

## **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.<sup>1</sup>

## 2.0 Team Members

Doug Bantam – Lincoln Electric System

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## 3.0 Introduction

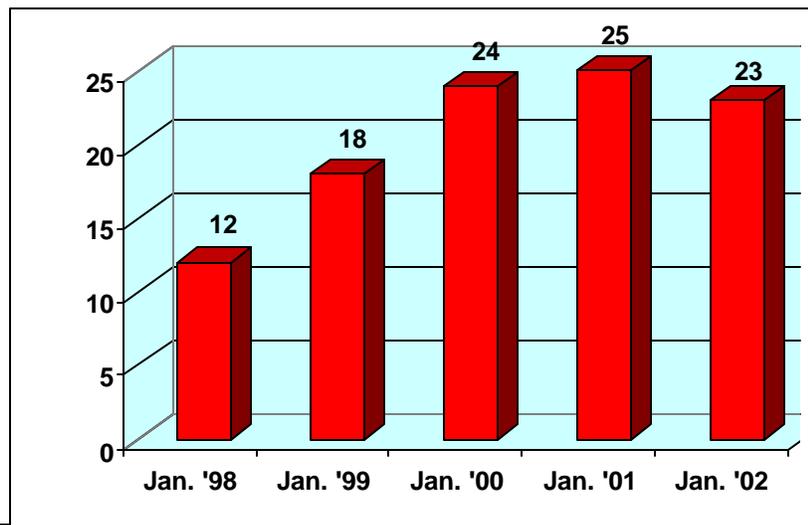
### 3.1 Deregulation Overview

Proponents of deregulation argue that competitive markets are more efficient than government regulated economic activities. Professor Willis Emmon's recent book on deregulation and privatization states: "Deregulation is a broad concept that encompasses easing or eliminating government restrictions in three major areas: a firm's freedom of entry into a market, its freedom of action within a market, and its profitability (maximum or minimum) within the market."<sup>2</sup> One of the biggest public policy challenges in achieving successful deregulation is the creation of truly competitive markets. The LR 455 Phase II Report, December 1999, analyzed the driving forces of retail electric deregulation and discussed the impacts of deregulating other industries in Nebraska such as airlines and telecommunications. See pp.8-16. As the Report clearly pointed out, in Nebraska "competitive markets" often bypass rural or sparsely populated areas, especially when the deregulating industry is capital intensive such as airlines, railroads, and telecommunications.

Skepticism about the consumer benefits of electric deregulation in Nebraska, along with Nebraska's competitive energy costs, were two key factors leading to the "condition certain" approach recommended in the LR 455 Phase II Report and adopted in LB 901 (2000).

Retail deregulation gained considerable popularity between the late 1990s and January 2001 with 25 state legislatures or regulatory agencies committing to various forms of retail customer choice. This trend reversed by January 2002 when only 23 states were considering such action. See Exhibit V-1.

**Exhibit V-1**  
**Number of States Moving to Implement Retail Competition**  
**5-Year Trend**



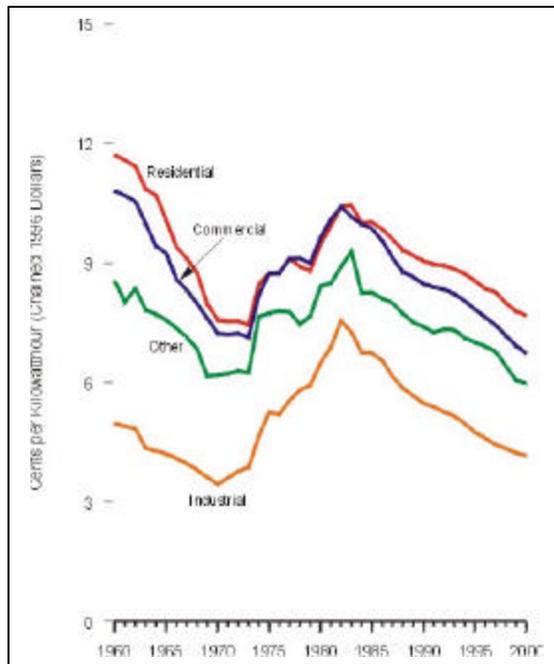
<sup>1</sup> This report reflects deregulation developments through August 20, 2002.

<sup>2</sup> Willis Emmons, *The Evolving Bargain*, "Strategic Implications of Deregulation and Privatization," 2000: p. 2.

However, developments which began during the summer of 2000 in California, Washington, Montana, New York and certain other states have created significant questions about the benefits of retail choice and have resulted in delays or repeals of retail choice in six states.

In inflation-adjusted terms, all sector prices for electricity fell steeply in the 1960s, reversed course around 1970 to rise sharply through the early 1980s, and then returned to a pattern of rapid decline. Over the decades, industrial consumers paid the lowest rates for electricity; residential customers usually paid the highest prices. By 2000, all sectors paid lower rates than they had in 1960. See Exhibit V-2.

**Exhibit V-2**  
**Retail Prices of Electricity by Sector**



#### 4.0 Status of Retail Competition in Selected States

“To be number one in the nation today isn’t saying very much with all the retail markets effectively closed.”<sup>3</sup>

In 2001 a number of state legislatures decided to re-think the merits of electricity retail competition. Within a six-month period, six states took legislative action to postpone the implementation of retail choice.

#### 4.1 Significant Legislative Actions Affecting the Implementation of Retail Choice

- Arkansas – Legislation was enacted in February 2001 to delay implementation of retail choice until October 2003 or later.
- Montana – Legislation enacted in May 2001 (HB 474) that delays until 2007 the date when consumers would be required to shop for alternative providers.
- Nevada – Legislation enacted in April 2001 repeals prior retail choice legislation and halts the sale of utility generation assets.
- New Mexico – Legislation signed in March 2001 to delay the implementation of retail choice until 2007.
- Oklahoma – Legislation enacted in May 2001 (SB 440) to repeal prior retail choice legislation. Task force created to study restructuring prior to further action.
- Oregon – Legislation enacted in July 2001 delaying the implementation of retail choice until March 2002.

<sup>3</sup> George Spencer, Publisher of *Restructuring Today* commenting on the relative “success” of Pennsylvania’s retail competition scheme. June 22, 2001.

A number of internet web sites contain comprehensive state-by-state summaries of the status of electric retail competition. The sites provide the status of restructuring legislation and regulation and details on the structure of the approach taken. However, because much of the recent regulatory and legislative activity on electricity restructuring has been to delay and/or repeal prior initiatives toward retail competition, none of these web sites was completely up to date as of the drafting of this report. Despite the many limitations of these sites regarding timeliness and accuracy, one can find useful information on the status of restructuring.

American Public Power Association

[www.appanet.org/legislativeregulatory/staterestructuring/index.cfm](http://www.appanet.org/legislativeregulatory/staterestructuring/index.cfm)

Edison Electric Institute

[www.eei.org/issues/comp\\_reg](http://www.eei.org/issues/comp_reg)

C.H. Guernsey & Company

[www.chguernsey-econ.com/restructuringlinks.html](http://www.chguernsey-econ.com/restructuringlinks.html)

National Association of Regulatory Utility Commissioners

[www.naruc.whatsup.net](http://www.naruc.whatsup.net)

National Rural Electric Cooperative Association

[www.nreca.org/leg\\_reg](http://www.nreca.org/leg_reg)

US Department of Energy (Energy Information Administration)

[www.eia.doe.gov/cneaf/electricity/chg\\_str/tab5rev.html](http://www.eia.doe.gov/cneaf/electricity/chg_str/tab5rev.html)

William Spratley Associates

[www.spratley.com](http://www.spratley.com)

The following pages contain a brief summary of the status and implementation of retail competition in several states. Some of these states have attempted a retail competition regimen for a number of years while others are just now beginning to implement retail competition legislation. It is important to understand that in no state was a vibrant competitive retail electricity market found. The dearth of competition is particularly pronounced in the residential sector. In the general case, the states that have “implemented” retail choice have done so on paper only with very few customers actually switching suppliers and very few suppliers actually marketing to customers. Pennsylvania was initially an exception, but has seen considerable decline in retail marketers.

On a national basis, average retail electricity prices have been trending downward since the mid-1980s due to improved power plant efficiencies and generally declining fuel costs, among other factors.

#### **4.1.1 Arizona**

Arizona is a classic example of how the implementation of retail competition initially produced a flurry of activity, which ultimately has reverted to the status quo. Pursuant to legislation enacted in 1998, the Arizona Corporation Commission promulgated regulations to implement retail choice. The legislation called for choice for all customers by December 31, 2000. Salt River Project, one of the largest public power electric utilities in the United States was included in the choice requirement with all customers eligible to choose by June 1, 2000.

Competitive suppliers are required to be certified by the Arizona Corporation Commission and a number of them completed the certification process. The retail choice legislation contained a number of important consumer safeguards. For example, the incumbent utility must be the supplier of last resort and serve all customers who did not exercise their option to switch. Pursuant to law, customer account information is deemed proprietary and cannot be released without the written consent of the customer. A customer cannot have his/her supplier switched without a written authorization and the law also contains prohibitions of certain abusive marketing practices.

Although the legal framework for retail competition is in place, there is virtually no retail competition in Arizona. None of the certified competitive suppliers are attempting to market to residential customers and the few

commercial and industrial customers that initially switched suppliers have now returned to the incumbent utility. The electricity crisis in California has had a chilling effect on consumer interest in retail competition in Arizona and many other states.

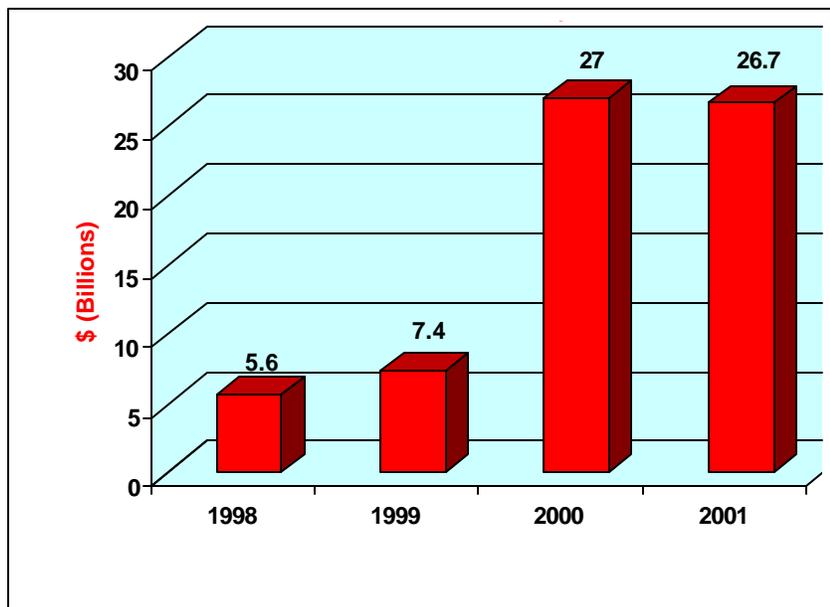
#### 4.1.2 California

The current negative reaction toward retail customer choice has been accelerated by California's flawed efforts to implement retail competition. California had electric rates among the highest in the nation when it passed retail choice legislation in 1996 (A.B. 1890). On September 26, 1996, California Governor Pete Wilson signed A.B. 1890 into law and ushered in one of the most expensive lessons in the annals of public policy making. The law which became effective in 1998 required the state's three major investor-owned utilities to participate, but allowed public power entities which comprise about 30% of California's market to opt out, which they all did. Over the course of the past year, politicians across the political spectrum at every level of government have been attempting to craft an exit strategy from what is widely regarded as an economic disaster for the state.

Under the California model, investor-owned electric utilities were required to divest their ownership in fossil-fueled generation assets and then to purchase power supply from the California Power Exchange. The price for supply was set by a day-ahead auction. In addition, electric utility transmission operations were transferred to a newly created independent system operator (ISO).

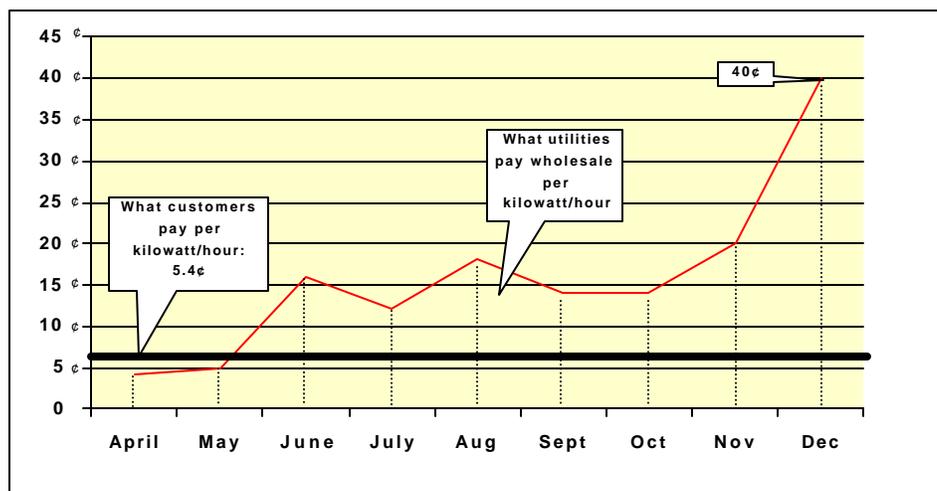
Initially, customers received a modest reduction from rates that were in effect during 1996. Retail rates were then fixed for a period of time while the utilities were allowed to collect transition charges to cover stranded investments. However, the utilities were forced to purchase power on the wholesale markets at auction prices and then sell at retail at fixed prices. The disconnect between the two prices became extreme during 2000 leaving the incumbent electric utilities billions of dollars short. See Exhibit V-3.

**Exhibit V-3**  
**Cost of Wholesale Electricity for California**



The state's largest investor-owned utility, Pacific Gas and Electric, is now in bankruptcy reorganization and the two other major electric companies are also seriously stressed financially. See Exhibit V-4. Retail rate increases exceeding 50% have been approved.

## Exhibit V-4 Pacific Gas & Electric 2000



The overwhelming number of customers who initially switched energy suppliers returned to the incumbent utilities during the peak of the wholesale energy-pricing crisis. See Exhibit V-5.

On March 21, 2002 the California PUC took the long anticipated step of suspending the direct access program effective back to September 20, 2001. At the time of the suspension, the California Department of Water Resources (DWR) was -- pursuant to legislative mandate -- purchasing electricity at wholesale on behalf of the customers of the three major California investor-owned utilities. In its order, the PUC reasoned that, "the suspension of the ability to acquire direct access service will provide DWR with a stable customer base from which to recover the cost of power it has purchased and continues to purchase."<sup>4</sup>

The order announced a remarkable shift in philosophy on the part of the PUC that had long championed the merits of customer choice and market efficiency. The order noted that customers will face high energy costs over the next few years and that, "Under these circumstances, customers might be tempted to switch from utility bundled service to electric service providers in order to avoid some of the impact of higher rates and take advantage of lower spot market prices. It is not in the public interest to permit such behavior."<sup>5</sup>

The order that was issued on a 3-2 vote was accompanied by a stinging dissent from PUC Commissioners Henry Duque and Richard Bilas who observed that, "Something else is going on here. We think that the DWR does not want direct access because if the public is presented with alternatives, it will make DWR's purchasing mistakes abundantly clear. Indeed, retaining direct access as a way to send price signals to consumers may be the only way to place pressure on DWR to make more prudent purchases."<sup>6</sup>

In February 2002, the California PUC filed what is known as a "Section 206" complaint with the Federal Energy Regulatory Commission (FERC) against certain sellers of long-term power contracts to the state. The Federal Power Act requires that the FERC ensure that all wholesale power contracts are "just and reasonable". The PUC's complaint alleges that a significant number of wholesale power contracts entered into by the state were at prices some \$21 billion in excess of what could be considered "just and reasonable" and that the state was forced to procure enormous amounts of electricity under conditions of extreme market power.

Recent disclosures in the Enron bankruptcy matter have given new ammunition to California's claims. Internal Enron memos discuss a variety of bogus energy trading strategies including artificially increasing the demand for transmission capacity that resulted in excess payments back to Enron. Senator Dianne Feinstein (D-CA) sent a letter to Attorney General John Ashcroft asking for a criminal investigation of Enron for actions she believes constitute

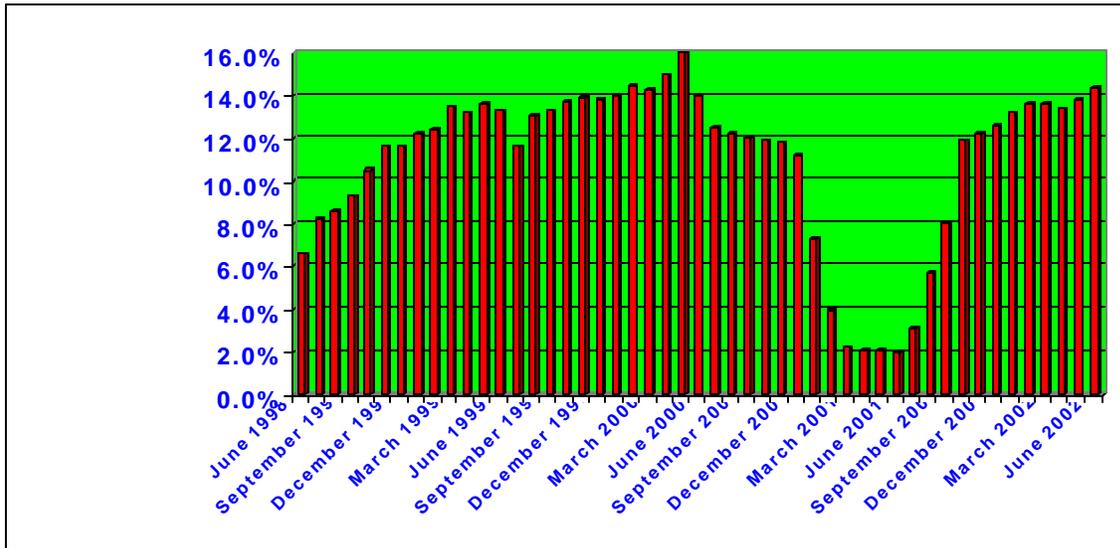
<sup>4</sup> Decision 01-09-060, September 20, 2001, page 4.

<sup>5</sup> IBID at page 6.

<sup>6</sup> IBID at page 15.

fraud. Senator Barbara Boxer (D-CA) pressed for Senate hearing on the matter and said that she hoped that Enron officials would "be sitting in a dark cell some day for what they did."<sup>7</sup>

**Exhibit V-5**  
**Direct Access Load as a Percentage of California Investor-  
 Owned Electric Utility Total kWh Load**



**4.1.3 Montana**

In April 1997, The Montana Electric Utility Industry Restructuring and Consumer Choice Act, (SB 390), was signed into law. In addition to addressing many policy issues related to electric industry restructuring, the Act required each major utility to file a transition plan with the Commission one year prior to the implementation of retail choice.

Montana Power Company's (MPC) transition plan was approved in July 1998, and their pilot program began in July 1999. PacifiCorp's transition plan was submitted in July 1997 and their pilot program started July 1998 for five of their large industrial customers. PacifiCorp's plan allowed residential customers to choose their retail supplier beginning January 1999.

Early experience with retail choice proved to be disappointing with very few customers switching suppliers. On October 27, 2000, the Montana PSC made the following observations in response to problems with Montana's retail deregulation:

- While market activity within some customer segments has been greater than in others, to date the percentage of all MPC customers who have moved to choice is less than 5/10ths of a percent.
- 23 of Montana's 25 rural electric cooperatives have opted not to restructure or offer retail choice. Only one competitive supplier is offering real alternative electricity supply products to MPC's residential and small business customers and that supplier recently informed its customers they will be returned to MPC service because market prices are above regulated, rate moratorium prices.
- The Northwest Power Planning Council suggests that the demand-supply imbalance contributing to higher wholesale prices will likely persist for several years.
- The Federal Energy Regulatory Commission has yet to fully implement its goal of open, independent, regional electricity transmission systems, which are prerequisites for workable wholesale and retail electricity supply markets.

<sup>7</sup> "California Officials Want Energy Refunds, Extension of Price Caps"; San Jose Mercury News; May 8, 2002.

- Given the current and projected wholesale market prices, it is unlikely that competitive suppliers will be able to offer electricity to the majority of MPC's retail customers at prices below rate-moratorium prices, which suggests it is very likely that electricity supply markets will not be workably competitive on July 1, 2002.

In May of 2001, HB 474 was signed into law, significantly altering the existing restructuring legislation, and extending the transition period to full retail choice until July 1, 2007. HB 474 allows customers being served by alternative suppliers to switch to the default supplier providing that the customer does not resell the electricity. The PSC is directed to adopt a mechanism to ensure the default supplier may fully recover electricity supply costs in rates.

In a May 14, 2002 article by PSC Commissioner Bob Rowe, the author notes that it was assumed that when the State of Montana restructured its power industry, almost all small customers would have chosen their own supplier by Summer 2002. In fact, Rowe states, "only a handful of residential customers have selected a competitive supplier and no competitive suppliers are actively marketing to them at this time."<sup>8</sup>

During 2001, the State's largest electric utility, Montana Power Company, was in a period of transition out of the electricity business and announced its intentions to sell off all energy related interests and re-focus the company into a telecommunications provider. The company's common stock, which was once highly favored on Wall Street, fell from \$60 per share in mid-2000 to less than \$3 per share in early 2002. In March 2002, the name "Montana Power" faded into history when the electric utility assets of the company were purchased by NorthWestern Energy Company based in South Dakota. The telecommunications assets were transformed into Touch America.

#### 4.1.4 Pennsylvania

Pennsylvania is often cited as the one state where retail competition exists in a meaningful way. The Electric Generation Customer Choice and Competition Act, was passed by the legislature in November 1996 and signed by the Governor on December 2, 1996. The bill required that retail access be phased-in over three periods starting in 1999. According to the Act, at least one third of the peak load of each customer class would be eligible for retail choice on January 1, 1999. In addition, the Commission interpreted the Act such that 66% of the peak load of each customer class would be eligible for retail choice by January 2, 1999, and 100% by January 2, 2000.

The Pennsylvania Office of Consumer Advocate offers the data set forth below on the percentage of customers who have switched from the incumbent suppliers as of April of 1999, 2000, 2001, and 2002. While the percentage of customers who have switched appears impressive in comparison to the lack of switching elsewhere in the country, it is clear that of the seven Pennsylvania markets, retail competition is occurring in a meaningful way in only two markets. Indeed in the other five markets, the percentage of customers who have switched has generally been less today than it was three years ago. See Exhibit V-6.

### Exhibit V-6

Percentage Switched As of April 1999

	Residential	Commercial	Industrial	Total
Allegheny Power	1.4	4.8	35.4	1.8
Duquesne Light	13.1	12.1	13.4	13.0
GPU Energy	3.8	13.0	28.4	5.0
PECO Energy	12.8	21.87	55.87	13.78
Penn Power	6.2	6.8	28.1	6.3
PPL	2.0	10.2	9.4	3.0
UGI	4.3	1.7	0	3.8

<sup>8</sup> "Public Service Commission Considers 'Default Supply Portfolio' ", Bob Rowe, May 14, 2002

**Percentage Switched As of April 2000**

	<b>Residential</b>	<b>Commercial</b>	<b>Industrial</b>	<b>Total</b>
<b>Allegheny Power</b>	<b>1.1</b>	<b>6.2</b>	<b>23.6</b>	<b>1.8</b>
<b>Duquesne Light</b>	<b>25.5</b>	<b>16.7</b>	<b>16.4</b>	<b>24.6</b>
<b>GPU Energy</b>	<b>4.99</b>	<b>15.02</b>	<b>32.04</b>	<b>6.31</b>
<b>PECO Energy</b>	<b>15.26</b>	<b>29.73</b>	<b>62.34</b>	<b>16.78</b>
<b>Penn Power</b>	<b>6.3</b>	<b>10.7</b>	<b>34.7</b>	<b>6.8</b>
<b>PPL</b>	<b>2.4</b>	<b>14.5</b>	<b>11.8</b>	<b>3.9</b>
<b>UGI</b>	<b>3.9</b>	<b>1.7</b>	<b>0</b>	<b>3.6</b>

**Percentage Switched As of April 2001**

	<b>Residential</b>	<b>Commercial</b>	<b>Industrial</b>	<b>Total</b>
<b>Allegheny Power</b>	<b>0.40</b>	<b>1.60</b>	<b>8.70</b>	<b>0.50</b>
<b>Duquesne Light</b>	<b>33.40</b>	<b>13.90</b>	<b>17.30</b>	<b>31.40</b>
<b>GPU Energy</b>	<b>3.90</b>	<b>8.30</b>	<b>13.30</b>	<b>4.50</b>
<b>PECO Energy</b>	<b>34.10</b>	<b>27.50</b>	<b>32.80</b>	<b>33.50</b>
<b>Penn Power</b>	<b>6.30</b>	<b>6.70</b>	<b>19.60</b>	<b>6.30</b>
<b>PPL</b>	<b>1.60</b>	<b>10.30</b>	<b>5.80</b>	<b>2.60</b>
<b>UGI</b>	<b>3.10</b>	<b>1.00</b>	<b>0</b>	<b>2.90</b>

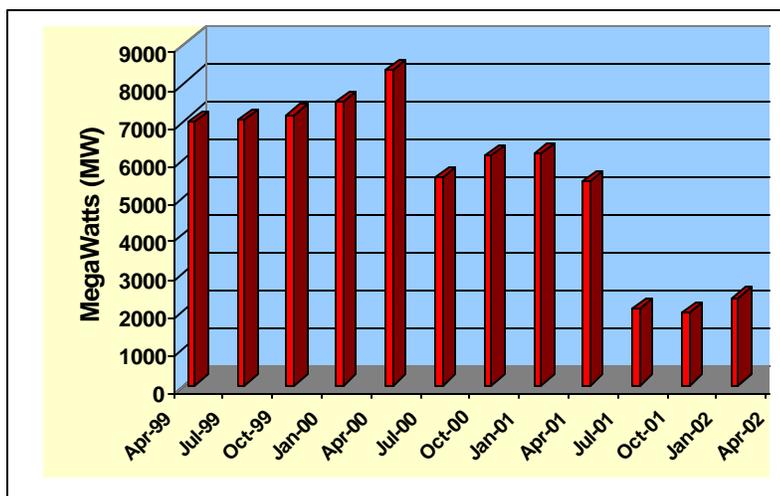
**Percentage Switched As of April 2002**

	<b>Residential</b>	<b>Commercial</b>	<b>Industrial</b>	<b>Total</b>
<b>Allegheny Power</b>	<b>0.2</b>	<b>.1</b>	<b>0.0</b>	<b>0.2</b>
<b>Duquesne Light</b>	<b>29.5</b>	<b>17.90</b>	<b>23.5</b>	<b>28.3</b>
<b>GPU Energy</b>	<b>0.4</b>	<b>.30</b>	<b>1.4</b>	<b>0.4</b>
<b>PECO Energy</b>	<b>25.4</b>	<b>5.80</b>	<b>2.3</b>	<b>23.4</b>
<b>Penn Power</b>	<b>1.0</b>	<b>0.4</b>	<b>2.6</b>	<b>0.9</b>
<b>PPL</b>	<b>0.2</b>	<b>1.4</b>	<b>1.6</b>	<b>0.3</b>
<b>UGI</b>	<b>0.2</b>	<b>0.3</b>	<b>0</b>	<b>0.2</b>

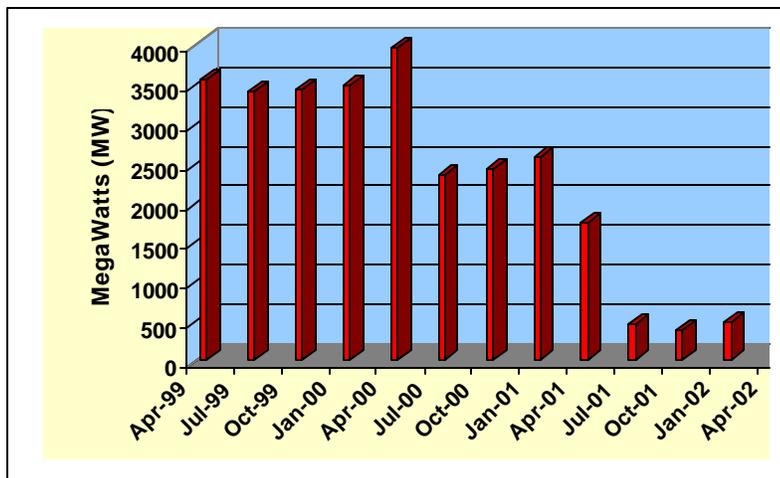
Another measure of the deterioration of retail choice in Pennsylvania can be seen in the following two graphs that show the number of megawatts of energy sold by competitive providers. Exhibit V-7 shows the energy sold by competitive providers to all customers and Exhibit V-8 shows the quantity of energy sold by competitive providers to industrial customers. In both instances, the more recent sales are considerably below that of three years ago.

According to statistics published by the Energy Association of Pennsylvania, the state generates well over 33,000 megawatts of energy per year -- about 5% of the total US capacity. Pennsylvania is second only to Texas in the amount of electric energy generated. Thus, as shown in the graphs, the quantity of energy sold by competitive providers is not a substantial factor in the total state market.

**Exhibit V-7**  
**Total Customer Load (MW) Served by Alternative Suppliers in Pennsylvania**



**Exhibit V-8**  
**Total Industrial Load (MW) Served by Alternative Suppliers in Pennsylvania**



Pennsylvania's retail market is also experiencing other difficulties. In December 2001, the Pennsylvania Office of Consumer Advocate announced that about 800 former customers of "Utility.com" would be receiving approximately \$50,000 in refunds. Refunds of about \$70,000 had previously been distributed to 1,000 former "Utility.com" customers. "Utility.com" was an electric generation supplier located in Eneerlyville California that did business primarily over the internet until it abruptly stopped serving customers and went out of business.

Pennsylvania, like many jurisdictions, has experienced some initial reduction in retail electric rates. However, rates have recently been increasing.

#### **4.1.5 New York**

The State of New York took a different path to implement retail competition. They accomplished the matter via regulatory ruling rather than through legislation. New York has phased in retail choice by way of a series of settlements with the individual investor-owned utilities in the state with choice for all customers as of July 1, 2001.

The New York Times recently reported on June 1, 2001, that the rates for Consolidated Edison Company, “the highest in the continental United States before deregulation, have risen significantly, up almost 40 percent from two years ago. Just yesterday, the managers of the state’s power grid predicted that peak summer rates could rise an additional 22 percent by 2003. The energy plan that President Bush issued last month lumps New York with California among the states with the nation’s most severe energy supply problems. A host of critics, from former commission staffers to business lobbyists to consumer advocates, say that deregulation in New York has gone awry.”

To date, there is little evidence of much customer switching particularly among residential and small commercial customers.

#### **4.1.6 Connecticut**

Pursuant to legislation enacted in April 1998, retail choice started in Connecticut in July 2000. Customers who choose the standard offer rates will get bill reductions of at least 10% below the rates in effect on December 31, 1996. A “systems benefits charge” is incorporated into the distribution charge collected by the incumbent utilities covering consumer education, dislocated utility worker programs, low income energy conservation, nuclear decommissioning, and funds for the development of renewable energy resources.

Incumbent utility companies were entitled to stranded cost recovery provided they divested themselves of non-nuclear generating assets by January 1, 2000. Divestiture did occur and stranded costs are now being recovered through a securitization process.

All electric suppliers must disclose their generation mix that must include a minimum of supply from renewable resources. This minimum increases over time.

Customers can change suppliers once every 12 months without charge or more often with a switching charge imposed. The retail choice rules also provide for anti-slamming provisions.

Although retail choice has technically been in effect since July 2000, the concept remains more theory than reality as most suppliers have shown little interest in the Connecticut market.

#### **4.1.7 New Hampshire**

In May 1996, pursuant to state legislation, New Hampshire launched a retail competition pilot program in anticipation of statewide retail competition. Nearly three dozen marketers entered the pilot and spent millions vying for 3% of the state’s customers. Cash incentives, bird feeders, and free evergreen trees were given away in an effort to win customers. One by one the marketers withdrew from the pilot. Enron, pulled out of the pilot after spending millions to attract 770 residential customers in the City of Peterborough.<sup>9</sup> As they withdrew, Enron explained, “It doesn’t make economic sense for us to hang on to our (new) customers.”

The state’s largest electric utility, Public Service Company of New Hampshire, then filed a legal challenge against the implementation of statewide retail competition claiming that the program would impair the firm’s financial viability. The case lingered for several years in State and Federal courts until September 2000 when a final settlement was reached between the company and the public utility commission providing for certain rate reductions and the implementation of retail competition.

Further legal complications ensued but have now been resolved. Retail competition was scheduled to begin in April 2001. Then the state legislature intervened and delayed the start until 2004.

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<sup>9</sup> “Enron Pulls Out of New Hampshire Retail Pilot,” Megawatt Daily, September 22, 1998.

#### **4.1.8 Vermont**

The Vermont electric “market” operates with traditional rate base rate-of-return regulation. The Public Service Board entered an order on January 14, 2000 to investigate “the establishment of specific retail access policies and procedures that would be applicable to the companies should they voluntarily open their service territories to retail choice.” This docket builds on earlier (1999) filings of the companies that outlines proposals to restructure the industry in Vermont. In February of 2002, the Vermont Public Service Board halted its investigation into retail competition stating that significant changes and uncertainty in the wholesale market for electricity make conditions inappropriate for the implementation of retail choice in Vermont for a few years.

Various legislative proposals in Vermont have not mandated the implementation of retail choice.

In October 2000, the State held a conference to publicly air issues associated with retail competition. The conference featured case studies of retail competition schemes in California, Pennsylvania and Massachusetts.

#### **4.1.9 Maine**

The Maine legislature enacted a law in May 1997 providing that retail competition would commence in March 2000. Unbundled bills were provided to customers starting in 1999 and divestiture of generation assets was required by March 2000. The law requires that all supplies include a 30% renewable resource portfolio (inclusive of hydro). In 1999, the Maine legislature appropriated \$1.6 million for a consumer education program.

Rising oil and natural gas prices are driving up the cost of electricity for industrial and large commercial customers while small business and residential customers are currently protected from higher prices under a two-year freeze. Trade press reports indicate that there has been very little residential customer switching in Maine thus far. A significant percentage of industrial customers have switched.

#### **4.1.10 Rhode Island**

Pursuant to state legislation, Rhode Island implemented retail choice effective July 1, 1997 for large industrial customers and July 1, 1998 for all customers. The state often boasts that it was the first to offer retail choice for its customers. Narragansett Electric Company had significant stranded costs that are being spread over a 12-year transition period through a customer surcharge. Demand-side management and renewable resource programs are being funded via a second surcharge.

From all accounts, retail choice in Rhode Island has been a failure. The only company competing for residential customers, Sunshine Energy (a subsidiary of FP&L Energy Services) withdrew from the market well over 2 years ago.

When retail choice was first offered, a number of large industrial customers banded together in a group known as The Energy Council of Rhode Island. These customers abandoned the incumbent utility and signed on with competitor Select Energy of Connecticut. When the one-year contract expired, Select Energy declined to renew it and the customers were forced to return to the incumbent (Narragansett). Narragansett agreed to take back the customers but only at a rate known as the “last resort rate” which is in excess of the standard offer rate being charged to all other industrial customers.

Rhode Island PUC member Kate Racine was quoted as saying that, “I think we are being very fair in allowing them back on at these rates” to which the industrial group responded, “The pioneers are getting punished in Rhode Island. It will be quite a while before we will see anyone leaving the standard offer.”<sup>10</sup>

#### **4.1.11 Massachusetts**

On March 1, 1998, the state of Massachusetts implemented what was described as the nation’s most progressive reform of traditional regulation of the electric utility industry. The plan called for immediate full retail choice for all customers and a 10% reduction in residential rates to be followed in September 1999 with an additional 5%

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<sup>10</sup> “R.I. Industrials Run From Restructuring,” Electricity Daily, June 23, 2000.

reduction. The plan provided for recovery of “prudently incurred” utility stranded costs and included special charges for public benefit programs including energy efficiency and development of renewable energy resources. When the largest power marketers shunned the residential market and other features of the new deregulation law came under closer scrutiny, a ballot initiative campaign was launched in an effort to repeal the new law. The utilities in the state raised and spent about \$8.5 million for the campaign and successfully defeated the measure.

As in virtually all states with retail choice programs, public power entities in Massachusetts were exempt from the retail choice mandate provided that they did not provide retail service outside their service territories.

By year-end 2000, regulators in Massachusetts approved significant rate increases for all customers receiving service under so-called “standard-offer” service. Provisions in the state’s retail choice law allow utilities to pass along to customers the costs associated with unusual fluctuations in the energy markets.

By most accounts, retail choice in Massachusetts exists on paper only with few customers or alternative power suppliers participating.

## **5.0 Recent Adopters of Retail Choice**

### **5.1 Ohio**

Pursuant to legislation enacted in 1999, Ohio commenced retail choice as of January 1, 2001. Industry newsletter, *Restructuring Today*, noted on May 17, 2001, that “not much is happening”. The newsletter interviewed Cinergy chief executive officer James Rogers who speculated that it would be years before a truly competitive market emerges, “because people for 50 years have been buying from their local utility.”

In late 2000, MidAmerican Energy became the first company to become registered as a certified competitive supplier in the Cincinnati Gas and Electric territory in southwest Ohio. A MidAmerican Energy press release dated November 27, 2000, stated that, “MidAmerican will compete in Ohio not only on price, but also on the basis of exceptional customer service.” MidAmerican established an office in Beachwood, Ohio and is currently contacting customers throughout the state. Little is publicly known about the success of this venture.

The web site of the Ohio Public Utility Commission provides a link to a study conducted by the Center for Research and Public Policy. The study summarizes a survey conducted during April-June 2000 that finds that...

- ❖ 38.2% of residential consumers and 53.8% of business consumers report hearing or reading about electric competition in Ohio.
- ❖ Utilities in Ohio receive positive ratings among residential and business consumers on "reliable service" -- 89.1% and 83.6% respectively.
- ❖ Large majorities of residential and business consumers (86.3% and 85.4% respectively) report having great or some confidence that service will continue uninterrupted in a new, competitive market. Still nearly 10% of each market segment has little or no confidence that service will continue uninterrupted.
- ❖ "Lower price" was perceived by both residential consumers (74.2%) and business consumers (76.0%) as the leading advantage to competition.
- ❖ The leading disadvantages to competition among residential consumers were slamming, marketing calls, higher prices, and lower reliability levels.

### **5.2 Illinois**

Pursuant to legislation enacted in 1997, Illinois has begun to transition to customer choice. As of December 31, 2000 all non-residential customers have the option to select their energy supplier. Residential customers were given the retail choice option as of May 1, 2002.

Because customer choice is so new in the state, there is little data to show how the law is working. However, the law requires the Illinois Commerce Commission to file an annual report to the legislature on the implementation of retail choice and the most recent report filed in April 2002 offers some sobering views on how retail choice is faring to date.

Below are a few key excerpts from that report:

The trends in the rate of customer switching and other quantitative measures of retail activity that were apparent in 2000 largely continued into 2001. The Commission continues to find signs of retail electric market growth in the service territories of the three largest utilities in the state. In the Commonwealth Edison (“ComEd”) service territory, a relatively large and growing number of customers have switched from ComEd’s basic bundled service to delivery services, continuing a growth pattern that began as soon as the market opened to electric customers in October 1999. By the end of 2001, over 18,000 ComEd customers had switched either to alternative supplier or to the Power Purchase Option (“PPO”), a market-based service that is available only to the customers of the utilities that assess transition charges. Customer switching is nearing or has surpassed the 1,000 customer mark in the service territories of AmerenCIPS and Illinois Power, the two other utilities that charge transition fees and thus offer the PPO as an alternative to bundled service.

However, customer switching is still negligible or non-existent in the service territories of the state’s smaller utilities. After two and one-half years of the availability of delivery services, there are few signs that customers in those service areas will have supply options other than the bundled service offering provided by the utilities when the restructuring law was enacted in late 1997.

The Commission explained in its 2001 report that growth in the retail market is dependent on the competitiveness of the wholesale market. There are indications, however, that the wholesale market is not yet capable of supporting a competitive retail market. One sign of a lack of a vibrant wholesale market is that about half of the power supplied to delivery services customers is being sold to suppliers by the incumbent utilities through the PPO rather than by independent producers. There are few signs at present that this situation will change in the near future.

While 18 suppliers are entitled to sell power and energy, only nine suppliers were active in 2001 (that is, actually made electricity sales). With one exception, each of these suppliers is either an Illinois utility or an affiliate of an Illinois gas and/or electric utility.

The Commission expects a slow start for the opening of the residential market in most areas of the State. One measure of the interest level among suppliers towards the residential market is the number of residential ARES applications. As of April 1, the Commission has not received any applications for certification to serve residential customers. However, as the Commission has received informal interest about certification requirements, including several suppliers not currently serving in the Illinois market, the Commission is hopeful that applications will be forthcoming in the near future.

To date, the restructuring law has provided significant consumer benefits through mandated reductions in residential bundled rates and a commercial and industrial customer rate freeze. In addition, some customers have been able to achieve savings by switching to delivery services, obtaining their electric supply either from the PPO or from Retail Electric Suppliers. While these are tangible benefits of the restructuring law, the rate freeze and mandated rate reductions end on January 1, 2005. The energy component of bundled service rates, as well as the price of energy to delivery services customers, will then be determined by the potentially volatile electricity wholesale market.

The development of robust wholesale competition would clearly be the ideal solution to the potential problems ahead. However, there is no guarantee that robust wholesale competition will develop in Illinois by January 2005. Unreasonably high wholesale electricity prices, attributable to the market power of sellers, may prevail as long-term contracts expire.

### 5.3 Texas

Legislation was enacted in 1999 to begin the process. Under the new law, the Texas PUC will begin 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 begins for all customers at which time retail rates are reduced by 6%.

Following are the key provisions of the new law:

- Freezes 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 percent 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 and property tax losses for affected school districts.
- Provides for automatic enrollment of qualified low-income families in low-income assistance programs.
- Prohibits disconnection of service for nonpayment during periods of extreme weather.
- Allows 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 service 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.

Texas has noted it is considerably different than California in its approach to retail deregulation. Generation capacity has been expanded within the state, so it does not rely on imports of electricity. With an expected peak demand of 67,000 megawatts, statewide capacity this summer is at 83,000 MW which provides a 24 percent reserve margin according to a June 20, 2001, news release from the Public Utility Commission of Texas. However, transmission investment has not kept up with generation expansion. Also, more than 45 percent of the generation is gas fired, leading to some concerns about future volatility in gas prices.

The jury is still out on the State of Texas Electrical Deregulation. After a brief pilot program last summer to test the waters nearly the entire state of Texas was struck with electrical deregulation on January 1<sup>st</sup> of this year and a 6.5% decrease in rates. Little detail on the actual numbers of customers switching providers have been provided in the articles reviewed. TXU does indicate they have done minimal switching. Most of the articles searched on the internet were written prior to the January 1<sup>st</sup> deregulation date and were speculative in nature.

Deregulation of retail sales of electricity in southeast Texas will be delayed until 2003 due to the lack of a regional transmission organization (RTO). Investor utilities serving southeast Texas did not draw competition during the pilot program. With an RTO there are hopes to get out-of-state competitors to ship electricity into southeast Texas. Also in northwestern and southwestern Texas, deregulation has also been delayed because those areas are not ready (no information was given as to why).

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 will remain in place until 2005 or until 40% of customers switch to another retail company.

#### **Uninterested Consumers/Program Glitches**

Despite aggressive promotional campaigns (billboards, TV, radio ads, direct mail), the average Texas consumer still isn't convinced there is much value in switching providers. Interest is not much higher among commercial and industrial companies. Household surveys taken show that a large majority indicates no plans to switch. The tough

sell for electrical deregulation for some can be traced to past telephone deregulation which left some homeowners without phone service for a week or more. For the fear of blackouts some did not participate in the pilot deregulation program, with only 39% of those eligible households participating.

Startup delays, lag (sometimes months) in switching customers to new providers, and computer problems at the Electric Reliability Council of Texas (ERCOT) in the pilot program have contributed to this consumer reluctance to switch providers. Also some major providers in the pilot program have since left the market. There have been comparisons drawn to the deregulation of the telephone market of past which showed a pattern of initial competition, followed by reduced prices, higher levels of innovation and subsequent market consolidation.

The aftermath of the California troubles and bankruptcy of Enron Corporation have also cast a shadow over deregulation. Recent disclosures of trading irregularities at Dynegy and Reliant have also created further doubts in consumers' minds.

The real battleground for incumbent utilities appears to be large industrial and commercial accounts. It appears that a monopolistic or duopolistic market scenario will be maintained for consumer accounts over the near term and a more fragmented market will emerge for commercial and industrial accounts.

### **Positive Comments**

On the positive side in contrast to California, Texas has plenty of power plants to supply power. Texas deregulation law also allows incumbent utilities to raise rates twice a year when natural gas rates change, shielding them from bankruptcy when power prices skyrocket. ERCOT's chief executive officer, Tom Noel, expects to be tinkering on the system for several years to fine-tune the final product. Texas PUC say they are encouraged and the market is in a transition phase. The head of TXU, chairman Erle Nye, still supports deregulation and predicts it will benefit Texas through lower electric rates and better service. He continues to say he is disappointed with the snags that are occurring and the trial pilot program should have been given more time and also deregulation phased in more slowly.

### **Continued Unrest**

Recently there have been calls by a member of the state legislative committee overseeing deregulation for the resignation of ERCOT's Tom Noel, for technical difficulties that continue to dog Texas deregulation. TXU recently announced that as many as 150,000 customers have gone without bills for several months and many municipalities report hundreds of thousands in lost savings because of billing problems.

ERCOT Chairman Jack Hawks recently stepped down because he does not have the confidence of all key constituents due to criticism from state legislators and others for failing to quickly correct customer switching and other problems.

On June 18, impatient state lawmakers gave notice they were losing patience and prepared to start fixing persistent problems in the state's deregulated market. They further ordered the PUC to step in and supervise election of a new ERCOT Stakeholders board.

Until the switching process is smoothed out consumers will continue to resist deregulation as they see no positive value in changing providers. Only time will tell the complete story.

## **6.0 Reconsideration of Retail Choice**

### **6.1 Nevada**

In 1997 the Nevada legislature enacted legislation calling for the implementation of retail choice. Additional legislation was enacted in 1999 delaying the onset of such competition until March 1, 2000 unless a determination was made that a later date was necessary to protect the public interest.

In 2001, Assembly Bill No. 369 was enacted that effectively repealed the implementation of retail choice. The preamble of the repeal legislation provides insight into the view of the state legislature on this question. Here are some excerpts from the preamble of the repeal legislation.

Several of the major industries in this state are particularly dependent upon electricity. Under present market conditions in the electric industry, comprehensive and effective regulation of electric utilities in this state is vital to the economy of this state and is essential to protect the health, safety and welfare of the residents of this state. Until present market conditions have changed and adequate mechanisms have been developed to allow this state to adjust its comprehensive regulation of electric utilities in Nevada, this state has a compelling interest in continuing its comprehensive regulation of electric utilities to protect the consumers in this state, to safeguard the economy of this state and to ensure that the electric utilities in this state provide adequate and reliable electric service at just and reasonable prices.

In recent years, the western United States has experienced a severe and ongoing crisis in the electric industry marked by critical shortages in the supply of electricity and extreme volatility in the price of electricity in the wholesale and retail markets. The severe and ongoing crisis in the electric industry in the western United States is both an immediate threat and a continuing danger to the economy of this state and to the health, safety and welfare of the residents of this state.

Until the severe and ongoing crisis in the electric industry in the western United States has sufficiently abated, this state must maintain its comprehensive regulation over electric utilities and its traditionally broad jurisdiction and control over electric generation assets to promote stability and predictability in the electric industry, to foster confidence in the financial markets, to ensure that consumers have adequate and reliable electric service and to protect the public from unjust and unreasonable utility rates.

## **6.2 Arkansas**

The Arkansas General Assembly enacted retail choice legislation in 1999 and amended it during the 2001 session. The amended bill postpones the start of retail competition in Arkansas from Jan. 1, 2002, until at least October 2003 and no later than October 2005. Spurred by concerns over deregulation issues in California, the Arkansas Public Service Commission (APSC) called a collaborative meeting in October 2000 of staff, investor-owned utilities, electric co-operatives, the attorney general, municipalities and industrial customers to examine the future of retail open access. The amended legislation was the final result.

Below is an overview of the key provisions of Arkansas' amended restructuring plan.

### **6.2.1 Customer Choice**

- Retail competition may begin as soon as Oct. 1, 2003 or it may be delayed by the APSC in one-year increments until Oct. 1, 2005.
- Investor-owned utilities and retail electric co-ops will participate in retail open access. Municipally owned utilities may opt in, but must open their markets to competition if they choose to do so.
- Customers who do not affirmatively choose an alternate supplier will stay with the utility's affiliated energy service supplier (ESP).

In December 2001 the Arkansas Public Service Commission provided a report to the legislature recommending either repeal of the Electric Consumer Choice Act of 1999, or a delay in the start of retail competition until 2012. The Commission estimated that retail competition could result in rate hikes of up to 13%. The legislature will consider this recommendation when it next meets in 2003.

### **6.2.2 Customer Protections/Reliability**

- The Arkansas PSC is working with various stakeholder groups to adopt consumer protection rules on a range of consumer issues.
- The Arkansas PSC will license and register suppliers.

### **6.2.3 Rate Freeze**

- Incumbent utilities have an obligation to provide default service, at frozen rates for a set time period.

## **6.2.4 Market Structure/Market Power**

- Act 1556 requires functional unbundling of generation, transmission and distribution/customer service business activities.
- All utilities and affiliate ESPs were required to file a market power study no later than January 2001. Accordingly, Southwestern Electric Power Company (AEP-SWEPCO) filed its market power study in November 2000. Pending analysis of these reports, the following may be required:
  - price caps.
  - asset separation.
  - auctioning of default customers and
  - as a last resort, divestiture of power plants.
- Companies must file a code of conduct with the APSC that is consistent with the Arkansas affiliate rules to prevent utilities from unfairly favoring their affiliates or harming competitors.

## **6.2.5 Stranded Cost Recovery**

- Stranded costs may be recovered, but in order to do so, utilities must use all reasonable mitigation measures.

## **6.2.6 Other Key Provisions**

- Bill production and issuance, credit and collections and call center functions related to bill production and issuance and credit and collections have been deemed competitive services.
- Utilities may recover all reasonable costs directly incurred by the transition to competition for three years following the start of retail competition. Default service rates cannot be increased to recover transition costs.

## **6.3 Oklahoma**

Under the state's 1997 law, retail access was scheduled to begin on July 1, 2002, pending passage of a more detailed restructuring implementation law. A restructuring implementation bill failed in the 2000 legislature and higher energy prices in the region and broad public awareness of the California energy situation made passage of implementation legislation a political impossibility for now. In the 2001 session of the legislature, a bill was enacted (SB 440) and has now been signed by Governor Keating which contains the following primary features:

- To delay implementation of retail competition until restructuring can be studied further,
- To require passage of enabling legislation to restart restructuring,
- To establish a study group to examine the state's transmission infrastructure and restructuring and
- To create tax credits to subsidize electricity produced by new renewable resources.

The legislation, as an emergency bill, became effective immediately upon its June 4 enactment.

### **6.3.1 Conditions for Starting Retail Competition**

While the measure does not specify a date when retail competition may be implemented, it does set general milestones that must be passed before retail competition can begin. Retail access can not be implemented in Oklahoma until:

1. The final report of the Advisory Committee is completed, which must be done by Dec. 31, 2002; and
2. "Electric restructuring enabling legislation is adopted by the Legislature and signed by the Governor."

Reauthorizing restructuring probably would be required even though SB 440 does not revoke any restructuring-related provisions of the 1997 law except the July 1, 2002, start date.

### **6.3.2 Restructuring Advisory Committee**

The law directs the Electric Restructuring Advisory Committee to:

- Study the current status of the state's electric transmission system as well as the study conducted by the Southwest Power Pool to identify potential points of congestion and suggested future transmission expansion including their financial impacts;
- Examine the electric issues report submitted to the legislature on Oct. 1, 1999;
- Analyze the operational characteristics and control systems of the current electric industry transmission infrastructure in the state;

- Solicit comments from consumers;
- Review any proposed federal legislation that may affect the state's electric industry;
- Examine how to encourage further development of "zero-emission electric generation facilities";
- Identify "management and control practices adopted by other states" for implementing restructuring and recommend those practices that may be of public benefit in Oklahoma; and
- Identify any other issues "relevant and necessary for the Advisory Committee to carry out its duties."

The nine member Advisory Committee will be in place until January 2005, unless terminated earlier by a majority of its members.

The interim report on transmission issues must be completed by Dec. 31, 2001. The final restructuring report must be adopted by a majority of the committee and be delivered to the governor and the legislative leadership by Dec. 31, 2002.

### **6.3.3 Renewables Tax Credit**

SB 440 establishes a new tax credit for tax years beginning on or after January 1, 2002, to offset the tax liability for a taxpayer's production and sale of electricity generated by eligible zero-emission facilities in the state. Eligible generation is a new renewable resource with a production capacity of 50 megawatts or larger using wind, moving water, sun or geothermal energy, and which resource is placed in operation after the effective date of SB 440. The credit is applied as a subsidy over 10 years on a declining scale.

### **6.4 Florida**

In November of 2001, Governor Jeb Bush's 2020 Study Commission issued a final report calling for the state to transition to a competitive wholesale electric market. However, the Commission recommended that the retail electric market remain regulated.

### **6.5 Louisiana**

The Louisiana Public Service Commission issued an order in December of 2001 that reaffirmed their earlier conclusions that retail competition in Louisiana, which is a low cost state, would not be in the public interest for any class of retail customer.<sup>11</sup> The Commission stated it's responsibility was to ensure ratepayers receive electric service at the lowest reasonable cost and that "retail competition in the electric industry has not achieved the success predicted by its proponents in any state where it has been implemented...".

The Commission began its study of retail competition in 1995. In 1997, the Commission's staff issued a report stating that retail competition might be in the public interest, depending on a number of factors and further studies. Upon further study, in 1999 the Commission staff concluded that retail competition was not in the public interest at that time. They stated it was unlikely to result in lower electric rates for Louisiana consumers. However, the Commission directed their staff to prepare a comprehensive plan for a transition to competition. In January of 2001 the staff submitted their plan for competition under which only industrial customers with average loads greater than 5 MW would be able to choose alternative suppliers. In its order of December 4, 2001 declining to pursue retail competition, the Commission directed staff to continue to monitor retail competition in neighboring states like Texas and developments at the federal level and report back annually.

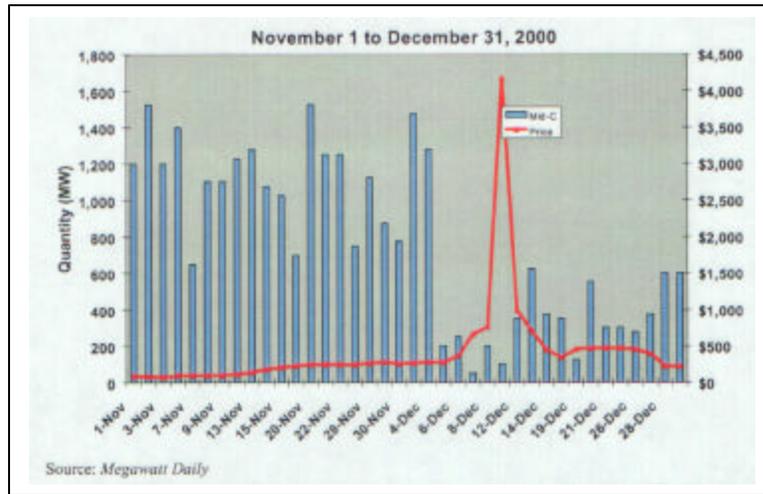
## **7.0 Regional Impacts**

The crisis in California affected the price of wholesale energy throughout the entire western grid that includes California, Oregon, Washington, Montana, Nevada, Idaho, Utah, Colorado, Wyoming, New Mexico, and Arizona (a small portion of far western Nebraska is also in the western grid). Volatile wholesale electric markets resulting, in part, from poorly implemented retail deregulation can have tremendous impacts on the price of electricity in states that have formally rejected retail choice. For example in Washington, which has not implemented retail choice, prices briefly reached several thousand dollars per megawatt-hour (MWH) in the wholesale market in December 2000 [see Exhibit V-9] and were averaging approximately \$300/MWH through the first five months of 2001.

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<sup>11</sup> Louisiana Public Service Commission, *in Re: Analysis of Competitive Implications, Ex Parte*; Docket Nos. U-21453, U-20925 (SC), U-22092 (SC) - (Sub-docket A) - B, (December 4, 2001).

**Exhibit V-9**  
**Price and Quantity at Mid Columbia Day-Ahead On-Peak Power**



For a comparison to 1990's prices, see Exhibit V-10.

**Exhibit V-10**  
**Average Cost of Power Purchases by Utilities 1990-1999**  
**(\$/MWH)**

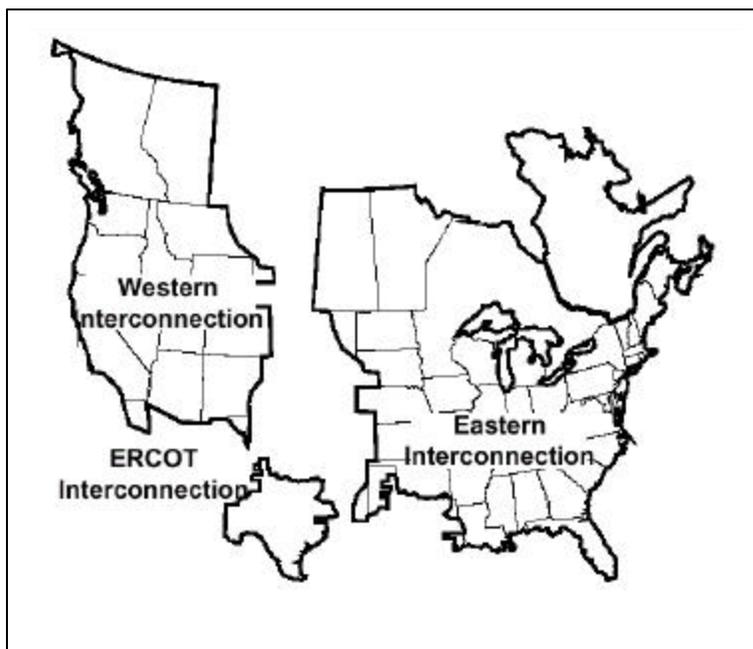
<u>Year</u>	<u>WSCC Subregion</u>				<u>Total</u>
	<u>Arizona</u>	<u>California</u>	<u>Northwest</u>	<u>Rockies</u>	
1990	\$38	\$53	\$20	\$28	\$38
1991	\$36	\$52	\$20	\$30	\$37
1992	\$38	\$57	\$22	\$32	\$40
1993	\$36	\$58	\$25	\$31	\$41
1994	\$37	\$61	\$27	\$36	\$42
1995	\$35	\$57	\$25	\$35	\$40
1996	\$32	\$54	\$29	\$34	\$36
1997	\$31	\$50	\$24	\$35	\$33
1998	\$30	\$55	\$29	\$36	\$36
1999	\$27	\$45	\$31	\$30	\$35

Source: Resource Data International, PowerDat Database, January, 2001.

Exhibit V-11 below shows the three transmission interconnections in the lower 48 states and Canada.

### Exhibit V-11

#### Three Transmission Interconnects



Each grid is essentially self-contained and there is only limited transfer capability between grids. Thus, surplus supplies or low generating costs in one grid are generally not transferable to another. Furthermore, the nation's electric transmission grid was primarily built by individual utilities to move electricity from generation facilities to distribution facilities. Following the Northeast blackout on November 9, 1965, in which 30 million people lost power, electric utilities formed the North American Electric Reliability Council (NERC). Greater emphasis was placed on interconnecting the transmission of individual utilities to improve regional reliability by providing emergency power among utilities through the creation of ten regional power pools. In some regions such as the Mid-Continent Area Power Pool (MAPP) in which Nebraska is located, there were also increased wholesale sales between utilities, but nothing approaching the level experienced in the past few years. The transmission grid was not designed to facilitate massive transfers of wholesale energy across large regions.

#### 8.0 Consideration of Retail Choice by Neighboring States

The six states that border Nebraska have all considered revisions to their laws for the purpose of implementing a retail choice regime – all six states have rejected such a move. In general these states, either through regulatory or legislative action, have concluded that the conditions for a successful implementation of retail choice are not yet present and that moving to choice is not in the best interests of customers in their state at this time.

## 8.1 Colorado

During 1998, the Colorado Legislature enacted Senate Bill 98-0152 that established the Colorado Electric Advisory Panel. The legislation called for the panel to make recommendations regarding the feasibility and desirability of implementing a retail choice regime in the state. The engineering/consulting firm of Stone and Webster was engaged to analyze the energy and economic modeling issues associated with the issue.

The Stone and Webster report concluded that, “restructuring the electric industry in Colorado will likely lead to an increase in retail electricity rates throughout the state. This finding holds for the current customers of all utilities, for all but one customer class (irrigation customers), for all years, for all regulatory cases considered, and for all scenarios considered.”<sup>12</sup>

On November 1, 1999 the Advisory Panel issued its final report. Of the 29 members on the panel, 17 voted that retail choice was not in the best interests of the State while 12 members voted in favor of pursuing deregulation.

The study notes that, “In summary we believe restructuring of the retail electric industry is not in the best interest of all Colorado consumers and the State as a whole for the following reasons:

- Colorado’s electric rates are relatively low. States that have actually implemented retail restructuring have almost always been high cost states. Significantly different issues arise when low cost states like Colorado consider adopting retail restructuring of the electric industry.
- The Panel’s consultant, Stone & Webster, which has conducted the only thorough study to date of retail restructuring impacts specific to Colorado, found that under every tested scenario, rates, on an average basis, were likely to go up—as much as 29% more than under the existing system over a twenty (20) year period—if retail restructuring were implemented.
- The predicted rate impacts will be disproportionate with low income, fixed income, rural, residential, and small business consumers suffering rate increases greater than the Stone & Webster projections, i.e., if large commercial and industrial consumers see decreases, then other consumers will see even greater increases than those projected.”<sup>13</sup>

## 8.2 Iowa

The Iowa State legislature devoted considerable time debating the merits of retail choice. During the 1999 and 2000 sessions of the legislature, retail choice legislation was the focus of attention. The Des Moines Register reported on April 12, 2000, that the state’s two largest investor-owned utilities (Mid-American Energy and Alliant Energy) spent over \$200,000 on lobbyists in an attempt to advance legislation.

Mid-American Energy launched a retail choice pilot program in Council Bluffs. The intent of the pilot was to demonstrate that multiple energy suppliers and marketers would seek to serve residential and small commercial customers if given the opportunity to do so. After a year or more of considerable effort, not a single competing firm entered the pilot. The Iowa Utilities Board terminated the pilot at mid-year 2000.

On March 2000 the Iowa legislature concluded its consideration of retail choice for the session and failed to advance a bill to the Governor.

## 8.3 Kansas

In April 1996, the Kansas Legislature enacted House Bill No. 2600 that created a Legislative Task Force to study electric retail competition. The Task Force engaged the services of the McFadden Consulting Group of Arvada, Colorado and Resource Data International of Boulder, Colorado to conduct a study of the subject. The study found that, “Many experts believe restructuring of the electric utility industry will provide economic benefit to consumers. Our analysis in this report supports that conclusion for the customers in Kansas.” The report further found that, “Competition is more effective than regulation at maintaining discipline in the marketplace” and that, “On an average statewide basis, prices in a deregulated market will be lower than in a regulated environment.”<sup>14</sup>

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<sup>12</sup> Report to the Colorado Electric Advisory panel prepared by Stone & Webster, July 1999, p. ES -2

<sup>13</sup> Final report of the Colorado Electricity Advisory Panel, November 1, 1999, p. 3 (Executive Summary)

<sup>14</sup> “An Analysis of the Impacts of Retail Wheeling on the State of Kansas”; McFadden Consulting Group, August 18, 1997, see Executive Summary.

That same year (1997) the Kansas Corporation Commission received a report prepared at its request by the National Regulatory Research Institute (NRRI) that reached similar conclusions by noting that, “retail competition should effectuate a more consumer-responsive, efficient electric power industry in Kansas. Consumers should see lower prices and the availability of additional electric services. The pertinent questions attending retail competition are not ‘if’ but ‘how’ and ‘when’.” The NRRI study took issue with an earlier study conducted by the Docking Institute for being “overly gloomy” in its assessment of retail choice. According to NRRI, the Docking Institute study incorrectly depicted retail choice as taking wealth away from rural areas and redistributing it to urban areas. The NRRI concluded that, “Taking everything into account, the best strategy for Kansas would be, in the shortest time possible, to pass legislation that would open up the state’s retail markets to competition.”

The NRRI conclusions were premised on the notion that, “Kansas cannot be characterized as a low-cost state for which under open markets, electricity prices would rise toward the regional average. Electricity prices in Kansas are currently above those in surrounding states.”<sup>15</sup>

A third study released in 1997 also added fuel to the push for retail choice in Kansas. A report issued by the Hugo Wall School of Urban and Public Affairs of Wichita State University found that all customers would benefit from retail choice but cautioned that, “Industrial customers are likely to be the major beneficiaries of a price-fixed competitive marketplace because of the electricity-intensive nature of their operations.”<sup>16</sup>

Notwithstanding the urging of retail choice proponents, the Kansas State Legislature has not enacted retail choice legislation.

#### **8.4 Missouri**

The Missouri Public Service Commission appointed 35 individuals to serve on the Retail Electric Competition Task Force in its Order of May 23, 1997. The Task Force was charged with preparing comprehensive reports to the Commission, based upon thorough investigation and study of retail wheeling of electricity and related issues, that recommend how Missouri should implement retail electric competition in the event that legislation is enacted which authorizes it.

On May 1, 1998 the task force submitted its report and concluded that, “the introduction of retail competition should proceed only if it can be shown to benefit all classes of consumers and should be implemented consistent with this goal. Regulation must continue for services that are not subject to full and fair competition. The appropriate regulatory authority must manage the transition to full and fair competition by monitoring market conduct, addressing any anti-competitive practices and mitigating market power.”<sup>17</sup>

The report detailed a number of consumer safeguards that should be in place in the event that the Missouri legislature advanced a bill implementing retail choice. A number of bills were introduced in recent years but the political climate has not been conducive to passage. Thus Missouri, like the other states in the region, is taking a wait-and-see attitude toward retail competition.

#### **8.5 South Dakota**

There has been only minimal interest in retail choice in South Dakota. In 1999 the Business Research Bureau of the University of South Dakota published a study on electricity restructuring and the impact on electric cooperatives. The study concluded that under retail choice, “South Dakota rural electric cooperative residential customer’s billings are projected to increase and their large industrial customer’s billings are projected to decrease.”<sup>18</sup>

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<sup>15</sup> “An Assessment of Retail Competition in Kansas’ Electric Power Industry”; National Regulatory Research Institute, September 1997, see Executive Summary.

<sup>16</sup> “The Impact of Retail Wheeling on Municipal Electric Utilities in Kansas.”

<sup>17</sup> Report of the Retail Electric Competition Task Force, May 1, 1998, p. 28

<sup>18</sup> “Electricity Pricing in a Restructured Electric Power Industry”, Business Research Bureau, University of South Dakota, January 14, 1999, see Executive Summary

In light of the highly rural nature of the South Dakota market and the relatively low cost of power, there has been no substantial legislative interest in pursuing retail choice.

## **8.6 Wyoming**

On May 14, 1996, the Wyoming Public Service Commission hosted a Stakeholders Dialogue and Collaborative on Electric Restructuring Issues in Casper, Wyoming. Because the idea of electric industry restructuring is complex, the Commission established six subcommittees to comment on the broad issues of electric restructuring in Wyoming. The process eventually resulted in the development of a white paper on the concept of retail choice in Wyoming. The paper did not result in firm conclusions one way or the other on the desirability of retail choice but rather was a comprehensive discussion of the many policy issues associated with such a policy move.<sup>19</sup>

The white paper recommended a study of the economic impacts of restructuring and subsequently hired Black and Veatch to conduct the work. This study, issued in September 1997, predicted only small benefits from retail choice.<sup>20</sup>

There has been only minimal legislative interest in retail choice and no legislation has been enacted on the subject.

## **9.0 Federal Issues**

Considerable discussions about electricity deregulation began during the 105<sup>th</sup> Congress (1997-98) and continue today. There has been no significant Federal legislation passed to date; however, energy bills have passed both the House and the Senate and are currently being discussed in conference. See discussion below.

Driven in large part by the electricity supply and reliability problems in the western United States, the issues of restructuring have now been expanded to include energy supply and infrastructure concerns. Transmission across the United States is frequently inadequate to support retail deregulation. Legislation addressing regional transmission entities, eminent domain, transmission reliability standards, and other issues have been the focus of both Congress and the FERC. Infrastructure/pipelines for natural gas supply have not kept up with growing demand for natural gas which has become the most common fuel for generating facilities built in the last 10 years.

Congress has been also dealing with electricity reliability issues. In 2000, Slade Gorton, (R-WA) introduced S.2071 'The Electric Reliability Act'. It passed the full Senate, but failed to gather enough support in the House prior to the conclusion of the 106th Congressional Legislative session last year. Reliability problems have increased with the changing roles of industry participants.

In the House of Representatives, national energy policy legislation (H.R. 4) was introduced on July 27, 2001 and was passed on August 2, 2001. S.517 was brought directly to the Senate floor without committee debate and passed on April 25, 2002, after weeks of robust debate.

H.R.4, Securing America's Future Energy Act, contains important provisions impacting public power electric utilities including: energy efficiency program reauthorization and funding, weatherization assistance program authorization and funding, taking the Nuclear Waste Fund off budget to remove artificial spending limits, reauthorization (for a 10-year period) of the Renewable Energy Production Incentive (REPI) Program, clean coal technology funding, authorizes funding for the DOE's Nuclear Energy Plant Optimization Program, and some private use tax relief for public power. Provisions also would allow for oil and gas drilling on a portion of the Arctic Wildlife Refuge.

S.517, the Senate bill, is significantly different from H.R. 4. S.517 has three basic goals:

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<sup>19</sup> "White Paper on Electric Utility Industry Restructuring Issues", November 12, 1996, Wyoming Public Service Commission.

<sup>20</sup> Study of the Potential Economic Impacts of Electric Restructuring on the State of Wyoming, Black and Veatch, September 1999, see Executive Summary

- Promote fuel diversity and renewable energy
- Improve efficient transmission and use of energy in industry, automobiles, buildings, and appliances
- Protect environment and begin addressing global climate issues

Some of the more specific issues include:

- Federal vs. State Jurisdiction
- Reliability
- Mergers
- Market Transparency
- Market-Based Rate Authority
- Renewable Portfolio Standard (RPS)
- Federal Purchase Requirement
- Pilot Program
- PURPA Reform
- PUHCA Repeal
- Pricing
- Hydro Re-licensing
- Price Anderson Act
- Renewable Energy Production Incentives (REPI)
- Clean Coal Incentives
- Private Use Tax Rules
- Climate Change

Whether compromise legislation can be agreed to should be known by October, 2002. Depending on its final form, this legislation could dramatically impact the electric industry throughout the nation.

## **9.1 Bush Administration National Energy Policy Recommendations**

On May 17, 2001 the Bush Administration National Energy Policy Development Group released its Final Report of Recommendations for a comprehensive national energy policy. While a total of 105 specific policy recommendations were included in a total of eight separate chapters, the following bullet points summarize some of the recommendations potentially impacting the electric power industry:

- The U.S. Environmental Protection Agency (EPA) should be directed to work with legislators to introduce multi-pollutant legislation that significantly reduces and caps emissions of sulfur dioxide, nitrogen oxides and mercury from electric power generators. Included should be:
  - Mandatory reduction targets
  - Phased in reductions
  - Provisions to allow utilities make modifications to their plants without fear of litigation
  - Market-based incentives
- The Office of Science and Technology and the President's Council of Science and Technology should make energy efficiency recommendations.
- The Secretary of Energy should promote energy efficiency and analyze the research and development programs in place relative to energy efficiency then make recommendations for future budget. These recommendations should include provisions for private partnerships.
- The Secretary of Energy should improve energy efficiency of appliances.
- Federal agencies should take measures to improve energy efficiency, especially those in areas with energy shortages

- Directs the Secretary of Energy to propose comprehensive electricity legislation.
- PUHCA should be repealed and PURPA should be reformed.
- FERC should be encouraged to use its existing statutory authority to promote competition.
- \$2 billion over the next 10 years should be devoted to clean coal technology. The research and development tax credit should be permanently extended.
- Nuclear energy should become a major component of our national energy policy. Licensing of reactors should be responsible but less stringent. EPA should be directed to study the Air Quality benefits of nuclear power and the Price-Anderson Act should be renewed.
- Exploration of advanced nuclear fuel technologies should be revisited.
- The licensing process for hydropower should be more efficient.
- Access to federal lands should be re-evaluated in order to increase biomass, solar and wind-based energy.
- The report supports a \$39.2 million increase in DOE's supply account for research and development of renewable energy sources.
- Tax credits should be offered for new landfill methane projects, biomass projects and wind technologies. Residential solar energy property should be encouraged with a 15% tax credit – maximum \$2,000. The ethanol excise tax exception should be continued.
- EPA should develop an industry partnership that encourages and rewards companies for buying renewable energy. The partnership should also make renewable energy more accessible for companies.
- \$1.2 billion of bid bonuses for the responsible leasing of ANWR should be allocated for research and development of renewable energy sources.
- Next generation technologies such as hydrogen and fusion should be developed.
- FERC should improve reliability of the interstate transmission system.
- Appropriate agencies should remove current constraints on the interstate transmission grid. The Secretary of Energy should complete a report by December 31, 2001 that explores a national energy grid.
- FERC, the Secretary of Interior and the State of Alaska should work with Canada to and other interested parties to expedite the construction of a natural gas pipeline to the lower 48 states.
- EPA should review existing enforcement actions for New Source Review and present a report to the President within 90 days. The Attorney General should review the enforcement actions to ensure that they are consistent with the Clear Air Act.

## **9.2 FERC**

The Federal Energy Regulatory Commission (FERC) regulates wholesale power sales and transmission transactions of jurisdictional utilities (investor-owned utilities, not public power, cooperatives, or federal utilities). Following passage of the Energy Policy Act of 1992, FERC has played a major role in developing regulatory policies designed to promote wholesale electric competition through open access transmission and through the creation of new regional transmission entities. Nebraska's electric utilities are non-jurisdictional. However, several transmission-owning utilities in Nebraska have voluntarily pursued arrangements to participate in FERC-approved transmission organizations.

On June 18, 2001 the Federal Energy Regulatory Commission voted unanimously to extend wholesale price controls over California spot market sales as well as spot market sales in the entire 11-state Western System Coordinating Council. For sales during Stage 1, 2, or 3 emergencies in California, prices would be capped at the highest cost generation delivered to the market. During non-emergency time periods, the prices are capped at 85% of the highest cost generation that was in effect during the most recent Stage 1 reserve deficiency period called by the California Independent System Operator. FERC purports to subject public power systems to these measures as a condition of access to the grid. The order is being challenged by several public power entities from California. One of the key issues for Nebraska will be whether FERC's current lack of authority over public power transmission and rates can be altered without federal legislation, if at all.

On July 12, 2001, FERC issued orders, the purpose of which is to create four regional transmission organizations. FERC's orders mandate action designed to create Southeast and Northeast RTOs. The orders do not require immediate action for the Midwest or West RTOs. See FERC Dockets RTO 01-99-000 and RTO 01-100-000. FERC's ability to make that happen and how Nebraska's public power, cooperative and federal transmission facilities might be voluntarily integrated in the process remain as open questions.

## 10.0 Conclusions

The establishment of the “condition-certain” approach in LB 901 has proven to be a wise policy decision by the State of Nebraska. This approach recognized the necessity of conditioning retail choice upon the establishment of adequate regional wholesale energy markets and adequate transmission networks, among other issues. Several of the states which opened retail electricity markets or were scheduled to do so on a “date certain” basis have retrenched and are now paying far greater attention to the need to establish viable regional wholesale markets prior to further implementing retail choice.

The following summarizes the conclusions of the report of Technical Group No. 5.

- Rates in retail choice states have been reduced primarily through regulatory mandates and capped during transition periods
- Wholesale prices have increased throughout most of the nation but declined significantly in June 2001 across the western United States
- Marketers have withdrawn or scaled back in many states with retail choice programs
- Few customers have switched suppliers in most retail choice states (and many of them have returned to incumbent utility)
- California/West Coast Energy Crisis has slowed national interest in retail choice
- Retail choice has taken a back seat to energy supply and other wholesale issues at the federal level
- Promises of wholesale or retail competition driving down energy prices have been generally unfulfilled thus far
- Retail choice is still alive and continues to evolve
- Must get wholesale markets right prior to implementing retail choice legislation
- Adequate power supply and reserves are crucial
- Adequate transmission is crucial
- Increased stability of fuel prices is needed for retail choice programs to function properly
- Better customer response to wholesale price signals are needed
- Development of a comprehensive energy policy has gained significant attention in Congress and the Bush Administration, but details are far from decided due, in part, to narrow political majorities
- FERC is actively involved in developing and addressing the transition to a more competitive wholesale market