CUSTOMER RESPONSE WHEN OFFERED THE OPPORTUNITY TO SWITCH ELECTRICITY SUPPLIER (ALTERNATIVE TITLE: HOW THE COMPETITION GAME WAS PLAYED IN NEW HAMPSHIRE)

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The first real-world experience with "head-to-head" competition in the retail electricity market (a.k.a. "retail wheeling") in the U.S. began in late April, 1996, in New Hampshire. With a tradition for minimum government regulation and electricity prices that for years have been either the highest or second-highest in the nation, New Hampshire was a logical place for electricity competition at the retail level to find both advocates and widespread political support. The catalyst was a 1994 request from Freedom Energy Company (a power marketing company formed by lawyer/engineer James Rodier) to be permitted to serve customers who are presently customers of Public Service of New Hampshire (PSNH). PSNH fought this request through several layers of the legal system. Ultimately, the NH Supreme Court ruled against an appeal by PSNH and other utilities that sought to block the Pilot Program, affirming a ruling by the NHPUC that utilities do not have exclusive franchise territories.

ADM Associates conducted a comprehensive process evaluation of the Pilot during the late summer and fall of 1996. The field research included an extensive series of on-site and telephone interviews with samples of customers in each sector in each utility's service territory (both participants and nonparticipants); interviews with other key players (i.e., representatives of the NHPUC, PSV organizations, and various "load aggregators"); and an examination of the "eligible customer" lists, the rules of the Pilot, and samples of print-media advertising and solicitation letters that were sent to eligible customers. Based on this research, a detailed analysis was performed to characterize: (1) how customers in each segment responded, and (2) the likely reasons for these differing responses. In particular, we sought to learn how customers reacted to various offering packages and marketing approaches. Some of the research questions were: Because they have been subjected to the same type of "pitch" for the past several years from telecommunications vendors, were residential and small C&I customers rather quickly "turned-off"? Or, because the size of the monthly bill is 10-20 times larger, were they more willing to listen to competing offers? Which offers were selected by participants in each stratum—and what were the reason(s)?

The Rules

With an eye on unfolding events in California's *Blue Book* proceedings, the NHPUC—with the backing of the legislature and governor—decided that a structured, state-wide Retail Competition Pilot Program would better serve the needs of the state than would competition restricted to a single utility. After a series of meetings attended by utilities, customers, and other stakeholders over a two-year period, and issuance of three draft versions of the "rules" that define the scope, timing, and procedures of the Pilot, the NHPUC issued the Final Guidelines on February 28, 1996.[1]

The basic rules governing the Pilot were:

1. Each of six electric utilities would file unbundled tariffs disaggregated into the following minimum functions: customer service, transmission, distribution, C&LM and power supply.[2] The power supply function was to be further disaggregated into two components: "electricity-supply" and "stranded-cost recovery". Only the "electricity-supply" component (which was typically about 20-25% of the total) was to be the subject of retail competition. The "stranded-cost recovery" component was the subject of heated negotiations. The final compromise was that the utilities would adjust the magnitude of this component so as to produce a minimum savings of 10%.

2. Each utility would allow customers representing 3% of its retail load—allocated proportionately among the residential, commercial, and industrial classes—to select an electricity supplier from among competing vendors.

3. Large commercial and industrial (C&I) participants would be selected only from each utility's pool of customers who individually volunteer to participate. However, two categories of residential and small C&I participants are defined: Individual volunteers and

[1] Subsequent legislation was signed into law that extends retail electricity competition to all utility customers as of January 1, 1998.

[2] The overriding policy objectives governing this unbundling were: (i) the provision of accurate market price signals for power supply services; (ii) nondiscriminatory transmission and distribution access and pricing; and (iii) the avoidance of cost shifting among classes or among customers within a class.

"GAC" participants. The latter are utility customers in a "Geographical Area of Choice." The rules stipulated that towns and cities could volunteer for the pilot as either an individual customer with multiple accounts at multiple locations, as a GAC, or both. If they volunteered as a GAC, it meant that all of the utility's residential/-small-C&I accounts within a designated geographical area were automatically "volunteered" as a group without their knowledge or consent. The rules of the Pilot stipulated that GAC participants were to comprise about 50% of each utility's load that was to be the eligible to competing electricity suppliers. Thus, the GAC category made the pilot more representative of a future situation whereby all customers would be exposed to the competitive retail electricity market; not just volunteers. (No customers were forced to change supplier, but all participants—individual and GAC alike—were exposed to the marketing blitz from competing vendors.)

4. All power-supply vendors (PSVs) who wanted to compete for the right to serve participating customers were required to register with the NHPUC. Registration required evidence that the applicant was: (1) registered with the New Hampshire Secretary of State, and (2) either a NEPOOL member or had a formal agreement with a NEPOOL member for the provision of back-up power. (The latter provision was intended to eliminate power-supply reliability as an issue in the Pilot.) Sponsoring utilities were permitted to compete via one or more affiliated PSVs.

5. Customers could start signing-up with PSVs on May 28, 1996. The Pilot will end two years from that date.

6. Aggregation of customers by a "third party" to gain market power was permitted.

The Players

Sponsoring Utilities. Six electric utilities were designated by the NHPUC as sponsors of the Pilot Program: All except one (which is a customer-owned co-operative organization) are subsidiaries of a larger corporation. Table 1 identifies the six, provides the acronym for each that are used in this paper, identifies each utility's "corporate parent" and the location of the parent's main corporate offices, and indicates one measure of size: the number of retail customers each reported having in 1995.

As this table shows, only three of the sponsoring utilities (CE, EHE and NHEC) are "100% New Hampshire" organizations; independent of control from an out-of-state entity. Other factors that also proved useful in understanding the differences in how each utility's customers reacted to the Pilot are.

- CE and E&HE have "small-city/suburban" service territories, moderately low rates (about 10 ¢/kWh average residential price in 1995), and excellent reputations with their customers.
- GSE also has a good reputation with its customers and moderately low rates, only slightly higher than those of CE and E&HE.
- CVE is the smallest and is geographically close to Vermont. Its rates are somewhat high (12.5 ¢/kWh average residential price).
- NHEC is the most rural and mountainous of the six. Its service area includes summer homes and cabins heated by wood stoves. It buys most of its electricity from PSNH, and has high rates (14 ¢/kWh average residential price).
- PSNH serves a large portion of the state, including the largest cities. It was the builder and major owner of the controversial Seabrook nuclear power plant, which encountered many regulatory hurdles. As a result of extensive delays and monumental cost overruns, PSNH was virtually bankrupt by 1989. A deal was put together whereby Northeast Utilities would acquire PSNH, and would be granted rate increases of 5.5% per year for 5 years once Seabrook began operating. As a result, PSNH has both high rates (14.4 ¢/kWh average residential price in 1995) and a strongly negative reputation among many of its customers. The

Table 1. Pilot Program Sponsoring Utilities

Sponsoring Utility	Acronym	"Corporate Parent" [HQ Location]	No. of Customers
Concord Electric Company	CE	UNITIL Corporation [NH]	26,404
Exeter & Hampton Electric Co.	EHE	UNITIL Corporation [NH]	36,873
Granite State Electric Company	GSE	New England Electric System [MA]	35,644
Connecticut Valley Electric Co.	CVE	Central Vermont Pub. Service [VT]	10,292
New Hampshire Electric Co-Op.	NHEC	(None) [NH]	67,465
Public Service Company of New Hampshire	PSNH	Northeast Utilities [CT]	406,054

> decision to build Seabrook and subsequent mismanagement of the project are seen as the reasons for high rates. A significant amount of animosity is also directed at Northeast Utilities.

As things developed, NHEC and its customers is sitting-out the game because of a legal dispute between NHEC and its wholesale power supplier, PSNH.

Power Supply Vendors (PSVs).

A total of 33 organizations registered with the NHPUC, but several teamed up and some decided to focus exclusively or primarily on the large C&I segment. Each of the five investor-owned sponsoring utilities (i.e., all except NHEC) was an active competitor. Northeast Utilities had four different entities competing, each testing a different approach.

Participating Customers. A total of about 17,000 customers were selected by the six utilities, half from one or more GACs and half from the pools of volunteers. (The four smaller utilities each selected one GAC; NHEC and PSNH each selected four.) In general, GAC participants included several different types of customers with regard to their initial awareness of and attitude toward the Pilot: (1) those who wanted to be "in the game" and had volunteered as individual customers; (2) those who had intended to volunteer, but for some reason failed to do so before the deadline; (3) those who were aware of the Pilot but had made the conscious decision not to participate would occur, and customers who for some reason had decided not to volunteer.

Aggregators. Some of the towns that sponsored GACs also functioned as aggregators, negotiating with PSVs an behalf of individual customers. The city of Manchester (which had applied to be a GAC but was not selected) also decided to be a aggregator. Two others were the Retail Merchants Association and the New Hampshire Taxpayers Association.

The Process

Marketing activities began in April, a month before the official start of the Pilot. Radio, TV, and print advertising was extensively used by a dozen PSVs to attempt to establish a unique "identity" in the minds of participants. The official "lists of participants" were submitted to the NHPUC by the utilities on May 1st. The NHPUC made them available to PSVs and the public, via both the internet and a set of diskettes. Targeted marketing via telephone and mail then began. One PSV worded its offer in a way that many participants misconstrued to mean the deadline was May 28th (not the first day they could sign up). Whether intended or not, this "tactic" garnered the PSV a large number of sign-ups.

A few PSVs got a late start, but by the end of June at least 20 PSVs had a strong presence in the residential and small C&I markets, playing the "AT&T vs. MCI vs. Sprint" game, using telemarketing and direct mail to try to get customers to sign with them rather than with a competitor. All offered price inducements, but some added the claim that they will supply only "Green" electricity produced from environmentally clean sources, such as hydropower or natural gas. A few offered a combination deal that included energy management services. A variety of free gifts was offered. Price offers were structured in a wide variety of ways: a fixed monthly cost plus a very low usage charge, a "sign-up bonus" that sometimes had an expiration date, a lottery that gave the winners free electricity, and blocked charges that increased with usage or decreased with usage. Some suppliers required a long-term contract, and some others allowed customers to switch suppliers at any time. Most quoted firm prices, but a few (who also allowed the customer to switch at any time) stated an initial low price but said it might change over the term of the Pilot.

Because of the wide variety of ways offers were structured, participants reported having a difficult time deciding which offer to pick. Some attempted to be methodical and use a spreadsheet on their home computer, while others homed-in on two or three contenders based on some characteristic, but then couldn't decide how to make the final choice. In many cases, the desired characteristic was the ability to subsequently switch to another supplier, which was another indication that the participants were not certain which deal was best. In other cases, the desired characteristic was "environmentally friendly" generation. Many participants who were satisfied with their local utility picked the affiliate of that utility. The reason was often a mixture of this satisfaction, a sense of "loyalty," the fact that the utility was a known quantity, and the desire to avoid receiving two separate electric bills. A high percentage of GAC customers tended to either go along with the GAC's selection (when the GAC acted as an aggregator), or to default to the local utility's affiliate for the reasons cited. In either case, the participant avoided making an independent, quantitative comparison of offers.

It is important to note that neither the GACs nor any of the other aggregators had *advance commitments* from the members of the group they represented. The aggregators sought special offers from PSVs and then negotiated the deals providing what each of them considered to be best. The customers represented by the aggregators could either accept this or select a different offer. The aggregators bargaining position would have been stronger if they had advance commitments from members, but the short period of time between when participants were selected and when sign-ups could begin precluded this.

Because the GACs represented half the available load, the ones that decided to be aggregators were an important target for about a half-dozen PSVs. (It is somewhat surprising that a larger number of PSVs did not target the GAC-aggregators.) The competition was keen among the PSVs that did go after this load. In most instances the winner offered a combination of:

- A lower price than the standard offer, with an even lower price if a certain number of participants signed-up by a certain date.
- A bonus to the sponsoring town (as high as $25,000 in one instance)
- Underwriting the cost of soliciting sign-ups
- Excellent "people skills" in dealing with town officials.

Price offers to individual residential and small C&I customers were typically in the 2.4–3.1 ¢/kWh range (The low end was not a firm price for two years.) The winning GAC prices were typically in the 2.25–2.35 ¢/kWh range. Large C&I customers could get even lower prices, down to the 1.95-2.15 ¢/kWh range. It is widely believed that the winning prices may turn out to be below cost, and that the for most PSVs the reason for competing in the Pilot was not to gain financial profit but rather to gain experience, to prepare for future competitions where the stakes are higher.

As might be expected, those participants from PSNH who strongly disliked their utility and its parent stated that they were happy to have the chance to pick a different supplier. It must be noted, however, that PSNH participants who hold this opinion are not in the majority, and a PSNH or NU affiliate was the PSV selected by a high percentage of PSNH participants. Also, the percentage of residential customers who volunteered for the Pilot was about the same for all utilities (i.e., it was no higher for PSNH).

Findings and Conclusions

- In general, the Pilot was well-designed and executed. This is especially true considering it was a pioneering effort and pushed forward by the NHPUC against a barrage of challenges from most of the sponsoring utilities. One of the significant disappointments or shortcomings was the fact that NHEC's customers were blocked from participating. However, the solution to this problem was beyond the control of the NHPUC.
- A surprisingly high percentage (more than half) of the nonparticipating customers who were surveyed reported that they were not aware of the Pilot. (Considering all the general publicity, this is an astounding statistic!) Of those who were aware of the Pilot, nearly half deliberately chose not to apply.
- Respondents reported that they believed the concept of retail competition to reduce electricity prices to be sound, but the large number of offers and advertising claims have created confusion in the minds of many of those who had volunteered to be participants. The confusing offers and the large numbers of mailed offers and telemarketing calls resulted in about 9 percent of residential and small C&I participants "opting-out" of the Pilot Program.
- Another reason for "small" C&I participants dropping out is that they were really large C&I customers with multiple facilities and utility accounts. One of their "small C&I" accounts had been selected, but because this represented only a small fraction of their total electric bill, they didn't want the hassle of dealing with PSVs just to save perhaps 15% of 1%-2% of their total bill. (This problem is an artifact of the pilot that would not occur in full-scale competition.)
- About two-thirds of the participants in all segments indicated that their reason for volunteering for the Pilot was "to save money." The second-most-often-cited reason was that "Competition is good—utilities should have to compete for customers."
- In the case of large C&I participants, the third-most-frequently-cited reason for volunteering was to "get experience with retail electricity competition." When asked to identify the considerations that determined which PSV they selected, three-quarters of the large C&I respondents indicated that price was the primary criterion. Other criteria that were ranked either first or second by a large fraction of these respondents were: "reputation of the firm" and "energy audit and energy-efficiency services." Many of these participants indicated that the extent to which the vendor's representatives "worked with them," and the "attitude and people-skills" of these representatives, also were significant factors in the selection process for some of them.
- The role played by aggregators was relatively small. In part, this was the result of: (1) the limited size of the Pilot, (2) the speed with which things moved once participants were selected, and (3) the lack of the aggregators' experience with retail electric competition.