



Grand Canyon State Electric
Cooperative Association, Inc.

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July 15, 2013

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Re: *Electric Cooperatives' Comments on Retail Electric Competition*
(Docket No. E-00000W-13-0135)

Dear Sir/Madam:

The following comments on retail electric competition/restructuring ("ER") are provided by the Arizona Electric Power Cooperative, Inc. ("AEPSCO"), Southwest Transmission Cooperative, Inc. ("SWTC"), Duncan Valley Electric Cooperative, Inc. ("Duncan"), Graham County Electric Cooperative, Inc. ("Graham"), Mohave Electric Cooperative, Inc. ("Mohave"), Navopache Electric Cooperative, Inc. ("Navopache"), Trico Electric Cooperative, Inc. ("Trico") and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur") (collectively, "the Cooperatives"). The Cooperatives submit these comments in response to the questions presented in Staff's Notice of Inquiry dated May 23, 2013.

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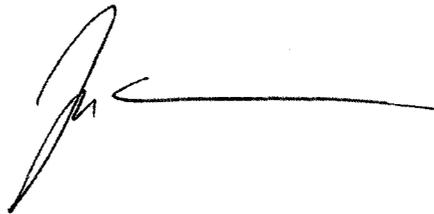
Docket Control
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Pursuant to Staff's Notice of Inquiry dated May 23, 2013, Grand Canyon State Electric Cooperative Association also hereby submits a request to remain on the service list for the above referenced proceeding. Copies of filings should be transmitted to:

John Wallace
Grand Canyon State Electric Cooperative Association, Inc.
2210 S. Priest Dr.
Tempe, AZ 85282
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Sincerely,

GRAND CANYON STATE ELECTRIC
COOPERATIVE ASSOCIATION



By _____

John V. Wallace

Original and thirteen (13) copies of
Electric Cooperatives' Comments
filed this 15th day of July, 2013
with:

DOCKET CONTROL
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**ELECTRIC COOPERATIVE COMMENTS ON RETAIL ELECTRIC MARKET
RESTRUCTURING (DOCKET NO. E-00000W-13-0135)**

The following comments on retail electric market restructuring (“ER”) are provided by the Arizona Electric Power Cooperative, Inc. (“AEPSCO”), Southwest Transmission Cooperative, Inc. (“SWTC”), Duncan Valley Electric Cooperative, Inc. (“Duncan”), Graham County Electric Cooperative, Inc. (“Graham”), Mohave Electric Cooperative, Inc. (“Mohave”), Navopache Electric Cooperative, Inc. (“Navopache”), Trico Electric Cooperative, Inc. (“Trico”) and Sulphur Springs Valley Electric Cooperative, Inc. (“Sulphur”) (collectively, “the Cooperatives”). The Cooperatives primarily submit these comments in response to the questions presented in Staff’s Notice of Inquiry dated May 23, 2013.

We first discuss why the ratemaking concept of average pricing is leading to an increased interest by primarily large customers in ER at this time. Finally, we provide our responses to the questions posed in Staff’s Notice of Inquiry dated May 23, 2013.

Individual cooperatives may supplement these comments. The Cooperatives, individually and collectively, also reserve the right to refine and revise these initial observations as new information becomes available.

Introduction

While the concept of “carrier of last resort” is relatively new in the ER world, for Arizona’s Cooperatives it’s a business as usual, decades old business model. Throughout our state’s rural areas, not-for-profit Cooperatives act everyday as the carrier of last resort bringing safe, reliable

and adequate service to tens of thousands of customers who otherwise would not be served by the investor-owned utility model.

Given the rural area's low population densities, the vast majority of our members are low load factor, high capital cost consumers—not the market paradigm which competitive electric providers seek. However, the relatively few members with lower capital cost, higher load factor commercial and industrial loads which the Cooperatives do serve, such as grocery chains, “big box” stores, hotel/motel franchises and casinos will be a likely target of competitive suppliers. The inexorable results will be (1) higher rates for the “unattractive customers” who remain behind and (2) a much less stable financial platform for rural electric cooperatives to continue to carry out their mission of “carrier of last resort.”

Further without a stable customer base, planning for and building out generation and transmission for future needs becomes much more difficult, risky and expensive. The uncertain load requirements and increased risks which come with ER, at a minimum, will drive up the finance costs associated with the necessary investment and, at worse, will force Cooperatives to postpone or not be able to finance essential infrastructure improvements.

Finally, the costs of implementing and securing the human and technical resources to accommodate a direct access system will be high. Conservatively, the Cooperatives estimate initial costs of at least \$80,000 per system with ongoing, increased annual expenses of \$40,000-\$80,000 for each Cooperative service territory.

The Cooperatives urge the Commission (a) not to implement RE in Arizona or, if it elects to proceed further, (b) to exempt Cooperatives' service territories from RE.

Average Price versus Market Price

ER policy should not be implemented simply because of lower gas prices and should be carefully considered given the associated costs and risks. Currently natural gas prices remain very low which has caused Large Customers (“LCs”) and Independent Power Producers (“IPPs”) to push for ER. In the current regulated market, the average rate charged by utilities to support their diversified portfolios is higher than the rates IPPs can deliver in an un-regulated market.

In order to assure safe, reliable and adequate power supplies to all customers (or members in the case of the not-for-profit Cooperatives), utilities have invested in and constructed over a long term an efficient, reliable and diversified power supply. Some of these assets carry higher costs than the natural gas fired units predominantly used by IPPs, but serve important, ongoing roles of delivering safe, reliable and adequate service to all customer classes.

In the regulated market, customers pay an average price vs. the market price for electricity. The average price is determined by factoring the average usage per customer class, the average cost of generation units, the average cost of transmission and distribution assets, etc. The Commission – as do most utility regulatory agencies – also relies heavily on recovery of utility costs through the kWh usage charge even though many of these costs are fixed in nature. This further increases the kWh rates of the utilities. To the extent a customer uses more than the average kWh usage of its class (*i.e.*, it is higher load factor customer), then that customer will pay a higher proportion of its classes’ costs.

When the price of natural gas is relatively low, as it is now, the difference between the rates the IPPs can bring to the market and these average utility rates can be quite substantial. But, if the high load factor customers can buy electricity from competitive power suppliers, then the amount

of fixed costs that were being covered by those customers is no longer available to cover the utilities' fixed costs. The result is higher rates for customers who do not have a choice (likely residential and small commercial) or who choose not to shop for a variety of reasons, including confusion and lack of sophistication. Ironically, keeping residential rates low has resulted in higher rates for others and it makes ER a more attractive alternative for large commercial and industrial customers.

The Commission should consider carefully whether it should go forward with a costly, risky and radical shift in the regulatory paradigm based upon what is, in all likelihood, a relatively temporary phenomenon.

**THE ELECTRIC COOPERATIVES' RESPONSES TO THE QUESTIONS
POSED IN THE COMMISSION'S MAY 23, 2013 LETTER TO STAKEHOLDERS**

- 1) Will retail electric competition reduce rates for all classes of customers — residential, small business, large business and industrial classes?

No. While it is likely that RE will open some lower cost shopping alternatives for the large business and industrial classes, residential and small business rates will go up. The Cooperatives firmly believe that RE will only bring rate instability to their members and service areas.

- 2) In addition to the possibility of reduced rates, identify any and all specific benefits of retail electric competition for each customer class.

Other than the potential for large customers possibly to enjoy rate reductions, the Cooperatives are not aware of any other material benefits of ER for other rate classes.

- 3) How can the benefits of competition apply to all customer classes equally or equitably?

The benefits cannot be spread to all customer classes equally or equitably because of the

differences in costs to serve each customer class; differences in usage; and the load characteristics of large vs. small customers. As discussed previously, it is more time consuming, resource intensive and less profitable for utilities and Electric Service Providers (“ESPs”) to serve residential and small commercial customers due to those customers’ low load factor and demand characteristics. As a result, the most profitable, higher load factor, large customers will be the target market of the ESPs—either individually or by aggregation.

If ER is allowed to proceed in Arizona, the few large customers will be “cherry-picked” from each cooperative’s service area. In addition, because many of the cooperatives serve in more moderate climates than Phoenix, the average revenue received from residential and small commercial customers is lower for Cooperatives as is customer density. That further affects the ability of utilities and ESPs to profitably serve these smaller customers.

- 4) Please identify the risks of retail electric competition to residential ratepayers and to the other customer classes. What entity, if any, would be the provider of last resort?

See also the responses to Question Nos. 1 and 3. The benefits of ER will not apply to all customer classes equally or equitably because of the differences in (1) the costs to serve each customer class (2) class usage characteristics and (3) load profiles of large vs. small customers. Finally, it is more time consuming and expensive to serve small customers – making it unlikely that homeowners and small commercial operators will be of any real interest to ESPs.

There are risks for customers who shift providers. Residential and small commercial customers are not as sophisticated in weighing these risks and the costs as well as the benefits associated with switching. In other states, customers have been switched to ESPs without their consent; other customers have been switched with promises of savings that do not materialize; and ESPs may also bundle electric services with other services-making a reliable, accurate evaluation of savings difficult.

On a related issue, there are also considerable risks and complications associated with large customers who leave the Cooperatives' systems and then want to return at a later date. Generation and transmission planning spans many years and cannot necessarily be modified rapidly to allow the return of large customers. The result is reliability concerns for the Cooperatives, their systems and the customers who remain – most likely the residential and small business segment.

Moreover, retail electric competition seriously complicates transmission planning. Providing transmission access at varying points which have no relation to the original connection between a particular generation source and load center for which the transmission was constructed is especially problematic in rural areas.

Normally, the incumbent utility by default becomes the provider of last resort. That's an untenable and unfair result for the Cooperative and those customers who stay behind because the Cooperative will end up serving the highest cost customers. Hence, as better load factor customers choose ESPs, the remaining customers face rate increases as a result.

Other risks include (1) difficulties in loan qualification in an uncertain ER market place; (2) reluctance to make investments because of demand unpredictability; and (3) negative effects on reliability as discussed in more detail below.

- 5) How can the Commission guarantee that there would be no market structure abuses and/or market manipulation in the transition to and implementation of retail electric competition?

If the Commission proceeds with ER, history and recent experience teach that it will not be able to guarantee there will be no market structure abuses and/or market manipulation.

In 2001, the California market was manipulated by Enron and other competitive suppliers which took advantage of the market's design. Twelve years later, lawsuits are still pending to collect damages on behalf of the customers who were injured by the abuses.

Fast-forward to just last year. Constellation Energy Commodities Group Inc.'s ("Constellation") \$245 million settlement with regulators to close charges of power market manipulation included the largest civil penalties handed out by the FERC since 2005. Without admitting wrongdoing, Constellation was also required to disgorge profits of \$110 million intended for a fund to benefit electric customers in the affected regions.

- 6) What, if any, features, entities or mechanisms must be in place in order for there to be an effective and efficient market structure for retail electric competition? How long would it take to implement these features, entities, or mechanisms?

If the Commission proceeds with ER, it will need to address and resolve the legal issues raised in response to Question No. 13 prior to undertaking a rulemaking. The Commission will also need to address the need for an Independent System Operator (“ISO”) or Regional Transmission Organization (“RTO”) and a host of other issues such as billing and metering processes, the need for Automated Metering Infrastructure (“AMI”) to accommodate ER, etc. We estimate conservatively that it will take a minimum of two years to resolve and implement regulatory solutions to various issues. Likely legal appeals will also take several years to resolve. All of which will leave carriers and consumers in a long-term state of uncertainty and confusion. Planning at all levels and by many entities – not just utilities – will suffer as a result.

- 7) Will retail electric competition require the divestiture of generation assets by regulated electric utilities? How would FERC regulation of these facilities be affected?

The *Phelps Dodge* case held that the Commission could not constitutionally require such divestiture. If the Commission proceeds with ER, in fairness, it will need to allow, but not

require, the divestiture of generation assets by regulated electric utilities to competitive subsidiaries regulated by FERC. It would be inconsistent to restructure the electric utility industry and not allow utilities to offer power at a market price. Instead, the market will set the price for generation which will fluctuate daily.

As a result of the market setting the price for generation, the ACC will be relinquishing its authority over setting the price for generation, the IRP process as well as the associated reliability to FERC. The ACC will be still approving rates which include generation costs but will no longer have authority over such. Given the lack of associated benefits in terms of price, customer satisfaction and reliability discussed in the other responses to these questions, it seems unfathomable that the ACC would want to take the huge risk of implementing ER. Especially given the fact that after 13 years there have been no demonstrable rewards associated with ER in other states. In fact, ER has resulted in higher prices and lower reliability.

- 8) What are the costs of the transition to retail electric competition, how should those costs be quantified, and who should bear them?

The generation, transmission and distribution cooperatives have direct or indirect loan commitments and debt service relating to their generation, transmission and distribution assets which must be paid for the life of those assets. To the extent that Cooperative customers purchase power from the market the Cooperative's will not recover from these customers certain of the fixed costs from these assets.

In order for the utilities to remain financially viable, a fixed cost recovery mechanism will be necessary. The customers who should bear these fixed costs are the customers who choose a competitive supplier.

Further, in order to implement the first set of the Commission's Retail Electric Competition Rules, Arizona Utilities collectively spent more than \$100 million on computer systems that would have accommodated ER. However, these investments and changes were made over ten years ago and these systems currently are obsolete. New, additional investments will be required to either update or replace them.

Further, there will be considerable costs to hire additional employees and to modify accounting, billing, metering and other systems to accommodate retail competition in the Cooperatives' service areas. Through their participation in the Process Standardization Work Group ("PSWG") several years ago, the Cooperatives investigated the costs necessary to meet their obligations under the current Rules if their territories were opened to competition. At that time, just the EDI software necessary to meet PSWG standards would have cost approximately \$80,000 per cooperative. Additional personnel would also have to be hired and trained in these hardware, software and other competition-related processes. The Cooperatives conservatively estimate that, depending upon the size of the system, 1-2 additional personnel would be required to perform various functions related to retail competition for an ongoing additional annual expense of \$40-80,000. Collectively, the six distribution cooperatives involved in these dockets estimate they would incur initial retail market opening costs of at least \$480,000 and total increased annual expense of roughly \$250,000 to \$500,000. These additional cost estimates do not include additional costs to be incurred by AEPCO or Southwest Transmission.

9) Will retail electric competition impact reliability? Why or why not?

Reliability will be impacted because utilities will no longer be required, nor will they be capable of, cohesive planning for future generation and transmission needs.

Traditionally, utilities have committed to and made investments and received financing to provide reliable power and the associated transmission over a very long period – in some cases 50 years or more. Further, utilities including the Cooperatives have planned these facilities, made these investments and borrowed funds in support with the understanding that it would have both the right and responsibility to reliably serve these customers.

If the ACC moves forward with ER, this commitment effectively is severed for all utilities. Investments in generation and transmission will be made when a market participant decides to build either generation or transmission. Investments will be driven by the market and not by sound planning processes. Further there is evidence to suggest that generators in ER markets have a disincentive to invest in new generation because it would increase the supply and lower the value of existing generation assets.

This is currently evident in the Texas market where wholesale price caps have increased by 66% but yet no new generation has been built as a result of this high market price signal. According to the Texas Coalition for Affordable Power (“TCAP”), there have been two rolling blackouts in the four years since ER was adopted and nine reliability emergencies that occurred in 2011. If no generation is built in Texas, then more blackouts will occur.

The same issues with regard to the unmet need for new generation are present in both Maryland and New Jersey. In both states, the state commissions have acknowledged the need for new generation but have no authority to order such new generation and have been restricted by the courts due to existing generators' legal challenges.

Utilities have balanced their generation portfolio by investing in different types of plants (coal, nuclear, gas, renewables, DSM). Under ER, the least cost resource which is currently gas-fired is all that would be constructed. This will lead to a dependence on one fuel source which could lead to large price fluctuations for customers as prices for natural gas change. ER will also threaten the continued use of coal and nuclear resources which will have very negative economic impacts on the rural areas of Arizona and remove a price hedge against rising natural gas prices as well as limit the operational flexibility of utilities.

Finally there is significant and undisputed decline in the generation reserve margin (margin of capacity held in reserve in case of an outage) in states that have adopted ER due to the factors such as the disincentive for current generators to build more generation as discussed above. According to TCAP, Texas had the highest reserve margins before ER and now has some of the lowest.

- 10) What are the issues relating to balancing area authorities, transmission planning, and control areas which must be addressed as part of a transition to retail electric competition?

In the Cooperatives' service territories, transmission capacity is limited and

uncertainty associated with ER will make this problem worse. Unless a utility can demonstrate a revenue source to repay loans and financing, additional transmission will not be constructed. Under ER, utilities will no longer be able to assure lenders of a revenue source, because customers will not be required to purchase generation and associated transmission from utilities.

An ISO or RTO will need to be formed to address balancing authorities, transmission planning and control areas and could cost hundreds of millions of dollars. However, the *Phelps Dodge* case held that the Commission could not constitutionally require participation in such an organization. That leaves the fate of this issue, at best, undecided.

- 11) Among the states that have transitioned to retail electric competition, which model best promotes the public interest for Arizonans? Which model should be avoided?

The Cooperatives are not aware of models in the minority of states that have transitioned to ER that best promote Arizona's public interest. Instead, ER has resulted in price increases and added significant risk to the provision of electric service according to the APPA study and TCAP article attached to these responses.

- 12) How have retail rates been affected in states that have implemented retail electric competition?

The lessons of competitive generation experiments in California, Texas, Pennsylvania, Nevada and elsewhere are that competition frequently often does not bring benefits and many have found that its burdens can be substantial. In a recent APPA Report on Retail Electric Rates published in April 2013, from 2006 to 2012, average rates paid in deregulated states have been at least 3.0 cents per kWh higher than average rates in regulated states.

Dr. Ken Rose in an article entitled, *States Retail Electricity Markets: How Are They Performing So Far*, published on June 12, 2012, draws similar conclusions as the APPA Report. He notes that the price gap between high cost states and the national average rates that high cost states tried to eliminate by implementing ER remains the essentially the same throughout the period 1990 until 2011.

Further, there can also be even more dramatic impacts. For example, when markets were deregulated in California, some customers experienced price fluctuations of 200 to 400 percent before temporary price caps were able to stop the hemorrhaging.

During the ten year history of ER in Texas, TCAP estimates that Texans paid \$11 billion in higher rates than the national average. TCAP further states that ER has cost the average customer more than \$3,000 in higher rates than the national average.

- 13) Is retail electric competition viable in Arizona in light of the Court of Appeals' decision in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83

P.3d 573 (App. 2004)? Are there other legal impediments to the transition to and/or implementation of retail electric competition?

See the analysis attached as Exhibit A.

- 14) Is retail electric competition compatible with the Commission's Renewable Energy Standard that requires Arizona's utilities serve at least 15% of their retail loads with renewable energy by 2025? (See A.A.C. R14-2-1801 et seq.)

The REST standard is not compatible with ER. In a restructured market place, the market will determine the generation mix not ACC policy or rules. Renewable resources are the most expensive generation resource that the Cooperatives have purchased. Even if the ACC makes the REST surcharge non-bypassable, the more expensive renewable resources will likely become a stranded cost. If the Commission does not eliminate the REST Standard, the ACC would need to require all ESPs to meet it.

- 15) Is retail electric competition compatible with the Commission's Energy Efficiency Standard that requires Arizona's electric utilities to achieve a 22% reduction in retail energy sales by consumption by 2020? (See A.A.C. R14-2-2401 et seq.)

For many of the same reasons, the Energy Efficiency (“EE”) standard is also not compatible with ER. If the ACC does not eliminate the EE Standard, the Commission would need to require all ESPs to meet it.

16) How should the Commission address net metering rates in a competitive market?

Net metering issues need to be addressed regardless of whether the ACC decides to move ahead with ER. Net metering rates result in net metered customers unfairly avoiding their portion of the fixed costs of providing electric service that is present whether a net metered customer receives any kWh from the utility. Currently, non-net metered customers are paying net metered customers’ portion of these fixed costs.

17) What impact will retail electric competition have on resource planning?

Integrated Resource Planning (“IRP”) obviously is not compatible with ER. In a restructured market place, the market will determine the generation mix used and to be constructed not ACC policy. This will render IRP policy obsolete. In addition, IRP information would, of necessity, be highly confidential in a restructured, competitive market place.

The planning, siting, financing and construction of generation and transmission are very complex processes which result in a significant barrier to entry for new

generators. This entry barrier benefits existing generators and also results in a reluctance to invest in new generation as market prices rise and supply is constrained. Texas has been struggling with this issue recently.

These constraints and barriers directly result in reliability issues as the current generation and transmission planning decisions shift from where these services are needed to where the highest price will be paid for these services.

18) How will retail electric competition affect public power utilities, cooperatives and federal controlled transmission systems?

The Cooperatives strongly believe retail competition will not benefit rural Arizona. Their basic position is that what remains of the existing electric competition rules (R14-2-1601, et seq.) should simply be repealed. History confirms that electric competition in the minority of states which have opened their markets has produced negative consumer impacts. That's also consistent with experience in the airline, banking and telecommunications fields which have demonstrated repeatedly that such initiatives usually leave rural areas unserved or underserved.

Due to the relatively low number of large commercial/industrial loads on the Cooperatives' systems, any lost loads will result in remaining customers paying that portion of fixed costs previously covered by customers who choose direct access. To further illustrate this point, 88% of the customers served by Cooperatives in Arizona are residential. However commercial and industrial customers account for 35 percent of the Cooperatives' revenues.

Direct access also complicates enormously generation and transmission as well as integrated resource planning.

The Cooperatives believe there simply is no reason why electric competition should resume in Arizona. Experience with electric competition in other areas; the ESPs' intent to serve only select loads; and the complications direct access poses to the generation, transmission and distribution needs of rural Arizona demonstrate competition is not in the public's interest.

EXHIBIT A

I. QUESTIONS PRESENTED. (By Item 13 of the Commission's May 23, 2013 Notice of Inquiry. Docket No. E-00000W-13-0135/In the Matter of the Commission's Inquiry into Retail Electric Competition.)

1. Is retail electric competition viable in Arizona in light of the Court of Appeals' decision in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004)?
2. Are there any other legal impediments to the transition to and/or implementation of retail electric competition?

II. DISCUSSION.

Retail electric competition—where the market, not the Commission, determines rates for competitive services—was declared unconstitutional in *Phelps Dodge v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004). Further, there are many more legal impediments to the transition to and/or implementation of retail electric competition.¹ Each of these roadblocks will be discussed below. It is important to view them within the confines of the following limitations on the Commission's powers and rulemaking authority:

- “The Commission does not possess any inherent powers...but instead exclusively derives its power from the constitution and the legislature.” *Phelps Dodge*, 207 Ariz. at 111, ¶ 54, 83 P.3d at 589 (citing *Williams v. Pipe Trades Indus. Program*, 100 Ariz. 14, 17, 409 P.2d 720, 722 (1966); *US West Communications, Inc. v. Arizona Corp. Com'n*, 197 Ariz. 16, 23, ¶ 29, 3 P.3d 936, 943 (App. 1999) (“US West I”)).
- “Article 15, Section 3 [of the Arizona Constitution] not only empowers the Commission to set just and reasonable rates, it *requires* the Commission to do so.” *Id.* at 107, ¶ 32, 83 P.3d at 585 (emphasis added); *see also* Ariz. Const. art. XV, § 3 (“The corporation commission shall have full power to, *and shall*, prescribe...just and reasonable rates and charges to be made and collected by public service corporations within the state for service rendered therein...”) (emphasis added).
- In fulfilling its obligations under Article XV, Section 3, the Commission must “consider[] the needs of all whose interests are involved, including public service corporations and the consuming public.” *Id.* at 128, ¶ 153, 83 P.3d at 606.

¹ This memo focuses on a variety of legal impediments to, and problems with, the *concept* of retail electric competition in Arizona. If, in the future, the Commission promulgates new retail electric competition rules, additional legal issues will become apparent in relation to whatever model is proposed. The existing rules are invalid for several reasons, i.e., certain provisions have been declared unlawful or unconstitutional; others are invalid for failure to submit for Attorney General review; and the remainder are non-compliant in relation to Administrative Procedure Act requirements.

- The Arizona Supreme Court has interpreted the Commission’s power to “supervise and regulate” public service corporations under A.R.S. § 40-202(A) as “bestowing no power on the Commission beyond that already provided by the constitution or specifically granted otherwise by the legislature.” *Id.* at 112, ¶ 58, 83 P.3d at 590 (citing *Southern Pac. Co. v Arizona Corp Com’n.*, 98 Ariz. 339, 348, 404 P.2d 692, 698 (1965) (“The right to supervise and regulate and do those things necessary and convenient in the exercise of [the Commission’s] power of supervision and regulation [of public service corporations] does not in and of itself grant additional powers to the Commission beyond that which the legislature specifically has set forth.”)).
- Finally, Arizona courts will not infer the grant of Commission authority “beyond the clear letter of the [Arizona Constitution or] statute.” *Id.* at 113, ¶ 59, 83 P.3d at 591 (citing *Southern Pac. Co.*, 98 Ariz. at 343, 404 P.2d at 695).

A. Retail Electric Competition is Not Viable in Light of the Court of Appeals’ Decision in *Phelps Dodge*.

In *Phelps Dodge*, the Court of Appeals evaluated whether the Commission properly approved the entry of competitive electric service providers into the Arizona market and ruled on a variety of constitutional, statutory and administrative challenges to Retail Electric Competition rules set forth in A.A.C. R14-2-1601 to R14-2-1616 (the “Rules”). There are key holdings in *Phelps Dodge* which are antithetical to retail electric competition in Arizona.

1. The Commission is Required to Set Just and Reasonable Rates by Finding and Using Fair Value.

Article XV, Section 3 of the Arizona Constitution “requires the Commission to ‘prescribe...just and reasonable rates and charges to be made and collected by public service corporations,’” which includes all electric public service corporations (“PSCs”) and potential competitive electric service providers (“ESPs”). *Phelps Dodge*, 207 Ariz. at 103-104, ¶ 18, 83 P.3d at 581-82. Further, Article XV, Section 14 of the Arizona Constitution requires the Commission to ascertain the fair value of the property of every public service corporation doing business in Arizona “[t]o assist the Commission in the ‘proper discharge of its duties.’” *Id.* at 104, ¶ 18, 83 P.3d at 582. The Court stated that the Constitution “requires the Commission to determine the fair value of property owned by the ESPs in Arizona and consider that finding in setting rates.” *Id.* at 105, ¶ 23, 83 P.3d at 583 (emphasis added). Further, it stressed that the Commission cannot “simply engage in a futile exercise of determining fair value and then completely ignore its findings.” *Id.* at 106, ¶ 26, 83 P.3d at 584. Rather, “fair-value

determinations *must* be used to aid the Commission . . . in setting rates” for all Public Service Corporations (“PSCs”), including competitive Electric Service Providers (“ESPs”). *Id.* (emphasis added).²

Given that holding, retail electric competition cannot be implemented in Arizona, because fair value ratemaking is inherently antithetical to the concept of rates established by a competitive market. That fact is readily apparent in the requests of ESP applicants currently filed in the Commission’s Docket Control.

For example, Direct Energy’s pending application (Docket No. 13-0126) specifies the formula to be used in calculating the rates to be charged for its services. Its rates’ formula gives *no* consideration to the fair value of Direct Energy’s property. *See* Direct Energy’s Application at p. 3, Appx. C and D. It specifies rates for non-residential and residential services which are (i) not less than Direct Energy’s marginal cost of providing the service and (ii) not more than the specific price index or generation rate of the customer’s applicable retail schedule in effect on the date the ESA is executed plus 35%. The applications submitted by PDM Energy and Constellation NewEnergy are similarly flawed.³ Allowing ESPs to set their own rates using this or similar formulas contravenes the Commission’s responsibilities to find and *use* fair value in establishing just and reasonable rates.

2. The Commission’s Ratemaking Duties Are Not Satisfied by Setting a Broad Range of Rates Within Which the Competitive Marketplace Can Operate.

The *Phelps Dodge* Court acknowledged that the Commission can establish a *just and reasonable* range of rates within which an ESP and consumer can negotiate the precise rate to be charged for electric service. *See Phelps Dodge*, 207 Ariz. at 109, ¶ 44, 83 P.3d at 587. However, the Court rejected “the Commission’s contention that its approval of a *broad* [or open-ended] range of rates within which the competitive marketplace can operate satisfies the Commission’s obligation to set just and reasonable rates.” *Id.* at 107, ¶ 33, 83 P.3d at 585 (emphasis supplied).

² *See also US West I*, 198 Ariz. at 217, ¶ 25, 8 P.3d at 405 (“We hold that the Arizona Constitution requires the Commission to determine a fair value rate base for all public service corporations before setting rates, unless and until the fair value determination requirement contained in article 15, section 14, is amended by the people of this state.”); *US West II*, 201 Ariz. at 246, ¶¶ 21-24, 34 P.3d at 355 (recognizing that “the commission is constitutionally required to ascertain the fair value of the [ESPs’] Arizona property,” and emphasizing the importance of the fair-value finding “in determining and avoiding the harsh extremes of the rate spectrum.”).

³ PDM Energy’s Application, Docket No. 06-0470 at p. 2, Attachment A (specifying a “market based energy charge, as negotiated, not to exceed on an average monthly basis \$6 per kilowatt-hour for a fixed energy price or as the adder to a *variable index price*, developed upon customer’s historical load and historical load patterns. (Emphasis added.) It further provides that electricity and demand charges will “likewise be established through negotiation.”). *See also* Constellation NewEnergy’s Application, Docket No. 12-0115 at 3, Appx. D and E (specifying a formula virtually identical to Direct Energy’s based on a variable price index or generation rate of the applicable retail schedule in effect on the date of execution of the ESA plus 35%).

The Court reasoned that the Commission cannot abdicate its constitutional responsibilities to set just and reasonable rates by allowing competitive market forces to determine those rates instead. *Id.* at 107, ¶ 32, 83 P.3d at 585. “Once an ESP is established in the market, it may increase its rates within the approved [broad] range without regard to consumer fairness or a fair return, possibly banking on some consumers’ natural reluctance to constantly monitor rates, discover abuses, and then switch services.” *Id.* at 107, ¶ 34, 83 P.3d at 585. “The constitution charges the Commission, *not* consumers themselves, with the duty to discover and remedy such potential overreaching by public service corporations.” *Id.*

The foregoing is significant when compared to the ranges of rates proposed, for example, by Direct Energy, PDM Energy and Constellation NewEnergy. All of them are contrary to the Court’s clear prohibition against setting a broad or open-ended range of rates within which the competitive marketplace can operate. *See* Section II(A)(1), *supra*. Each has asked the Commission to approve an open-ended range of rates, the low end of which is based on the entity’s unknown marginal cost, and the high end of which is calculated with reference either to an unknown, variable market-determined index or a very high dollar cap. The *Phelps Dodge* Court specifically rejected a substantially similar scheme, stating:

The potential for overreaching [by ESPs] is exemplified by the Commission’s approval of a wide range of rates that PG & E may charge consumers. In accordance with the Rules, the Commission authorized PG & E to charge consumers a negotiated, market-based rate that is not less than PG & E’s marginal cost nor greater than \$25 per kilowatt hour. The Commission did not ascertain PG & E’s marginal cost. Additionally, at the time the Commission set the maximum rate, the average price of electricity was 3 cents to 5 cents per kilowatt hour. Thus, any rate PG & E can negotiate between its unknown marginal cost and a rate that is roughly 500 to 830 times the average price of electricity, regardless of fairness to the consumer, its impact on an Affected Utility, or whether the rate provides a fair return, is deemed “just and reasonable.” *The potential for abuse in pricing within this virtually unrestricted range of rates is apparent and can only be avoided by having the Commission, rather than the market alone, set just and reasonable rates.*

Id. at 108, ¶ 35, 83 P.3d at 586 (emphasis added).

While PDM’s \$6 per kilowatt hour is less than PG&E’s \$25/kWh, it certainly qualifies as another example of “potential abuse in pricing,” which the *Phelps Dodge* decision condemns. To put that 6 dollars per kWh retail price cap flexibility in context, from July 2012 through June 2013 at the Palo Verde hub, the wholesale maximum monthly average on peak price was 3.5 cents per kWh. With the \$6/kWh tariff “cap,” that gives PJM more than 171 times its wholesale cost in retail pricing flexibility.

Moreover, “[b]y exclusively allowing the market to set the ESP’s rates, the Commission also abdicates its responsibility to ensure that such rates are fair to the ESPs...[because] [a]n ESP may set its rates low in order to attract customers, possibly denying itself a fair return and

causing it to cut costs or raise charges elsewhere to compensate.” *Id.* at 108, ¶ 37, 83 P.3d at 586. “Such measures could potentially affect service to the detriment of the consuming public.” *Id.*

There’s clearly a potential for abuse and a host of other problems associated with the unrestricted, variable, market-determined ranges of rates proposed by prospective ESPs like Direct Energy, PDM Energy and Constellation NewEnergy. *Phelps Dodge* just as obviously prohibits these proposed rates, which begs the question—is there *any* permissible rate or range of rates that would even appeal to a hopeful ESP? And, if so, why hasn’t a hopeful ESP submitted an application that proposes a permissible rate or range of rates?

The reason no such filing has been made is the rates’ flexibility necessary for retail electric competition is *inherently* inconsistent, *inter alia*, with the Commission’s constitutional obligation to set just and reasonable rates.

Retail electric competition simply is not viable in Arizona in light of the Court of Appeals’ decision in *Phelps Dodge*.

B. Other Legal Impediments to Retail Electric Competition in Arizona.

There are several additional impediments to transitioning to and/or implementing retail electric competition in Arizona. Absent a proposed set of rules, it is impossible to outline definitively all of the potential pitfalls, hazards and road blocks. However, we can offer the following observations.

1. Electric Service Providers Cannot Charge Discriminatory Rates.

Implementing retail electric competition in Arizona would violate various constitutional and statutory anti-discrimination provisions by enabling ESPs to charge different rates to similarly situated customers.

Article XV, Section 12 of the Arizona Constitution states: “All charges made for service rendered, or to be rendered, by public service corporations within this state shall be just and reasonable, and *no discrimination in charges, service, or facilities shall be made between persons or places for rendering a like and contemporaneous service.*” Similarly, A.R.S. § 40-334 states: “A public service corporation shall not, as to rates, charges...or in any other respect, make or grant any preference or advantage to any person or subject any person to any prejudice or disadvantage...No public service corporation shall establish or maintain any unreasonable difference as to rates, charges...or in any other respect...between classes of services.”

The Arizona Supreme Court has recognized that the “law on discrimination as applied to public service corporations generally is well settled.” *Town of Wickenburg v. Sabin*, 68 Ariz. 75, 77, 200 P.2d 342, 343 (1948).

The charges must be equal to all for the same service under like circumstances. A public service corporation is impressed with the obligation of furnishing its service to each patron at the same price it makes to every other patron for the same or substantially the same or similar service. It must be equal in its dealings with all. It must treat the members of the general public alike. All patrons of the same class are entitled to the same service on equal terms. The law will not and cannot tolerate discrimination in the charges.

Id. at 77-78, 200 P.2d 342, 343-44 (citations and internal quotations omitted).

As explained above, ESP hopefuls are seeking to implement rates that necessarily will vary from one customer to the next based on the market index price *in effect on the date of execution of a particular agreement*. These ever-changing indices enable ESPs to charge similarly situated customers different rates based solely upon the respective dates those customers elected to receive service from the ESP. In other words, they allow ESPs to charge discriminatory rates in violation of settled law. Further, either ESP or self-aggregation of differently situated customer groups into common purchasing classes violates statutory and constitutional discrimination prohibitions.

2. The Implementation of Retail Electric Competition Will Interfere With the Commission's Jurisdiction and Authority Over Electric Service in Arizona.

In order to preserve its own jurisdiction and authority over electric service, the Commission should refrain from transitioning to or implementing retail electric service in Arizona. Under the Federal Power Act (the "Act"), the FERC has broad jurisdiction and authority to regulate electric utility companies engaged in interstate commerce. *See* 16 U.S.C.A. §§ 824, *et seq.* For example:

- The Act contemplates that FERC, "in the exercise of its broad regulatory powers, may determine coverage of the Act . . . [and] issue such orders, rules and regulations as it may find necessary or appropriate to carry out the provisions of the Act." *Federal Power Commission v. Arizona Edison Co.*, 194 F.2d 679, 684 (9th Cir. 1952).
- FERC is charged with provid[ing] "effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *New York v. F.E.R.C.*, 535 U.S. 1, 6 (2002).
- FERC's jurisdiction "includ[es] the transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce." *Id.* at 6-7 (internal quotations omitted).
- And, FERC has authority to "correct unlawful practices" of "unreasonable rates and undue discrimination with respect to any transmission sale subject to [FERC's] jurisdiction." *Id.* at 7 (internal quotations omitted).

- The United States Supreme Court agreed with FERC “that transmissions on the interconnected national grids constitute transmissions in interstate commerce,” *id.* at 16, and that FERC has “jurisdiction over the transmission of electric energy in interstate commerce... [including] jurisdiction over both wholesale *and* retail transmissions,” *id.* at 15 and 18-19 (emphasis added). The Court reasoned that, “[b]ecause the FPA authorizes FERCs jurisdiction over interstate transmissions, without regard to whether the transmissions are sold to a reseller or directly to a consumer, FERC’s exercise of this power is valid.” *Id.* at 20.
- And, FERC has jurisdiction and authority to investigate alleged discrimination in the *retail electricity market*, “make findings concerning undue discrimination in the *retail electricity market*,” and is even *required to* “provide a remedy for that discrimination.” *Id.* at 27 (emphasis added) (citing 16 U.S.C. § 824e(a)).

Based on the foregoing, if the Commission decides to implement retail electric competition, it must be prepared to surrender much of its own jurisdiction and authority over the transmission of electricity to Arizona customers, including at least some of its currently exclusive and plenary ratemaking authority.

3. Finally, We Offer the Following Non-Exhaustive Comments on Additional Legal Impediments to the Introduction of Retail Competition in Arizona:⁴

- The *Phelps Dodge* Court held that utilities cannot be compelled to join an organization like an RTO, i.e., in that case, the Arizona Independent Scheduling Administrator. No state has restructured without an operational RTO in place.
- Another impediment related to the unconstitutionality of market-determined rates and price discrimination prohibitions is the separate statutory requirement (A.R.S. § 40-367) that rates be on file with the Commission and open to public inspection. Competitive providers must be required to file and disclose the various and different “deals” actually given to customers.
- The current rules violate the equal protection provisions of the 14th Amendment to the United States Constitution and Article II, Section 13 of the Arizona Constitution in that they do not provide equal treatment of all electric utilities and electric service providers in Arizona.
- The current rules also impermissibly interfere with the internal management and operations of utilities.

⁴ The Cooperatives reserve the right to raise additional legal issues and objections if and as this inquiry proceeds.


FERC

FEDERAL ENERGY REGULATORY COMMISSION

Chairman Jon Wellinghoff
Statement
March 15, 2012
Docket Nos. IN12-7-000

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The Constellation Energy Commodities Group Investigation

"Last Friday, we unanimously approved a Stipulation and Consent Agreement between the Commission's Office of Enforcement and Constellation Energy Commodities Group. Our order concluded a lengthy and complex investigation. I commend and thank our Office of Enforcement, including the team that worked on the investigation, for its tremendous work on behalf of consumers. It is a landmark case that will have long term benefits for all electric market consumers.

As detailed in the order, Enforcement Staff determined that Constellation engaged in manipulation that resulted in economic losses to market participants who bought and sold energy in the day-ahead markets of ISO New England and the New York Independent System Operator. Enforcement Staff also determined that this manipulation distorted price discovery for all market participants.

The severity of Constellation's conduct is demonstrated by its agreement to pay a civil penalty of \$135 million and to disgorge unjust profits of \$110 million or a total settlement amount of \$245 million. This total reflects the largest penalty that the Commission has imposed under the expanded enforcement authority that Congress assigned to us in 2005. Furthermore, the employees involved in the subject trading activities have been removed from any position that performs any duties related to managing, directing, or engaging in wholesale physical and financial energy trading. It is my hope and belief that this order again reinforces this Commission's commitment to protecting the integrity of the markets that are subject to our oversight and protecting the interests of consumers dependent on those markets.

Compliance, not penalties, remains my primary goal. To that end, the Stipulation and Consent Agreement is instructive regarding the characteristics of a robust compliance program. Now based on that agreement, Constellation will institute a policy and process to monitor profit and loss concentrations in virtual transactions and physical schedules of electric energy and to review and document the purpose of virtual transactions.

In addition, Constellation will develop and enforce policies which require that communications by its traders, including but not limited to instant messaging (IMs), email, and phone calls be preserved and a system should be set up whereby such communications will be regularly monitored by its compliance group for potential irregularities or illegalities.

Constellation also must adopt or maintain compliance measures and procedures related to its trading of jurisdictional products, including virtual transactions, scheduling of physical power, TCCs and FTRs. These measures shall include improved training for its traders, supervisors, and managers regarding the Commission's regulations prohibiting manipulation of jurisdictional energy markets and the Commission's regulations governing energy trading, including the adherence to the tariffs in the organized markets in which it participates and providing accurate information to the Commission, RTOs and ISOs.

I urge all companies to include these components in their compliance program.

In my view, all wholesale market participants should focus on four main points.

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First, do not trade uneconomically on one position in order to benefit the value of another. Second, senior management will be held accountable. Senior management has an obligation to proactively monitor for market manipulation and to pursue concerns once brought to their attention. Third, tell the truth, the whole truth, and nothing but the truth when questioned. Finally, understand that the Commission will be vigorous in using its anti-manipulation authority to protect consumers.

As a final point, I note that since the issuance of the Commission's order, a senior Constellation official has stated publicly that the company's practices at issue here were "lawful portfolio risk management transactions." In my opinion, clearly that is not the case. The Stipulation and Consent Agreement sets forth a detailed description of the transactions that I believe Constellation knowingly and willfully engaged in that form the basis of Enforcement Staff's conclusion that Constellation engaged in market manipulation, fraud, and misrepresentation. I urge anyone who has any question as to Constellation's actions in this case to read that Stipulation and Consent Agreement."

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Updated: March 15, 2012

Retail Electric Rates in Deregulated and Regulated States: 2012 Update

Published April 2013



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Retail Electric Rates in Deregulated and Regulated States: 2012 Update

The U.S. Department of Energy, Energy Information Administration (EIA) data show that between 1997 and 2012, increases in retail electric prices were higher in states with deregulated electric markets than in regulated states. EIA has just published full-year 2012 data, allowing a 15-year comparison between deregulated and regulated states.

The deregulated category includes states with retail choice programs, and whose rates are strongly influenced by wholesale power prices in markets under the jurisdiction of the Federal Energy Regulatory Commission (FERC). These states allow end-use customers to choose their electricity provider (retail choice) and no longer have rate caps or other forms of regulatory protections that limit customers' exposure to wholesale market prices. Deregulated states are California, Connecticut, the District of Columbia, Delaware, Illinois, Massachusetts, Maryland, Maine, Michigan, Montana, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, and Rhode Island.

The regulated category includes those states with traditional rate regulation. Ohio has been added to the list of deregulated states as its transitional rate regulation has come to an end.

Average retail rates for each category were calculated by dividing total annual revenue from sales to consumers by total annual sales to consumers.

In most deregulated states, IOUs sold off their electric generating facilities as part of the implementation of the retail choice regime. Over the past few years, the percentage of customers purchasing from an alternative supplier has increased and currently ranges from about 15 to 45 percent in most retail choice states. The distribution utility purchases power from the wholesale market to serve the remaining customers not purchasing from an alternative supplier. (This is generally called default or provider-of-last-resort service). With the exception of part of Montana, all of these states are located in regions where wholesale electricity prices are set through centralized wholesale markets run by regional transmission organizations (RTOs) and Independent System Operators (ISOs).

The following chart and graph cover fifteen years of experience with retail choice programs. 1997 was chosen as the starting year as it represents the last year with essentially no retail choice activity. The decline in rates in deregulated states in 1998 and 1999 most likely reflects the effect of mandated rate decreases in retail choice states, but the decline was short-lived as rates began rising again in 2000.

Rates for both deregulated and regulated states increased steadily for the first half of the previous decade, then increased dramatically in deregulated states between 2005 and 2006 as more rate caps came off and natural gas prices increased. Rates in regulated states also increased, though at a slightly slower pace. The decline in natural gas prices has kept rates in deregulated states relatively flat from 2008-2012. Rates in regulated

states increased slightly by 0.6 cents during this period, but are still 25 percent below rates in deregulated states.

States that implemented retail choice electric plans were generally high cost states, and the hope was that competition by electric suppliers would result in lower rates. In 1997, the states in the deregulated category had average rates that were 2.8 cents per kWh above rates in the regulated states (8.6 vs. 5.8). Unfortunately, the retail choice experience – complete with the combined effect of divestiture of utility generating assets, and exposure of retail consumers to wholesale rates set in RTO markets – has resulted in an even larger gap in 2012, with deregulated states paying, on average, rates that are 3.0 cents per kWh above rates in regulated states (11.9 vs. 8.9).

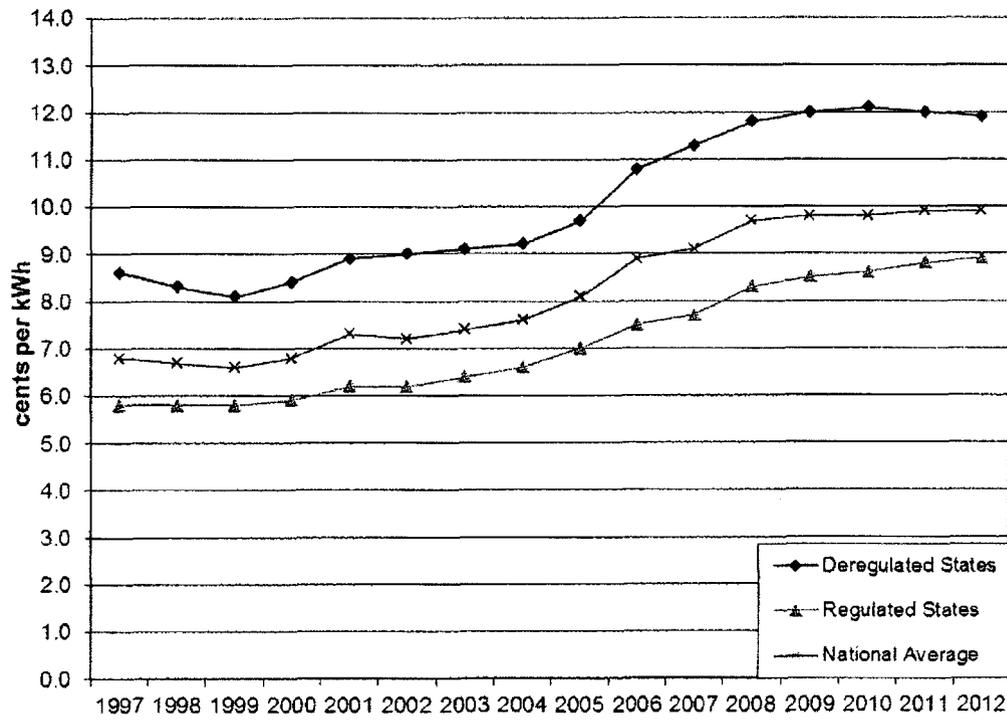
Average Revenue per Kilowatt-hour: Deregulated vs. Regulated States

Source: Energy Information Administration, Forms EIA-861 and EIA-826.

	<u>Deregulated States</u> (in cents per kilowatt-hour)	<u>Regulated States</u>	<u>National</u>
1997	8.6	5.8	6.8
1998	8.3	5.8	6.7
1999	8.1	5.8	6.6
2000	8.4	5.9	6.8
2001	8.9	6.2	7.3
2002	9.0	6.2	7.2
2003	9.1	6.4	7.4
2004	9.2	6.6	7.6
2005	9.7	7.0	8.1
2006	10.8	7.5	8.9
2007	11.3	7.7	9.1
2008	11.8	8.3	9.7
2009	12.0	8.5	9.8
2010	12.1	8.6	9.8
2011	12.0	8.8	9.9
2012	11.9	8.9	9.9
 <u>Difference, in cents per kilowatt-hour</u>			
1997-2012	3.3	3.1	3.1

Notes: Deregulated states include: CA,CT,DC,DE,IL,MA,MD,ME,MI,MT,NH,NJ,NY,OH,PA,RI
 Regulated states include all other states except for Texas.
 Texas is included in the National average.

Average Rates: Deregulated vs. Regulated States

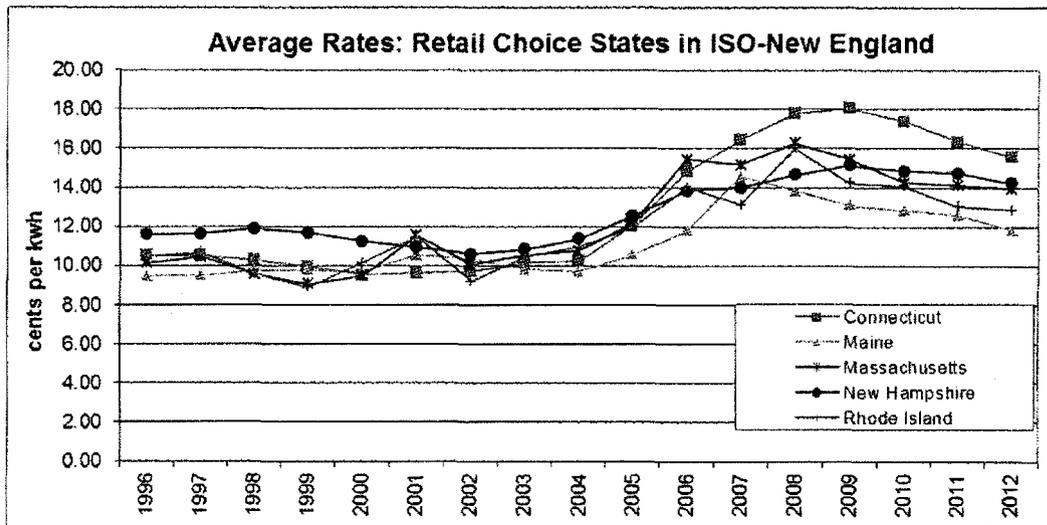


Data for Individual States

Five of the 15 states in the deregulated category are located in the footprint of the New England RTO (known as ISO-New England). The table below shows that rates for all five states were already well above the national average in 1997. Over the 15-year period, both Connecticut and Massachusetts experienced rate increases significantly above the national average. The graph shows that rates in these New England states have declined over the last three to four years. This is most likely a result of steep drops in natural gas prices, as the New England region relies heavily on natural gas for generation.

State Average Customer Rates, in cents per kWh

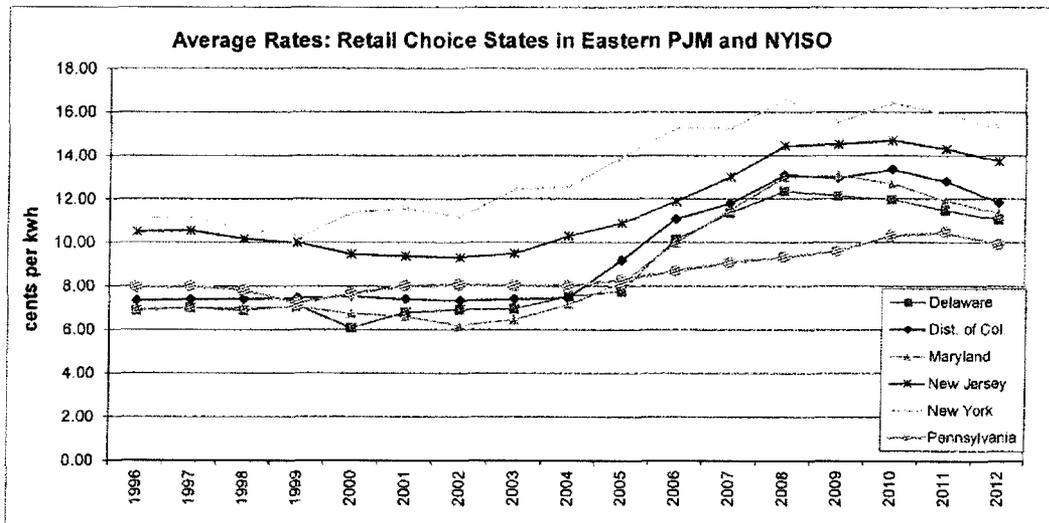
	<u>1997</u>	<u>2012</u>	<u>Difference</u>
<u>ISO - New England</u>			
Connecticut	10.5	15.6	5.1
Maine	9.5	11.8	2.3
Massachusetts	10.4	13.9	3.5
New Hampshire	11.6	14.2	2.6
Rhode Island	10.7	12.9	2.2
National Average	6.8	9.9	3.1



Four retail choice states and the District of Columbia are in the PJM RTO, and the state of New York comprises the New York RTO (known as NYISO). The table below shows that retail rates in all jurisdictions except Pennsylvania increased more than the national average between 1997 and 2012. Most Pennsylvania customers were still subject to rate caps until 2011. Rates for this state increased slightly as the rate caps came off in 2010 and 2011.

State Average Customer Rates, in cents per kWh

	<u>1997</u>	<u>2012</u>	<u>Difference</u>
<u>Eastern PJM and NYISO</u>			
Delaware	7.0	11.1	4.1
District of Columbia	7.4	11.8	4.4
Maryland	7.0	11.3	4.3
New Jersey	10.5	13.7	3.2
Pennsylvania	8.0	9.9	1.9
New York	11.1	15.2	4.1
National Average	6.8	9.9	3.1



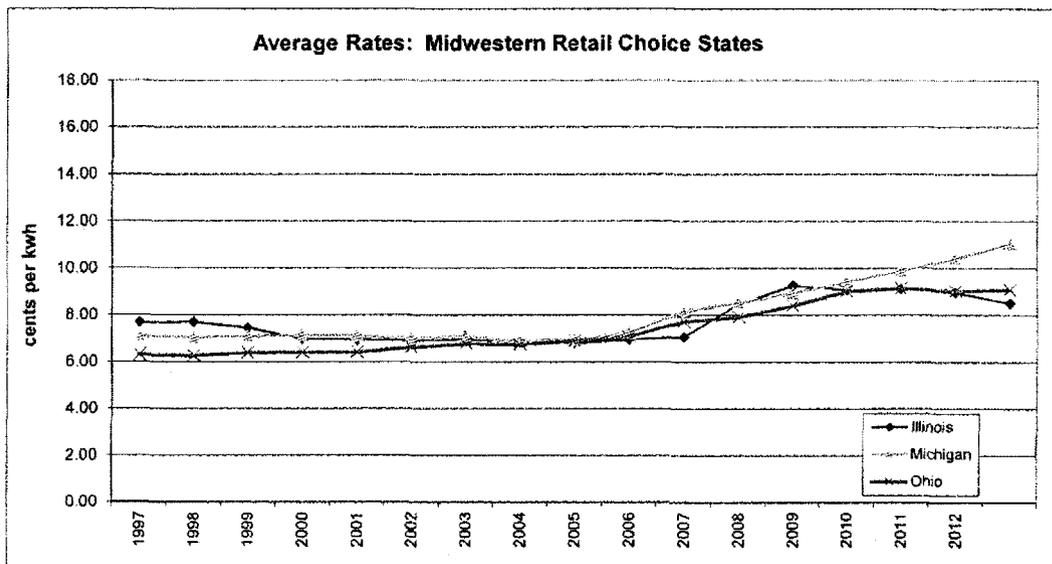
Utilities in the three retail choice states in the Midwest operate in both PJM and the Midwest ISO (MISO). Commonwealth Edison, which serves over 60 percent of the load in Illinois, is in PJM, while the rest of the Illinois utilities, almost all of Michigan, and the northern half of Ohio are in MISO. Rates in Illinois were subject to a rate cap through 2006. The state used an auction process to establish the 2007 rate, and because the results were so high, subsequently negotiated a refund settlement with the largest utilities. The settlement was authorized by a 2007 law that also established the Illinois Power Authority to procure power for the state's IOUs.

Unlike IOUs in most retail choice states, Michigan utilities did not sell their generating assets, and as a consequence, only depend on wholesale power markets for a portion of their customers' power needs. Under the terms of a 2008 law, participation in retail choice programs is capped at ten percent of an IOU's retail sales.

Until recently, Ohio utilities had been subject to transition rate regulation. IOUs were required to offer customers a rate approved by the Public Utilities Commission of Ohio (PUCO) under a cost-plus-based electricity plan. Beginning in 2012 a large share of IOU load was bid at competitive auctions, and a majority of customers had switched to alternative suppliers. Because a large portion of Ohio ratepayers are now directly exposed to wholesale market prices, as of 2012 Ohio is considered a deregulated state.

State Average Customer Rates, in cents per kWh

	<u>1997</u>	<u>2012</u>	<u>Difference</u>
<u>Midwest</u>			
Illinois	7.7	8.5	0.8
Michigan	7.0	11.0	4.0
Ohio	6.3	9.1	2.8
National Average	6.8	9.9	3.1



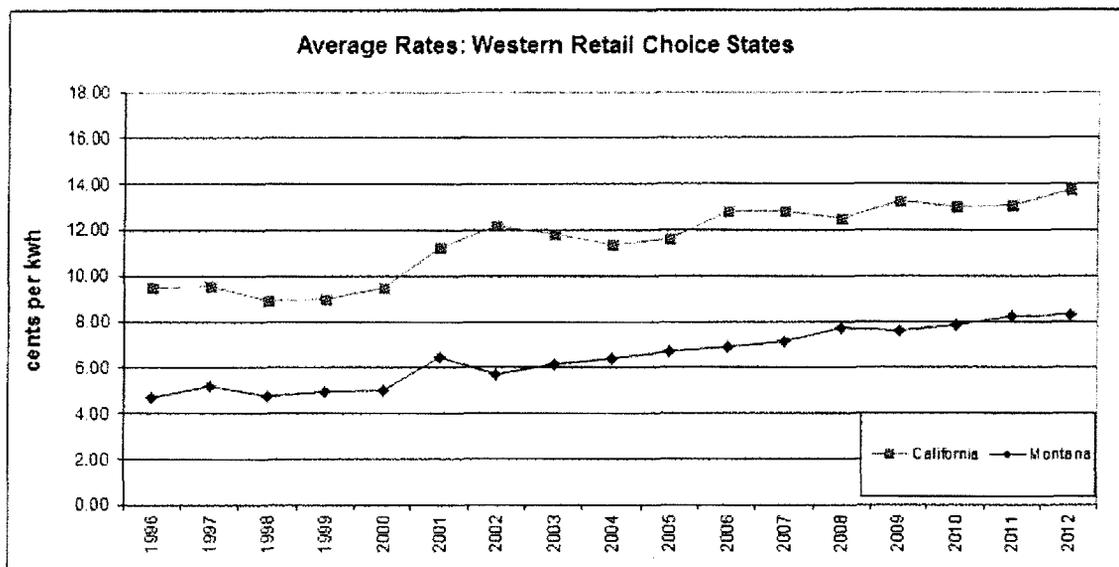
Only two western states implemented retail choice: California, which comprises the California ISO, and Montana. Both states currently have very limited retail choice programs. Average rates in California have increased more than the national average, while rates in Montana have increased exactly at the national average.

Following the California energy crisis in 2000-2001, retail choice was suspended in California, and the only customers that could choose their providers were those who were on retail choice plans at the time of the suspension. An October 2009 law allowed retail choice for commercial and industrial customers up to the level achieved prior to the suspension of retail choice, and in April 2010, the state Public Utilities Commission set the level at 11 percent of total retail sales.

Montana is the only retail choice state not entirely in an RTO, but the state's IOU sold off all of its generation, so the utility must purchase power in wholesale power markets, including RTO-operated markets. Montana enacted a law in 2007 to end retail choice for all but large customers with more than 5 megawatts of load and those customers on retail choice plans as of October 2007.

State Average Customer Rates, in cents per kWh

	1997	2012	Difference
<u>Western States</u>			
California	9.5	13.8	4.3
Montana	5.2	8.3	3.1
National Average	6.8	9.9	3.1



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Electric Deregulation Promises Remain Unfulfilled

Written on: January 25, 2012

AUSTIN, Texas—(BUSINESS WIRE) (<http://www.businesswire.com/>)—Texans under electric deregulation have consistently paid more for electricity than Texans living in areas that remain outside deregulation, according to a new report released for the 10-year anniversary of retail competition.

Deregulated Electricity in Texas: The First 10 Years of Retail Competition (<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Fhistoryofderegulation.tcaptx.com%2F&esheet=50144522&lan=en-US&anchor=Deregulated+Electricity+in+Texas%3A+The+First+10+Years+of+Retail+Competition&index=1&md5=ede07a2c0b1e152036301e913dd9>)

also reveals that Texans have been saddled with more than \$7 billion in deregulation-related charges known as stranded costs. And while average statewide rates have come down in recent years, they remain stuck above rates in adjoining states.

Commissioned by the [Texas Coalition for Affordable Power](http://www.tcap.org/) (<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Ftcaptx.com&esheet=50144522&lan=en-US&anchor=Texas+Coalition+for+Affordable+Power&index=2&md5=24ab857aa4d4bb8b29f2ff2e8e9ae>) ("TCAP"), a nonprofit coalition of 163 municipalities and other political subdivisions, the report tells the story of retail electric deregulation in Texas from the beginning. It was released digitally on the TCAP website (<http://historyofderegulation.tcaptx.com/>) (<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Fhistoryofderegulation.tcaptx.com%2F&esheet=50144522&lan=en-US&anchor=http%3A%2F%2Fhistoryofderegulation.tcaptx.com%2F>)

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[2F&index=3&md5=4d336a9f9f840e91845ba4dbbf8fcfe0\)\)](#) and includes recent pricing data and in-depth articles focusing on energy policy. It updates an earlier report from 2009.

TCAP board president Jay Doegey says the report shows there's more work to be done before deregulation can be declared a success. Deregulation of the state's retail electricity markets began 10 years ago, this month. Under the law, retail electric providers in many parts of the state can compete for customers.

"Although we've made some progress, serious concerns remain," said Doegey. "Electricity prices and complaints have recently decreased from record high levels experienced earlier in the deregulation process, but problems remain. Neither are these recent price declines sufficient to offset the billions of dollars in excess costs to consumers. All this points to a market that is deregulated, but still not fully competitive. Texans deserve meaningful reform."

Among the report's key findings:

Texans in deregulated areas of the state have consistently paid higher average annual electricity prices than Texans outside deregulation. This added expense has cost a typical customer under deregulation more than \$3,000 since the beginning of retail competition.

Electricity prices above the national average have cost Texans more than \$11 billion during the 10-year history of retail competition. Only recently has the trend of above-the-national-average prices in Texas changed.

The number of electric providers has increased under the deregulation law — but so has the complexity of electric contracts. Complaints from electricity customers have been much greater during deregulation, as compared to complaints filed annually prior to deregulation.

Texas had the highest generation reserve margins in the nation prior to the implementation of the deregulation law. Texas now has among the lowest. This has led to serious reliability challenges for the state's power grid.

There have been two statewide rolling blackouts in four years under deregulation, and at least nine reliability emergencies last year alone. By contrast, the state's grid operator ordered statewide rolling blackouts only once in 30-plus years before deregulation.

Some generators have recommended market changes designed specifically to increase their profit margins. Many of these proposals abandon competitive principles, and instead rely upon artificial price supports and regulatory intervention to engineer higher prices. But generators offer no guarantee that new supplies will be added to stay ahead of the demand for electricity.

Although the Texas Legislature adopted a helpful reform in 2011, potential abuse in the wholesale power market remains a concern.

[Deregulated Electricity in Texas](#)
<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Fhistoryofderegulation.tcaptx.com%2F&esheet=50144522&lan=en->

[US&anchor=Deregulated+Electricity+in+Texas&index=4&md5=597e09d324a7d9715a4430da8dc148bc](#) is based on months of research, including a review of journalistic accounts, regulatory documents, academic studies and data from the United States Energy Information Administration.

“Affordable energy saves money for Texans — both as ratepayers and taxpayers,” said TCAP Executive Director Randy Moravec. “Affordable electricity also supports economic development for our communities and a better life for our citizens. For the sake of home consumers, businesses and local governments — it is important that this market work. That’s why reforms calling for greater market transparency and the prevention of abusive pricing are so important.”

About the [Texas Coalition for Affordable Power](#) (<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Ftcaptx.com&esheet=50144522&lan=en-US&anchor=Texas+Coalition+for+Affordable+Power&index=5&md5=55e851ecf4a3e5364483df637629>)

Unlike the sponsors of other reports about the state’s deregulated power market, TCAP derives no profit from selling electricity. Instead, the 163 political subdivisions that comprise TCAP purchase electricity for their own governmental needs. TCAP understands how high-cost power can undermine city budgets, can cause businesses to relocate out of state, and can place heavy burdens on home consumers. TCAP wants what all Texans want: an affordable and reliable supply of power and a vibrant economy.

Photos/Multimedia Gallery Available:
<http://www.businesswire.com/cgi-bin/mmg.cgi?id=50144522&lang=en> (<http://cts.businesswire.com/ct/CT?id=smartlink&url=http%3A%2F%2Fwww.businesswire.com%2Fcgi-bin%2Fmmg.cgi%3Fid%3D50144522%26lang%3Den&esheet=50144522&lan=en-US&anchor=http%3A%2F%2Fwww.businesswire.com%2Fcgi-bin%2Fmmg.cgi%3Fid%3D50144522%26lang%3Den&index=6&md5=549953446cd615d001aec7473ef9b70f>)

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