

# **ELECTRIC DEREGULATION**

**By Legislative Affairs**

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## **Introduction**

The National Electric Light Association, which later became the Edison Electric Institute, held a convention in 1898 where it was proposed the electricity industry be regulated by the states. At the time, the impetus for regulation was the need to market investor-owned utilities to the public in a more positive light, as the public was becoming more and more interested in the idea of municipally-owned utilities. Over the next century, the electric industry would both benefit and suffer from regulations that created natural monopolies, imposed various power generating restrictions, and allowed utilities to vertically integrate all phases of electric service provision.

A century later, the electric industry did a complete about-face, by spear heading a deregulation movement buffered by numerous state and federal legislative and regulatory proposals. Why did this occur, what will a regulated environment look like, and how can commercial brokers benefit from and prepare for this change? This paper will look at the basic tenants of electric deregulation, federal and state deregulation efforts, and how property managers can prepare and respond to the sixth major U.S. industrial deregulation of the 20<sup>th</sup> century.

### **What is Electric Deregulation, and what is its Purpose?**

Electric utilities in the United States are generally structured as a vertically integrated industry. This integration can be broken into three, distinct stages: Generation, Transmission, and Distribution. The generation of electricity refers to creating electricity from fossil fuels, or from renewable energy sources such as wind, solar energy, or water. From this stage, the energy is Transmitted from the generation plants to wholesale distribution centers. Finally, the wholesalers Distribute the energy along the power grid to retail consumers.

The Public Utility Regulatory Policy Act of 1935 allowed utilities to own and operate all three of these stages in a regulated environment that protected each utility from competition, within certain geographic boundaries. In 1978, Congress passed the Public Utility Regulatory Policies Act laying the groundwork for deregulation and competition by opening wholesale power markets to non-utility producers of electricity.

In 1992, Congress passed the Energy Policy Act, which opened the doors for competition at the wholesale (Transmission) stage of the process. The Federal Energy Regulatory Commission implemented the intent of the Act in 1996 with Orders 888 and 889 with the stated objective to “remove impediments to competition in wholesale trade and to bring more efficient, lower cost power to the Nation’s electricity consumers.” The Commission’s orders required open and equal access to jurisdictional utilities’ transmission lines for all electricity producers, providing for the states’ restructuring of the electric industry to allow customers direct access to retail power generation.

Utilities began to publicize the benefits of a fully competitive electric environment in which competition can also occur at the Generation stage of the process. State and federal legislation to deregulate the electric industry has focused on creating laws that remove competitive barriers at the Generation stage.

In a deregulated environment, the energy you receive will be distributed to you over the same

power lines from which you currently receive electricity, however (depending on the state you live in) you will not have to purchase the power itself from the same company that owns those power lines. Rather, generators of electricity will compete against each other for your business, and will sell the energy they generate to wholesale distributors who will then distribute the energy to you over the existing lines. In order to allow competition at this stage, deregulation also involves utility divestiture of certain assets, so that utilities are no longer vertically integrated.

In a deregulated environment, the electric industry has argued that price discrepancies between states will be mitigated or removed, prices will generally fall, and customer service will improve. Critics have questioned whether or not smaller consumers will see any cost savings, and have also been concerned with the impact deregulation will have on the environment and our fossil fuel consumption.

At this time it is unclear what effect the introduction of competition at the retail level will have on retail prices in the future. In the states that have deregulated the electric industry, most have implemented a phased approach to creating competitive markets. As a result, the full effect of competition on retail prices cannot be determined at this time.

Commercial brokers should take notice of this issue as federal and state governments have passed related legislation in recent years. While industry and commercial consumers may benefit from the increased competition, smaller consumers such as property owners and managers and residential consumers may not benefit as much considering the electrical volume they consume. Aggregation, ("the act of coming together in alliances to increase consumer negotiating leverage to obtain lower rates from utility companies in a competitive market"), is therefore a likely option for those who may not benefit individually.

## State Legislation and Deregulation

By 2000, all fifty states had at a minimum begun to discuss in their legislatures the deregulation of electric utilities, or had begun deregulation studies in their regulatory agencies. The following list contains the names of all states that as of March 2005 have either passed deregulation legislation in their General Assemblies, or have implemented a deregulated environment through their state regulatory agencies:

Arizona	Maine	New York
Arkansas	Massachusetts	Oklahoma
California	Michigan	Oregon
Connecticut	Montana	Pennsylvania
Delaware	Nevada	Rhode Island
Washington D.C.	New Hampshire	Texas
Illinois	New Mexico	Virginia
		West Virginia

The remaining states have all addressed the deregulation issue, but have not enacted legislation or adopted orders. For detailed information on the states that have made progress towards creating a competitive electric service provider market, please refer to **Appendix 1**, which

displays enacted laws and regulatory efforts in the states, as well as information about electricity rate reductions and phase-in periods for full implementation of retail competition.

## **Shopper's Guide for Choosing a Service Provider**

The information below is provided to give you a better understanding of how to interpret your utility bill, the rates you are currently receiving, and how those rates will compare to other service providers' rates. In addition, a section on lease clauses for a deregulated environment has been included to help you understand how your lease agreements with tenants can impact your bottom line in a retail competition environment. Finally, **Appendix 2** is a shopper's guide checklist that you can use when you are ready to evaluate your market options.

### **Data Collection: Performing An Electric Audit**

Before you begin to shop for an electric service provider, there is a significant amount of information you should be gathering regarding your present and future energy needs, and your consumption patterns. In a deregulated environment, it is expected that electric service providers will divide the electricity market into smaller consumption modules, to customize product types and markets. By gathering energy usage information, you will be developing what is referred to as a "Load Profile", or a profile of all your energy consumption needs and patterns. This profile will aid you in choosing a service provider that most closely and inexpensively meets your energy needs.

But how do you develop this load profile? Here are some tips that will guide through the process.

**Review your energy consumption patterns from the past two to three years.** You will be looking to determine the following: (1) when do you use power?; (2) how does your facility's power use vary by time of day or season?; (3) what is the total load of energy your facility demands in a typical 24 hour period? This information will allow you to develop your 24 hour load profile. Your utility bills will most likely not contain information this specific, so you will be forced to rely on other sources for the information. If you already have submetered your delivery systems, you probably already have specific information collected. If not, your current service provider may be able to provide you with this information for no charge, or possibly for a small fee. Additionally, you should have one year's consumption, on and off peak demand usage, and peak demand graphed so that you can have a visual representation of your consumption patterns. These three measures of your consumption are typical measurements used by utilities when they develop rate schedules.

**Get a copy of your electric utility's rate schedule.** Different utilities have different schedules for charges, most of which are based on kWh usage. The rate schedule, along with a typical year's consumption pattern, will provide you with benchmark information you can use to compare your current pricing with competitors' pricing and rate schedules.

**Understand the different components of your electric bill.** Your consumption charge on your bill is only one of many charges that make up your total bill. In order to make an informed decision on a service provider, you should understand each type of charge. Please note that individual utilities may have slightly different names for these charges. Due to the wide variety of terms used across the country, the information below is an explanation of the general

categories of charges used by most utilities; the charges you see on your utility bill may not be identical to the names of charges below.

*Consumption Charges:* This basic charge measures the quantity of electricity you consume, typically in kWh's in one month increments. This charge is found on all bills, regardless of the type of customer.

*Demand Charges:* These charges measure the maximum demand, or highest consumption peak, during the billing cycle. Larger industrial and commercial consumers usually receive this type of charge. Demand charges are used by utilities to offset the cost of maintaining additional capacity for peak demands. Information on your peak demand patterns may help you to not only negotiate better deals, but will give you the opportunity to pinpoint peak demand causes and better manage energy consumption during such periods. Typical demand charges include Load Control On-Peak Demand; Maximum Demand, and Firm Demand.

*Ratchet and Power Factor Charges:* Ratchet charges may be used in your utility's rate schedule to bill you based on the maximum demand for energy you have had during a previous, or current billing cycle. Power factors measure the efficiency at which electricity is consumed by a customer. Low efficiency may trigger a penalty charge with some providers.

## **Lease Terms And Agreements With Tenants**

Deregulation of the electric utility industry may provide an opportunity for you to capture savings on energy costs. An important consideration in determining these savings is the structure of lease agreements with tenants. The majority of tenants receive electricity in one of three ways:

1. *Electric Rent Inclusion:* The charge for electricity is built into the base rent for the tenant. In this situation, the landlord may be able to receive lower utility costs without having to pass the reduction along to tenants.
2. *Submetered Electric:* The landlord provides electricity to tenants, and charges each tenant individually, based on consumption. Here again, it is possible for the landlord to benefit if the tenant is charged based upon a landlord-determined rate schedule, and the landlord finds a new service provider with a more beneficial schedule.
3. *Direct Metered Electric:* The tenant contracts directly with the electric service provider. In this case, the landlord is not involved and would have little opportunity to benefit from switching providers.

The types of charges reported on your bill will be a factor of whether you are a residential, commercial, or industrial consumer, and of the utility company you use. Consequently, there is no simple way for the CCIM Institute to identify which exact charges you should concern yourself with, as this information varies greatly from customer to customer.

In addition to understanding the impact electric service agreements with tenants can have on you in a deregulated environment, the language of the lease itself can also affect your ability to manage retail competition. Lease language for new leases, and amendments to existing

leases should contain a standard clause that protects the landlord in a deregulated environment.

This clause should be drafted by your attorney, and made part of the lease. Even if your state is not currently operating in a deregulated environment, you should seriously consider adding such a clause, as deregulation nationwide is inevitable in the next several years. Consider the following when preparing your lease clause.

**Does your lease give tenants the ability to influence your choice of service provider?** If so, you may want to modify the lease to explicitly preserve your ability to choose the provider.

**Can you charge a tenant for the cost of switching service providers?** It is likely that some sort of fee will be levied against you if you change service providers. If you provide electric service to your tenants, you may want to revise leases passing this cost on to them.

**Does the lease specify by name the current service provider?** If so, you should probably remove such reference, as it may prevent you from switching service providers without the consent of the tenant. Alternately, you may also want to structure your leases so that you maintain the right to stay with your current service provider, even if you are urged by your tenants to consider a switch.

**Does the lease ensure access to tenants' space?** A new service provider may need temporary access to areas within tenants' leased space in order to install new wires, etc. Your lease should specify that the landlord reserves the right to gain access to such spaces, and that the tenant agrees to cooperate with you and any electric service provider you use.

**Does the lease protect you from complications related to interruption of electric service to your tenants?** Though unlikely, it is possible the switch from one service provider to another could cause an interruption in service that may trigger a law suit from a tenant. You should consider placing a clause in the lease that prevents you from being responsible for any claims or losses the tenant may suffer as a result of disruptions or changes in electric service.

**Does the lease protect other tenants from rate increases if one tenant decides to join a power aggregation consortium, or aggregates with its corporate partners?** In a deregulated environment, some states have made it possible for individual companies or even residents to join together, or "aggregate", their purchasing power in order to command a lower price for power. An example of this might be an anchor of a shopping center who decides to go with another service provider because the rest of the corporate stores in the area are aggregating their purchasing. As a result of the anchor leaving the shopping center's service provider contract, the service provider may increase the rate charged to the remaining customers. Who pays this increase?

Focusing on these questions when modifying your leases should aid you in protecting yourself in a deregulated electric environment.

## APPENDIX 1

State	Enacting Legislation and Date of Passage	Regulatory Actions	Implementation Date and/or Phase-In Period	Rate Reductions
Arizona	HB 2663 was enacted 5/29/98.	Regulatory Settlement Orders.	Access for residential, commercial, and industrial customers December 1998; Full retail access for all customers January 1, 2001.	
Arkansas	SB 236 enacted 2/20/01.	Information not available at this time.	Access for residential, commercial, and industrial customers October 1, 2003. Full retail access for all customers October 1, 2005.	
California	AB 1890 was enacted on 9/23/96. This bill is California's primary restructuring legislation.	The California Public Utilities Commission has extensive regulatory oversight in the dereg. process. Details of their oversight and actions are too extensive to report here, but in general have involved regulation of firms entering the deregulation market.	Access for all customers March 31, 1998.	Small customers received a 10% reduction by 1/98, and a minimum 20% reduction by 4/02.
Connecticut	On April 30, 1998, HB 5005, a bill to introduce electric competition in the state, was enacted.		Access for residential, commercial, and industrial customers by January 1, 2000. Full retail access for all customers July 1, 2000.	HB 5005 directed the DPUC to investigate the amount of rate reductions retail customers can expect from the deregulated environment.
Delaware	The restructuring bill HB 10 was enacted March 31, 1999.	In January 1998 the DPSC report was issued on deregulation. It recommended retail competition no later than 12 months following the passage of enabling legislation.	Access for residential customers October 1, 2000. Access for commercial and industrial customers October 1, 1999. Full retail access for all customers April 1, 2001.	
D.C.	PSC Order 11796 was enacted 9/18/2000.		Full retail access for all customers January 1, 2001.	
Illinois	On 12/16/97, three bills passed the General Assembly (HB 362, HB 1817, and SB 56) which effectively deregulated retail electric markets in Illinois. On 6/30/99 Illinois SB 24 was enacted.	Competitive Transition Charge (exit fee) has been implemented to help offset stranded costs, and will be in effect through 2006.	Access for residential customers by May 1, 2002. Access for large industrial and commercial customers (which consume more than 4 megawatts and 1/3 using less) by October 1, 1999. Full retail access for all customers by May 1, 2002.	15% rate cut for residential ComEd customers, 8/98. Additional 5% cut, 5/02. 5% rate cut on 8/98 for AmerenUE and Central Illinois Public Service residential customers; two additional cuts by 5/02 to bring rate into sync w/ Midwest average. CILCO residential customers received three cuts from 8/98 to 5/02 which totaled 5%.

Maine	On May 23, 1997, HB 568 was signed into law. This bill was one of the first state electric deregulation bills to be passed in the U.S.		Full retail access for all customers as of March 1, 2000.	No legislatively mandated rate reductions were a part of the restructuring bill, though the Public Utilities Commission is to closely monitor retail prices to make sure that a competitive environment is in the best interest of the state.
Maryland	SB 300, a restructuring bill, was enacted 4/8/99.	12/97: The Maryland Public Service Commission issues a restructuring order which recommends a phase-in of retail competition.	Access for residential, commercial, and industrial customers July 1, 2000. Full retail access for all customers July 1, 2002.	
Massachusetts	On 11/25/97 the restructuring bill HB 5117 was enacted.	Massachusetts Department of Public Utilities passed a restructuring order in 1996.	Full retail access for all customers March 1, 1998.	As of March 1, 1998, there was an immediate 10% rate and an additional 15% cut the following year.
Michigan	While the state was moving forward with restructuring under a Commission order, SB 937 and SB 1253 were Enacted in June of 2000.	In December, 1996, the Public Service Commission issued a report which suggested a phase-in retail environment, beginning in 1997. In June 1997, it issued its electric restructuring order. Following the order a variety of regulatory actions took place to implement restructuring.		Detroit Edison recently received a 10% rate increase approval and CMS Energy has a pending request. New consumer protection Rules include monetary penalties for substandard service. Consumers are faced with increasing utility rates.
Montana	In May of 1997, SB 390 was enacted.	The various regulatory actions that have been taken have been focused on implementation, as legislation has already been passed.	By July 1, 2004, full retail Access for all customers was provided.	
Nevada	In July of 1997, AB 366, Nevada's major deregulation legislation, was enacted. In April 2001, AB 369 was enacted, suspending the provisions of AB 366 for residential customers. In July 2001, AB 661 was enacted, allowing large commercial and industrial consumer access in 2002.	The Public Utilities Commission has adopted several orders for implementing deregulation. It will continue active involvement by reviewing deregulation plans from individual utilities.	Access for commercial and Industrial customers in 2002.	

New Hampshire	In May of 1996, New Hampshire was the first state in the U.S. to adopt an electric deregulation bill - H.B. 1392. In February 1997, PUC Orders were enacted. SB 472 was enacted in 2000, followed by additional PUC Orders.	October 21, 1997, the Public Utilities Commission's Rule 300 became effective. This Rule Outlined the restructured electric environment in New Hampshire. A statewide pilot program was Initiated beginning January 1, 1998 to test the deregulated environment. It is in effect until June 30, 1998.	Full retail access for all customers May 1, 2001. legal impediments had delayed the process.	
New Jersey	Major deregulation legislation was passed in 1999. AB 10/SB 5 were enacted in February 1999, followed by a Board of Public Utilities Order in July 1999.		Full retail access for all customers by November 14, 1999.	
New Mexico	SB 428 was enacted 4/8/99 providing retail access to residential, commercial, and industrial customers. On 3/8/01, SB 266 was enacted, delaying the provisions of SB 428 until January 1, 2007 and July 1, 2008.		Access for residential customers January 1, 2007. Access for commercial and industrial customers July 1, 2008.	
New York		The Public Utilities Commission was actively involved in reviewing and approving individual utilities' restructuring plans. A PSC Order was issued on 5/20/96.	Full retail access for all customers by July 1, 2001. Implementation varied for each investor-owned utility.	Between 11 and 13 cents a kilowatt hour, plus delivery fees. Recent law makes new suppliers subject to same rules as old utilities. Most companies charge variable prices which adds risk for customers.
Ohio	SB 3 was enacted 7/6/99. (The legislation was based on a Joint Committee on Electric Deregulation report to the legislature in January 1998.)	The Public Utilities Commission had previously issued an order regarding "conjunctive billing," which allowed for aggregation of consumer contracts with utilities, in order to receive lower rates.		Changes in prices vary, but power aggregators usually offer savings over the utilities. Aggregators are delivering decent discounts, in one case 6% less than the competing utility. Not all areas have competition.
Oklahoma	In April of 1997, SB 500 was signed by the Governor; the bill is the major deregulation legislation in Oklahoma. In addition to the deregulation mandates, it requires that a number of studies be implemented by the Oklahoma Corporation Commission (OCC), prior to the retail competition deadline. In May 2001, SB 440 was enacted, delaying the provisions of SB 500 indefinitely.		Under SB 500 retail access would have begun July 1, 2002; however, implementation has been delayed indefinitely.	

Oregon	On July 23, 1999, electric deregulation legislation, SB 1149, was enacted. The Public Utilities Commission issued an order in August 2000. On June 21, 2001, HB 3633 was enacted, delaying the provisions of SB 1149 and the PUC Order implementing retail access from October 1, 2001 until March 1, 2002. Subject to some reservations.		Access for commercial and industrial customers on March 1, 2002.	
Pennsylvania	In November of 1996, H.B. 1509 was enacted. This bill is Pennsylvania's major deregulation legislation.		Access for residential, commercial, and industrial customers on January 1, 1999 and full retail access for all customers January 1, 2000.	Prices as of 3/1/05 between 6 and 10 cents a kilowatt hour plus delivery fees. Industry analysts have cited Pennsylvania as the most successful state in achieving its goals in restructuring.
Rhode Island	Deregulation legislation was passed in August of 1996 (96-H 8124). Two additional bills - HB 6288 and HB 7003 - have been passed to implement a gross receipts tax on service providers, and to manage the recovery of stranded costs.	The Public Utilities Commission managed the phase-in period.	Access for residential, commercial, and industrial customers on July 1, 1997 and full retail access for all customers January 1, 1998.	
Texas	Restructuring legislation was enacted (SB 7) on May 27, 1999.		Access for residential, commercial, and industrial customers on July 31, 2001 and full retail access for all customers on January 1, 2002.	Prices between 9.6 and 13.2 cents a kilowatt hour plus fees. Suppliers often levy extra fees; for example, calls to help desks.
Virginia	On July 1, 1999, a restructuring bill, SB 1269, was enacted.	Virginia's State Corporation Commission published a restructuring report at the end of 1997. The recommendations on phase-in were generally implemented through legislation passed by the General Assembly before SB 1269 was enacted.	Full retail access for all customers by January 1, 2004.	.
West Virginia	HB 4277, enacted in 1998, directed the Public Service Commission to draft a restructuring plan and to do research on various related topics.	The Public Service Commission's Plan was approved December 20, 1999.	The legislature has not passed necessary legislation to implement retail access.	

**A note regarding this checklist: After careful review, the checklist below was developed as a general list of questions to be used by managers of all types of properties. It is the CCIM Institute's conclusion that the questions listed below represent questions that should be asked of any electric service provider, irrespective of property type. Nonetheless, there may be questions below that are not applicable to any one specific property type, and there may also be additional questions to be asked that are not contained herein. Please review this list of questions prior to using the guide so that you can decide which are most important and applicable to your company.**

## APPENDIX 2

- Has the SP<sup>1</sup> provided you with a cost per kilowatt hour (kWh) for electricity, and has the SP given you information on how its rate ranks with other SP's?
- When shopping, ask the service provider for information on how their rates compare to other electric service providers. Also ask to see their rate schedule.
- Does the SP state that there is a minimum usage clause in the contract, and if so, are you comfortable with this?
- What is the length of the agreement, and does the contract stipulate a minimum time period in which you must purchase electricity from them?
- How will you be billed, and what are the billing options?
- Is the SP trying to sell you anything other than electricity, and if so, what?
- If you decide to make changes in your contract, are there any costs?
- Does the SP require a termination fee if you decide to change providers?
- What power sources does the SP use to produce electricity?
- Does the SP offer incentives to help you use energy more efficiently?
- Is the SP registered with your state's public utilities commission, or other applicable governmental entity?
- Is the SP intending to sell your name and address to other industry-related companies?
- Does your state have a "right to rescind" clause, and if so, how long do you have to change your mind about an SP?
- If the SP has offered you "free" electricity for a certain amount of time, will the SP increase your rate later to compensate for the free period?
- Do you have the ability to receive a less expensive rate if you aggregate your properties onto one contract?
- Will the SP be assessing you a Competitive Transition Charge for switching to their service?
- Will the SP provide you with information on how much your last year's bills would have been if you had been with them?
- Will your current SP offer you a discounted rate if you agree not to change SP's?
- Will there be a reinstallation charge if you return to your current SP after having left them?
- Will your negotiated rate with an alternative SP change if one or more of your commercial tenants chooses to aggregate their power needs with other businesses in their chain, leaving your contract with less purchasing power?
- Has the SP clearly described to you how service requests should be handled, and who you should contact if there is an interruption in service?
- Have you asked the SP about the probability of potentially damaging power surges (from "dirty power" and other sources) coming into your property?

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<sup>1</sup> SP = Service Provider

## **Additional Resources**

For more information visit your State's Public Utility Commission. The National Association of Regulatory Utility Commissioners' website provides links to all fifty states' websites at <http://www.naruc.org/displaycommon.cfm?an=15>.

For more information on Electric Power Industry Restructuring and Deregulation, visit the U.S. Energy Information Administration at <http://www.eia.doe.gov/cneaf/electricity/page/restructure.html>.