Why We Need a Connecticut Power Authority

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on Behalf of AARP Connecticut

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Thank you, Chairwoman Nardello and members of the energy committee, for the opportunity to testify here today in support of H.B. No. 6510 (RAISED) AN ACT ESTABLISHING A PUBLIC POWER AUTHORITY.

Introduction

Ten years ago the California state government took a painful misstep in trying to bring the benefits of electricity competition to Californians. California had long envied the lower rates available in neighboring states, and embarked in a radical departure from traditional utility regulation. As part of its restructuring, California constructed a complex administrative system in which wholesale electricity market bids, bidders, and price calculations were all secret.

Two years after implementing this system, it was obvious to all that the people of California were suffering from this catastrophic mistake. In 2009, California still retains a massive administrative infrastructure complete with market secrecy. Even though the nature of competitive markets should lead to comparable wholesale prices across large regions, California's wholesale electricity market continues to show significantly higher costs than those of its neighbors.

The situation in Connecticut is not much better. Your wholesale electricity prices are now among the highest in the nation. The so-called "forward prices" for March are higher than elsewhere in New England.

In April 1998, Connecticut state government enacted Public Act 98-28, largely duplicating the failed California experiment. Connecticut is under the New England Independent System Operator, which is subject to the Federal Energy Regulatory Commission. However, FERC has resisted the reforms needed to protect New England's consumers from exorbitantly high utility bills. This may be an understatement.

FERC has become so dazzled by the complex system operators it supports that the Commission simply ignores its role in protecting consumers.

This leaves Connecticut state government in a difficult position. It is difficult and some say impossible to turn back the clock and return to the previous regulatory system. In fact, it is difficult to promote open wholesale competition without the costly market mechanisms of the New England Independent System Operator since FERC's approval is required.

In order to realize competitive benefits, the state needs to find a path around the costly prices at the New England Independent System Operator. Other states, facing similar problems, are debating or adopting a straightforward solution – establishing a state power authority that can build and purchase resources cost-effectively and sell the resulting cheaper electricity directly to their consumers. While this may appear to be a novel idea for Connecticut, similar solutions over the past hundred years have worked well, such as the New York Power Authority, the Tennessee Valley Authority, the Bonneville Power Administration, the Western Area Power Administration, and the California Department of Water Resources. They are excellent examples of state and federal initiatives that successfully compete with distorted markets and deliver significant savings to consumers.

In January 2007, the people of Illinois began to receive very high utility bills. By August, the Governor signed a law that established the Illinois Power Agency. This agency, tasked with finding less expensive and more environmentally appropriate energy resources, has already been able to purchase electricity in the open market at prices lower than those available from the existing Independent System Operators.

What Went Wrong?

A spirited debate is happening across the United States concerning the lack of success of administered power markets like those of the New England Independent System Operator. At the heart of the problem are the New England ISO's "single price auction" and the almost complete absence of transparency.

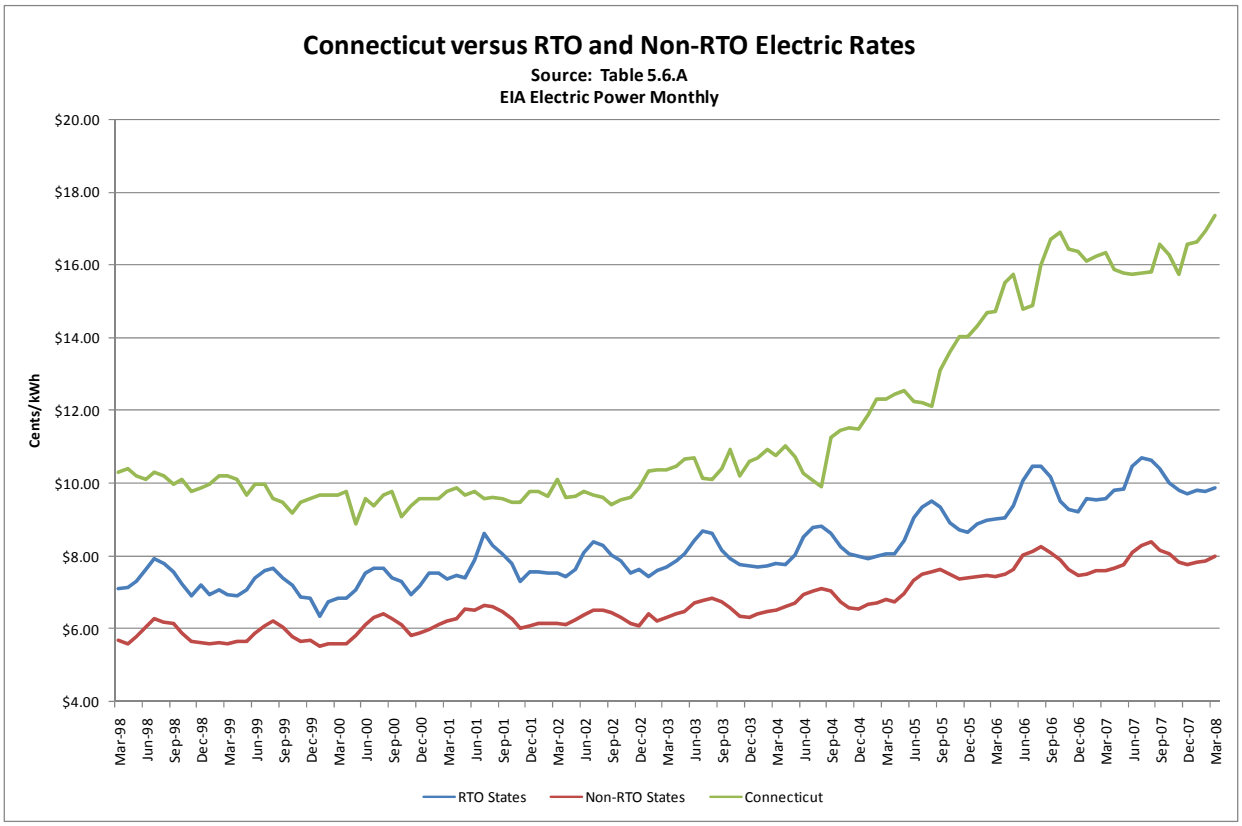
In 1981, the Bonneville Power Administration pioneered competition in wholesale electric markets by selling a large portion of its massive electric generation on the open market. Nearly thirty years ago, I can remember finding uses for open market electricity to meet industrial needs throughout the Pacific Northwest. By 1987 the experiment was so successful that FERC adopted an open market for electricity throughout the western half of the U.S. on an experimental basis. In 1991, FERC adopted the solution on a permanent basis.

Then, as now, electricity is sold in an open outcry market where bids are public and the terms and conditions are set by the market and not a secretive bureaucracy. Wholesale prices fell dramatically until, in 1998, California chose a system where state-chartered bureaucracies determine prices in a "black box". California's neighbors on the other hand prudently invested in low-cost generation that

allowed them to keep the benefits of their investments. The market for electricity was transparent, which means that market information was available for public review.

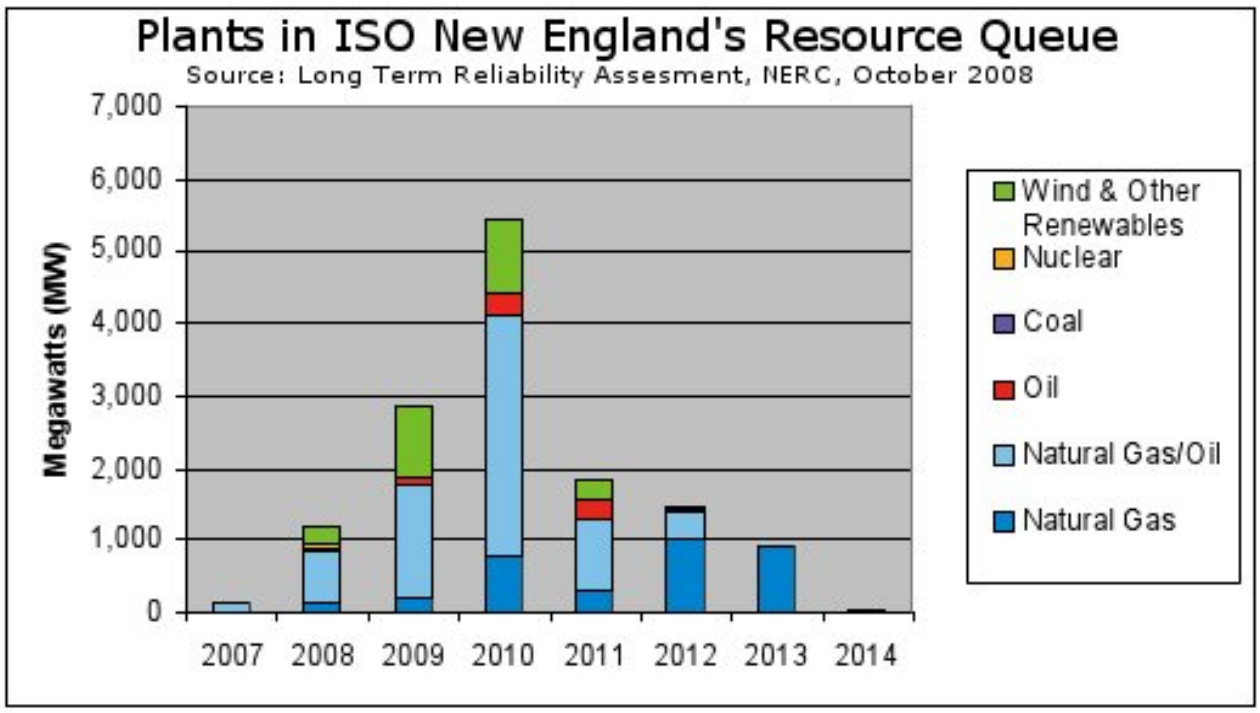
While there is nothing intrinsically wrong about single price auctions for the commodity, electricity, it represents a world in which – by law – consumers are forced to purchase their groceries at a designated supermarket. They cannot buy in bulk for long-term supply from large discount grocers. And in Connecticut, "supplies" that you have already purchased, like the electricity from Bridgeport Harbor and Millstone, have been re-priced to market prices, to the benefit of the plant owners.

The following chart shows Connecticut retail prices compared to those across the U.S.:



Those states with Independent System Operators, also known as Regional Transmission Organizations (RTO), have seen electric rates climb continuously above those states with open wholesale competition. Connecticut's fate has been far worse than the U.S. average, however.

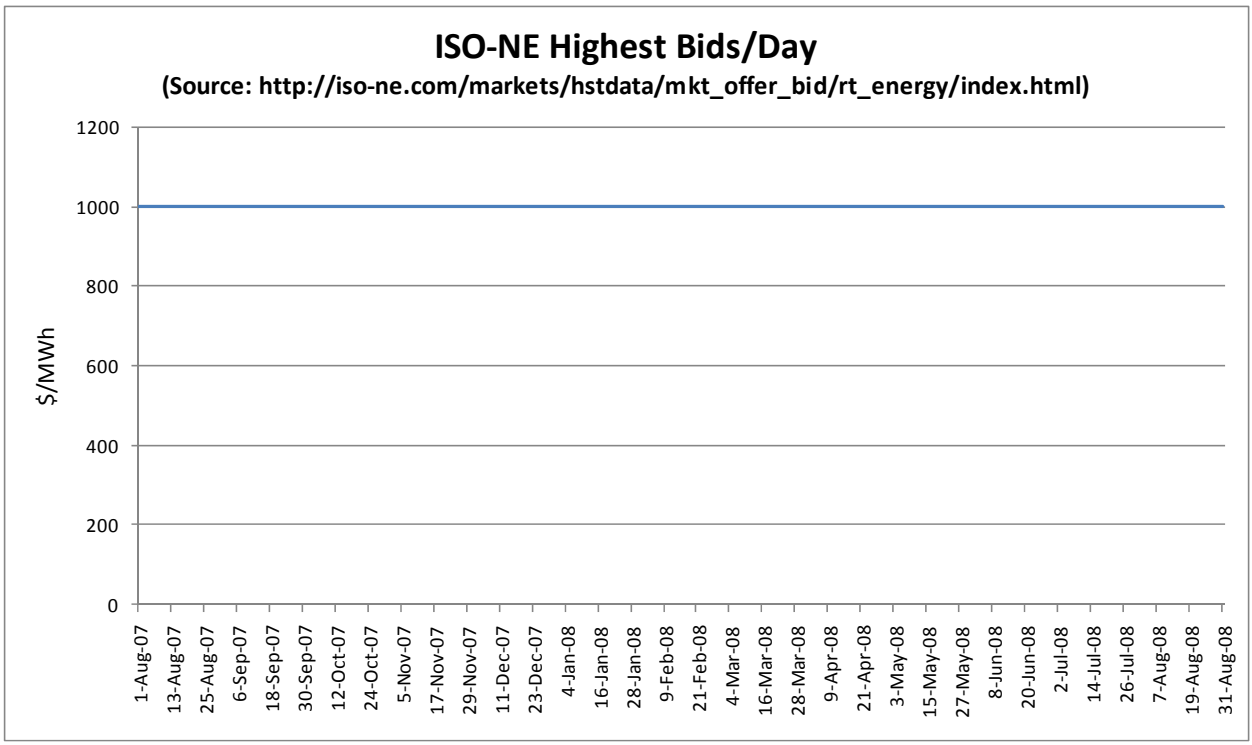
While the proponents of centralized administered wholesale electricity markets blame the high prices on the cost of fossil fuels, the reality is that the differential increase during Hurricane Katrina's natural gas spike continued to rise even when the price of natural gas later dropped. One irony of the New England Independent System Operator's computer algorithms that are used to set the market price is that New England is slated to become increasingly dependent on natural gas in years to come, thus exacerbating your high price crisis:



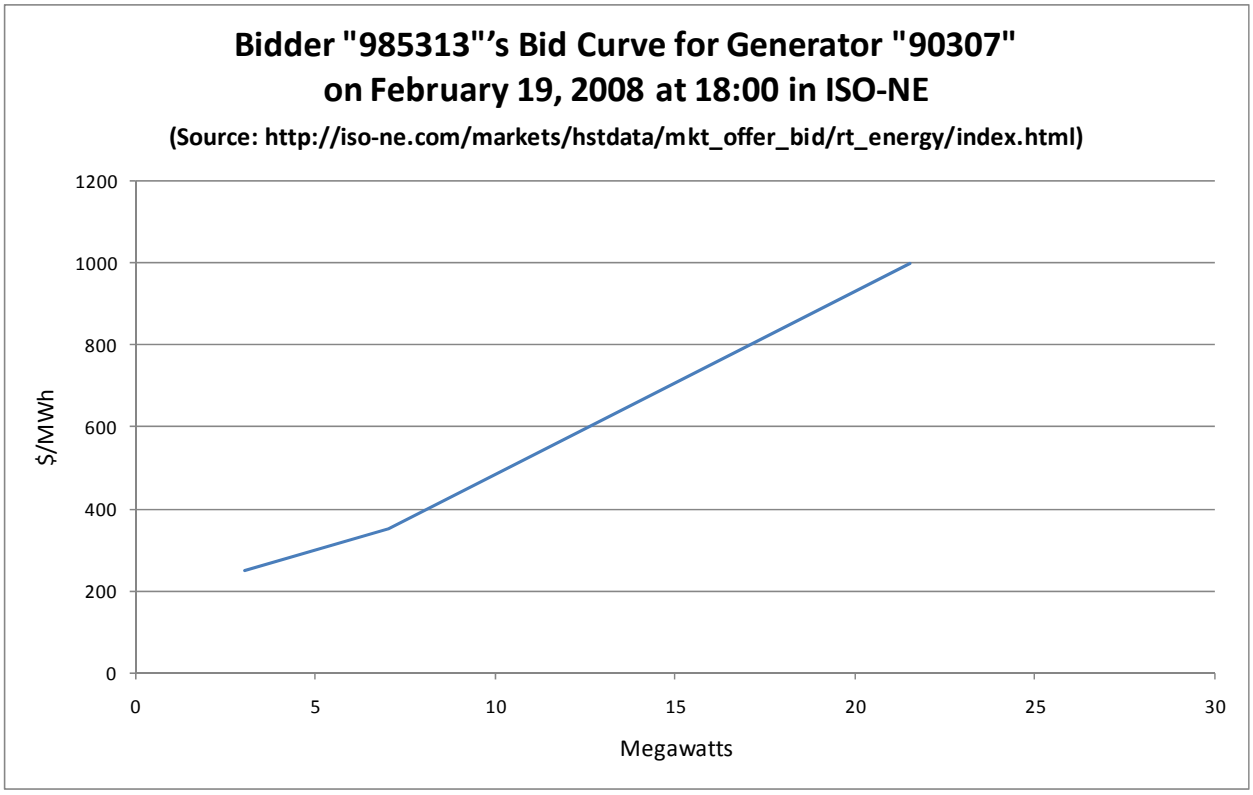
If the cause of Connecticut's dismal performance is reliance on natural gas, it is highly doubtful that the New England ISO's increasing dependence on natural gas will bring any relief.

Now we come to the matter of the lack of transparency. In New England, the bids and the identities of the bidders are secret. In effect, Connecticut might not like the available prices, but your state government, the public, and decision-makers are not allowed to find out where the prices come from. The decision to eliminate transparency from the electric markets that was pioneered in California has been blindly adopted by other Independent System Operators including New England.

Returning to the grocery metaphor, imagine that a governmental board sets the price of your groceries. You are forbidden to know the identity of the wholesale suppliers and you can only find out about their bids months later. Obviously, you would be concerned when you found out that your prices were much higher than the rest of the U.S. To make matters worse, when you review the bids (with the bidders' names removed), you find that many of the bids were nonsensical. In New England, there are two bidders who continuously make bids of $1,000/MWh – ten to twenty times any possible level of the cost of production. In fact, these bids occur every day of the year.



The individual bids make even less sense:



Transparency problems are present in all of our nation's Independent System Operators. Texas, recently, took a step toward reducing the degree of secrecy. When it changed the delay on the release of market bids from 180 days to 60 days, average bids fell by $12/MWh and maximum bids fell by $82/MWh. Not surprisingly, an efficient way of policing manipulative bidding behavior is to reveal the bids and the bidders.

You may very well conclude that in a market that produces absurdly high prices and that is characterized by inexplicable bids, some degree of Enron-style problems are at work. Unfortunately, only FERC can force the New England Independent System Operator to add transparency to their markets.

What Is the Solution?

The solution adopted in Illinois last year has worked very well. Illinois, like Connecticut, is subject to Independent System Operators under FERC jurisdiction. Illinois, like Connecticut, actively worked to reduce the abuses at the ISOs, but with little success. After a particularly costly cycle of power purchases by Illinois load-serving entities in 2006, the Illinois Attorney General filed evidence of abuses at FERC. The rapidly settled case resulted in a $1,000,000,000 refund for ratepayers and the legislative creation of the Illinois Power Agency. Even with rising natural gas prices, purchases by the new agency have been less costly than those under the previous system.

Establishing a Connecticut Power Authority has great potential to help Connecticut mitigate its high electricity prices. The possibility exists to provide power and realize savings in an efficient manner. Several key benefits associated with the formation of a state power authority in Connecticut are outlined below.

A CPA could have the ability to finance new plants either by outright ownership or by long-term contracts. Since renewable resources are likely to be high capital cost options, this may be the only short-term solution for adding these options to the resource mix in Connecticut. It is also possible that a state power authority whose sole mandate is planning/procurement could receive better terms and more benefits because of "clout".

By signing long-term contracts with resource developers, the CPA could beat New England ISO's wholesale price. The CPA could provide power at fully allocated cost to Connecticut consumers and businesses and be able to choose from a broader portfolio of plants than those currently selected in the Forward Capacity market including those that are significantly more cost effective. In other words, it could buy power more cheaply because there is no longer an auction process, and because long-term bilateral contracts should result in lower prices.

A Connecticut Power Authority could be similarly constituted on the model of the new Illinois Power Agency which is tax exempt by statute and has the authority to issue both taxable and tax-free revenue

bonds to build *in-state generation plants.*[1] The use of tax-free bonds would usually lower the overall financing costs for new generation. This would allow the CPA to compete with the market to push the price of electricity closer to cost-of-service. Tax-free bonds offer lower interest rates than other types of bonds. Therefore, a CPA would have advantages in financing over investor-owned utilities.

A CPA could extend financing to a non–state-owned plant in exchange for traditional regulatory treatment. The CPA could function as either a financing entity or a guarantor for developer-built power plants. The model for this is the "acquisition" and "net billing" techniques used by the Bonneville Power Administration to facilitate resource development in the Pacific Northwest. It is a step below outright plant construction, even on a turnkey basis, since the developer would need to agree to the CPA's terms and conditions. The CPA could require that a proposed plant is either priced at fully allocated cost or that the differential between market prices and fully allocated cost is returned to ratepayers.

A CPA could help streamline Connecticut's complex energy planning/procurement. Presently, the DPUC receives input from the utilities, Consumer Counsel, State Attorney General, Siting Council, etc. Yet in addition to handling rate cases and consumer complaints for natural gas and electricity, it regulates telcom, CATV and water and handles their associated rate cases and consumer complaints. It is possible that Connecticut's ratepayers could be better served if the existing structure reflected the energy agencies' strengths, i.e. rate issues (DPUC), siting (Siting Council) and plan/procure (CPA).[2]

It is desirable for a CPA to administer the procurement process. To avoid repeating the mistakes of the secret auction that led to record-high utility bills in 2007, the Illinois legislation provides a blueprint for the new agency (from Section 1-5: "Develop electric generation and co-generation facilities that use indigenous coal or renewable resources, or both, financed with bonds issued by the Illinois Finance Authority"; "Supply electricity from the Agency's facilities at cost to one or more of the following: municipal electric systems, governmental aggregators, or rural electric cooperatives in Illinois."). Like Illinois, a Connecticut authority could be required to "Develop electricity procurement plans to ensure adequate, reliable, affordable, efficient, and environmentally sustainable electric service at the lowest total cost over time, taking into account any benefits of price stability" (Section 1-5) and other factors the public deems important. To the extent feasible the procurement plan could be submitted to both the DPUC and the public for review, and the procurement process monitored after the Illinois model.

A CPA could call upon the expertise of similar organizations. Staffing for the Connecticut Power Authority could draw from the state's existing energy agencies. Another domestic source of qualified individuals could be the Connecticut Municipal Electric Energy Cooperative (CMEEC), "a publicly directed joint action supply agency formed by the state's municipal electric utilities in 1976 under authority of the

[1] (20 ILCS 3855/) Illinois Power Agency Act, Section 1-57.
[2] See the state's existing energy matrices at http://www.ctenergy.org/pdf/MatricesPh1Apr08.pdf; this is the first phase of the study now underway by CAEB to look at various energy issues as mandated by the General Assembly.

state's General Statutes."[3] The new Connecticut authority could also be encouraged to apply the best practices of established authorities such as NYPA, Connecticut's neighbor, and relevant federal agencies.

A CPA could be funded efficiently. Fears that a new agency might exhaust allotted start-up costs (estimated at $2 million in the State Attorney General's proposed legislation; see Appendix) could be allayed by studying the recent enabling legislation in Illinois. Unlike an ISO/RTO, a state power authority needs no outsized budget and vast bureaucracy. The Illinois Power Agency Act, for example, specifies that $25 million be paid into a trust fund and that the interest be used to cover the agency's administrative costs to the extent that the monies are not recovered through planning, procurement, and project development fees that are required by law. The new agency at present has one employee (the executive director) and an annual budget of slightly over $1.2 million (an "upfront" appropriation from general revenue funds – a loan to be repaid from investment proceeds in the trust fund).[4] Its major task is an RFP for new resources to be paid at fully embedded cost; such an RFP does not even remotely cost $1 million.

A systems benefits charge (SBC) on ratepayers' monthly utility bills could help to finance the CPA. Connecticut ratepayers already pay SBCs in the form of small amounts that benefit all classes of customers. SBCs pay "for programs in consumer education, worker protection, hardship cases, and nuclear decommissioning",[5] payments in lieu of property taxes, integrated resource planning expenses, etc.[6]

Conclusion

The people of Connecticut and your state's economy are suffering. Continuing down the same path is unlikely to be less painful. Substantive change at the New England Independent System Operator is also unlikely. Connecticut needs to adopt solutions that it can implement unilaterally. The solution, establishing a state power authority, lies within your grasp. The citizens of Illinois will be happy to tell you that their state power agency – barely a year old and running on a barebones budget – is already making a significant difference.

Thank you.

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[3] "CMEEC is owned by the municipal utilities in the cities of Groton and Norwich, the Borough of Jewett City, and the Second (South Norwalk) and Third (East Norwalk) Taxing Districts of the City of Norwalk, Connecticut. CMEEC also provides all the power required by other utilities participating in CMEEC including the Town of Wallingford Department of Public Utilities, the Bozrah Light and Power Company, and the Mohegan Tribal Utility Authority." See http://www.cmeec.com/WHOISCMEEC.htm

[4] The goal was to avoid any costs being imposed on taxpayers; Connecticut could consider a similar vehicle – a user fee–funded state agency.

[5] http://www.uinet.com/uinet/connect/UINet/Top+Navigator/About+UI/Doing+Business+With+UI/Suppliers+-+Aggregators/CT+Code+of+Conduct/Suppliers+and+Aggregators+-+CT+Code+of+Conduct+-+Restructuring

[6] In 2007, CL&P's SBC was spread across approximately 1.3 million customers and UI's across approximately 300,000 customers.