Campaign for Fair Electric Rates

Q&A on Electricity Markets and Problems

Q: What Happened to the Electricity Markets?

A: In the 1990s, some states decided 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 allowed to pick from among several companies in purchasing their power. Most of these companies didn't generate their own power and some weren't even located in the state.

Meanwhile, the federal agency that regulates wholesale power sales, the Federal Energy Regulatory Commission (FERC), deregulated some markets several years ago. Instead of pricing electricity by the cost of production plus a reasonable profit, the commission 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 allowed entities called regional transmission organizations (RTOs) to operate wholesale markets, including short-term markets where electricity is bought and sold under highly complex arrangements, with little timely information disclosed on how these prices were determined.

Meanwhile, many of the states that deregulated at the retail level are located within these RTOs. As part of the state-level restructuring, many investor-owned utilities sold off their power plants, often to unregulated affiliates. Now these utilities have to buy their power in the wholesale market, in some cases from the very generating plants they once owned and which were largely paid for by their customers. With few consumers actually purchasing power from alternative suppliers, many homeowners and businesses are directly exposed to the high wholesale prices

Some of these states have had retail price caps in place and thus are not yet fully exposed to the wholesale market rates. But in many deregulated states, the price caps have come off, resulting in dramatic rate increases. Last year, consumers in deregulated states were paying 4.4 cents per kilowatt-hour more than those in regulated states, an increase of 40 percent from the difference in 1997.

For residential customers living in a deregulated state without price caps, their average monthly bill is $30 more per month than for residential customers in the rest of the country, equal to almost $350 per year.[1]

Commercial and industrial customers, from small businesses to large factories, have also been hard hit. Commercial customers use an average of 6,000 kilowatt-hours a month; those in fully deregulated states pay over $300 more on their monthly bills, or more than $3,600 per year.[2] This has made areas with RTOs unattractive to business, which means fewer jobs and economic development. For example, Allegheny Technologies, a metals company with 3,500 employees, is considering leaving the state of Pennsylvania because of the looming price increases from electricity market restructuring.[3] In Frederick, Maryland, ALCOA had to close a well-run, technically up-to-date plant due to the lack of long-term contracts for electricity at affordable prices.[4]

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 who are earning the highest 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 reward all sellers with the highest price bid that RTO accepts 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 contracts to serve retail customers, and results in consumers being saddled with higher, uncompetitive rates. Such outcomes are hardly what one would expect form a competitive market.

Q: What Does It Mean When You Hear Prices Should be "Just and Reasonable?"

A: It basically means prices must be fair. In recent years there have been growing concerns about RTO-run wholesale electricity markets. Some of the biggest concerns are unreasonably high wholesale power prices, high administrative costs, and a lack of price transparency. Since deregulation began in the 1990s, consumers in some regions have seen electricity prices more than double. The economic disadvantage to consumers in RTO regions as a result of increased electricity prices is unjust and unreasonable.

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." Furthermore, the FERC has the authority and responsibility to determine just and reasonable rates and enforce those rates. Electricity rates for consumers must comply with the standards and requirements of the Federal Power Act. Prices should be governed by reason, and 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.

The problem is that the FERC also allowed RTOs to develop and run electricity markets that allow the highest sellers' offer accepted in an hour to 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 justified or 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, since the sellers in RTO regions are more interested in handsome profits than long-term planning or tamping down price volatility in the electricity market. More generating plants would mean more competition, lessening the profitability of the existing plants.

Despite the power-plant owners' huge profits, these companies have not invested in needed new infrastructure. So in regions with an RTO, projected future demand appears unlikely to be met by construction of power plants and lines.

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

A: At least 15 states and the District of Columbia have restructured their retail markets and also are located within RTOs – covering an estimated 68 million residential, commercial and industrial electric customers. Some of these states are home to a significant amount of industry and are critical to the US economy. Moreover, many advocates of wholesale and retail restructuring would like to expand these markets to other regions.

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.

Politically, high prices reduce the ability of federal and state legislators to implement carbon reduction programs that include fees to fund investment in clean energy and energy efficiency.

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 of RTO market failures that 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.[5]

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, behavior of sellers indicating possible 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: On December 17, 2007, a diverse group of 41 consumer advocacy, business, and public power organizations came together to ask the FERC to investigate whether restructured wholesale electricity markets are producing unjust and unreasonable wholesale power prices. 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.[6]

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 put forth 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. All of these proposals seek to reintroduce the use of actual production costs as a limitation on prices and to increase the use of long-term contracts.[7] A recent proposal from the American Public Power Association would eliminate the RTO-operated markets altogether, allowing the RTOs to focus on the operation of a reliable transmission system.[8]

FERC has denied the simple straightforward request made in December 2007 that the Commission invoke its existing legal authority to determine if current rates meet the "just and reasonable" standard set out in the Federal Power Act. Because of its legal and investigative powers, and because FERC can obtain all market data while market participants cannot, FERC is the best entity to lead the development of necessary changes.

It is time for FERC to implement reforms to the design of the current markets. Such reforms should meet three simple criteria:

1. A market structure that is fair and reasonable, better reflecting the costs incurred in generating electricity;
2. Improved and more timely transparency and accountability; and
3. A consumer-focused system that assures we have the power supplies we need to meet our future needs, while addressing the environmental challenges we face.

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[1] The monthly bills were determined by calculating the weighted average electric rate and monthly consumption from 2006 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
[2] See footnote 3.

[3] *Businesses flip-flop on electricity deregulation Companies say state plan they once extolled as a way to exact fairer pricing doesn't work*, by Sam Kennedy, Allentown Morning Call, September 22, 2007.
[4] Speaker materials of Walter Brockway, Alcoa, Inc., at the May 8, 2007 Conference on Competition in Wholesale Power Markets, Docket AD07-7.
[5] 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.
[6] See APPA Press Release, December 17, 2007, http://www.appanet.org/files/PDFs/PressRelease41GroupsAskFERCtoInvestigateElectricRates121707.pdf
[7] *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, Comment of Portland Cement Association, Multiple Intervenors, PJM Industrial Customer Coalition, et al under RM07-19-000, January 11, 2008.
[8] Consumers in Peril: Why RTO-Run Electricity Markets Fail to Produce Just and Reasonable Electric Rates, American Public Power Association, February 2008, http://www.appanet.org/files/PDFs/ConsumersinPeril%2Epdf