

EQB Members Asked to Vote Against Pennsylvania Mercury Emissions Proposal

A coalition of industry and organized labor has asked members of the Environmental Quality Board (EQB) to either move to significantly amend mercury emission regulations proposed by the Department of Environmental Protection, or reject them all together. Coalition members, including the United Mine Workers and the Pennsylvania Coal Association, support language in the federal Clean Air Mercury Rule – language included in legislation recently introduced in the Pennsylvania House and Senate. [To see a complete copy of the letter click here.](#)

Following Is a Q&A Compiled by COMPETE on the Rise in Electricity Rates, and the Value of the Competitive Market (COMPETE is a Washington D.C. coalition of businesses, institutions, and associations advocating competition in the electricity marketplace)

1. Why are electricity rates going up? Why have rate increases in regulated states been smaller than recent price increases in deregulated states?

Electricity rates have been rising throughout the country. These increases are largely a result of rising costs for the fuel used by generators to produce electricity. In fact, fossil fuel costs have increased over 150 percent since 1999. Rising natural gas prices have been at the heart of the increases. Consider that PJM spot market prices in 2005 rose more than 37 percent. Energy experts attribute most of that increase to increases in natural gas prices.

Regulatory policy also played a significant role in creating upward pressure on natural gas and electricity prices. Stringent environmental regulations at the federal, region and state levels led generators when constructing new plants to rely almost exclusively on natural gas. At the same time, other policies made it more difficult to develop new natural gas supplies to meet this demand. The result is what we are witnessing today: escalating natural gas prices, and electricity rates.

In addition, fuel costs are rising due to global demand for fossil fuels, the impact of supply interruptions from last year's hurricanes, and insufficient domestic production. Despite this pressure, if you look at price increases over the same time-frame in other consumer goods like food, housing and health care, you will find that electricity price increases are mostly modest by comparison.

Headlines about skyrocketing increases in electricity rates in some states that have retail competition don't tell the whole story. Electricity rates are not rising because of competition. Many of the states that introduced retail competition included rate freezes that kept rates unchanged for a period of years even as the costs of generating electricity increased. Imagine buying a house in 1996 and paying the same property taxes year after year, even though the school age population is growing. For a while, everything is fine. But, after ten years, you have to choose between either much higher taxes or a bankrupt school system. These price freezes are not sustainable in the face of economic realities. Remember -- lifting a rate freeze is like pulling off a band aid. You only have to do it once -- but the longer you wait, the more it hurts.

Make no mistake -- retail customers in states that don't allow choice have been hit with much higher costs as well -- often in the form of an automatic increase on their bill. In these states, steady increases over a number of years have been passed through to consumers. These regular, smaller price hikes can add up to dramatic changes in price over time. Recent reports by several state utility commissions document that prices in competitive markets are lower than what would have been the case in a rate-regulated environment.

2. Rate increases in regulated regions are not only smaller, but in deregulated states all we see are big jumps in prices. Why is that?

In most of the states that restructured to increase competition, political agreements were made to cap rates and, in some cases, actually roll them back, for a period of time. As a result, many customers in restructured states have been paying below market rates in recent years despite increases in the cost of generating electricity. As these rate caps expire, rates are catching up and starting to reflect market prices that are being driven by very high fuel prices. That isn't to say that customers haven't benefited from restructuring. Public reports show that even when current prices are adjusted for fuel increases, customers have saved billions of dollars as a result of competitive markets and restructuring. It is also important to note that some state regulatory commissions have taken a variety of steps to phase in these rate increases so customers don't see a big increase all at once. Finally, requiring utilities to supply power at below market rates keeps competitors from entering those markets. By contrast, states like New York and Texas have markets with multiple competitors selling to consumers.

3. Advocates of competition promised better prices for consumers and that there would be many companies fighting to supply customers in states that restructured. Why haven't we seen these lower prices, and where are all the alternative suppliers that were expected? Where is the "customer choice"?

We have in fact seen many competitive suppliers fighting to serve customers and studies have repeatedly shown that there have been lower costs because of competitive reforms. In some cases, that competition is occurring at the wholesale level. Electricity distribution companies have more options than ever before. They can run their own plants, or buy from a wide range of power suppliers - a fact that may be unknown to most retail electricity consumers. In New Jersey and Maryland, for example, a dozen or more electricity suppliers participated in state-wide auctions, fighting for the right to meet state-wide power needs.

Many states have successful competitive programs for retail consumers. If you run a small business or farm in Texas, for instance, you can choose to buy electricity from any one of a number of quality companies, who can offer you a range of products and services (including "green" or "clean" power options). Not all state programs have worked so well, unfortunately. Where the electricity prices were reduced or frozen by regulation, competition generally hasn't taken hold. These artificially low prices have kept away alternative suppliers to the traditional local utility. However, once price freezes end, we have seen competitors enter the market to meet the needs of retail customers.

4. Isn't it time to admit competition has failed for electricity? Why not go back to state-supervised, cost-based rate regulation?

The goal of all policymakers should be to ensure affordable and reliable electricity for consumers. Competition keeps costs as low as possible, drives innovation, and produces the benefits customers are seeking -- because the customer calls the shots. This is true whether you're talking about telecom services, the advent of discount department stores, or the changes in the automobile industry in the last quarter century. It is also true for electricity. The fact is, we need more competition, not less.

It's easy to forget what the world was like before competitive forces took hold. Power plants running at only a fraction of what they're capable of. Massive cost overruns on the construction of new power plants. There is little incentive for utilities to save money, because everything was bankrolled by the captive customer who had no other choice. Many of these captive customers were the businesses -- small and large -- that create jobs and grow the economy.

When electricity suppliers are allowed to compete with each other to sell their product, the customer wins. If you could only buy your car – a critical investment for many – from one company, the result would certainly be higher prices, poor choices and unhappy consumers. When prices are set by regulation and based on costs plus a profit margin, utilities are rewarded for charging more, not less.

5. Ok, maybe we can't "put the genie completely back in the bottle," but at the very least, why shouldn't we just go back to cost-of-service rates for the generation of electricity; after all, it seems to work well in the Southeast.

States restructured in the first place because cost-of-service rate regulation rewards utilities for higher costs, not lower ones. Competitive markets, on the other hand, reward generators for providing reliable service at lower costs. Cost-of-service rates encourage power plant operators to inflate costs and run power plants inefficiently, which saddles consumers with over-priced electricity.

In theory, regulators can act as a watch dog and disallow unnecessary costs. However, history shows this watch dog to be mostly ineffective: utility cost overruns regularly have been passed on to consumers. Decisions that might bankrupt a market-tested company are routinely overlooked for rate-regulated utilities. In the short-term, capping an electricity generator's revenue at cost might save money. But the long-term results are just as clear: costly inefficiency, bloated corporate bureaucracies, and poor financial decision making if monopoly utilities replace competitive electricity suppliers.

In the Southeast, rates have been historically lower than in some other regions because much of the electricity is generated by very old power plants with relatively modest environmental controls and better access to a range of fuel resources. These factors, not vertically-integrated utilities regulated under "cost-of-service" rates, gave this region an advantage over regions that have tougher environmental requirements and newer power plant investments. Whether this advantage will remain in the future is an open question for the Southeast as the cost of fossil fuels rises, and as the power plants in the region are required to install expensive pollution control equipment to meet tougher federal Clean Air Act regulations.

Even in the Southeast, there is ample evidence that increased competition would provide benefits to consumers. For example, in many Southeast states, highly inefficient and costlier natural gas-fired generation continues to be operated by vertically-integrated utilities and the output sold into the market, while state-of-the-art units built by competitive suppliers, that could save precious natural gas resources and consumers' money, are idled by poor procurement policies and discriminatory transmission practices.

6. Why do 2 cent/kwh nuclear plants get paid a price set by 17 cent/kwh gas plants? If my state gets most of its power from nuclear and coal units, why should we tolerate higher prices driven by the cost of natural gas?

First off there is no such thing as a 2-cent/kwh nuclear power plant. That amount refers to the net fuel cost, not the total cost to produce a kilowatt of electricity. Net fuel costs may be close to 2 cents but other costs like security, maintenance, depreciation and capital improvements all add to the total cost of producing electricity from a nuclear power plant. No company could operate a complex coal or nuclear power plant if prices cover fuel costs and little more. Just as an airline can't buy a plane for the cost of the aluminum, you can't buy nuclear power over the long-run without paying for the multi-billion dollar capital investment in the power plant.

Electricity demand is met by a fleet of power plants that use a variety of fuels to generate electricity. The mix of fuels varies by the region of the country. Power from these plants is sold both under long-term contracts and, in regions with organized markets, through a spot market. Power purchased on the spot market is used to meet immediate demand so that all consumers are served without brownouts or blackouts. In these spot markets, power plants are paid the price bid by the last generation needed to serve consumer demand. In some regions, gas-fired units are the best source of this last-minute electricity and thus set the spot market price.

Most electricity consumers are unaware of this spot market price for power. Their electricity suppliers, using techniques to reduce commercial risk, buy a mix of power under long-term contracts and from the spot market. This portfolio of supplies keeps consumer prices from jumping around with the price of any one fuel. Effective risk management ensures both that lower average costs are paid by consumers and that the best, most economic power plant is built and run.

7. Can't we just let utilities build 2-cent nuclear power instead of running 17-cent gas-fired peakers?

Each type of generating plant has a different operating profile. Demand for electricity is not even throughout a given day or between seasons of the year. Demand is higher during the daytime, for example, than it is at night. Demand is also higher in the summer in many regions due to higher demand for air conditioning in that season. To meet this fluctuating demand, some power plants run virtually all the time because they are less expensive to operate, but also because they take a long time to start after being shut down. By contrast, others, such as gas-fired peaking plants, can be turned on and off more readily to run only when needed to meet consumer demand for electricity the instant it is required.

To serve the customer's demand you need a combination of long run-time and short start up plants to stay in synch. Long run-time plants usually have lower costs than short start up plants. To meet changing load requirements you must use lower cost, long run time (sometimes referred to as base load) plants complemented by more flexible, but more expensive, short start time generation plants that run only a smaller fraction of the time. Both types of plants are needed for a reliable electricity system. This blend of higher cost and lower cost electricity is what makes up the price that consumers pay for reliable service.

8. Competitive companies can go bankrupt, yet regulated monopolies seldom do. Doesn't this prove that competitive companies are poorly equipped to provide the public with electricity, an essential commodity?

One of the most important benefits of competitive markets is that they shift risk away from ratepayers and toward the shareholders of competitive companies and those that lend them money. Competitive companies are more disciplined because more is at risk for them if they fail. For one thing, competitive power suppliers don't get paid unless their power plants run, and their plants don't run if their output is not priced to beat their competitors. By contrast, monopoly rate-regulated utilities get paid regardless of whether their plants run efficiently or run at all. They have incentives to drive up costs to earn a profit on those higher costs.

Competitive suppliers focus on managing all the risks associated with producing power. Some competitive companies made bad investment decisions, in a few cases filing for bankruptcy to reorganize their affairs. What is important to understand is that, even when competitive companies reorganize, the power plants they developed continue to operate and supply power to customers. Corporate executives may lose their jobs, but the good news is that the customer wins because suppliers bear the risk. Those competitive suppliers that have been reorganized emerged from bankruptcy as stronger competitors. By contrast, when financial difficulties hit rate-regulated utilities, captive ratepayers or taxpayers are hit with the cost. Over the last thirty years, these consumers have paid hundreds of billions for utility mistakes. Competition – even with the risk of bankruptcy that confronts all businesses in a marketplace – is a better deal.

9. Competition was supposed to shift the risk away from consumers. But now generators want “capacity payments” in addition to what they receive for the power they generate. These payments are just another guaranteed rate of return like the system that competition was supposed to replace. What’s worse, now they’re saying even capacity payments aren’t enough to get them to build new coal and nuclear plants at a time when we need to diversify our fuel sources away from natural gas to generate electricity.

In a fully competitive market, power generators would only get paid for the electricity they produce. However, rather than fully embracing competition, every wholesale market today has one or more forms of “market mitigation” – a fancy term for artificial limits on how high prices can go. If prices are held artificially low for a period of time, particularly as operating and capital costs for new plants increase, investment in new facilities will not be made, and even existing plants may not be able to be maintained. Therefore, a capacity payment is needed to compensate a power generator for some of the fixed costs of the power plant that stands ready to generate electricity. This is especially important for plants that are desperately needed to keep the lights on during the hottest summer days but barely run the rest of the year.

Competitive suppliers already operate a diverse mix of coal, nuclear, renewable, and gas-fired power plants. These companies are also developing new coal, nuclear and renewable plants and expanding existing facilities. Whether they are built by a competitive supplier or a vertically-integrated monopoly utility, coal and nuclear plants require billions of dollars to construct, take a long time to build, and may not work as predicted. In markets where investor profits are limited, capacity payments may be the only way to ensure that needed, fuel-diverse power plants get built – on time and without regulatory guarantees that force customers to pay for bad investment decisions.

10. Our state is rich in coal and we want an IGCC coal gasification plant built in our state. Isn't the best approach to help our local utility finance this project with state bonds or other ratepayer and taxpayer incentives?

No. When the nation relied on utilities to build all the new power plants in a given area twenty years ago, we created billions of dollars in "stranded costs" that ratepayers are still paying off today. It has been proven time and again that competition can get those plants built and operating more quickly and more cost effectively. Competitive suppliers own and operate nuclear, coal, natural gas and renewable power plants. Any state that desires a specific resource mix should decide what type of incentives to offer and then invite all developers to compete to build new plants. Just as you'd comparison shop before buying a car, anyone seeking a new power plant should recognize that head to head competition is the best way to ensure that customers get the best deal and are not stuck with cost overruns or poorly operating plants. Lets build the "right" plant at the best cost.

11. In many places, there are "spot markets" for electricity, in which prices go up and down on an hourly and daily basis. Do customers see these fluctuations in their bills?

A spot market for electricity is like the market for U.S. Treasury bonds or for commodities traded on the Chicago Mercantile Exchange. The electricity spot price represents the price at any one moment for additional electricity supply. It changes on a frequent basis and helps form the basis for pricing longer-term contracts. During peak times of the day, the spot market price can climb very high as the power system strains to meet every customer's power needs. A hot afternoon in the summer will usually result in high spot prices for electricity. Conversely, during other times in the typical day, surplus generation can drive spot market prices to very, very low levels.

Consumers don't buy directly from the spot market just as they don't get a pure Treasury bond rate on their home mortgage or pay the Chicago Mercantile Exchange price for orange juice. Treasury bonds set the foundation for a mortgage that consumers can purchase. Spot market electricity prices set the foundation for long-term power contracts that a retail consumer's power company will sign with a wholesale electric power generator. If the retail company is to succeed in a competitive world, it will need to manage its wholesale purchases (both long-term and spot market) so as to keep prices low over time and reduce the up and down fluctuations in price for the consumer. With effective management by the retail power company, most consumers will be completely unaware of the spot market price and its constant movement.

12. Why do we need to build more power plants? The lights are on today, why not just stress conservation, transmission and the plants we have today?

This is a false choice. Electricity demand is projected to increase in coming years even with greater conservation. The U.S. economy has become remarkably energy efficient in recent decades. However, electricity remains the lifeblood of the economy, powering homes, factories, hospitals and the information age. As the economy grows and the population expands, new power plants will be needed to meet these demands and replace aging power plants which use too much fuel and emit higher air emissions.

It just isn't smart to put all our eggs in one basket. Just as financial advisors recommend that consumers diversify their financial assets, we need a diverse mix of new generation plants using a variety of fuels, plus more conservation, more energy efficiency, and more transmission investment. We also need greater efficiencies and higher output from existing power plants. Competitive suppliers have proven they can run existing plants better than when the plants did not face competition. Lastly, competitive markets bring more transparency to retail prices. Often rate regulation leads to hidden costs and confusing bills which hinder effective conservation policies.

13. Natural disasters strike all parts of the country. These disasters often disrupt power service, sometimes for weeks. Don't we need vertically-integrated utilities to turn the power back on after these disasters?

Utilities of all kinds – vertically-integrated as well as those without their own power generation – rely on each other to help restore service following a natural disaster. For example, utilities from all over the United States, not just local vertically-integrated companies, sent crews to the Gulf Coast to help with service restoration after Hurricanes Katrina and Rita in 2005. Independent power plants also were crucial to the restoration of our critical natural gas and oil infrastructure. There is simply nothing about vertical integration that makes it easier to get service restored after a natural disaster as compared to how quickly service is restored in regions without a vertically-integrated utility.

14. All competition has brought is more natural gas fired power plants, when what we need is more coal and nuclear. Aren't competitive markets permanently biased toward construction of a gas-fired plant??

It is a myth that most competitive power plants are natural gas-fired. Nearly 40% of the electric generation capacity in the U.S. is competitive and more than two-thirds of this output is from coal, nuclear and renewable power plants.

During most of the past 15 years, natural gas has had cost and environmental advantages that made it preferred by new power plant developers – whether competitive or rate-regulated. Now that gas prices have risen, there's been a steady shift of focus to alternative resources—coal, renewable, and nuclear. Competitive markets have helped this process by creating fundamental new opportunities for investment in fuel diversity. Coal-fired power plants that are built at the mine can use new regional markets to get access to distant customers. High technology renewable power developers can implement national strategies appropriate to the resource (e.g., wind). Larger company balance sheets and better nuclear plant management opens the door for the first new nuclear investment in a generation. Lastly, competitive generators have an excellent record of true technical innovation. Whether gas, coal or renewables, our companies have pushed the envelope when it comes to efficiency, cost-management and better pollution control.

Some gas-fired power plants that were built recently are, in fact, not running today – idled by high gas prices. If these unused power plants are owned by rate-regulated utility companies, customers are paying for them anyway. If these plants are owned by competitive firms, customers are not. Once again, in rate-regulated businesses, good investment strategies and ideas are not required. In competitive markets, they are. Build the right plant at the lowest price!

Dennis Buckley Selected First Executive Director of Organization of PJM States

The Organization of PJM States (OPSI) has announced that Dennis Buckley, Esq., most recently with the law firm of Klett Rooney Lieber & Schorling in Harrisburg, has been selected as the group's first executive director. Buckley has also served as Counsel and Energy Advisor to two Chairmen of the Public Utility Commission. OPSI was incorporated in May of 2005, and acts as a liaison group to the PJM Interconnection. The following jurisdictions make up the membership in OPSI: Delaware, the District of Columbia, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia. Buckley begins his new job on June. 5.