



## Q&A on Electricity Markets and Problems

### **Q: What Changes Have been Made to Electricity Markets?**

A: In the 1990s, both state and federal agencies fundamentally altered the long-standing regulation of electric utilities in the United States. These changes are generally described as deregulation or restructuring.

Some states decided that the investor-owned for-profit electric utilities should no longer be regulated monopolies and, instead, should be deregulated and face competition, just as trucks, railroads and airlines had during the 1980s. In these states, including some large ones like New York and California, consumers were given the right to purchase power from companies other than their local utility, paving the way for electric rates that would be set by the market instead of by the costs of producing such power.

Meanwhile, the federal agency that regulates wholesale power sales, the Federal Energy Regulatory Commission (FERC), also deregulated the electricity markets under its jurisdiction. Instead of pricing electricity by the cost of production plus a reasonable profit, the commission also allowed the wholesale power companies to let the market set the price.

These changes were predicated on the promise that deregulation would promote competition, spur efficiencies and innovation and result in lower rates for consumers – predictions that turned out to be wrong.

### **Q: How Have These Changes Affected Consumers?**

A: In the Northeast, Mid-Atlantic, Midwest and California the FERC encouraged the establishment of entities called regional transmission organizations (RTOs) to operate wholesale, short-term markets where electricity is bought and sold with minimal regulation in highly complex deals. Not only are these transactions complicated, there is little information disclosed on how prices are set.

Meanwhile, as part of the state-level restructuring, many investor-owned utilities were required to sell off their power plants, often to unregulated affiliates. Now these utilities have to buy their power in the problematic wholesale markets, in some cases from the very generating plants they once owned and which were largely paid for by their customers! Because few residential and small commercial consumers are actually purchasing power from alternative suppliers, many homeowners and businesses have been hit by these high wholesale prices through the utility purchases on their behalf. Not only have these high costs hurt consumers' pocketbooks, they've made it more difficult for businesses to compete and in some cases cost jobs. As a

result, a number of states (Ohio, Michigan, Connecticut, Pennsylvania and Maryland) have taken steps or are studying measures to protect consumers from the downfalls of deregulation.

### **Q. What is the Measure of these Price Impacts?**

Consumers in deregulated states located within RTO markets were paying 56 percent more than consumers in regulated states in 2007, or 4.4 cents per kilowatt-hour more.

Residential customers living in a deregulated state without price caps pay an average \$30 more per month than residential customers in the rest of the country, equal to \$360 per year.<sup>1</sup>

Commercial and industrial customers, from small businesses to large factories, have also been hard hit. Commercial customers use an average of 6,500 kilowatt-hours a month; those in fully deregulated states pay over \$300 more on their monthly bills, or more than \$3,600 per year.<sup>2</sup> This has made areas with RTOs unattractive to business, which means fewer jobs and economic development in states already hit hard by the recession. Electricity costs in Massachusetts have contributed to the shutdown of several plants with the loss of an estimated 2,000 jobs.<sup>3</sup> In Frederick, Maryland, ALCOA closed a well-run, state-of-the-art plant in 2006 due to the lack of long-term contracts for electricity at affordable prices.<sup>4</sup> Donsco, Inc., a scrap metal company in Pennsylvania, has placed a \$10 million expansion plan on hold because of the unpredictability of electricity prices.<sup>5</sup>

### **Q: If Deregulation Was Supposed to Increase Competition, Why Aren't Your Bills Lower?**

A: The markets are hardly “deregulated.” Instead they are operated by vast bureaucracies whose rules are highly influenced by the very sellers earning high profits. Within these complex markets, the sellers bid to supply power at any rate they choose.

Under what was supposed to be competition, rates are no longer based on these suppliers' costs, and moreover, hourly auctions run by the RTOs reward all sellers with the highest price bid that is accepted for that time period. On top of this cash flow, new rules allow millions of dollars to be paid to suppliers simply for ownership of power plants. These high wholesale power prices are reflected in prices paid by utilities in deregulated states that continue to serve consumers with no other available electricity supplier. As a result, instead of “choice,” consumers are saddled with higher, uncompetitive rates.

### **Q: What is Meant by “Prices Should be ‘Just and Reasonable’?”**

A: It basically means prices must be fair. The Federal Power Act, (the federal law that governs rates in wholesale electric markets) requires that “all rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable and any such rate or change that is not just and reasonable is hereby declared to be unlawful.”

FERC has the authority and responsibility to determine just and reasonable rates and enforce those rates. But FERC has chosen to let the “market” discipline prices, despite evidence that the market is not competitive. Such evidence includes a disparity between prices and costs, limited options for stable long-term contracts, difficulty of entry for new competitors, and the gap between prices paid in regulated and unregulated regions. Sellers should not be able to charge whatever price a dysfunctional “market” will bear.

**Q: Why Don’t Regional Transmission Organizations work?**

A: The FERC approved the creation of RTOs to ensure everybody buying and selling electricity has access to the transmission lines needed to move their power, an important RTO function. But FERC also encouraged the RTO to develop and operate electricity markets that allow the highest sellers’ offer in an hour to be accepted and set the price of electricity, regardless of what it cost to generate. The RTOs monitor the markets for market power, but this has proven to be ineffective. Nor is there sufficient information on the costs and behavior of sellers to allow participants to assess whether the prices being charged are just and reasonable. This is not competition; this is a license to take advantage of customers, threatening the well-being of residential consumers and businesses.

In their original form, RTOs were supposed to prevent another big blackout like we had in California and on the East Coast and Midwest a few years ago. But what’s actually happened is that the long-term reliability of power supplies is threatened. Despite the power-plant owners’ huge profits, these companies have not invested in necessary new and clean power generation or transmission infrastructure. In most regions of the country, projected future demand exceeds the expected available supply. The RTOs have responded to these potential shortages simply by creating mechanisms to pay the owners of power plants to simply keep their plants in operation, or high incentive fees for the construction of transmission lines.

**Q: Why Should We Worry About This Since It Only Affects A Few States?**

A: An estimated 68 million residential, industrial and commercial electricity customers are affected by this issue in 15 states and the District of Columbia. Some of these states are home to industries critical to the U.S. economy. And advocates of wholesale and retail restructuring would like to expand these markets across the country, posing even greater threats to the economy.

**Q: But Isn’t Climate Change the Biggest Concern for Electricity Policy? How Does Restructuring Affect Carbon Emissions?**

A: Investment in new technologies needed to support energy efficiency and renewable energy is difficult when families and businesses are already paying more than they can afford (or should have to pay) for electricity. Households struggling to pay their utility bills do not have available cash for efficient appliances, and a factory laying off workers cannot afford the capital expenditures involved in installing high efficiency motors.

Moreover, implementation of a cap-and-trade program for carbon emissions would be extremely difficult to do in a fair manner in the RTO-run markets. Consumers would wind up paying the cost of carbon emissions even to plants that do not emit carbon dioxide, such as nuclear power. In the current economy, consumers cannot afford to pay more for electricity just

so some power companies can profit. This additional layer of costs simply makes carbon mitigation strategies more difficult to implement.

**Q: Other Than These Price Trends, Is There Evidence That These Markets Are Not Achieving the Benefits of Competition?**

A: Under the Electric Market Reform Initiative (EMRI), the American Public Power Association commissioned a series of investigations of the restructured wholesale electricity markets. The findings of these studies constitute real evidence that RTO market failures are harming consumers, and they stand in stark contrast to the contrary claims by the RTOs and the owners of unregulated generation selling into those markets.<sup>6</sup>

The academics and energy consultants who conducted the EMRI studies found a market characterized not by competition, innovations and efficiency, but by great disparities between prices and costs, sellers who may be engaging in price manipulation, extremely high profits by unregulated owners of generation, and a lack of investment in needed infrastructure improvements.

**Q: Which Organizations Share the Concerns About Today's Electricity Markets?**

A: A diverse group of 41 consumer advocacy, business, and public power organizations came together in December 2007 to ask the FERC to investigate whether restructured wholesale electricity markets are producing just and reasonable wholesale power prices, as the law requires. A wide array of interests was represented on this request, from AARP, Public Citizen and the Consumer Federation of America, to the American Forest & Paper Association, the American Iron and Steel Institute, and numerous other industrial consumer representatives.<sup>7</sup> These concerns were dismissed by FERC.

Many consumer, low-income, industrial and public power groups have since formed the Campaign for Fair Electric Rates to continue to advocate for reforms to federal wholesale markets to ensure just and reasonable rates. For more information about CFER, go to: <http://www.fairelectricrates.net>.

**Q: But Aren't You Just Whining About the Problems Instead of Proposing Solutions?**

A: Supporters of the current market structure often make this accusation. Yet they ignore the many proposals that have already been put forth. Examples include proposals by the Carnegie Mellon Electricity Industry Center, the American Forest and Paper Association and a group of industrial customers, including the Portland Cement Association, Mittal Steel and the PJM Industrial Customer Coalition. The American Public Power Association has recently released its Competitive Market Plan, which like other proposals seeks to tie actual production costs to spot market prices and to increase the use of long-term contracts.<sup>8</sup>

It is time for FERC to implement reforms to the design of the current markets. Such reforms should meet three simple criteria outlined by the Campaign for Fair Electric Rates:

1. A market structure that produces just and reasonable prices, is fair to all market participants, and where the benefits of factors such as fuel diversity and operational efficiencies are shared equitably between consumers and suppliers.;

2. Improved and more timely transparency and accountability to consumers; and
3. A consumer-focused system that assures reliability and capacity growth to meet our future needs.

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<sup>1</sup> The monthly bills were determined by calculating the weighted average electric rate and monthly consumption from 2007 for consumers in the states that do not have price caps and in the remaining states, multiplying the average consumption and rates for each group, and subtracting the difference. This data was provided by the Energy Information Administration, Table 5, <http://www.eia.doe.gov/cneaf/electricity/esr/table5.xls>

<sup>2</sup> See footnote 3.

<sup>3</sup> Soaring electricity prices leave state's manufacturers struggling, higher power bills contribute to plant closings, Boston Globe, By Robert Gavin, January 18, 2008.

<sup>4</sup> Speaker materials of Walter Brockway, Alcoa, Inc., at the May 8, 2007 Conference on Competition in Wholesale Power Markets, Docket AD07-7, , <http://www.ferc.gov/EventCalendar/Files/20070508083948-Brockway,%20Alcoa.pdf>

<sup>5</sup> Remarks By Arthur K. Mann, Sr., Chairman, Donsco, Inc., Pennsylvania Public Utility Commission, En Banc Hearing, October 23, 2008, <http://www.puc.state.pa.us/electric/pdf/EnBanc-WEM/Tmy-Donsco102308.pdf>

<sup>6</sup> A summary of the initial studies can be found at: <http://www.appanet.org/files/PDFs/EMRISummarybooklet.pdf>, or for full studies themselves, go to <http://www.appanet.org/emri.cfm>.

<sup>7</sup> See APPA Press Release, December 17, 2007,

<http://www.appanet.org/files/PDFs/PressRelease41GroupsAskFERCtoInvestigateElectricRates121707.pdf>

<sup>8</sup> *Deregulation/Restructuring – Where Should We Go From Here?*, Carnegie Mellon Electricity Industry Center Working Paper 07-07 <http://wpweb2.tepper.cmu.edu/ceic/papers/ceic-07-07.asp>; Comment of American Forest & Paper Association under RM07-19 and AD07-7, September 14, 2007, [http://elibrary.ferc.gov/idmws/File\\_list.asp?document\\_id=13538931](http://elibrary.ferc.gov/idmws/File_list.asp?document_id=13538931); Alternative Market Design Proposal Informational Filing. Portland Cement Association and Mittal Steel, FERC Technical Conference, April 30, 2008, <http://www.ferc.gov/EventCalendar/Files/20080507071814-Williams,%20Portland%20Cement%20Association%20Informational%20Filing.pdf>; APPA's Competitive Market Plan, February 2009, [www.appanet.org/emri.cfm](http://www.appanet.org/emri.cfm).