Chapter 5

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

1.0 Purpose

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

2.0 Team Members

Doug Bantam – Lincoln Electric System
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Jay Holmquist – Nebraska Rural Electric Association
John McClure – Nebraska Public Power District
Tom Richards – Omaha Public Power District

3.0 Introduction

3.1 Deregulation Overview

Little has changed with the development of retail choice around the nation in the past year. Most state retail choice programs are either struggling or inactive. On September 1, 2004, the State Corporation Commission of Virginia issued a press release describing the findings of its fourth annual report on retail choice in Virginia. The press release notes, "that the electricity supply industry continues to struggle following price run-ups, disclosures of accounting and dated improprieties, creditworthiness issues and volatile fuel prices, particularly natural gas." The press release concludes "that Virginia is not the exception when it comes to the lack of competitive activity for electricity supply service. In other states with retail choice, energy markets are generally inactive with few customers able to purchase power at a price lower than their traditional utility company."

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

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

Because Texas continues to receive attention as the most successful retail choice state, there is a Texas update in this report. This report also contains a new section on federal developments. President Bush signed comprehensive energy legislation on August 8, 2005.

4.0 Texas

Because of the national significance of the public policy choices adopted in Texas, the material below contains background on the Texas retail electric program as well the most recent of their efforts.

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

Following are the key provisions of the Texas law:

- Froze electric rates for investor-owned electric utilities in Texas through 2001.
- Prohibits large utilities from lowering their rates for residential and small commercial customers before 2005, or until 40 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 in low-income assistance programs.
- Prohibits disconnection of service for nonpayment during periods of extreme weather.

- Allow customers to receive one bill for their electric service in an easy-to-read format and understandable language.
- Creates a Do Not Call list for customers who do not wish to be called by telemarketers on behalf of electric providers.
- Provides customer protection against discrimination, against being billed for unauthorized charges (cramming), against unauthorized change of service provider (slamming) and other unfair, misleading and deceptive practices.

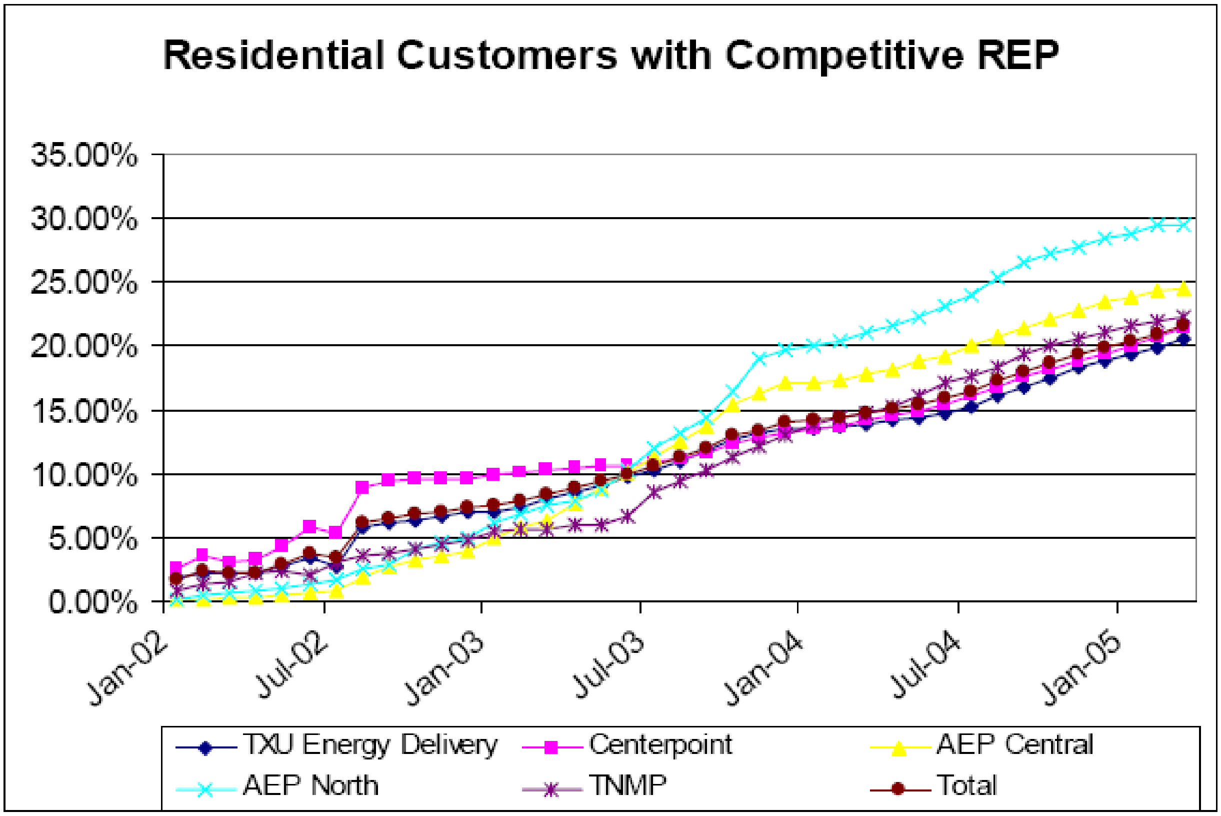
It is important to note that much of the Texas region is operated as a separate electrical interconnection. This limits and confines the size of the restructured area and restricts the impact of wholesale energy deliveries from potentially lower cost resources. When Texas initiated the retail choice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

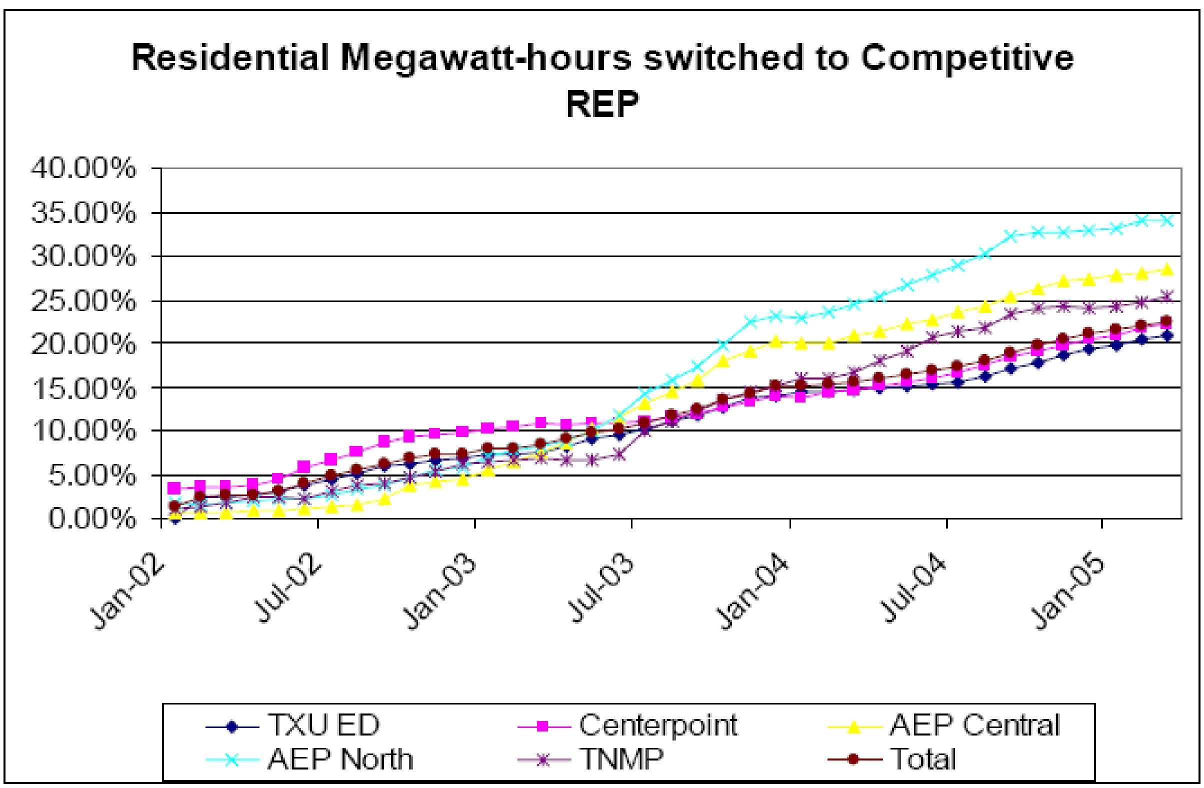
Under the Texas deregulation program, electric utilities were divided into three areas: retail, power generation, and transmission and distribution. Any investor-owned companies that wish to enter the retail market must create an affiliate company. To ensure deregulation, the Texas Public Utilities Commission created a price-to-beat for investor-owned affiliates that will remain in place until 2005 or until 40% of customers switch to another retail company. In September of 2004, the price-to-beat in the five distribution areas ranged from 10.9 to 13.0¢kWh with the average residential at 11.7¢. Price-to-beat rates have increased approximately 30% since January 2002.

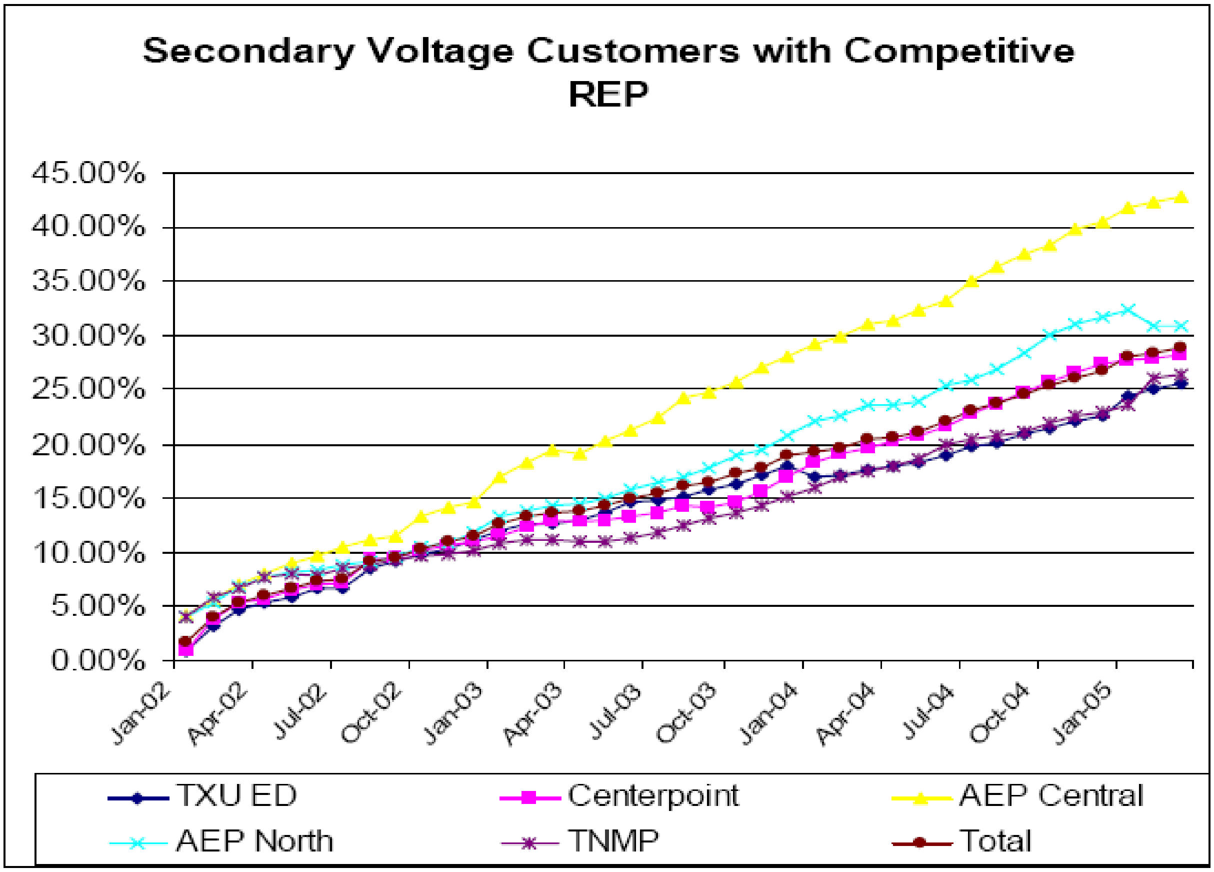
The Texas Public Utility Commission continues to monitor and report on the status of retail competition in Texas. These “Report Cards” remain positive. Generally, retail choice participation is growing. During 2004 until March 2005, participation at the residential level has grown from just over 14% to 21.6% and small industrial and commercial participation has increased from 19% to 28.9%.

As of June 24, 2005, over 1,920,000 retail customers were taking service from a non-affiliated provider. The Public Utilities Commission of Texas states in their June 2005 “Report Card on Retail Competition”, the percentage of megawatt hours (MWH’s) serviced by non-affiliated retail electric providers (REP’s), is nearly 22.5% of residential load. Among customers served at secondary voltage, mostly commercial and some small industrial customers, almost 60% of the load has switched to competitive providers. Over 65% of the large industrial loads have switched. These percentages are higher than the percentage of customers who have switched because the larger commercial and industrial customers comprise a significant portion of the energy consumption in the state.

The following charts have been extracted from the most recent Texas Public Utility Commission Report in June 2005. The Texas Retail Choice Program continues to grow and is considered by the Texas PUC to be a successful and cost-effective program.


Residential Customers with Competitive REP
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
Jan-02
Jul-02
Jan-03
Jul-03
Jan-04
Jul-04
Jan-05
TXU Energy Delivery
Centerpoint
AEP Central
AEP North
TNMP
Total


Residential Megawatt-hours switched to Competitive REP
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
Jan-02
Jul-02
Jan-03
Jul-03
Jan-04
Jul-04
Jan-05
TXU ED
Centerpoint
AEP Central
AEP North
TNMP
Total



5.0 Federal Issues

Driven in large part by the electricity supply and reliability problems in the western United States, as well as the large blackout in the Northeast in August 2003, the focus of restructuring has been expanded to include energy supply, renewable energy incentives, infrastructure concerns, as well as reliability. Transmission across the United States is frequently inadequate to support retail deregulation. Legislation addressing transmission issues included eminent domain, transmission reliability standards, and other issues that have been the focus of both Congress and the FERC. Infrastructure/pipelines for natural gas supply have not kept up with the growing demand for natural gas, which has become the most common fuel for generating facilities built in the last 10 years.

A major focus of both the Bush Administration and Congress has been on development and passage of national energy policy legislation.

<u>Background/Status</u>

- Bush Administration National Energy Policy Development Report Released – May 2001
- House of Representatives responded quickly and passed H.R. 4 – August 2, 2001
- Senate delayed consideration of energy policy legislation until early 2002. S.517 passed Full Senate- April 25, 2002.
- House/Senate Energy Conference failed to reconcile differences between H.R. 4 and S.517 – legislation died at the end of the 107th Congressional Legislative Session in November 2002.
- House of Representatives in the 108th Congress passed H.R.6 on April 11, 2003.
- Senate passed legislation (also designated as H.R.6 after House passage) on July 31, 2003.
- House/Senate Energy Conference commenced in September 2003 to resolve legislative differences with final agreement reached on November 16, 2003.

- Energy Conference Report passed by the House on November 18, 2003.
- Senate cloture vote to end debate moved forward on the Energy Conference Report on November 21, 2003 failed by a vote of 57 Yeas to 40 Nays, 3 Not Voting (60 votes needed).
- Renewed efforts of passage of energy legislation in 2004 in the Senate failed with no passage of energy legislation throughout the 108th Congress.
- House of Representatives in the 109th Congress passed H.R.6 on April 21, 2005.
- Senate passed legislation (also designated H.R.6 after House passage) on June 28, 2005.
- Energy Conference Report passed by the House on July 28, 2005 followed by Senate passage on July 29, 2005.
- National energy policy legislation signed into law by President Bush on August 8, 2005.

Some of the Major Provisions of Interest to Electric Utilities in the H.R.6 Conference Report Include:

Repeal of the Public Utility Holding Company Act of 1935 – FERC granted access to utility affiliates books and records and FERC provided with merger review authority.

Reform of the Public Utility Regulatory Policy Act of 1978 – eliminates mandatory electric utility purchase requirements for electricity generated by qualifying co-generators or small power producers, so long as these generators have access to competitive wholesale markets. Smart metering, net metering, and interconnection provisions are also included.

FERC Lite – limited expansion of FERC jurisdiction over public power to promote wholesale power markets. Public power would provide transmission services at non-rate terms and conditions that are comparable to what they have for themselves. No FERC ratemaking authority over public power was included.

Service Obligation/Native Load Protection – requires FERC to ensure that load service entities are allowed to reserve their transmission assets to serve native load customers before transmission capacity is made available to others.

Uniform Refund Authority – authorizes FERC to order refunds from large public power systems if short-term wholesale sales are made in violation of FERC rules.

Participant Funded Transmission – authorizes FERC to approve of participant funding plans for transmission upgrades that would be paid for by those requesting the upgrades without requiring participation in an RTO or ISO.

Transmission Reliability Standards – standards will be FERC approved, mandatory, and enforceable with penalty provisions.

Transmission Siting Authority – FERC authorized to permit and approve needed new transmission if state(s) cause obstacles.

Renewable Energy Production Incentive (REPI) – reauthorizes the REPI program until 10-1-2016, and puts landfill gas projects on equal funding priority as wind, solar, biomass, etc. Comparable to IOU production tax credits in that the payout for generation is over a 10-year period. Funding is dependent on annual congressional appropriations.

Clean Energy Bonds – these bonds will provide public power systems with interest-free loans to finance qualified renewable energy projects. The federal government would pay a tax credit to the bondholder in lieu of the issuer paying interest. The program is authorized for two years/$800 million cap.

6.0 Conclusions

- Retail choice programs achieved mixed results ranging from failure (CA) to no impact (AZ) to some success (TX).
- Natural gas prices are at an all time high significantly increasing the cost of gas-fired generation.
- 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.
- 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.
- Increased stability of fuel prices is needed for retail choice programs to function properly.
- Better customer response to wholesale price signals is needed.
- Enactment of comprehensive energy legislation will have significant impacts on wholesale and retail electricity markets.
- FERC is actively involved in developing and addressing the transition to a more competitive wholesale market.