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1317 F Street NW
Suite 600
Washington, DC 20004
Phone: 202-745-6331
Fax: 202-783-0329

www.competecoalition.com

Consumers Will Not Benefit if States “Re-Regulate” Retail Electricity Markets When Rate Freezes Expire

Deregulation or restructuring of retail electricity markets generally began in the mid-1990s. Retail regulation is a state issue and not all states chose to pursue competitive markets for retail customers. Where they did, various methods of deregulation were used, which has resulted in different market structures throughout the country.

As part of a transition to retail competition, some states chose to freeze retail rates for several years. Rate freezes for retail consumers that elected not to switch to alternative suppliers are currently expiring in several states. In Maryland and Delaware, for example, rate freezes in place since 1999 are expiring. Given the significant rise in commodity prices used to fuel generating plants, it should come as no surprise that rates in Maryland, Delaware and other states will increase to take into account the higher prices in today's wholesale electricity market.

Opponents of competition have sought to use these rate increases as proof that competitive markets do not work. They seem to forget that states that retain traditional cost-plus regulation also have experienced increases due to rising fuel prices: The Tennessee Valley Authority recently approved fuel-related rate increases of approximately 18% for its customers; Georgia Power and Savannah Power (subsidiaries of the Southern Company) received increases of approximately 10% and 14%, respectively; Nevada Power is seeking an increase of more than 10%; Progress Energy Florida received an increase of 12%; Xcel Energy Colorado is seeking an increase of approximately 20%; and Entergy Mississippi received increases of approximately 24 % over the past few months.

And although the price lag incorporated in cost-plus regulation softens the immediacy of fuel price increases, it does not negate the fact that consumers in regulated states are and will be paying higher prices as fuel prices rise. Moreover, if fuel prices fall, consumers in those states that have allowed retail competition will receive the benefits of falling fuel prices, while consumers in cost-plus regulated states will continue paying for fuel surcharges until regulators remove them.

Rate freezes and stabilization plans generally were embraced as transition mechanisms in some states that restructured their electricity markets during the mid-late 1990s, and consumers benefited as a result. The purpose was to provide consumers an immediate benefit as part of a restructuring plan. Meanwhile, the cost

of generation of fuel has increased for generators in all states¹ -- those that restructured and those that did not. There is simply no way to avoid this reality -- fuel costs, and, thus, the cost of producing and supplying electricity, have increased substantially.

In states that have had electricity rate freezes in place, consumers have been insulated from the true cost of producing and supplying electricity and thus generally unaware of the sharp increases in such costs over the past several years.² Not surprisingly, consumers are expressing considerable concern that their electricity bills will rise to take account of this reality. While the sharp increases are unfortunate, customers were not always fully attuned to past regulatory ratemaking processes and may not have understood the magnitude and value of the substantial rate discounts that had been afforded in the past.

As states move to lift these rate freezes, some are arguing for a return to old fashioned, heavy-handed, cost-plus utility regulation. These critics are willing to toss aside the many benefits of competition, and, thereby, eliminate price signals, customer choice, and tailored products and services for customers. They are willing to shift the risk of bad business or investment decisions away from investors and largely back to consumers, erode the large gains in generation efficiency that have been achieved, and eliminate opportunities for a robust demand response that would have a substantial price dampening effect. They also seem to be willing to forego the considerable environmental benefits that restructuring has brought about.

Others argue that the solution is to continue rate freezes or establish new rate stabilization plans to "protect" consumers, denying the utilities that must purchase power on their behalf the opportunity to recover their purchased power costs. This "solution" failed miserably in California and only exacerbated the problems, making the utilities non-creditworthy, discouraging demand response solutions, forcing PG&E into bankruptcy and the state into the power purchasing business, eating into the state budget surplus, and creating power shortages that caused rolling blackouts.

Re-regulation is not in the public interest. Policymakers should stay the course on competition and promote policies at the retail level that provide customers increased choices for electricity supply, now and in the long term.³ Policymakers should not move to implement policies that tie the hands of customers. This knee-jerk response will only lead us back to the "good old days" of stranded costs and poor investment and business decision making.

¹ Based on Bureau of Labor Statistics (Consumer Price Index) and the NYMEX, certain energy product prices increased considerably from 1999-2005; natural gas (approximately 80%); oil (about 140%), and coal (about 140%).

² For example, in the 1998-99 time frame the average energy price (load weighted LMP) in PJM was about \$25 MWh. It rose to about \$45 MWh in 2004-05, and further climbed to about \$70 MWh in January 2006. PJM State of the Market Report at 17 (March 2006).

³ "It's time to move to a competitive market for electricity. If politicians have a better idea of how to accomplish that, they should serve it up. But suggestions that the rate freeze stay in place--we're going on nine years, remember -- ignore the fact that the costs of producing energy, as the costs of virtually all products, continue to rise. Political leaders do consumers no favor by seeking to put a legal blockade on a market system. That will only put at risk the reliability of the supply of electricity to Illinois homes." *Power Struggle*, *Chicago Tribune*, September 14, 2005 (Editorial).