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COMPETE

Electricity Competition IS the Public Interest

June 26, 2006

Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: Electric Energy Market Competition Task Force Docket
AD05-17-000

Dear Secretary Salas:

COMPETE,[1] the Electric Power Supply Association (EPSA)[2] and the Alliance for Retail Choice (ARC)[3] respectfully submit these comments[4] on the draft report issued on June 5, 2006 by the Electric Energy Market Competition Task Force.

Introduction

COMPETE, EPSA and ARC commend the Task Force for a thoughtful report that definitively compiles the benefits that competitive electricity markets provide to consumers. The Task Force has demonstrated a clear understanding of the problems that can be endemic in a heavily regulated industry -- operational inefficiencies, large cost overruns with respect to power plant construction, utility ratepayers bearing the burden of poor investment decisions -- that persuaded both lawmakers and regulators to implement pro-market policies. These factors are just as relevant today as they were when the movement to competitive electricity markets began.

Moreover, in markets dominated by utilities that own both transmission and generation, problems with transmission access and market foreclosure still exist in the absence of an independent grid operator. The Task Force has correctly pointed out that Order No. 888, despite its

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[1] COMPETE is a national advocacy coalition bringing together diverse electricity stakeholders who recognize the reliability, low-cost, environmental and other benefits of competitive electricity markets. COMPETE serves as a network to demonstrate public support for the principles outlined in the COMPETE mission statement, which can be found at www.competecoalition.com

[2] EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. See www.epsa.org

[3] The Alliance for Retail Choice advocates for the continued development of retail energy choice markets, providing a voice for competitive energy retailers and their customers at the federal and state levels. The Alliance includes many of the nation's leading retail energy suppliers who collectively serve more than 35,000 MW of customer load. See www.allianceforretailchoice.com

[4] Individual organizations and companies are submitting more detailed comments.

huge value in creating competitive wholesale markets, has not eliminated undue discrimination. The establishment of a truly independent operator such as an RTO is the best way to ensure a level playing field where all resources may compete to provide customers with the lowest-priced power available. The draft report demonstrates a clear understanding of this issue, and we urge the Task Force explicitly to recommend such a remedy.

Competition is Working for the Benefit of Consumers

There is a growing body of solid evidence that competition is benefiting consumers. COMPETE, EPSA and ARC urge the Task Force explicitly to acknowledge that electricity competition is the best way to secure the efficiencies, prices, products and services, and innovation that benefit consumers in both the short and long terms. We also recommend that the Task Force urge policymakers to continue to make improvements in market structure and design to achieve the maximum consumer benefit.

Attachment A to this filing is an Open Letter to Policymakers issued separately today by eight distinguished economists[5] hailing the virtues of electricity competition, and urging policymakers to stay the course and continue to improve competitive electricity markets. The letter is a ringing endorsement of electricity competition. The economists write:

> Among economists, it is almost universally accepted that well functioning competitive electricity markets yield the greatest benefits to consumers in terms of price, investment and innovation especially when regulated alternatives are no longer warranted. And, despite currently high electricity prices in many regions, driven by very high fuel input costs used to generate electricity, we are confident that well structured markets and robust competition are providing substantial benefits to electricity consumers. More importantly, these benefits will increase over time if an effective restructuring process and competitive market implementation program continue to receive support from policymakers.[6]

The economists challenge recent reports that attempt to blame rising electricity prices on industry restructuring, concluding instead that the real reason is dramatic increases in fuel costs at a time when retail rate freezes are coming to an end:

> We are concerned that faulting competitive markets for today's high prices diverts the focus and resolve of policymakers to continue with restructuring and make further improvements in market institutions and design in order to provide consumers with the full benefits of competition. …No state, regulated or restructured, will ultimately

[5] The signatories to the letter are: Paul L. Joskow (Massachusetts Institute of Technology); Alfred E. Kahn (Cornell University); William W. Hogan (Harvard University); Peter Cramton (University of Maryland); Howard J. Axelrod (Energy Strategies, Inc.); Vernon L. Smith (International Foundation for Research in Experimental Economics); David W. DeRamus (Bates White, LLC); and Gary L. Hunt (Global Energy Decisions).

[6] Attachment A at 1.

escape the burden of the higher generation fuel prices we are experiencing now.[7]

The economists outline a number of benefits flowing from competitive electricity markets such as large gains in generator efficiency, credible price signals, tailored products and services, demand response and significant environmental benefits. In conclusion, the economists "urge policymakers to focus on making necessary improvements in market design and resist the temptation to reject competition for a return to heavy-handed regulation."[8] We commend this excellent letter to the Task Force for review and consideration.[9]

The compelling endorsement of competition by these distinguished economists is certainly consistent with the views expressed in a June 17, 2006 speech on energy policy by Federal Reserve Board Chairman Ben Bernanke. Chairman Bernanke commented that in the short run, prices for natural gas and crude oil are likely to remain high given strong world economic growth and limited ability to increase energy supplies. He expressed great confidence, however, in the power of market forces, stating emphatically that "in the long run, market forces will respond" with new technologies, alternative fuels and an increase in energy supplies.[10]

Indeed, electricity competition is working for consumers, unleashing innovation and significant market efficiencies. We again remind the Task Force that an October 2005 study by Cambridge Energy Research Associates (CERA) found that electricity competition had imposed cost discipline and led to more innovation and greater efficiency, resulting in U.S. residential consumers paying $34 billion less for electricity over the past seven years than they would have paid under traditional regulation.[11] In addition, a July 2005 study of wholesale electricity competition in the eastern U.S. by Global Energy Decisions found more than $15 billion in benefits to consumers during the 1999-2003 period.[12]

The evidence of consumer benefits continues to mount. On February 2, 2006, the Public Utility Commission of Texas issued a staff report entitled "Electricity Prices in Competitive Retail Markets in Texas." The report found that millions of electricity customers in ERCOT had received substantial benefits from retail competition. Had customers in Houston and Dallas switched to the lowest-cost provider in their territory, they could have realized savings of $1450 and

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[7] *Id.*

[8] *Id.* at 2.

[9] A recently-released study prepared for The Edison Foundation by The Brattle Group also underscores that recent sharp increases in fuel costs -- "unprecedented by historical standards" -- have greatly impacted delivered electricity prices in both restructured and regulated regions. Why Are Electricity Prices Increasing? An Industry-Wide Perspective, http://www.eei.org/industry_issues/electricity_policy/state_and_local_policies/rising_electricity_costs/Brattle_Report.pdf.

[10] Chairman Ben Bernanke, Remarks before the Economic Club of Chicago, Chicago, Ill. June 17, 2006). Chairman Bernanke's views about the essential value of competitive markets seem consistent with the views of his predecessor, Chairman Alan Greenspan, expressed last fall: "Governments today ... are rediscovering the benefits of competition....[F]lexibility is most readily achieved by fostering an environment of maximum competition." Chairman Alan Greenspan, Remarks before the National Italian American Foundation, Washington, D.C. (Oct. 12, 2005).

[11] Cambridge Energy Research Associates (CERA), "Beyond the Crossroads, The Future Direction of Power Industry Restructuring" (CERA Special Report), at I-1 (October 2005).

[12] Global Energy Decisions, "Putting Competitive Power Markets to the Test, The Benefits of Competition in America's Electric Grid: Cost Savings and Operating Efficiencies" (Global Energy Decisions Study), at ES-1 and RS-7 (July 2005).

$800 respectively since January 2002. The report also heralds, however, that even customers that did not switch benefited from retail competition by having access to a variety of new service and pricing options, plus sources for energy efficiency gains and renewable energy.[13]

On March 2, 2006, the New York Public Service Commission (PSC) issued a staff report for the time period 1996-2004. This report found that real electricity prices resulting from competitive markets dropped an average of 16 percent for New York residential customers and between 14.7 and 17.7 percent for commercial and industrial customers. The PSC staff report commented that 4,200 MW of efficient new generation capacity had been added since utilities had divested their generation facilities and (as noted a number of times in the Task Force's draft report) that, unlike investments by regulated utilities, "ratepayers are not at risk for cost overruns or inefficient operations." Finally, after taking a look at other states, the staff report concluded that customers in retail competition states generally "fared better than the average residential customer in states without retail access."[14]

Illinois is another example where utility restructuring is taking place and has saved consumers billions of dollars. Starting October 1999 large commercial and industrial customers were afforded the benefits of retail competition. In its sixth annual report on retail competition, made to the Illinois Legislature and the Governor in May 2006, the Illinois Commerce Commission concluded that by December 2005 about 50% of customers with a peak demand greater than one MW, representing 56% of customer load in the larger demand category, had switched to a retail electric supplier.[15]

Illinois and other states[16] are moving away from the old system of government-regulated electricity rates toward a more competitive market for electricity. While more work needs to be done so that all customers receive the benefits of choice, states that are advancing towards competition are providing benefits to customers, and they must continue to advance to achieve the full benefits of competition for all customers. Over the long run, that's the best way to govern supply and demand--and encourage conservation--of power.

Recognizing this, a June 19, 2006 editorial in the Chicago Tribune declared that competitive electricity markets are good for Illinois:

> Illinois and other states are going to move away from the old system of government-regulated electricity rates and into a competitive market. And they should. Over the long run, that's going to be the best way to govern supply and demand--and encourage conservation--of power. Those who want to delay the move to an electricity market seem to have a mistaken nostalgia for the old days.[17]

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[13] The report may be downloaded at http://interchange.puc.state.tx.us/WebApp/Interchange/Documents/32198_7_504891.PDF.

[14] The report may be downloaded at http://www.dps.state.ny.us/StaffReportCompetition.pdf.

[15] Reports from the ICC to the Illinois General Assembly and Governor with respect to retail competition in Illinois can be viewed at http://www.icc.state.il.us/ec/electricity.aspx.

[16] For two recent articles on competition in Connecticut, see "Why electricity restructuring is working for Connecticut," April 23, 2006, accessed at the New Haven Register: http://www.nhregister.com; and "Energy price spikes spur manufacturers to action," April 14, 2006, accessed at the Hartford Business Journal: http://www.hbjournal.com.

[17] http://www.chicagotribune.com/news/opinion/chi-0606190168jun19,1,7404257.story

The Task Force's draft report accurately captures the key requisites for well structured retail electricity markets, pointing out that the price charged for POLR service must be responsive to the price of electricity in the marketplace, and that artificial price caps distort retail competition, discourage new entrants to the market, and hinder retail competitors that are already active. All customers must be able to choose their supplier based on a true comparison of prices, and the costs of retail electricity service must be properly allocated so that customers are not required to pay twice for the same service.

Where the rules for competitive retail markets are rational, those markets have grown significantly. The draft report accurately states that substantial numbers of industrial customers have switched to alternative suppliers. Indeed, according to tabulations provided to ARC by KEMA, Inc., an international energy consulting firm, competitive electricity suppliers serve some 70 GW of peak load across the United States.

Customers have publicly expressed support for retail competition and have touted the considerable benefits of retail choice -- competitive prices, tailored contract terms, improved energy management, environmentally superior supply sources and improved customer service.[18] These are precisely the results that we should look for from a well structured retail market that offers customers a broad array of choices.

[18] To access these customer testimonials, go to www.allianceforretailchoice.com.

III. Conclusion

COMPETE, EPSA and ARC commend the Task Force for a balanced and thoughtful draft report. There is a growing body of evidence, including testimonials from customers, that competition is providing considerable consumer benefits. Policymakers that are promoting competitive electricity markets should stay the course and continue to make improvements in market structure and design. As the attached economists' letter concludes, policymakers should "resist the temptation to reject competition for a return to heavy-handed regulation. We are persuaded that competition in electricity markets will stand the test of time and provide visible customer benefits."[19]

Sincerely,

William L. Massey, on behalf of
COMPETE

John E. Shelk, on behalf of
Electric Power Supply Association

Thomas Rawls, on behalf of
Alliance for Retail Choice

[19] Attachment A at 2.

ATTACHMENT A

June 26, 2006

Open Letter to Policymakers

Dear Policymaker:

As economists that have both followed and participated in the discussion on restructuring the electricity industry to support competitive wholesale and retail electricity markets, we prepared this letter to provide our views about the value of continued support for the development of competitive markets for electricity.

Among economists, it is almost universally accepted that well functioning competitive electricity markets yield the greatest benefits to consumers in terms of price, investment and innovation especially when regulated alternatives are no longer warranted. And, despite currently high electricity prices in many regions, driven by very high fuel input costs used to generate electricity, we are confident that well structured markets and robust competition are providing substantial benefits to electricity consumers. More importantly, these benefits will increase over time if an effective restructuring process and competitive market implementation program continue to receive support from policymakers. Unfortunately, recent reports have blamed rising electricity prices on industry restructuring. These reports fail to identify the primary cause of today's rising electricity prices --- dramatic increases in fuel costs at a time when retail rate freezes introduced as a transition to competition have come to an end. We are concerned that faulting competitive markets for today's high prices diverts the focus and resolve of policymakers to continue with restructuring and make further improvements in market institutions and design in order to provide consumers with the full benefits of competition.

First, competition and markets are not to blame for recent increases in electricity prices. The current high electricity prices are largely the result of dramatically higher fuel costs. During the period 2000-2005, the price of natural gas increased 375%, and the price of coal increased 30%. These are the two primary fossil fuels used for electricity generation. These increases have been magnified by the end of many retail price freezes that were put in place in many states as part of the transition to competition. Commodity price increases are being felt both in restructured states and in states with vertically integrated utilities. Retail prices have increased more in restructured states than in regulated states in the last year, largely because of their greater use of clean, natural gas-fueled generating capacity, but they increased less in restructured states in the previous few years. While there has been considerable publicity about sharp increases in electricity prices in restructured states such as Maryland and Delaware, where long-term retail rate freezes are expiring, we would point out that, during 2000-2005, regulated rates increased by 47% in Oklahoma and, since 2000, by 43% in Colorado, just to give two examples. No state, regulated or restructured, will ultimately escape the burden of the higher generation fuel prices we are experiencing now.

Second, properly structured, competitive markets shift the risk of bad business and investment decisions away from consumers by having the shareholders of competitive suppliers, and not electricity customers, bear those risks. Cost-of-service regulation clearly has its place in some aspects of the electricity industry such as distribution and transmission. However, where market forces can operate, as they have for electric generation, competition can shield consumers from construction and operating cost overruns. The shifting of risks from customers to suppliers in a competitive market is a huge benefit for consumers in the long run since wiser investment choices and better cost control incentives will lead to more efficient outcomes.

Third, restructured electricity markets are an efficient and reliable way to allocate resources, and there is growing evidence and convincing studies that show that consumers have saved billions of dollars in energy costs as a result of competitive markets when compared to the traditional regulation in effect before competition was implemented. The savings from competition are real dollars in the pockets of consumers, and those savings will continue after fuel prices retreat from their current high levels. In addition, there have been multiple new entrants and large gains in generator performance with competition. One estimate found that performance improvements from divested power plants produced enough additional energy to power more than 25 million households in the Eastern interconnect for a year. Customers are beginning to gain access to more tailored products and services. Credible price signals provide opportunities to develop a robust demand response that both has a significant price dampening effect and relieves the stresses and strains on the delivery systems. And, restructuring and competition have brought significant environmental benefits, with reduced emissions resulting from increased operating efficiencies, improved regional dispatch of generating resources, and the use of market signals to stimulate increased investment in transmission, emission control technology, highly fuel-efficient new generation and renewables.

In sum, despite the recent increases in electricity prices, policymakers should stay the course and continue to support restructuring and the evolution of competitive wholesale and retail markets for power. Competition is the very foundation of our nation's economy. Competitive electricity markets are relatively new and will continue to evolve. We urge policymakers to focus on making necessary improvements in market design and resist the temptation to reject competition for a return to heavy-handed regulation. We are persuaded that competition in electricity markets will stand the test of time and continue to provide visible customer benefits.

Sincerely,

Paul L. Joskow Professor of Economics
and Director of the Center for Energy
and Environmental Policy Research
Massachusetts Institute of Technology

Alfred E. Kahn
Robert Julius Thorne
Professor of Political Economy, Emeritus
Cornell University

William W. Hogan Raymond Plank Professor
of Global Energy Policy, John F. Kennedy
School of Government Harvard University

Peter Cramton
Professor of Economics
University of Maryland

Howard J. Axelrod President Energy Strategies,
Inc.

Vernon L. Smith
President
International Foundation for Research in
Experimental Economics

David W. DeRamus, Ph.D. Partner Bates White, LLC

Gary L. Hunt
President Global Energy Advisors