circumstances and constituency views, which type of aggregation program will best serve their citizenries, it is best if legislation not preclude any program type — including all-inclusive aggregation — as an option. Our focus on opt-out aggregation is a pragmatic one.

⁸¹ While aimed at state legislation, these features may also apply to national legislation promoting municipal aggregation.

A. Authority To Aggregate

The key element of state aggregation legislation is establishing the right of municipalities, individually or jointly, to aggregate automatically the load of all electricity consumers within their jurisdiction *on an opt-out basis*. Legislation should also authorize municipal aggregators to implement state electricity-related social and environmental policies as part of the aggregation program. Finally, legislation should preserve municipally owned power systems.

1. Clarify The Application Of “Home Rule” Authority To Electricity Services

“Home rule,” as described more fully in the **Appendix**, refers to the power bestowed by a state government on its local governments to enact and enforce local laws. Absent state legislation explicitly granting local governments the right to aggregate on an opt-out basis, the extent to which local governments possess the authority to aggregate (on an opt-out or all-inclusive basis) will depend on the extent of home-rule power and how that power is interpreted by courts of law to apply to municipal aggregation in retail electricity markets.

Legislation explicitly authorizing municipal governments to provide electricity services for their constituents will be desirable in most states.

Legislation explicitly authorizing municipal governments to provide electricity services for their constituents will be desirable in most states for one or all of the following reasons:

- (a) To grant opt-out aggregation authority where such authority is not provided by the state’s home rule laws;
- (b) To clear up any uncertainty regarding the application of home rule to opt-out aggregation; and
- (c) To deter legal challenge.

Legislation should authorize municipalities specifically: **(a)** to solicit bids and broker electric energy and related services on behalf of their jurisdictional consumers; **(b)** to enter into agreements to facilitate the sale and purchase of such services; and **(c)** to take title to and resell electric services.

2. Establish Conditions For Opt-Out Aggregation

State legislators may want to impose a few basic conditions on the opt-out process.

State legislators may want to impose a few basic conditions on the opt-out process to ensure that the public is informed of such programs and that individuals have a reasonable opportunity to opt out of the programs. The conditions should be fashioned carefully, and should exclude inflexible restrictions that could constrain municipalities' negotiating flexibility and limit their ability to shape effective aggregation programs.

Some appropriate conditions would be:

- (a) Requiring a majority vote of the governing body of the municipality;
- (b) Requiring the municipality to hold at least two public hearings on the program, one before issuing a request for proposals and one before entering into a contract with the selected provider(s);
- (c) Requiring the municipality clearly to disclose to each consumer:
 - (i) That the consumer will be automatically enrolled in the aggregation program unless the consumer affirmatively elects not to be enrolled by means of a stated procedure; and
 - (ii) The terms and conditions of the service offered under the aggregation program, which should be provided reasonably in advance of the opt-out deadline;
- (d) Requiring the municipality to offer individual consumers a reasonable opportunity to opt out of the aggregation program:
 - (i) before they are initially enrolled; and
 - (ii) at any time after enrollment, potentially subject to a reasonable, cost-based opt-out fee.⁸²

Setting forth general guidelines, by using terms like “reasonable” and “cost-based,” will provide municipal governments the flexibility necessary to respond to market conditions and constituent interests.

⁸² States should allow municipalities to charge reasonable, cost-based fees since opt-outs may impose real costs on suppliers or other customers. Cost-based fees will encourage economically rational consumer behavior.

Prescribing more specific conditions, such as disallowing exit fees altogether, will necessarily be arbitrary and, as such, could compromise the ability of the municipality to attract the best possible offers. For example, although it is likely that a large majority of consumers will not opt out of the program (because the municipality will have secured more attractive service than the default service that most consumers would otherwise continue to receive), it is possible to create a “Catch 22” problem in which bidders need to know how many consumers they will be serving, but consumers need to know the bid price before deciding whether to opt out. Municipalities need to have the ability to structure their programs so as to minimize such problems by, for example, limiting unrestricted opt-out periods to what the market can bear and to what is reasonable from the perspective of their constituents.

3. Require Assistance By Distribution Utilities

Because the incumbent utility has been the exclusive seller for many years, it controls a good deal of the machinery and data necessary to implement aggregation. These utilities, if they are retail competitors hoping to retain their present customers, will not necessarily have an interest assisting municipal aggregators. This combination of control of resources and disincentive to assist necessitates requiring the utility to take those actions necessary to assist aggregation, where the aggregator cannot feasibly carry out those actions directly.

Legislation therefore should contain either specific directives, or it should direct the public utility commission to create rules and enforce compliance. Examples might include requiring the utility to:

(a) identify accurately — by account codes and meter numbers — all customers who have not selected a competitive supplier within the jurisdiction of the municipality; and (b) transfer the data to the supplier selected under the aggregation program.

4. Establish The Authority Of Governments To Act Together

Within limits, the larger the aggregated load, the more efficient it is likely to be to serve that load. This market reality may require local governments, especially small towns, to combine their constituents’ load with the loads of neighboring localities in order to draw attractive bids.

Not only are larger loads more attractive to a potential supplier but, as discussed in **Part II.A.2.b**, combining loads will also tend to produce a higher overall load factor, which is also attractive to many suppliers. Joint aggregation efforts will also reduce the transaction costs and administrative overhead that would otherwise be duplicated by each municipality, allowing, for example, the use of a single industry consultant to facilitate the negotiation process. To enable these efficiencies where they exist, aggregation legislation should specifically authorize local governments, as well as the state government’s purchasing department, to act together in aggregation ventures.

Where local jurisdictions overlap, such as cities within a county, aggregation legislation should make clear which jurisdictions have the authority to determine whether to aggregate or not and whether to join with other government entities or not. One way to resolve any ambiguity would be to rest the authority with the “most local” municipality — *i.e.*, the governing bodies of cities and townships.⁸³

5. Allow Local Implementation Of “Public Goods” Policies

Historically, the protected monopoly status of utilities allowed regulators to require utilities to provide for various “public goods,” including programs to support low-income customers, energy efficiency, renewable energy, and research and development, although not all states have provided programs in all of these areas. When the retail monopoly is eliminated, many states will want to find alternative means to support the programs so that no supplier is placed at a competitive disadvantage with other suppliers in the new marketplace. The new policy mechanisms that have been adopted include “system benefits charges” and “portfolio standards.”

⁸³ Unless a legislative exemption is made, facilities of the state or county that are located within a city or township would be affected the same as any other customer within the jurisdiction: they would have the ability to opt out of the program. If the state expects to aggregate its load, and in the process set standards and bring purchasing power to the market, it may make sense to treat state-owned facilities on an opt-in basis.

Public-goods policies will not hinder aggregation efforts as long as the policies treat all consumers and all retail providers equally. If, however, these policies allow for local implementation under state guidelines, the goals of the policies can be met (or exceeded) while enhancing local aggregation programs.

As long as state-wide guidelines are met, local jurisdictions should have some discretion to define [public goods] programs and target the benefits.

a. Public Benefits Charges

In the case of public-benefits charges assessed to consumers to support energy-efficiency, low-income, or renewable energy programs, a municipal aggregator should have the option to obtain the funds collected from the municipality's jurisdictional consumers and implement the programs locally, in conjunction with the aggregation program. As long as statewide guidelines are met, local jurisdictions should have some discretion to define programs and target the benefits. Municipalities should also have the option of increasing those charges to further the same goals.

b. Portfolio Standards

Portfolio standards are inherently amenable to control by a municipal aggregator because they require retail sellers to meet minimum renewable energy or energy-efficiency content requirements, which can be directly influenced by the municipality in its request-for-proposals and in negotiations with suppliers.

Renewable energy portfolio standards, which have been adopted in several states, require retail electricity suppliers to include a minimum amount of renewable energy in their resource portfolios, or to support an equivalent amount of renewable energy through a market-based system of tradable credits.⁸⁴ A municipality negotiating with suppliers for aggregated service could specify how the standard should be met, *e.g.*, by supporting local renewable energy projects.

The concept of an energy-efficiency portfolio standard parallels the renewables portfolio standard, but has been less widely discussed

⁸⁴ See *A Powerful Opportunity: Making Renewable Energy the Standard*, Union of Concerned Scientists (www.ucsusa.org). January 1999.

and has not been adopted by any state.⁸⁵ Such a policy would require retail electricity suppliers to support energy savings equivalent to some percentage of total end-use energy sales by purchasing “energy efficiency credits.” A state agency would determine the types of energy-efficiency activities that would qualify for credits, determine how much credit each completed energy-efficiency measure would be awarded, and issue credits for completed measures. Under such a tradable credit system, a municipality negotiating with suppliers for aggregated service could specify how the standard should be met, *e.g.*, by purchasing credits generated in the community by a local community service organization.

6. Relationship Between Municipal Aggregation Efforts And Existing Municipal Utility Systems

“Electricity competition” is not a recent event. From the early days of electric service through the present, investor-owned utilities and publicly owned systems governed by municipalities have vied for customer favor. Today, over 2,020 local governments own their own power systems,⁸⁶ integrating electric service with their other municipal services and serving residents on a nonprofit basis.

The entry of municipal aggregators should have distinct benefits for the traditional municipal utility.

The entry of municipal aggregators should have at least four distinct benefits for the traditional municipal utility:

- (1) If municipal aggregators become sophisticated, influential purchasers, they will attract diverse new sellers. Seller diversity can reduce the market power of large incumbent utilities, to the benefit of all purchasers, including traditional municipal utilities.
- (2) Municipal aggregators will be potential purchasers of surplus capacity from existing municipal systems, helping existing systems smooth out their capacity planning.
- (3) Municipal aggregators can jointly shop for power with existing municipal systems, increasing the purchasing efficiencies for each.

⁸⁵ See “Energy Efficiency in a Restructured Environment,” *Energy Perspectives*, Tellus Institute. September 1998.

⁸⁶ Energy Information Administration Forms EIA 860 and 861.

- (4) Municipal aggregators' public-interest focus makes them useful allies in efforts to encourage consumers and their elected representatives to adopt long-term methods of increasing the efficiency and decreasing the adverse environmental effects of electricity consumption.

Legislation authorizing municipal aggregation need not apply to, or affect legally, existing municipal utility systems. (To avoid any uncertainty, legislation could make this nonapplicability explicit.) The citizens of municipalities with existing utility systems already have voted their preferences. There is no present need to force a reexamination of those preferences. Municipal utility systems already are aggregators for their residents, whose satisfaction with the result is implicit in their ongoing decision to leave those systems in place.

B. Regulation Of Municipal Aggregators (And Their Suppliers)

With a few exceptions indicated in the subsections below, municipal aggregators should be subject to the same state regulations as private-sector entities performing the same services. As discussed in **Part V**, unnecessary regulatory scrutiny could introduce delays that could complicate the negotiating process and interfere with the execution of aggregation programs.

If a municipal aggregator administers public-purpose funds collected on a statewide basis (see **Part IV.A.5** above), such as for energy-efficiency programs, it should meet the same program standards that govern the expenditure of the rest of the fund. The state will have required the funds to be collected in order to meet goals deemed to be important to the state's overall welfare. Municipalities should therefore use these funds to help fulfill these goals. Municipalities ought to be able to collect additional funds to further the goals established by the state, or to meet additional objectives they deem worthwhile.

1. Municipalities Acting As Retail Sellers

If the municipality is itself selling retail services, it should be subject to many of the same laws and regulations as other retail sellers, including:

- (a) Regulations aimed at ensuring system reliability and default service in the event of supplier failure to deliver;
- (b) Most regulations aimed at consumer protection, such as billing and written-terms-of-service requirements; and
- (c) Consumer-education requirements, such as “electricity facts” labels (indicating, *e.g.*, fuel sources and stating service costs in a uniformly comparable manner).

Consumers of the municipality will benefit from most of the standards set forth by the state. Statewide uniformity of minimum consumer protection and education standards will facilitate consumer understanding of their rights and responsibilities.

One essential exception to requirements imposed on all retailers is that, to enable opt-out aggregation (the importance of which is discussed in **Part III**), individual consumer-authorization requirements should not apply to the municipality. Other possible exceptions to licensing and consumer-protection regulations may include those aimed at potentially transient companies (*e.g.*, requiring the posting of security to protect potential customer security deposits and overbillings).

2. Municipalities Acting As Brokers

To enable opt-out aggregation, it is essential that individual consumer-authorization requirements not apply to the municipality or its chosen supplier(s).

If the municipality is acting as a broker, by bringing buyers and sellers together, it should be subject to most of the laws and regulations that apply to private-sector companies performing the same services. As with the municipality-as-retailer, municipalities-as-brokers should be subject to all regulations pertaining to system reliability, and most regulations pertaining to consumer protection and education (if any).

Again, to enable opt-out aggregation, it is essential that individual consumer-authorization requirements not apply to the municipality or its chosen supplier(s). The legislation should clarify the legal status of municipal aggregators so that regulatory treatment is appropriate.

This is especially important if licensing requirements are broadly applicable, *e.g.*, to any person executing a “contract relating to the sale of electric generation services ... to end use customers,” as is the case in Connecticut. Connecticut made an exception for municipal aggregators, requiring municipalities to register instead with the Department of Public Utility Control on a form prescribed by the department and requiring the department to “consider ... whether one or more of the licensing requirements ... should not be imposed on municipalities or political subdivisions that act as aggregators.”⁸⁷

C. Modifications To Sunshine Laws And Municipal Contracting Laws

Municipalities need to be able to keep confidential the pricing and terms of all bids until all negotiations are concluded and final recommendations are made. Revealing confidential information can skew the direction of a negotiation, create an unfair advantage for the bidder in negotiations, and set the price floor for any future bids. If existing state law does not provide for the confidentiality of information between municipalities and vendors during negotiations that would apply also to any aggregation activities, the aggregation law should include language protecting such negotiations. Municipal law should also allow such confidentiality.

D. Aggregation By Initiative

Where citizens do not have existing authority to use the initiative process to induce their local government to act, aggregation legislation can open up that avenue. While citizens of Ohio’s municipal corporations already have the authority to run an initiative, for example, citizens of counties and townships did not, so that right was conferred for the purposes of electric service aggregation in Ohio’s restructuring legislation.⁸⁸

⁸⁷ 1998 Ct. H.B. 5005 §§ 23 and 70.

⁸⁸ Amended Substitute Senate Bill 3, § 4928.20 (1999).

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Part V

Legislative Provisions That Impede Aggregation

Efforts to enact municipal aggregation must prepare for two forms of opposition. This Part describes legislative provisions that hinder aggregation by confining municipal authority or increasing the cost of the process. These hindrances may take three forms: restrictions on local government activity, restrictions on the type of aggregation, and provisions that harm competition generally. **Part VI** summarizes, and responds to, seven arguments opponents make against municipal aggregation.

A. Restrictions On Local Government Authority

Some state restructuring laws have directly restricted the ability of local governments to provide electricity services themselves, to grant an exclusive electric franchise to a selected provider, or to bargain for electricity service on behalf of their constituents. Attempts have also been made to alter the democratic-process requirements of a municipality when it comes to aggregation. These restrictions have often been made on the basis of the arguments that are rebutted in **Part VI**. For all of the reasons discussed in **Part II**, local government involvement in the provision of electricity services should remain an option for electricity consumers.

1. Eliminating Exclusive Franchise Rights For Electricity Service

Eliminating the ability of local governments to grant an exclusive franchise for the provision of electricity services that are deemed by the state to be competitive eliminates the ability of municipal utilities to provide these services along with noncompetitive (*i.e.*, distribution) services. It ends the status of existing municipal utilities as the sole provider of electricity and related services. It also prevents a municipal utility from granting an exclusive franchise for electricity services, usually through competitive bid, to a private party. Legislatures could indirectly eliminate the majority's ability to have their municipal officials handle electricity by authorizing individuals to shop for electricity services that are deemed to be competitive, regardless of whether they are served by a municipal utility.

2. Requiring Individual Authorization

Rules that are designed to prevent companies from enrolling consumers into their service without obtaining their authorization may also prevent municipal aggregation.

Rules that are designed to prevent companies from enrolling consumers into their service without obtaining their authorization may also prevent municipal aggregation. If all retail sellers are required to obtain the consent of each individual consumer before enrolling them into their service, and no exception is made for retail sellers selected by municipal aggregators or municipalities that are providing retail service, municipal aggregation is *de facto* limited to an opt-in program. Alternatively, municipalities may be “allowed” to conduct aggregation programs on an opt-in basis, thereby disallowing opt-out aggregation. As discussed in **Part III**, “opt in” aggregation, which requires the individual consent of each consumer, eliminates many of the advantages that can be gained through opt-out aggregation.

Examples. New Jersey’s restructuring statute states:

*. . . Any business or residential customer that elects to purchase electric generation service or gas supply service through a government energy aggregation program must do so affirmatively and voluntarily, as evidenced by a signature authorizing the customer’s participation in a government energy aggregation program for electric generation service or a gas supply service where the terms and conditions of the program are clearly and plainly articulated in writing to the customer before the customer’s signature.*⁸⁹

California’s restructuring statute states:

*. . . Aggregation may be accomplished by private market aggregators, cities, counties, special districts or on any other basis made available by market opportunities and agreeable by positive written declaration by individual consumers.*⁹⁰

3. Requiring A Ballot Vote By The Full Electorate

Municipal governments routinely make decisions that affect the lives of their citizens. Providing an option for electricity service, while

⁸⁹ Section 44, New Jersey Electric Discount and Energy Competition Act (1999).

⁹⁰ Cal. Pub. Util. Code § 366(b).

Provisions requiring municipalities to seek the direct approval of the electorate are likely attempts to hinder aggregation efforts.

important to the health, welfare, and pocketbooks of the citizenry, is no more important to their well-being than providing police and fire protection and water, sewer, and garbage service. Elected officials are held accountable for their actions in elections, and elected bodies can seek the approval of the electorate if they deem it necessary to gauge public opinion. Contracting for aggregated electric service should be no different.

Provisions requiring municipalities to seek the direct approval of the electorate are likely attempts to hinder aggregation efforts by delaying and increasing the cost of the process.

4. Requiring A Super-Majority Vote

Local governments provide a variety of essential services based on majority votes of their governing bodies and usually without any vote of the electorate. A majority-vote requirement is sufficient to allow the local government to pursue benefits that are deemed by the majority to be potentially greater than what could be achieved by individuals acting on their own. This is especially true with opt-out aggregation, since individuals will still have the opportunity to shop on their own. Requiring supermajority votes puts a “thumb on the scale” against aggregation.

B. Restrictions On Aggregation Programs

1. Requiring Frequent Or Unlimited Opt-Out Ability

As long as consumers have initially been provided an unrestricted opportunity to opt out of the aggregation program, requiring municipalities to allow frequent, unrestricted opt-outs could either compromise their ability to obtain attractive bids or increase program costs for all other consumers, or both.⁹¹

In general, the longer the contract term and the more secure the load, the lower the rate will be, since suppliers are willing to discount

⁹¹ Ohio’s aggregation law provides an example of such a restriction. It requires municipalities to allow any person enrolled in an aggregation program the opportunity to opt out of the program every two years without paying a switching fee.

prices in exchange for long-term certainty. (This is more true for power from new renewable energy facilities, since their higher up-front capital costs require longer debt-repayment periods.) Shorter contract periods require investments to be recouped over the shorter time period, raising energy costs. Therefore, supply costs may be reduced if the aggregation program is structured with opt-out fees that reflect the supplier's cost of losing a customer prior to the expiration of its contract with the municipality.

States should allow municipalities to charge reasonable, cost-based fees⁹² if such fees prove necessary. This may be the case if a customer who opts out imposes real costs on the supplier or other customers. Opt-outs could impose costs on the supplier if, for example, the supplier's agreement with a generator requires the supplier to pay a penalty if it does not purchase the full amount of energy it has contracted for. This penalty cost will be imposed on all remaining customers if the supplier is allowed to pass through these costs, or, if pass-through is not allowed, the supplier will reflect the potential cost in its initial bid.

Imposing specific, inflexible requirements on aggregation programs may complicate aggregation efforts and potentially jeopardize them.

This said, it may be that municipalities find it desirable to structure their aggregation programs with periodic opportunities for unrestricted opt-outs. This may encourage the supplier to keep rates and services competitive. However, such provisions should be carefully crafted in view of market conditions and constituents' interests, rather than being inflexibly prescribed by the state.

2. Imposing Other Program Limitations

Imposing specific, inflexible requirements on aggregation programs may complicate aggregation efforts and potentially jeopardize them. Such restrictions will reduce the chances that municipalities will be able to secure deals for small customers that are comparable to what large customers, which do not face such restrictions, are getting.

⁹² To encourage market-based fees that are as low as possible, opt-out fees could be structured into the municipality's request-for-bids.

Examples:

- Massachusetts requires municipalities to allow customers to opt out of the program within 180 days of being enrolled.
- In New Jersey, a government aggregator is allowed to enter into only one contract for the provision of electric generation service and one contract for the provision of gas supply service to consumers in its jurisdiction.

Because these limitations are imposed without consideration of the specific needs and circumstances of each aggregation program, they will necessarily be artificial and arbitrary. In the Massachusetts example above, there may be other reasonable methods of allowing opt-outs other than a 180-day (six-month) post-enrollment period, such as a pre-enrollment opt-out window discussed in **Part IV.A.2**. Under New Jersey’s “one contract” limitation, a municipality will be unable to obtain services from two or more suppliers, even if contracting with more than one supplier can better meet its needs (*e.g.*, to provide different services to customer groups with different needs), or if more than one type of service (*e.g.*, one “green”) is desired and can be more efficiently provided by multiple providers. Municipalities should be able to contract with as many providers as are necessary to create an optimal aggregation program.

3. Subjecting Municipal Aggregators To Unnecessary State Scrutiny

Subjecting municipal aggregation efforts to greater regulatory review than applied to their private-sector counterparts is unnecessary.

As indicated in **Part IV.B**, municipalities should be subject to most state regulations that protect system reliability and benefit consumers and which apply to other retailers and aggregators. In addition, local officials will be held publicly accountable for the aggregation programs they design. Subjecting municipal aggregation efforts to greater regulatory review than applied to their private-sector counterparts is therefore unnecessary and, more importantly, may seriously impair those efforts.

Example: Massachusetts’ aggregation law requires municipal aggregators to file their aggregation plan and program details with state regulators for review and approval, requires state regulators to

hold a public hearing on the plan, and prohibits such plans from including rates higher than default service rates unless justified by renewable energy content.⁹³

Because some suppliers can keep a bid open for only a short period of time before they need a commitment, delays caused by these processes (which also create the opportunity for competing suppliers to intervene with the intention of causing delay) have the potential to undermine contracts that have already been negotiated and approved at the local level. Additional delays could cause municipalities to reissue an RFP or to give up the effort entirely.

Provisions that require aggregation programs to secure rates that are equal to or lower than default service rates force local officials to accept a state legislature's view of what balance between cost and quality is best for their community. Local officials, without much prodding from the state, will be reluctant to adopt aggregation programs unless they provide significant economic or environmental benefits, or both. Moreover, there may be several legitimate reasons for a municipality to purchase power at somewhat higher rates — because, for instance, it wants to support a local power producer that guarantees long-term price stability, serves as an important economic base for the community, provides significant local environmental benefits,⁹⁴ or all three.

As discussed in **Part IV.B**, municipalities and their suppliers should abide by all regulations necessary to ensure system reliability and consumer protection and education. In addition, as recommended in **Part IV.A.2**, the aggregation program should be subject to local public hearings. State regulatory oversight should be limited to ensuring compliance with these provisions. Rather than requiring a lengthy process of state review, the state's utility commission could be given a limited period of time (*e.g.*, 30 days) to ensure compliance by the program.

⁹³ Mass. Ann. Laws ch. 164, § 134(a).

⁹⁴ A power plant that burns agricultural wastes as fuel, for example, may prevent in-field burning of such wastes (which causes serious local air quality impacts) or landfilling of the wastes.

To foster municipal aggregation efforts, a state energy office or utility commission could be directed to offer assistance to municipalities in developing and executing their aggregation programs.

C. Provisions That Harm Competition Generally

1. Overview

The fate of municipal aggregation is tied to the fate of electric competition generally.

The fate of municipal aggregation is tied to the fate of electric competition generally. Aggregation means that a larger entity shops on behalf of many smaller customers, relieving those customers of the burdens of comparison shopping and enhancing their purchasing power. These features can promote competition. But these features cannot materialize if the market lacks a sufficient number of electricity sellers with whom the aggregator can negotiate. If the market is structured to advantage the incumbent utility and discourage new electric sellers, aggregation will not realize its potential. Likewise, if sellers can compete successfully only for large customers, the load diversity of communities, which is important to aggregation, can be eroded, delaying or permanently damaging the prospects for aggregation that benefits all consumers. Advocates of municipal aggregation, therefore, must not limit their statutory review and understanding to the provisions that directly address municipal aggregation. They also must consider anti-competitive provisions throughout the entire statute that defeat the potential of municipal aggregation. This subsection provides an introduction to these issues.

Before retail competition is authorized, the incumbent utility has nearly 100 percent market share. It has had this share for decades. This commanding position translates into many competitive advantages that will help it preserve its share of the market. The incumbent has name recognition and, often, customer loyalty. The incumbent can negotiate long-term contracts with customers, merge with potential competitors, and take other measures to strengthen its position before competition. The incumbent can use assets, such as customer information, expert staff, and ratepayer-funded distribution and transmission facilities, to promote its competitive ventures. These incumbent activities, which newcomers cannot readily replicate, can discourage new entrants and render the

market, once “competition” is authorized, no more competitive than it was before.

The [restructuring] statute should not create new competitive advantages for incumbents that defeat the prospects of competition.

Municipal aggregation provisions will be part of a larger restructuring statute. That statute must ensure that competitors will be able to enter the market and compete effectively. The statute should limit, or authorize the state commission to limit, the incumbent’s ability to use its competitive advantages to preclude effective competition. Moreover, the statute should not create new competitive advantages for incumbents that defeat the prospects of competition.

A few of the many ways in which a statute that seeks to create competition actually may discourage it are briefly identified below. These include: legislated rate freezes and reductions; inadequate market-power remedies; provisions that preclude competitive suppliers from serving as default service providers; the inappropriate application of licensing requirements; and over-recovery of stranded costs. There are many bases for arguing against these provisions and omissions. The focus here, however, is solely on their effect on competition.

2. Market Distortions Due To Rate Freezes And Reductions

State competition statutes frequently provide “default” service for customers who do not or cannot find competitive suppliers. Some state statutes require rate freezes or reductions, relative to pre-competition rates, for this service. These rate levels frequently lack a basis in either traditional cost-based ratemaking or in market forces and therefore are artificial.

The opportunity to obtain a legislated rate reduction by not shopping for a competitive supplier compounds the anticompetitive effects of customer inertia by further discouraging customers from shopping in the competitive market. This is particularly the case where the default service provider is the incumbent utility because: (1) brand loyalty is an incentive not to shop; and (2) competitors do not have the opportunity to get a foothold in the market by providing default service. Customers who can take no action and receive default service set at artificially low prices will not have an incentive to support their local officials’ proposals for municipal aggregation. In addition,

potential suppliers to aggregated loads will have difficulty competing with artificially low default service rates.

3. Inadequate Protection Against Market Power

Despite state legislative authorization of competition, the incumbent utility — initially and for a good while into the future — may retain enough of its pre-competition market share that it has the power to influence prices and supply, and take actions which discourage its prospective competitors. The statute should, directly or by granting the commission authority, include provisions that prevent the acquisition, maintenance, and exercise of such market power. The problem arises in several areas.

a. Mergers

Electric utility incumbents are merging increasingly, with each other or with entities in related fields. The customary purpose of these mergers is to protect existing market positions as well as to seek new markets. Often, these mergers eliminate potential competitors, particularly when the mergers involve adjacent companies that might have competed directly. Most states have statutes that provide for commission oversight of transactions involving the change in control of a utility. It is important, however, for the restructuring statute to update the commission's existing merger authority to address the concerns of the competitive retail market.

The statute should address the factors that the commission may consider and the type of transactions it may review. The commission must have the authority to consider the effect of the merger on the competitive market, even if the transaction takes place prior to competition. Also, there are certain types of transactions that are of particular concern as the competitive market develops. These include changes in control of providers of default service, providers of noncompetitive services, and affiliates and assets providing essential inputs to the provision of default and noncompetitive service.

b. Distribution Company Affiliate Rules

If a company engages in both noncompetitive and competitive businesses, the company will have an incentive to use its noncompetitive businesses' resources, the costs of which it recovers

through the ratemaking process, to subsidize its competitive business. The anticompetitive effect of this behavior is particularly harmful in a newly competitive market where competitors do not yet exist. Restructuring statutes typically seek to lessen this risk by requiring some degree of separation of the resources used to produce the competitive and noncompetitive services and imposing a code of conduct on the distribution company to protect against the use of noncompetitive assets to promote competitive businesses.

There are three types of separation that a restructuring statute may require or authorize the commission to require. These include:

- (1) *Divestiture* of assets used in the competitive business, by transfer to an unaffiliated entity;
- (2) *Structural separation*, which requires separation of the competitive and noncompetitive businesses into separate affiliated corporations; and
- (3) *Functional separation*, which requires some degree of separation of the businesses, usually including separation of books and employees, but does not require separate corporations. This method is ineffective in curbing anticompetitive behavior, even if the statute requires a code of conduct.

Codes of conduct must guard against the anticompetitive effects of transfers of employees and information between noncompetitive and competitive affiliates, the common use of administrative resources, and competitive affiliates' use of the incumbent utility's name and logo. If a competitive affiliate uses the incumbent's name and logo, for example, the affiliate will enjoy unfair competitive advantages because customers are likely to believe that: **(a)** the affiliate is the same company as the incumbent; **(b)** the affiliate is subject to greater state oversight than other competitors; and **(c)** they will receive better distribution service. The commission must have authority to address this and all other aspects of the distribution company/affiliate relationship to protect competition.

c. Other Commission Tools To Remedy Market Power

Preventative and remedial measures may include commission authority to: (1) limit the prices that competitive suppliers may charge for services if the commission finds that there is ineffective competition in the market; (2) order the distribution company to divest itself of generation assets where necessary to prevent an anticompetitive result; (3) order transmission utilities to modify their facilities to alleviate transmission constraints that may result in market power; (4) order owners of generation capacity to make generation available to competitive suppliers if necessary for the development of effective competition; and (5) approve, reject, or modify long-term contracts as necessary to protect the development of effective competition.

4. Preclusion Of Competition In The Selection Of The Default Service Provider

Due to natural customer inertia and “brand loyalty,” many customers are likely to do nothing when competition comes. If the incumbent automatically retains these customers because the statute provides that the incumbent is the default service provider for customers who do not or cannot choose a supplier, few competitors will enter the market. Commission authority to select the default service provider or providers by competitive bid can stimulate diversity and competition by allowing competitive suppliers to enjoy the benefit of customer inertia and limiting the effect of brand loyalty, which presents an additional inducement to customers to remain with default service if the incumbent is the provider.

5. Inappropriate Application Of Licensing Requirements

Statutory licensing provisions include requirements that ensure that competitive suppliers are qualified to provide safe and reliable service. Often the licensing provision includes other standards, such as those pertaining to procompetitive behavior and consumer and environmental protection. If the incumbent competitive supplier is exempt from the licensing requirements, it will have an unfair

competitive advantage as it will avoid the costs of compliance and penalties for failure to comply.⁹⁵

6. Over-Recovery Of Stranded And Transition Costs

Customers will not choose competitive suppliers if they have to pay ... stranded-cost charges that eliminate the opportunity for savings in the competitive market.

Customers will not choose competitive suppliers if they have to pay “transition to competition” and stranded-cost charges that eliminate the opportunity for savings in the competitive market. Moreover, the incumbent enjoys an unfair competitive advantage if it recovers from ratepayers the costs of competition that all competitors must incur.

- (a) *Stranded Costs.* Stranded costs are the amounts by which the incumbent’s past investments exceed the investments’ value in a competitive market. The incumbent should have to mitigate stranded costs on an ongoing basis. The commission should calculate the amount using a market-value estimate that achieves the most reasonable result and adjust the amount as actual market values become available.
- (b) *Transition Costs.* The statute should limit the recovery of costs associated with the transition to those costs that the commission requires in connection with restructuring and that the utility incurs prudently.

⁹⁵ As we discuss in **Part IV.B**, there may be reasons why municipal aggregators should not be subject to all licensing requirements.

Promoting Competitive Electricity Markets Through Community Purchasing

Part VI

Responses To Common Arguments Against Aggregation Legislation

A. “Government Involvement In Markets Is Inconsistent With Competition”

Some contend that municipal aggregation is antithetical to the creation of competitive electricity markets because it requires government participation. This argument has at least three flaws.

First, the argument incorrectly implies that “government participation” is “government regulation.” Governments participate in markets of all kinds without regulating them. Like individuals and businesses, governments enter into procurement contracts for goods and services without regulating those goods and services. Municipal aggregation means citizens voting by majority to procure a service for themselves. The local government does not regulate the supplier. It selects a supplier.

Second, municipal aggregation gives consumers more, not less, choice because it gives them the option of being represented collectively in the market rather than individually.

Third, real electricity competition is more likely with municipal aggregation than without it. In most states, “competition” begins with the incumbent utility controlling the same 100 percent market share it has controlled for decades, and doing all it can to retain that share. (See **Part V.C** for a more detailed discussion of the incumbent utility’s role.) Strong, sophisticated participation by organized customer groups, able to seek and evaluate alternative bids while reducing transaction costs, is one of the few means of keeping the now deregulated monopoly from cementing its control.

Municipal aggregation gives consumers more, not less, choice because it gives them the option of being represented collectively in the market.

B. “Aggregation Will Create Market Barriers And Stifle Competition”

Municipal aggregation means that consumers will make decisions not as individuals but as a group. This fact leads some to contend that aggregation erects barriers to the development of customer-supplier relationships that are the basis of a competitive market. This argument assumes that the only efficient customer-supplier relationship is the individual customer-individual supplier relationship. That assumption

is not fact-based. Aggregators arise in many markets where the economics are attractive. Consumers do not buy bread at the mills and milk at the farms; they buy both at groceries — aggregators who differentiate themselves not only on price, but on customer services, packaging, financing plans, and other features.

In the electric industry, there is a good chance that aggregation, as opposed to individual purchasing, will stimulate greater competition and a more efficient market.

In the electric industry, there is a good chance that aggregation, as opposed to individual purchasing, will stimulate greater competition and a more efficient market. *First*, through greater bargaining power, municipal aggregation can provide consumers with choices they might not have as individuals — access to more suppliers, lower prices, better services, benefits to the local economy, and improved product quality (e.g., lower environmental impacts). *Second*, municipal aggregation creates strong buyers, which, as discussed in **Part II.C**, are necessary to counterbalance a concentration of suppliers and create real competition among them. *Third*, municipal aggregation enables consumers to avoid high transaction costs (see **Part II.A.2**), which increases consumer benefits and improves market efficiency. Otherwise, the transactions costs that would have to be paid by small customers (including their time and suppliers’ advertising) will reduce or negate any available benefits. Whether these possibilities will be realized is not known; but they represent real possibilities that warrant the attempt.

C. “Forms of Public Aggregation That Restrict Opt-Out Are ‘Undemocratic’”

Some argue that the substitution of government purchasing for individual purchasing, even under an opt-out regime, is “undemocratic” because it limits the individual’s ability to choose a supplier.⁹⁶ In municipal aggregation, citizens elect city officials who make decisions affecting those citizens and then stand for reelection. To describe this representative process as “undemocratic” is to misunderstand, or ignore, 200 years of political history. One would

⁹⁶ For example, opt-out programs may allow any individual to opt-out initially, but may require a cost-based fee to be paid for opt-outs after enrollment, or may allow opt-outs only during certain established periods after enrollment.

not describe the local education system as “undemocratic” merely because one is obligated to attend the public school if one fails to select affirmatively a private school.

In fact, the “opt out” approach offers more individual choice than many local decisions because the minority who prefers to shop with sellers other than the municipality can do so. Furthermore, if opt-out provisions were eliminated, aggregation would be no less “democratic” than many other municipal services, such as garbage collection, water and sewer service, and other services — much as pre-restructuring electric service was provided.

D. “Opt-Out Aggregation Is A Form Of ‘Slamming’”

Some have argued that automatic municipal aggregation is tantamount to “slamming” practices by unscrupulous businesses.... This argument has more rhetoric than logic.

“Slamming” occurs when a service provider switches a customer without that customer’s knowledge or consent. Some have argued that automatic municipal aggregation is tantamount to “slamming” practices by unscrupulous businesses because a consumer’s provider is changed without his or her authorization. This argument has more rhetoric than logic.

With aggregation, there is consent. With aggregation, the decision to shop collectively for cheaper electricity is made in the open. Consent is given by the local legislative body or directly by the electorate. The “slamming” argument wrongly equates a majority vote, performed in an open, democratic process, with the secret and fraudulent practices of profit-seeking companies.

Adherents of the “slamming” argument do not often mention the absence of consent accompanying the century-long practice of forcing most citizens to buy from investor-owned utilities, whose officials do not stand for public election, ever, let alone every four years. The argument, moreover, conflicts with the utilities’ ardent efforts to be the automatic default provider for customers who fail to participate in markets. Whereas a municipal aggregator would have to defend its aggregation role at each election, the utility-as-default-provider would obtain, and keep, the role automatically.

E. “Public Aggregation Will Be Influenced By Politics And Patronage”

One should not let hyperbole about corruption in local democratic government undermine the very potential of that government to serve the people.

To block citizen aggregation on the grounds that the citizens’ representative will corrupt the process is to traffic in self-contradiction and in cynicism: self-contradiction, because every citizen, including those making this argument, expects and receives many, many local services without citing any corruption concern, and cynicism, because the argument would exclude an entire market participant based on hopelessness over that participant’s ability to behave honestly. One should not let hyperbole about corruption in local democratic government undermine the very potential of that government to serve the people.

In any event, tools are available to address these concerns in a measured fashion. As discussed in **Part IV**, authorizing legislation should set forth basic standards to govern municipal aggregation programs, including requirements for public hearings and adequate consumer notification. Legislation should also subject municipal aggregators to most, if not all, of the consumer protection provisions that govern private aggregators. Municipalities are also usually already subject to state laws requiring fair bidding, open meetings, and public information requirements, which should apply to aggregation programs. Any fears of corruption could be addressed by subjecting electric providers to additional, specific penalties for violating any existing anti-corruption statutes.

F. “Promoting Municipal Aggregation Will Trigger Another Round Of Attack On Municipal Utilities”

Given a long history of political attacks on municipal power systems by utilities, it is understandable that public power proponents might fear opening up the issue of municipal authority in restructuring legislation. However, that issue will almost certainly arise in the political process surrounding industry restructuring anyway. Moreover, existing municipal systems may be more at risk by not addressing this issue. By taking a strong, proactive stance and explaining why municipal aggregation is consistent with and, in fact,

promotes competition, existing municipal systems may be better off than simply attempting to defend their current status quo.

Community choice legislation also should not have any impact on existing or potential municipal utilities. Rather, community choice adds another important option for those municipalities that do not own their own electric system and want to protect their citizens in the electricity marketplace. We discuss the relationship between municipal aggregation and new municipals further in **Part IV.A.6**.

G. “Home Rule Authority Precludes The Need For Aggregation Legislation”

In states where home-rule authority⁹⁷ is strong and clear, specific legislative language authorizing municipal aggregation may not be necessary. However, even in these states and certainly in states where the authority conferred by home rule is less clear, explicit authorization will be desirable both to remove any uncertainty and to deter legal challenge, even if the challenge is likely to fail.

⁹⁷ “Home rule,” discussed in **Part IV** and the **Appendix**, refers to the power bestowed by a state government on its local governments to enact and enforce local laws.

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Conclusion

Evaluating The
Aggregation Option

This report has described the role that municipal aggregation can play in making competition effective for all customers. It has compared different types of municipal aggregation, and offered suggestions for the drafting of state aggregation statutes.

Successful aggregation depends, of course, not only on choosing an appropriate form of aggregation and enacting an appropriate statute, but also on careful implementation. Many steps lie ahead. A consistent strategy would include:

- (a) Disseminating education materials geared to various categories of consumers;
- (b) Developing the professional skills, within consulting firms and within municipal government, necessary to evaluate competitive bids and to implement these programs; and
- (c) Integrating the aggregation concept into the community's full response to competition.

This last point warrants emphasis. Aggregation, by definition, involves the entire community. There are many ways for this involvement to occur. For example:

- (1) A municipal government intending to shop the competitive market to serve its own needs can consider combining its load with that of its residents into a single purchasing effort.
- (2) Neighboring municipalities can work together to devise joint aggregation programs to create even greater bargaining power, and associations of municipal governments should work to foster these arrangements.
- (3) Municipalities whose distribution-franchise grants to investor-owned utilities are expiring or otherwise open to renegotiation may receive offers from the existing franchisee, or a competitor, to pay a higher franchise fee. In evaluating such offers, the municipality should examine the full range of options available to them, comparing the gains from the higher franchise fee with the long-term benefits from competition.

These types of activities, and more, can help municipal aggregation fulfill its potential to foster a competitive and efficient electricity market for small consumers.

Promoting Competitive Electricity Markets Through Community Purchasing

Appendix

Information on “Home Rule”

I. Home Rule Explained

Each state's constitution, statutes, or both establish the framework for home rule, which dictates the extent to which local entities may govern themselves free from intervention or preemption by the state. Home rule, therefore, is a creation of state law and derivative of the state's powers. As the Supreme Court observed, "A municipal corporation, in the exercise of all of its duties, including those most strictly local or internal, is but a department of the State. The [state] legislature may give it all the powers such a being is capable of receiving, making it a miniature State within its locality." *Barnes v. District of Columbia*, 91 U.S. 540, 544 (1875).

Because it is dependent on each state, home rule is not easily defined. However, an authority on municipal law explains the concept of home rule as follows:

*If a state so chooses it may fashion its basic law so as to grant home rule or self-government to its municipal corporations. So, the constitution of a state may delegate to the inhabitants of a locality the power to frame a charter for local government and where so delegated the legislature has no power to curtail this right. Statutes in some states, frequently referred to as home-rule acts, have been enacted pursuant to a mandatory provision of the constitution, as supplementary to the constitution.*⁹⁸

Professor McQuillan describes the purpose of home rule as follows:

The purpose of home-rule constitutional provisions is to eliminate to some extent the authority of the legislature over the municipality, and to bestow on the municipalities coming under home rule full power of local self-government as to all subjects that are strictly of municipal concern, or germane to municipal functioning, and not in conflict with the constitution or applicable general laws. When the interest of the state is paramount to or joint with that of the municipality, the municipal corporation has no power to act absent a delegation from the legislature. Depending upon applicable constitutional provisions, a charter adopted

⁹⁸ McQuillan, *Municipal Corporations*, § 3.21, at 304 (footnotes omitted).

*under home rule may become the organic law of the municipality and supersede all general laws in conflict with it relating to purely municipal affairs.*⁹⁹

II. Understanding Home Rule In Each State

Because home rule is purely a creation of state law, the meaning of “home rule” may vary significantly from state to state. The starting point of analysis will be the particular state’s constitution. Some state constitutions make home rule self-executing, *i.e.*, the constitution requires no action on the part of the state legislature in order for localities to enact a home-rule charter, establishing their authority to enact local laws. Other state constitutions require that the state legislature enact legislation establishing general limits on exercise of the right to make a home-rule charter. Still other state constitutions have self-executing provisions allowing localities to adopt home-rule charters, but those charters may then be subject to the state legislature’s power to alter their provisions.

Understanding how home rule applies in any given state therefore requires an analysis of: (1) the state’s constitution, (2) state legislation creating or restricting home rule authority, and (3) court decisions interpreting the state constitution and the relevant statutes. In other words, the extent to which a locality is free to act will depend on how that particular state’s constitution limits or expands home-rule power, the state’s statutes affecting home-rule power, and the extent to which state regulation overlaps and/or conflicts with the subject area that the locality wants to regulate. See **Subsection IV** below for examples of how state home rule provisions vary.

III. Applicability Of Home Rule To Municipal Aggregation

As indicated above, the authority of municipalities to aggregate their citizens will automatically depend on the individual state’s constitutional and statutory home-rule provisions. But it will also depend on the state’s policies regarding utility regulation and

⁹⁹ McQuillan, § 3.21(a), at 306-07.

aggregation. In some states, absent a direct conflict with state law, municipalities may be free to automatically enroll their citizens into electric service aggregation programs. In others, home rule may not permit aggregation without explicit approval from the state legislature. For any particular aggregation effort, it may be necessary to distinguish whether it involves:

- (i) The validity of a local act in the absence of a contrary state law;
- (ii) The validity of a state law in the absence of a contrary local act;
- (iii) The validity of a local act said to conflict with a state law; or
- (iv) The validity of a state law said to conflict with a local act.

The particular aggregation plan would then need to be assessed against the home rule jurisprudence in the particular state. In some states, the analysis may largely be factual, based on the perception of whether aggregation efforts are local in nature or are intertwined or conflict with statewide utility policy. The more consistent the aggregation effort is with state policy, the more likely it is to survive without preemption.

In addition, there may be different applications of home rule within a given state to different sorts of local governing bodies. For example, some states limit home rule to cities having a certain minimum population. In such cases, whether aggregation is covered by home rule may depend on what type of local government entity is doing the aggregating or has enacted the provision establishing aggregation.

IV. Examples of State Home-Rule Provisions

A. Colorado

The Colorado constitution establishes the city of Denver as a home-rule city. This means that “Denver may exercise only those powers granted by the state constitution — including plenary legislative power over local and municipal matters — and not restricted by its charter, and those powers granted by the General Assembly in areas where the city derives no authority from the constitution.” Thus, for “purely local and municipal matters,” Denver’s charter provisions and legislation supersede conflicting state statutes. However, in

matters of “purely statewide concern” where there has been no grant of power to the city by the constitution or state statute, “the city is without power to act at all.” When matters are not “purely” local or statewide, then both the state and municipality may enact legislation over the subject matter so long as no conflict exists. If there is a conflict, then state law will preempt the local law. The determination of what is a state or local interest is made on an ad-hoc basis.

Example: Denver’s ability to establish water appropriations for users outside of city limits was challenged. The Court held that providing water to water users within the Denver metropolitan area but outside the boundaries of Denver was a matter of local concern. The state’s extensive legislation over water use in Colorado meant that the matter was one of state interest as well. Denver could regulate the water use because its actions did not conflict with state law.¹⁰⁰

B. Kansas

Article 12, Section 5, of the Kansas Constitution provides for home rule in Kansas. Under their Home Rule authority, cities are “empowered to determine their local affairs and government,” and the cities “shall exercise such determination by ordinance,” subject only to state statutes of statewide concern applicable uniformly to all cities. The Constitution also provides that the powers and authority granted to cities under the Home Rule Amendment “shall be liberally construed for the purpose of giving to cities the largest measure of self-government.”

Example: The city of Topeka enacted an ordinance regulating the issuance of franchises for the operation of cable television systems in the city. The permit requirement was contested by a company denied a permit. The winner of the permit was the highest bidder, which agreed to pay two percent of its gross revenues to a local university.

The court said that “[a]n objective of the Home Rule Amendment to the Kansas Constitution was to give each municipality authority to carry out municipal functions without statutory authorization.” Thus, the city had the authority to enact its permit requirement,

¹⁰⁰ *Denver v. Colorado River Water Conservation District*, 696 P.2d 730 (1985).

which the court found “reasonable.” However, the court found unreasonable, and therefore beyond the authority of the city, the two percent gross revenue condition agreed to by the winner of the bidding. The Court said, “the total fee exacted by the City for administering the CATV system by the City governing body is far beyond what is reasonably necessary for regulatory purposes.”¹⁰¹

C. Oregon

Home rule constitutional provision is intended primarily to allow local citizens to decide how to organize the local government and to determine the scope of the authority of its Charter without having to obtain permission from state legislature.

Oregon statutes generally cannot affect the structure and procedures of local municipalities, unless it is justified by a need to safeguard the interests of persons or entities affected by the procedures of local government. “[A] general law addressed primarily to substantive social, economic, or other regulatory objectives of the state prevails over contrary policies preferred by some local governments if it is clearly intended to do so, unless the law is shown to be irreconcilable with the local community’s freedom to choose its own political form. In that case, such a state law must yield in those particulars necessary to preserve that freedom of local organization.”¹⁰²

D. Texas

With full power of self government, home-rule cities can do anything that the state government could have authorized them to do. Home-rule cities look to state law not for what they can do but for what they cannot do, *i.e.*, limits on their powers.¹⁰³

¹⁰¹ *Capitol Cable, Inc., v. City of Topeka, Kansas*, 209 Kan. 152; 495 P.2d 885 (1972).

¹⁰² *La Grande v. Public Employees Retirement Board*, 576 P.2d 1204 (1978) (footnotes omitted).

¹⁰³ *Corpus Christi v. Continental Bus Systems*, 445 S.W.2d 12 (Tex. Civ. App. 1969).

E. New York

Powers not conferred directly to municipalities under home rule constitutional provision must be delegated to municipalities by state legislation. In the absence of constitutional or statutory authorization, municipalities cannot enact local laws.¹⁰⁴

¹⁰⁴ *Carodix Corp. v. Comiskey*, 39 N.Y.S.2d 732 (App. Div. 1943).

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