



**House Subcommittee
On
Energy and Air Quality**

**The
California Energy Crisis
and
Recommendations for
Federal Legislation**



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This document reflects the views of the National Energy Marketers Association and does not necessarily reflect the views of any specific member of the Association.

I. Introduction

My name is Craig G. Goodman. I am submitting this testimony as President of the National Energy Marketers Association (NEM). NEM is a national, non-profit trade association representing a regionally diverse cross-section of both wholesale and retail marketers of energy and energy-related products, services, information and technology throughout the United States. NEM members include: small regional marketers; large international wholesale and retail energy suppliers; energy consumers; billing firms, metering firms, Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, customer service and information technology providers. Affiliated and independent marketers have come together under the NEM auspices to forge consensus and to help eliminate as many issues as possible that would delay competition. NEM supports the implementation of laws, regulations, standards of conduct, rates, tariffs and operating procedures: (a) that provide all customers meaningful choice; (b) that implement open, efficient, “liquid” and price-competitive energy markets, and (c) that encourage the development of new, and innovative energy services and technologies, at the earliest possible date.

As a national trade organization, NEM brings a wide range of experiences, as well as broad perspectives to its testimony in this proceeding that should aide the United States House Subcommittee on Energy and Air Quality and enhance the quality of the record to be developed here. NEM currently participates in more than 50 restructuring proceedings around the country and at the FERC. The testimony and recommendations presented here represent major issues and barriers to price competition that are most often confronted in proceedings around the country.

II. Background

Price competition is the goal of deregulation, whether it is for airfares, long distance telephone rates or energy prices. Meaningful choice and true price competition are always the best consumer protection laws possible. When laws and regulations set prices, restrict access to consumers, establish barriers to entry, mandate sales of assets coupled with spot purchases of volatile commodities, markets get distorted and everyone loses, consumers, taxpayers, utilities, governments and suppliers. Real competition always works. Deregulation is not a failure. *California Style Deregulation*, however, is a failure.

California was first and could have established a model for other states to follow. Unfortunately, a number of political compromises made supply shortages and price spikes inevitable. In the face of strong and growing demand for power, no new power plants were built. Price cuts were legislated at the same time that tens of billions of dollars in stranded costs were allowed into rates. Energy sellers and buyers were prohibited from doing business with each other and all energy purchases and sales were mandated through a state run monopoly. Simultaneously, utilities sold most of their generating assets at values higher than book value and purchased energy supplies in the spot market. All this occurred at a time when no new power plant construction made future shortages and price spikes foreseeable and ownership of existing plants excellent investments. Financially, the utilities were selling electricity short without generation to deliver as a hedge against price increases. Predictably, wholesale prices grew to meet demand yet, at the same time, retail prices were capped. This is a recipe for disaster in any market.

California is one of the world's largest economies, the epicenter of a worldwide technology revolution, and built around an electricity system that is in need of significant new investments to deliver "digital power quality." The direct and

indirect impact to California, the western United States and the global economy of local decisions that stalled construction of needed supplies is potentially astronomical. Meaningful choice and true price competition can only occur when consumers are assured that new supplies will be available to meet their growing demand. This has not happened in California.

Now, California is in a cycle of stage 3 energy emergencies with rolling blackouts, major utilities are having cash flow and credit/confidence crises, taxpayers and consumers are revolting against both high prices and utility bailouts, new generation and construction is stalled, and politicians have actually threatened to expropriate private generating assets that utilities sold when values were high and shortages were foreseeable. New proposals would also call for the government to take over transmission lines.

While California-style deregulation is unique, the impact of the California energy crisis is not contained within the borders of the state, and will be felt throughout the region and could affect the national and global economies. The impact of California's energy and environmental choices is now being passed on to ratepayers throughout the Northwest. Ironically, in order to allay short-term blackouts, older, coal-burning facilities that could have been replaced with newer cleaner plants will be running overtime for the foreseeable future.

Importantly, every state has a legitimate interest in protecting in-state consumers from increasing energy prices. However, the current 60-year old system of federal and state laws and regulations were designed around a local franchise monopoly paradigm. To deliver the lowest possible prices to consumers, new laws and regulations are needed immediately so that competitive suppliers can super-aggregate energy demand and deliver national economies of scale to even the smallest consumers. Competitive energy suppliers cannot succeed unless they can offer consumers lower prices than the local franchise monopoly.

III. Recommendations

There are a number of actions that federal and state governments need to take to ensure the proper restructuring of the electric industry. Members of NEM spent hundreds of man-days forging consensus on the proper role of the federal, state and local governments in the implementation of electric restructuring. NEM members operate in virtually every market that has opened for competition, and their broad base of experience was the basis for the attached document entitled, "*National Guidelines for Restructuring the Electric Generation, Transmission and Distribution Industries.*" Since this document was released, the California model for deregulation has produced empirical evidence as to how the failure of one state's deregulation program can have significant economic and environmental impacts on other states as well as the national and global economies.

Accordingly, NEM urges the Congress to consider a number of important actions to bring meaningful choice and true price competition to all U.S. consumers of energy at the earliest possible date. Generally speaking these actions would: (a) encourage the development of national economies of scale through more uniform rules, operating procedures, tariff structures, scheduling coordination and technology platforms, (b) limit utility services to pure monopoly functions (transmission and distribution) and provide current monopoly cost-base prices to consumers as "shopping credits" to procure competitive services, and (c) expand existing energy and environmental tax credits to include *Qualified Restructuring Investments* such as advanced metering, computer system upgrades, distributed generation and provide tax and performance based regulatory incentives for infrastructure upgrades, congestion management, maintenance and streamlined interconnection procedures.

A. National Economies of Scale are Critical to Lower Energy Prices. True price competition and lower energy prices require competitive suppliers to achieve national, or at least, regional economies of scale. Competitive suppliers can only succeed in winning customers away from incumbent utilities if they can offer lower prices, better services, more novel products, services and technologies or all three.

Currently, there are 50 different states with different rules in multiple utility service territories, different data protocols and transaction sets, different operating rules, different switching, scheduling and customer protection rules, even different units of measurements. As long as market participants are forced to divert scarce resources to customize computer systems, billing, back-office, and customer care facilities, and to develop and maintain non-standardized information protocols or develop specialized knowledge of different business rules in each jurisdiction, it drives energy prices higher nationwide. Add to this the fact that one marked failure like California can have a devastating impact on consumers, taxpayers, financial markets and regional ecosystems.

Energy is the lifeblood of the world economy. It is time to coordinate and implement relative uniformity among the states, in rules, processes, procedures, scheduling delivery, and even information technologies.¹ There are a significant number of business rules,² consumer protection laws, technology platforms and comparable operating rules and scheduling processes which, if established fairly, efficiently, and uniformly across the country could bring significant cost savings and have a profound impact on the country and the reliability of energy supplies.

¹ *National Energy Technology Policy* (October 30, 2000). Available on the NEM website at: http://www.energymarketers.com/documents/NEM_National_Energy_Technology_Policy_final.pdf

²Uniform Business Practices for the Retail Energy Market, Sponsored by EEI, NEM, CUBR and EPSA. Accessible at www.eei.org.

B. Utilities Should Exit the Merchant Function and Consumers Should Be Provided Shopping Credits Equal to Current Monopoly Prices to Shop for Competitive Services. Utilities should be encouraged to "exit" competitive businesses and focus all ratepayer dollars on performing services that can only be performed by a natural monopoly. In the process, consumers should be given "shopping credits" on their utility bills equal to the utility's fully embedded costs of providing competitive services that have been historically bundled with traditional monopoly services. Currently, captive utility customers pay monopoly prices for a bundle of services that include many products and services that can and should be provided by competitive suppliers at competitive prices. Failure to give consumers credits that reflect the full costs historically associated with these services will send erroneous pricing signals to consumers and cause consumers to pay twice for the same services. Shopping credits which "back out" the proper amounts from utility rates will permit consumers to shop for competitive services, encourage price competition among suppliers, improve efficiency and stimulate innovation. Until consumers are given the full monopoly prices they are currently paying for competitive services to shop for alternative energy services, price competition and lower energy costs will be difficult to achieve.

C. Federal and State Tax and Regulatory Incentives are Needed Immediately for Investments in New Energy Supplies, Conservation, Technology, and Infrastructure Immediately. The United States has entered the digital age with an energy infrastructure constructed for the industrial revolution. The United States is operating on a level of reliability that cannot support digital power quality needs. A flicker of the lights in Silicon Valley has global impacts.

One of the lowest cost, highest yield policy solutions is to create targeted tax incentives to encourage all forms of new energy supply, technology and conservation investments. This includes investments in new pipes and wires to reduce congestion, advanced metering systems, new computer systems, new energy supplies as well as distributed generation. Both the state and federal governments have powerful and effective tools to encourage new investments in energy supply and conservation. The federal tax code already contains a myriad of targeted energy, environmental and efficiency tax credits that should be updated to increase the supply of electricity and natural gas and reduce consumption. Either or both the existing energy tax credits contained in Section 48 of the Internal Revenue Code (IRC), or the existing credit for research contained in Section 41 of the IRC, could be expanded to include "qualified energy restructuring investments."

NEM recommends that the definition of "qualified restructuring investments" include, at a minimum, expenses incurred to modernize and upgrade computer and information systems, metering systems, billing systems and customer care facilities to facilitate competitive restructuring. The credit should be available to both regulated and unregulated entities. To ensure that restructuring tax credits and regulatory incentives are targeted and effective, investments that are not "qualified" should also not qualify for stranded cost recovery.

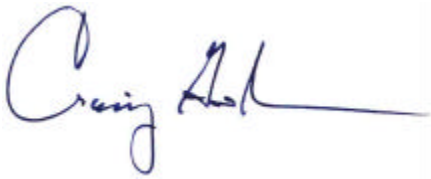
Conclusion

The market structure and added supplies necessary for deregulation to succeed in California were not in place, and the failure of *California style deregulation* was therefore predictable. In order to prevent similar crises, permit meaningful choice and true price competition and ensure the reliability of a digital quality U.S. energy infrastructure, (a) far greater uniformity is necessary among the states to achieve national economies of scale, (b) utilities must be incented to exit the

merchant function while consumers are given adequate shopping credits to shop for competitive supplies, and (c) existing tax and regulatory incentives must be expanded to encourage new investments in energy supply, technology and conservation.

If both federal and state laws are written in a manner that ensures meaningful price competition for the smallest retail consumer, the country will benefit from lower energy costs, greater efficiency and improved competitiveness internationally. Higher energy costs operate like a regressive tax on low-income individuals and small businesses. Conversely, laws and policies that help to lower energy prices have a disproportionately greater benefit for lower income individuals and those on a fixed monthly income. NEM experts are available to work with Committee staff to draft appropriate language to implement these recommendations.

Respectfully submitted,

A handwritten signature in blue ink, reading "Craig Goodman", followed by a vertical line.

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