May 31, 2007

Open Letter to Policy Makers

The undersigned former Chairs and Commissioners of the Federal Energy Regulatory Commission (FERC) express our support for continuing federal policies to promote open and competitive markets for electric power. This is a matter of our nation's security and economic welfare. We strongly believe that the pressures of the global energy economy and the need to protect the environment require that state and federal policymakers must work aggressively to reinvent how the business of producing and delivering power is regulated in response to these 21st Century challenges.

Congress has clearly established that competition in wholesale electricity markets is part of America's energy policy. In 1978, the Public Utility Regulatory Policies Act first opened the door to competition in generation supply. In 1992 and again in 2005, Congress passed Energy Policy Acts reaffirming its bipartisan commitment to wholesale competition and strengthening the ability of the FERC to promote and protect those wholesale markets.

Consistent with the will of Congress, FERC took a landmark step in spurring competition in the electric utility industry when it issued Orders Nos. 888 and 889 to ensure open and nondiscriminatory access to the transmission system more than a decade ago. Since that time, the Commission has issued thousands of competition-friendly rules and case decisions. As former FERC Commissioners acting on a bipartisan basis, we voted time and again in support of those rules and orders.[1] We did so because the incentives and risk-allocation properties of competitive markets represent the best means to produce at the least cost the reliable supply of electricity needed for the nation's welfare and economic competitiveness.

Orders Nos. 888 and 889 quickly and clearly demonstrated that organized regional competitive markets provide the best wholesale platform in support of retail markets of any type. Their independence, large scope, transparency, robust markets and state-of-the-art operations are vital for participants to have faith in the fairness of the marketplace and to ensure that commercial transactions reflect physical realities. We applaud the Commission's support for these competitive markets through the years and urge the Commission to continue to do so.

We understood when we supported the transition to competition in general, and competitive regional markets in particular, that it would take time for the benefits of the

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[1] Former Commissioner Langdon was not a Commissioner during the votes on Orders Nos. 888 and 889 but voted for many pro-competitive orders during his tenure on the Commission.

Commission's policies to become clear. This has proven especially true as the states placed a number of conditions on restructuring programs, such as below-market long-term rate caps, and different conditions for different customers, and transmission investment failed to keep pace with developing market demands. Moreover, competitive markets have emerged just as generation fuel prices have substantially increased, masking market benefits and causing some observers to focus too much on the short-term prices in organized markets and not enough on long-term positive trends.

Nevertheless, the evidence that is increasingly available clearly shows that competitive markets are producing real and tangible benefits now.

Increased efficiency. Competition has improved the operating efficiency of power plants and helped lower costs. Since 1996, operation and maintenance costs at nuclear and coal plants have decreased while their capacity factors have increased. A number of studies confirm significant increases in generation efficiency. In addition, refueling outage times at nuclear plants have decreased as well. Investment in new, efficient generation has also produced environmental benefits. New England's move to more efficient gas-fired generation replaced oil and older power plants, reducing carbon dioxide emissions by 22%, nitrogen oxide emissions by 57%, and sulfur oxide emissions by 56% while generation increased by 25%. And in Texas, competitive forces have resulted in the replacement of older power plants with new, efficient plants, making a major contribution to reducing emissions and progress in meeting national air quality standards in the Houston-Galveston and Dallas-Fort Worth areas.

Lower costs. As competition has taken hold, customers have saved money. Competition resulted in $34 billion in savings to residential customers across the country between 1997 and 2004 compared to what would have been paid under traditional regulation. In the mid-Atlantic and New York area, customers have saved between $430 million and $1.3 billion each year over a similar period. In PJM, the hourly market prices for 2006, when adjusted for fuel costs, were actually 36% lower than in 1999. And in California, total wholesale energy and ancillary service costs were down 16 percent or $2.2 billion while total energy consumption was up 9.3% in the past year. In states that have competitive procurement, production and procurement costs have risen only 5.6% while oil and natural gas prices have increased 135% and 210%, respectively. Competitive markets provide better access to lower cost generators and shift risk away from customers and toward generators, thereby strengthening the incentive to lower costs.

Demand response. Demand response saves customers money and promotes conservation and energy efficiency. Competitive markets offer a significantly better platform to promote demand response than traditional cost-of-service regulation. In an RTO, generators and customers see a clear signal on the value of demand response resources and the regional system operator can integrate the product into the least-cost dispatch. PJM now has 6,700 MW of demand response resources, which represent 4.6% of its peak load. During a week in August 2006 with high peak prices, PJM found that demand response programs saved customers in its region more than $650 million - $230 million in a single day.

Renewable resources. Regional competitive markets, supported by adequate and strategic investment in region-wide transmission infrastructure, facilitate renewable energy development. Regional market rules and protocols, such as spot markets for balancing supply and demand, price-based congestion management, and regional netting of load and generation, accommodate the intermittent characteristics of renewable resources. Environmental groups, such as the Natural Resources Defense Council and the American Wind Energy Association, have noted that nearly three-fourths of installed wind capacity is located in RTOs, even though less than half of wind development potential is in those areas. Facilitating renewable resource development enhances our nation's energy independence and security and helps achieve our environmental goals.

Technological innovation. Regional competitive markets have become an incubator for technologically innovative energy products that respond directly to customer preferences. The communications infrastructure needed for these sophisticated markets to operate has created enormous opportunities for integrating real-time price signals into dispatch decisions and for providing information needed for the efficient use of demand and intermittent resources. The RTOs have installed the most advanced systems for network analysis, scheduling, monitoring and forecasting in the industry. For example, generation scheduling software adopted by PJM in 2004 was the first of its kind in the industry and was made possible by PJM's large size and scale.

Improved reliability. Regional planning processes in RTOs help identify generation and transmission needed to ensure adequate supply. The large scope of the regional competitive markets decreases the number of decision makers, thereby improving coordination in moving power supplies where they are needed, and it allows the operator to see a broader picture of grid conditions. RTOs also provide ancillary service markets, such as those for reserves, frequency and voltage regulation and support that allow operators to react quickly. This combination of scope and sophistication provides increased flexibility for responding to contingencies. RTOs have also established various coordination agreements and market-based congestion management between each RTO and its neighbors to improve cooperative grid management.

Customer testimonials. Satisfied customers are always a good indicator that something is working. A group of commercial customers, including Best Buy, A&P, 7-11 Stores, Federated Department Stores, and Wal-Mart recently wrote to the FERC Commissioners to say that competitive markets have resulted in significant savings for them and their customers and they encouraged the Commission to stand firm in its pro-competitive policies. Likewise, customers have written letters to governors in Illinois and Pennsylvania and to the legislatures in Virginia and Connecticut supporting competitive markets and citing benefits such as enhanced reliability, greater access to renewable resources, increased conservation and efficiency, and substantial cost savings on their electricity bills.

Despite very positive evidence, some observers, alarmed over some of the recent price increases in restructured states, suggest that it's time to return to traditional regulation. That would be a grave mistake. The recent price increases are not the result of competition. Rather, the causes are higher fuel prices coupled with the removal of price caps that have kept rates artificially low while fuel prices soared. Between 2000 and 2005, natural gas prices rose more than 300% and coal nearly 33%.

It is important to recognize that price increases have in no way been limited to restructured states. Since 1999, electricity prices have generally increased the same (34%) across states with organized markets and across those without such markets. In particular, increases in five selected regulated states (Nevada, Florida, Mississippi, Louisiana, and Oklahoma) ranged from 39% to 62% during this same time.

Finally, memories of the "good old days" of regulation can be myopic and selective. The good old days were not good for consumers, which is why policymakers moved to promote competitive markets as an alternative to inefficient regulation. By the 1980s, it was clear that cost-of-service regulation had brought customers poor performance in terms of too much generation capacity that always cost more than expected, generators that were not available as much as they could be, declining investment in the electric transmission system that would otherwise have broadened customer access to the lowest-cost resources, and a culture that was resistant to new technology. Customers paid for this inefficiency in their monthly bills. Between 1970 and 1985, residential rates more than tripled (25% in real terms) and commercial rates quadrupled (86% in real terms). Investors also shared in the pain. Between 1985 and 1992 there were $22 billion in write-offs of nuclear plants. Industrial customers were building their own generators as a way to bypass their local utilities.

These disturbing developments prompted the move to competitive markets, both by Congress and regulators. The evidence was clear that traditional regulation was not working, and technological innovations in generation and transmission rendered invalid the premise that electricity production was a natural monopoly. Moving to competition was the right thing to do then and it remains the right policy today. As Federal Reserve Chairman Bernanke recently observed, "(m)arkets aggregate diffuse information more effectively and set prices more efficiently than any central planner possibly could. The result is powerful competitive incentives for business to produce, at the least cost, the goods and services that our citizens value most." He went on to observe that targeted regulation may sometimes be needed, but regulation comes with costs of compliance as well as reductions in innovation and competition.[2] In sum, competitive markets enable the nation to meet the challenges we face, with efficiency, fuel diversity, technological ingenuity, and new investment. Monopoly and old-fashioned economic controls will stifle these creative forces.

It is clear that a competitive electricity policy has benefited customers and has the intellectual and factual support to continue in the future. We urge policymakers to continue and to strengthen this worthy effort as the seeds we have planted begin to bear fruit for our nation.

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[2] Remarks by Ben Bernanke, "Financial Regulation and the Invisible Hand," at the New York University Law School, April 11, 2007.

Sincerely,

Vicky A. Bailey
Commissioner, 1993-2000

Linda Breathitt
Commissioner, 1997-2002

Nora Mead Brownell
Commissioner, 2001-2006

James J. Hoecker
Chairman, 1997-2001
Commissioner, 1993-1997

Jerry J. Langdon
Commissioner, 1988-1993

William L. Massey
Commissioner, 1993-2003

Elizabeth Anne Moler
Chair, 1993-1997
Commissioner, 1988-1993

Donald F. Santa
Commissioner, 1993-1997

Pat Wood, III
Chairman, 2001-2005