

## COMPETE Clips

### Study warns against return to regulation in electricity markets

By Kathleen Hart  
SNL Power Daily  
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While many states and stakeholders in the electric utility industry are advocating a return to regulation, a study released Dec. 8 at a COMPETE Coalition media event finds that competitive markets lead to more cost-effective infrastructure investments.

“America must meet the dual challenges of energy security and environmental sustainability in a highly competitive global market. It is estimated that we may need a more than \$2 trillion investment in our energy infrastructure to address these issues,” William Massey, a former FERC commissioner and counsel for the COMPETE Coalition, said in a news release. “This study provides resounding confirmation that electricity competition fosters the innovation, discipline and efficiencies to most effectively make this investment.”

The report, “Embrace Electric Competition or It’s Déjà Vu All Over Again,” was prepared by the NorthBridge Group and commissioned by Reliant Energy Inc. It urges policymakers to learn from mistakes made during the 1970s in navigating the energy challenges facing the nation.

“The response to the energy crisis of the 1970s resulted in a \$200 billion mistake, in which monopoly markets led to excess capacity and cost overruns which were felt for decades,” COMPETE said in the news release. Four flaws of regulation at that time included “a lack of clear price signals resulting in a reserve margin twice as large as necessary; perverse capital incentives that unnecessarily cost consumers billions of dollars; improper allocation of risks to consumers rather than investors; and a tendency for regulatory fixes to overcompensate.”

Competition provides “the right price signals and promotes efficiency in existing plant operations and customer consumption,” Frank Huntowski, a director at the NorthBridge Group, said Dec. 8.

“The decisions we make will be difficult, but decades of experience and this study suggest that monopoly structures are not well-equipped to meet such challenges.”

Recent experience in restructured electricity markets and experience in other competitive industries “suggests that competitive markets are well-equipped to meet these challenges. We should learn from this history and avoid ‘déjà vu all over again,’” he said. Massey said that policy decisions aimed at meeting electricity generation and transmission infrastructure challenges should be made “with a long-term focus on what model will foster efficiency, reliability and sustainability over time. Competitive markets continue to prove that they are better equipped to reach these goals.”

**NorthBridge Study Says Past Regulation Failed to Solve Problems Similar to Today's**  
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Electric regulation failed to meet the challenges of higher fuel costs, substantial capital cost escalation, serious environmental concerns, and unanticipated changes in customer demand in the 1970s, and there is no reason to believe similar command-and-control policies will meet today's similar challenges, the NorthBridge Group said in a new study released yesterday.

The analysis, *Embrace Electric Competition Or Its Déjà Vu All Over Again*, was first reported by Matters (11/25/08, 11/19/08), and was released at a Compete Coalition forum. NorthBridge concluded that the regulated response to the challenges of the 1970s amounted to a mistake on the order of \$200 billion, or more, in today's dollars, from the "massive" overbuild of baseload generation.

The overbuild, as well as well huge cost overruns, resulted in excess supply and high rates that were felt for decades, NorthBridge said. Lower than expected load growth in the 1970s meant that the costs of power plants, which were more expensive than originally estimated, were spread over a smaller than expected customer base.

Nominal electric rates rose by over 300% from 1970 to their peak in 1985, while real rates rose by 60% in the same time period, due to the flaws inherent in regulation, NorthBridge said.

Among the problems inherent in regulation is a lack of clear price signals, which contributed to a slow regulatory response that failed to curb the over-building of baseload nuclear and coal capacity as costs spiraled and the need for capacity evaporated, NorthBridge reported. "As a result, the total U.S. reserve margin peaked at 42 percent in 1982, more than twice the 15 to 20 percent level generally deemed necessary to maintain system reliability," NorthBridge found.

Regulatory "fixes" also tend to overcompensate, and in the 1970s led to administratively mandated qualifying facilities which burdened electric utilities and their customers with a \$50 billion overhang of mandatory long-term contracts established at prices well above their actual avoided cost or any reasonable proxy of market prices, NorthBridge noted.

NorthBridge contrasted the 1970s overbuild, paid by ratepayers, with the glut of gas-fired generation in the early 2000s. When prices and over-building made gas-fired generation uneconomic, competitive builders cancelled 78% of capacity planned or under construction with a planned in-service date of 2003 or later, while regulated builders cancelled only 37% of capacity, NorthBridge found.

"Unlike in the 1970s and 1980s, these uneconomic investments did not adversely impact customers in non-regulated states since unregulated investors - not ratepayers - bore the risk of these investments," NorthBridge pointed out.

NorthBridge dismissed criticisms of competition, especially comparisons of rates in restructured and non-restructured states, such as those done by Power in the Public Interest.

NorthBridge concluded that had natural gas prices remained at the \$3/MMBtu level as in the late 1990s, the rates in non-restructured states would have risen 18% from 1997 to 2007, compared to a 22% rise in restructured states.

The small difference is primarily caused by the variation in fuel inputs used to produce electricity combined with differences in how electricity is priced to end-use customers in regulated and restructured states, NorthBridge said. NorthBridge cautioned against returns to command-and-control regulation cloaked as portfolio management or long-term contracts procured under new forms of integrated resource planning.

"[T]hese actions are nothing more than a return to the central planning of the past – the same central planning that tried to select the right amount and the right mix of technologies in the 1970s and failed," NorthBridge argued.

Re-entry of regulated utilities into the generation business, whether through direct utility ownership or allowing utilities to enter into long-term contracts with new generators, is risky for customers, NorthBridge contended, since a centrally planned risk is transferred to retail customers. Furthermore, re-entry of utilities into the generation business is incompatible with wholesale competition and will deter – and perhaps even eliminate - market-based entry of new generation, NorthBridge argued. "It is not likely that rate based investments could coexist with competitive generation," NorthBridge said.

## **Compete Coalition welcomes shift to an Obama administration**

By Tom Tiernan

Platts Electric Power Daily

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The energy challenges facing President-elect Barack Obama can best be addressed through well-structured, competitive power markets and not government command-and-control philosophies that led to inefficiencies and cost overruns in the past, William Massey, counsel to the Compete Coalition, said Tuesday.

Massey, a former commissioner at the Federal Energy Regulatory Commission and now a partner with Covington & Burling, said the massive investment needed to build out the transmission grid, foster renewable resources and address greenhouse gas emissions can be tackled within restructured power markets. "Competitive markets can function within whatever system Congress wants to set up" or whatever priorities the Obama administration sets out, Massey said in an interview.

Obama's campaign pledges and talk of moving to a greener economy sit well with the Compete Coalition, although the group does not have a position on a national renewable portfolio standard or a cap-and-trade emissions scheme, Massey said.

The coalition, which is a collection of more than 270 generators, marketers, renewable energy firms and retail customers who support restructured markets, has been preaching about the connection between competition and renewable resources for years, Massey noted. "We understand that the government is going to play a strong role in setting priorities. We are all for that. There is a strong shift here and we think moving toward a greener economy is a good idea and consistent" with Compete Coalition philosophies, he said.

Even though there is a lot of market uncertainty on climate change, "what market participants advocate is just 'tell us what the rules are as soon as you can, so we can make decisions accordingly,'" Massey said.

Changes are inevitable with a new president but "I don't think there will be a major shift at FERC" under Obama, in that the commission will continue to support renewable resources and focus on enforcement and oversight of competitive markets, Massey said. He does believe there will be less "splintering," or conflicts between federal and state authorities and within hybrid power markets, as some elements of regional transmission organizations become more attractive to those in bilateral markets as the President-elect appears to thrive on having diverse interests work out differences.

Among the "holy wars" within the power industry, the allocation of costs for transmission additions has been a perpetual issue that may or may not be tackled by Congress, Massey said. He expects cost allocation to be debated in Congress, but if lawmakers do not step in and dictate policy, it will be up to FERC and others to work out their differences.

Whoever is named to lead FERC will put his or her own imprint on the agency, but current members of the commission support competitive markets and RTOs, as outlined in the recent final rule on organized markets, Massey pointed out.