

MONOPOLIES OR MARKETS? ELECTRIC COMPETITION IN TEXAS

THE ISSUE

Introducing competition into Texas' retail and wholesale electricity markets has made Texas the greatest success story in the United States—if not the world—in moving away from the model of heavily regulated public utilities, i.e., government-mandated monopolies. That success is largely due to policymakers' willingness to let markets work and not manipulate prices or other policies for political reasons.

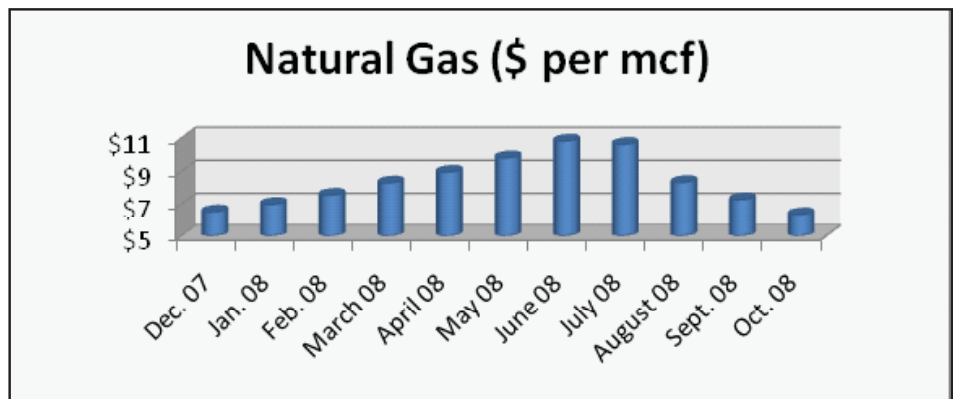
The transformation of American electricity markets was dominated elsewhere by a political competition to “design” markets. However, Texas did not “design” a retail market in any meaningful sense—it instead set general rules for Competitive Retail Electric Providers (CREPs) and Affiliated Retail Electric Providers (AREPs) and allowed them to compete.

The resulting predictability of Texas markets helps explain why ERCOT territory has seen investment in new generation to a level that continues to maintain reserve margins adequate for powering Texas' future economic growth.

Our research establishes conclusively that critics of the Texas electricity market in 2006 and 2007 spoke too soon. Though they claimed that deregulation wasn't working, subsequent results under full deregulation have proven otherwise.

The same pattern of faulty reasoning held true across the country. For instance, deregulation was widely blamed for causing California's power crisis. However, the California electricity market was never deregulated. A poorly designed set of wholesale regulations combined with retail price controls led to that market's collapse when natural gas prices skyrocketed.

What the facts actually show is that electricity prices have not gone up because of deregulation; instead, they have fluctuated with overall energy prices.

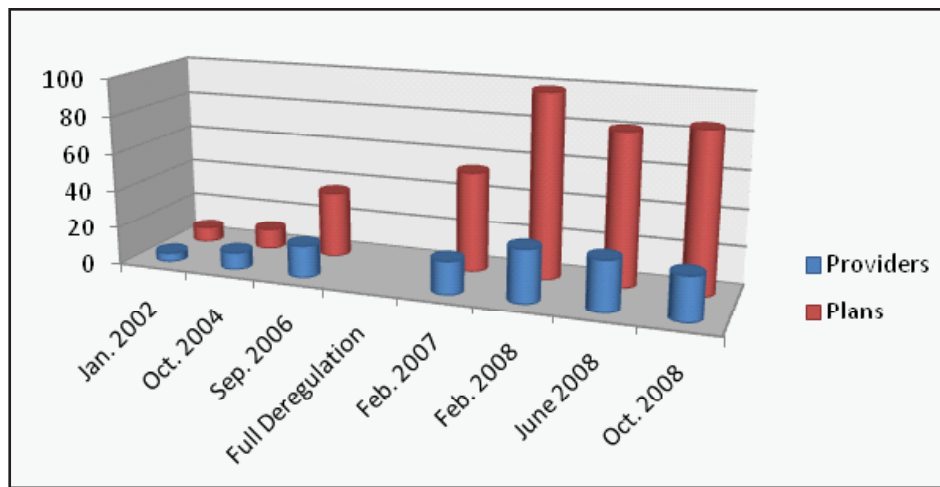


For instance, natural gas prices have swung wildly this year, beginning and ending around \$6 per mcf, but jumping as high as \$10.82 per mcf in June. Similarly, the average of all 1 year fixed price offers for electricity peaked in June.



Clearly, Texas electricity prices are high when energy prices are high—especially when natural gas is high, because Texas is highly dependent on natural gas. But, unlike California, the design of Texas’ electric market has allowed it to perform well and remain competitive in spite of high energy prices.

One area where this is obvious is in consumer choice. Consumers can lock in today’s rate for the long term or let it float month-to-month. They can pick providers and rate plans based on their fuel sources.



This explosion in consumer choice is rooted in the highly competitive nature of the retail electricity market. The percentage of residential customers who have chosen competitive rate plans more than doubled to 81 percent as the state completed the transition into full deregulation. And, of course, the remaining 19 percent of the market can choose (or not choose) a new plan at any time.

Additionally, competition in the energy-only wholesale market has led to the construction of more than \$20 billion in new generation facilities in Texas since wholesale deregulation began in the 1990s. An additional \$25 billion is currently under construction or planned. This gives Texas the hope of enough electricity to meet its future energy needs and helps support healthy retail competition.

Texas has experienced some problems lately with a few retail electric providers going out of business. But as of June, only 42,044 out of 5.4 million customers were dropped by their provider, and no one lost service. The market is working as planned.

Some challenges do remain, however, especially in the wholesale and transmission markets. For instance:

- Congestion management in the zonal system has at times created artificial scarcity;
- Wholesale price caps may inhibit investment in peak capacity generation;
- Mandates on fuel mix (e.g., natural gas and wind) for generation create inefficiencies and increase retail prices;
- Environmental laws restrict coal and nuclear generation while increasing consumer costs; and
- Building transmission for wind energy from West Texas through the CREZ process could cost Texas consumers more than \$17.9 billion through 2025.

Cost of Selected Texas Wind Energy Subsidies

Wind Generation Subsidy	Peak Annual Cost	Total Cost 2008 - 2025
CREZ Transmission (state)	\$1,326,000,000	\$17,901,000,000
PTC (federal)	789,937,795	9,027,173,625
RECs (state)	126,932,400	1,436,163,947
Total	\$2,242,870,195	\$28,364,337,571

THE FACTS

- ★ In September 2006, the average Texas consumer in an area open to electric competition had access to about 17 retail electric providers offering about 36 different rate plans. Today, those same consumers can choose from 23 providers (on average) and about 85 rate plans.
- ★ Since competition began, the five former monopoly electric providers have lost between 56 and 80 percent of their market share.
- ★ As of October 2008, 77.3 percent of residential consumers had chosen a competitive rate plan, and 83 percent had made an observable choice of providers.
- ★ Deregulation has not caused a significant increase in Texas electricity prices. Among those nine states that rely heavily on natural gas, Texas had the third lowest rates before deregulation, and still has the third lowest rates today. For all states, Texas had the 14th highest average electricity rates in the country prior to deregulation; as of December, Texas had slightly improved to 15th.
- ★ The 14 states that have higher electricity prices than Texas include New York, Massachusetts, California, Nevada, and Connecticut.
- ★ The cost of subsidies, tax breaks, market disruptions, and increased production/ancillary costs associated with wind energy in Texas could top out at more than \$4 billion per year, and total at least \$60 billion through 2025.

RECOMMENDATIONS

- ★ Maintain the current practice in Texas of providing a framework for competition without prescribing how market participants should compete with one another.
- ★ Avoid unpredictable major alterations of the existing market structure that will dash expectations of future stability and ruin the climate for investment.
- ★ Continue support for scheduled improvements to the wholesale market, including:
 - ★ Improvement to ERCOT's management of the system;
 - ★ Market Monitor;
 - ★ 2009 Day-Ahead Markets; and
 - ★ 2009 Nodal Pricing.
- ★ Look for ways to reduce consumer costs, including:
 - ★ Examine ways to reduce uplift (i.e., socialization of transmission costs).
 - ★ Eliminate mandates on fuel mix:
 - ★ Eliminate the renewable portfolio standard (RPS). At the least, do not expand it or target it for certain fuels or technologies; and
 - ★ Eliminate requirement that 50 percent of new generation be natural gas.
 - ★ Re-evaluate environmental restrictions that restrict generation capacity.
 - ★ Reduce municipal franchise fees.
 - ★ Avoid new mandates and regulations such as:
 - ★ More stringent building codes;
 - ★ "Energy-efficient" building programs;
 - ★ Technology, equipment, and deployment standards; and
 - ★ Restrictions on carbon dioxide emissions.
- ★ Proceed with caution in implementing any requirements that might restrict market entry and competition, including:
 - ★ Certification of REPs;
 - ★ REP disclosure to customers; and
 - ★ Provider of Last Resort rules.

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RESOURCES

- *Texas Wind Energy: Past, Present, and Future* by Drew Thornley, Texas Public Policy Foundation (Oct. 2008) <http://www.texaspolicy.com/pdf/2008-09-RR07-WindEnergy-dt.pdf>.
- *Texas Electric Meter: Measuring the Effects of Electricity Deregulation* by Bill Peacock (Mar. 2007) <http://www.texaspolicy.com/pdf/2008-03-RR02-ElectricMeter-proof.pdf>.
- *Power for the Future: The Debate Over New Coal-Fired Power Plants in Texas* by H. Sterling Burnett (Jan. 2008) <http://www.texaspolicy.com/pdf/2008-01-PP02-power-burnett.pdf>.
- *Q&A on the Texas Electric Market* by Bill Peacock (Apr. 2007) <http://www.texaspolicy.com/pdf/2007-04-PB17-Q&A-bp.pdf>.
- *Competition in Texas Electric Markets: What Texas Did Right and What's Left to Do* by Robert Michaels, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-RR07-electric3-rm.pdf>.
- *Electricity in Texas* by Robert J. Michaels, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-02-RR04-electricity-rm.pdf>.

