



# Regulation of Electricity Markets

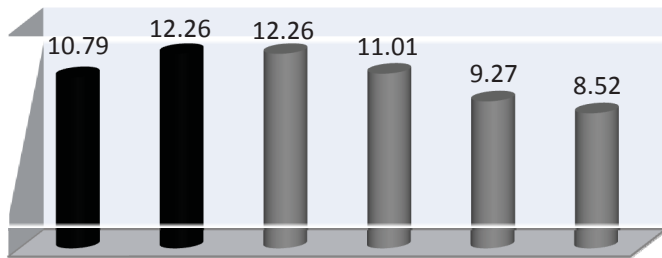
By Bill Peacock, Vice President of Research & Director, Center for Economic Freedom

## THE ISSUE

Fourteen years ago, Texas began restructuring its electricity market to foster wholesale competition. Six years later, competition was introduced into the retail market. Three years ago, all retail electricity price controls were eliminated. How has Texas fared in the transition to less regulation?

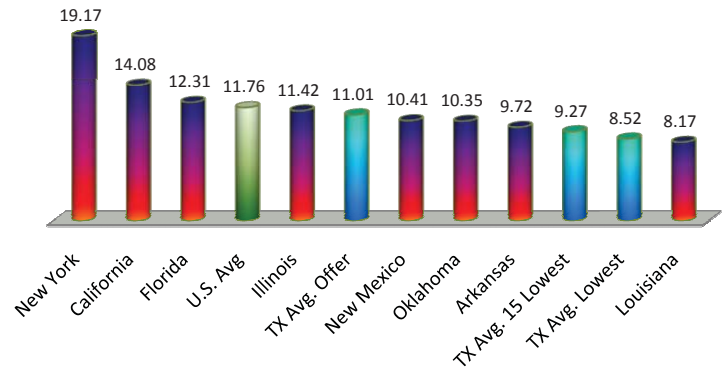
### Prices

Despite debate about the right sources of data to use when comparing pre- and post-restructuring prices, the numbers show unequivocally that consumers can purchase electricity in Texas today for less than they could a decade ago under heavy regulation.



In 2001, the average price in Texas was 8.77 cents per kWh. Today the average price of the lowest 15 offers in ERCOT is only 9.27 cents per kWh—an increase of only 5.7 percent since 2001, compared to the average national price increase of 41.6 percent.

The average lowest offer in Texas is 8.52 cents per kWh, actually lower than the 2001 price. Taking inflation into account, Texans can purchase electricity today for as much as 11.3 percent below 2001 prices.



Additionally, actual Texas prices compare well with national prices, and even those of our neighbors. The 9.27 cents per kWh of the average 15 lowest offers in Texas is 29.4 percent lower than the national average and 37.5 percent lower than the 14.83 cents per kWh average price in the rest of the five largest states.

Texas' significantly lower electricity prices may be one reason the state recently moved past New York and California as home to the largest number of Fortune 500 companies.

### Reliability

At the same time, Texas has ample reserve margins. ERCOT sets a target of a 12.5 percent reserve margin over expected summer peak capacity. Last summer, Texas had a reserve margin of about 16.8 percent. ERCOT projects the state will have reserve margins of 21.8 percent, 19.9 percent, and 18.1 percent over the next three years, respectively.

What explains the ample reserve margins and the poor initial projections? Texas' restructured energy-only market has much to do with it. In capacity markets in other states where generators must get permission to build new generation facilities. In Texas, generating companies build facilities when they believe they can turn a profit.

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ERCOT Reserve Margin Projections

2010	2011	2012	2013	2014	2015
21.8%	19.9%	18.1%	14.7%	12.3%	10.2%

The lack of a requirement for state pre-approval means for ERCOT less long-term knowledge of when facilities will be online. Yet the profit incentive has led to an investment of over \$25 billion in 39,000 MW of new generation since 1996, ensuring that investors, not consumers, assume the risk of selling all this electricity. In capacity markets, the cost of the new generation is added into the rate base and paid for by consumers whether they need it or not.

**Competition**

The final indicator of whether restructuring is working is the competitiveness of the Texas electricity market. The best way to determine competitiveness is participation in the market. The investment in generation seen in the previous section shows the competitiveness of the wholesale market. However, competition is also strong in the retail market. The average Texan in ERCOT can choose from 138 different plans offered by 29 different providers. This is up from five providers offering eight plans in 2002.

Almost 82 percent of consumers have actively chosen competitive rate plans. The rest, meanwhile, have benefited from competition through lowered rates on old plans or from getting competitive rates through move-ins. Almost everyone is participating in Texas' highly competitive electricity market.

**Texas Sunset Review of the Public Utility Commission**

The Texas Sunset Advisory Commission Staff Report on the PUC calls for increased government intervention in the marketplace, completely missing the tremendous benefits to consumers of the current market-based system. The commission calls for increased regulatory authority in the areas of restitution, administrative penalties, and cease-and-desist orders, while failing to document any problems in these areas. These are solutions in search of a problem.

**THE FACTS**

- ★ In 2001, the average price in Texas was 8.77 cents per kWh; today the average price of the lowest 15 offers in ERCOT is only 9.27 cents per kWh.
- ★ The average lowest offer in Texas is 8.52 cents per kWh, actually lower than the 2001 price.
- ★ Adjusting for inflation, Texans can purchase electricity today for as much as 11.3 percent below 2001 prices.
- ★ Since competition began, the five former monopoly electric providers have lost between 56 and 80 percent of their market share.
- ★ As of June 2009, almost 82 percent of residential consumers had chosen a competitive rate plan.
- ★ Texas electricity prices are lower than those of economic competitors such as New York, California, and Florida.
- ★ The biggest threats to consumers' electric bills are the cost of subsidies, taxes and fees; market disruptions; and increased production costs through government intervention in the marketplace. Together, these factors could increase the annual cost for Texas by \$3 billion per year.
- ★ The recommendations of the Texas Sunset Commission staff are without merit, and will increase consumer costs and reduce market efficiency.

**RECOMMENDATIONS**

- ★ Maintain the current market structure in Texas, avoiding unpredictable major alterations of the existing market structure that will dash expectations of future stability and ruin the climate for investment.

- ★ Reject the recommendations of the Texas Sunset Advisory Commission Staff Report.
- ★ Look for ways to reduce consumer costs, including:
  - Examine ways to reduce uplift (i.e., socialization of transmission costs);
  - Eliminate the renewable portfolio standard (RPS). At the least, do not expand it or target it for certain fuels or technologies;
  - Eliminate the requirement that 50 percent of new generation use natural gas;
  - Re-evaluate environmental restrictions that restrict generation capacity;
  - Reduce municipal franchise fees; and
  - 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.

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*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, Texas Public Policy Foundation (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>. ★

## RESOURCES

*Prices, Reliability, and Consumer Choice in the Texas Electricity Market* by Bill Peacock, Texas Public Policy Foundation (Jan. 2010) <http://www.texaspolicy.com/pdf/2010-01-PP05-electricity-bp2.pdf>.

*The Texas Electricity Market: Competition Work—Getting There Is the Problem* by Bill Peacock, Texas Public Policy Foundation (Dec. 2009) <http://www.texaspolicy.com/pdf/Goldwater%20November%202009.pdf>.

