Chapter 5

"Any other information the board believes to be beneficial to the Governor, the Legislature, and Nebraska's citizens when considering whether retail electric competition would be beneficial, such as, but not limited to, an update on deregulation activities in other states and an update on federal deregulation legislation."

1.0 Purpose

Provide information on deregulation activities in other states, an update on federal deregulation legislation, and other public policy developments relating to electric deregulation.

2.0 Team Members

Kurt Stradley	–	Lincoln Electric System (LES)
Tim Grove	–	Omaha Public Power District (OPPD)
Jay Holmquist	–	Nebraska Rural Electric Association (NREA)
John McClure	–	Nebraska Public Power District (NPPD)
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3.0 Introduction and Deregulation Overview

Less than 1/3 of the states have some form of retail electric competition, but in many cases, the incumbent local utility is providing the power supply. No state has enacted retail choice legislation since 2000 and several states have scaled back or repealed retail choice initiatives, most recently in 2007 Virginia passed legislation eliminating future retail competition for all customers except industrial customers with 5 MW or greater loads. State retail electric markets have gained considerable attention in the past few years due to significant increases in retail electricity prices. Escalating and volatile fuel prices are a key driver, but do not fully explain all the cost increases. Many state retail choice programs are either struggling or inactive. As noted in a previous report, on September 1, 2004, the State Corporation Commission of Virginia issued a press release describing the findings of its fourth annual report on retail choice in Virginia. The press release notes *"that the electricity supply industry continues to struggle following price run-ups, disclosures of accounting and dated improprieties, creditworthiness issues and volatile fuel prices, particularly natural gas."* The press release concludes *"that Virginia is not the exception when it comes to the lack of competitive activity for electricity supply service. In other states with retail choice, energy markets are generally inactive with few customers able to purchase power at a price lower than their traditional utility company."*

On September 1, 2005, the State Corporation Commission of Virginia issued its fifth annual report stating that "retail competition" in Virginia has not lead to lower prices than would have been charged under traditional regulation. The executive summary ends with the following assessment of retail choice:

> *"It appears that, from the data so far, most retail customers (especially residential) in restructured states where the transition period has ended and the price is now based on the wholesale market, are seeing prices increase faster than in the non-restructured states or states still in transition with a price cap. At best, at this point in time, no discernable overall benefit to retail consumers can be seen from restructuring."*

Not all states agree with this assessment. In the Report to the 80th Texas Legislature, Scope of Competition in Electric Markets in Texas dated January, 2007, the Texas PUC concluded

without any data that *"it is likely that residential customers are paying lower rates than would have been produced through regulation."* (pg. 61).

Several states have faced significant challenges with retail choice as rate caps were removed as part of retail restructuring programs. Last year, 72% retail rate increases were proposed in Maryland as retail price caps were ending. In Illinois, another state with retail rate caps, rate increases exceeding 50% were proposed for January 1, 2007, but were later reduced. A more detailed discussion on Illinois is found at 6.0. below.

4.0 Texas

Because of the national significance of the public policy choices adopted in Texas, the material below contains background on the Texas retail electric program and the status of the program efforts.

Legislation was enacted in 1999 to begin the process. Under the new law, the Texas PUC began the process of certifying competitive retail electric providers. On June 1, 2000 a pilot retail competition program commenced and on January 1, 2002 full retail choice began for all customers at which time retail rates were reduced by 6%.

Following are the key provisions of the Texas law:

- Froze electric rates for investor-owned electric utilities in Texas through 2001.
- Prohibits large utilities from lowering their rates for residential and small commercial customers before 2005, or until 40% of their customers are served by competitors.
- Exempts electric cooperatives and city-owned electric companies from customer choice unless their governing boards decide to open their markets to competition.
- Allows customers the choice of using renewable energy (wind and solar power for example).
- Requires older electric generators to meet current environmental rules by 2003 or be shut down.
- Creates a fund to pay for lower rates for low-income families in low-income families in low-income assistance programs.
- Prohibits disconnection of service for nonpayment during periods of extreme weather.
- Allow customers to receive one bill for their electric service in an easy-to-read format and understandable language.
- Creates a Do Not Call list for customers who do not wish to be called by telemarketers on behalf of electric providers.
- Provides customer protection against discrimination, against being billed for unauthorized charges (cramming), against unauthorized change of service provider (slamming) and other unfair, misleading and deceptive practices.

It is important to note that much of the Texas region is operated as a separate electrical interconnection. This limits and confines the size of the restructured area and restricts the impact of wholesale energy deliveries from potentially lower cost resources. When Texas initiated the Retail Choice Program, the impacted region was operating with significant generation in reserve and significant new Independent Power Producer (IPP) projects underway. In addition, retail rates are relatively high, in the 10¢/kWh range, compared to other regions of the U.S. With high reserves, new generation coming on line and high retail rates, Texas becomes somewhat of a special case. With excess generation capacity, numerous new, highly efficient, independent generation projects and a high underlying retail electric rate level, the Texas region provided a prime opportunity to initiate retail choice. This is not to discount what has been accomplished by the Texas electrical industry. It is, however, a confirmation that for retail choice to be successful, the appropriate preconditions need to be in place.

Under the Texas deregulation program, electric utilities were divided into three areas: retail, power generation and transmission and distribution. Any investor-owned companies that wish to enter the retail market must create an affiliate company. To ensure deregulation, the Texas Public Utilities Commission created a price-to-beat for investor-owned affiliates that was to remain in place until 2005 or until 40% of customers switched to another retail company. In September of 2004 the price-to-beat in the five distribution areas ranged from 10.9 to 13.0¢/kWh with the average residential at 11.7¢. Price-to-beat rates have increased significantly since January 2002. For 2006, the residential price to beat jumped dramatically and was over 18¢/kWh for one IOU and over 19¢/kWh for another and the average was over 16¢/kWh.

The Texas Public Utility Commission monitors and reports on the status of retail choice in Texas. By 2006, more than 60% of the state's total electric load was being served by alternative suppliers.

The following chart is a comparison of average retail electric revenue per kWh in Nebraska, which has not adopted retail choice and three states that have choice. Retail rate caps have come off in Texas and are coming off in Illinois:

	Nebraska	Texas	Illinois	Pennsylvania	U.S. Average
1996	5.32¢	6.16¢	7.69¢	7.96¢	6.86¢
1997	5.30¢	6.17¢	7.71¢	7.99¢	6.85¢
1998	5.30¢	6.07¢	7.46¢	7.86¢	6.74¢
1999	5.31¢	6.04¢	6.98¢	7.67¢	6.64¢
2000	5.31¢	6.49¢	6.94¢	7.65¢	6.81¢
2001	5.39¢	7.38¢	6.90¢	8.01¢	7.29¢
2002	5.55¢	6.62¢	6.97¢	8.01¢	7.20¢
2003	5.64¢	7.50¢	6.88¢	7.98¢	7.44¢
2004	5.70¢	7.95¢	6.80¢	8.00¢	7.61¢
2005	5.82¢	9.11¢	6.97¢	8.27¢	8.14¢
2006	6.06¢	10.30¢	7.11¢	8.63¢	8.85¢

Source: U.S. Energy Information Administration – www.eia.doe.gov

5.0 Pennsylvania

An example of the limited success of retail choice is reflected in the recent summary from Pennsylvania that shows several of the investor-owned utilities have no customers choosing alternative supplies and others have few commercial and industrial customers choosing an alternative supplier.

Number & Percentage of Customers Served By An Alternative Supplier
As of 7/1/2007

	Residential		Commercial		Industrial		Total	
Allegheny Power	0	0%	0	0%	0	0%	0	0%
Duquesne Light	88,718	16.9%	10,302	17.1%	631	44.4%	99,651	17%
MetEd/Penelec	0	0%	0	0%	3	0.1%	3	0%
PECO Energy	4,664	0.3%	28,077	18.2%	5	0.2%	32,746	2.1%
Penn Power	11,247	7.6%	1,911	9.2%	140	63.1%	13,298	7.9%
PPL	0	0%	40	0%	5	0.1%	45	0%
UGI	0	0%	0	0%	0	0%	0	0%
TOTAL	**104,629**		**40,330**		**784**		**145,743**	

Pennsylvania Office of Consumer Advocate 7/25/07

The following testimony from September 5, 2007, provides an excellent summary of retail choice experiences around the nation:

> *When the Pennsylvania electric restructuring law was enacted in 1996, it was widely assumed that competition would drive down the price of generation (which is why we allowed our utilities to recover billions of dollars of "stranded" costs) and that the great majority of customers would flock to lower-priced competitive retail markets (which is why we required that retail choice be phased-in gradually over three years). Rate caps were implemented just in case rates did not go down as anticipated, in order to prevent utilities from charging* ***both*** *for stranded costs and for higher than expected generation rates. As it turned out, however, due in large part to high natural gas and other fossil fuel prices, and the manner in which wholesale prices are set in the PJM market, wholesale generation prices have increased substantially in the last several years, while retail competition – particularly for residential customers – has been dormant, both in Pennsylvania and in most other restructured states.*

Testimony of Sonny Popowsky, Consumer Advocate of Pennsylvania before PA House Consumer Affairs Committee

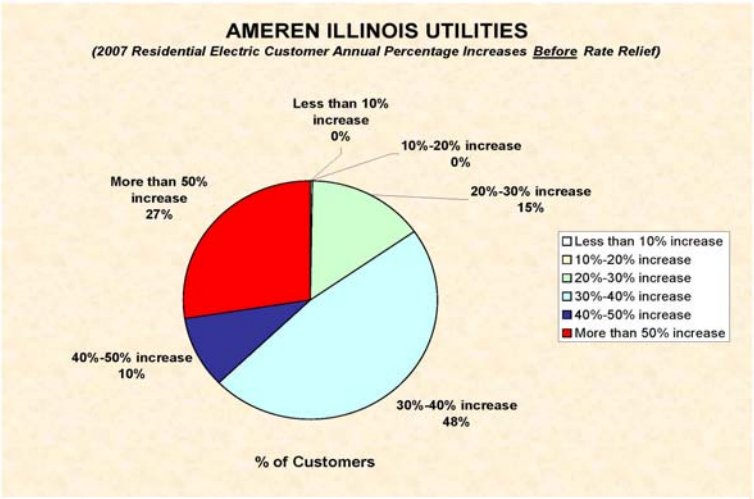
6.0 Illinois

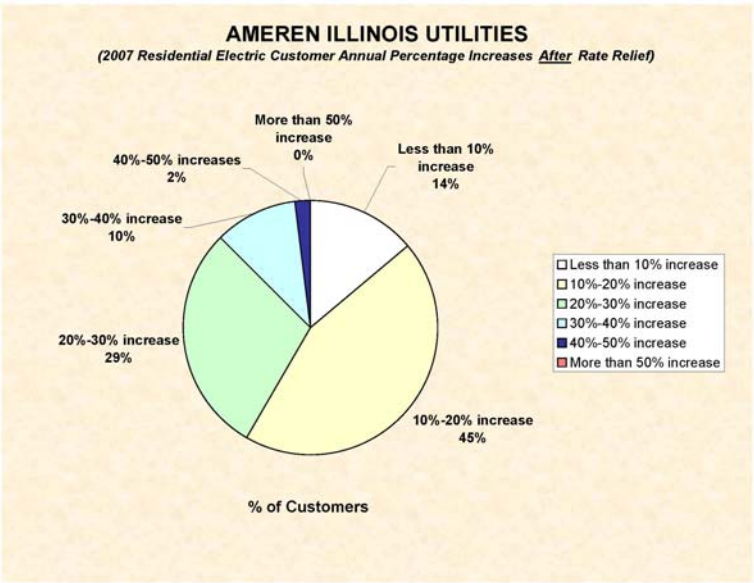
The Utility Reform Legislation passed late in 1997. The enactment of The Electric Service Customer Choice and Rate Relief Act of 1997 (HB 362) was phased in over an eight-year transition period that would allow utility customers to gradually switch to other suppliers. The intention of the eight-year transition was to "allow" Commonwealth Edison and the state's other expensive electric companies to allow them to streamline operations, lower costs

and prepare for a competitive electricity market. The Illinois Commerce Commission (ICC) is responsible for overseeing the transition of the competition into the electric industry.

In exchange for the extended phase-in of competition, residential customers received an upfront rate decrease of 15%. In the first year of the new law, Commonwealth Edison changed top management, put up all of their fossil-fuel power plants for sale and shut down the largest nuclear plant ever retired in the United States. Illinois Power Company announced it would sell or close its only nuclear plant and the four other smaller electric utilities in the state were purchased by larger out of state companies.

The mandatory transition period ended January 1, 2007. Illinois lifted its rate caps at that time and now there is talk of reinstating the rate cap because of the major rate increases. Legislation was introduced and passed to avert a crisis. However, a rate relief package of nearly $1 billion was provided by investor-owned utilities. Below are charts showing the proposed and rate relief-adjusted rates for one of the distribution utilities in the state:





7.0 Conclusions

- The cost of gas is becoming an increasingly important fuel source for electricity generation now producing approximately 20% of the Nation's electricity.
  - Texas is producing approximately 50% of its electricity with natural gas.
- Natural gas sets the market price for electricity in several retail and wholesale markets.
- Promises of wholesale or retail competition driving down energy prices have not occurred.
- Competitive wholesale markets are a necessary precedent to successfully implementing retail choice.
- Adequate power supply, reserves, and infrastructure are crucial.
- Elimination of the "obligation to serve" is a contributing factor to the reduction of generation reserve margins.
- Customers served by regulated retail markets have generally experienced lower electric rate increases than customers served by "competitive" retail markets.