

WHITE PAPER
IMPLICATIONS OF PROPOSAL 51
FLORIDA CHAMBER OF COMMERCE

Proposal 51 would permit all retail electricity consumers in the State of Florida to choose their supplier of electric energy. Specifically, Proposal 51 states that electricity customers have “the right to choose the provider of [their] electricity service, including, but not limited to, selecting from multiple providers in a competitive electricity market, or by producing electricity by themselves or in association with others.” In other words, Proposal 51 proposes to deregulate retail electricity service in Florida.

A number of states have pursued electricity deregulation in the past 20 years, and the majority of them have experienced “buyer’s remorse.” As will be shown below, promised reductions in retail electricity rates have not materialized, customers have been forced to bear substantial stranded cost burdens, and system reliability has deteriorated. Moreover, many of the states’ most vulnerable residents and business owners have been forced to pay ever-increasing monthly electricity bills. Florida, under the guidance of then-Governor Bush, analyzed the costs and benefits of electricity deregulation in 2000, and at that time decided not to pursue deregulation. Little, if anything, has changed in the meantime.

A. Retail Rate Increases in Deregulated States Have Outpaced those in States with Traditional Cost-of-Service Ratemaking.

Two decades ago, a number of states began the process of deregulating retail electric markets, with 18 states plus the District of Columbia ultimately going forward with deregulation to varying degrees.¹ These states deregulated because they believed that increased competition would result in lower electricity prices for consumers. Reports have stated that none of these

¹ California, Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, Montana, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Texas, Virginia, and the District of Columbia.

jurisdictions can call deregulation a success.² At least four of those states subsequently decided to re-regulate or to suspend deregulation, as the promised price benefits have not materialized.³ Two additional states passed statutes declining to pursue deregulation after initial approvals.⁴ Not one state has deregulated in the past decade.⁵ As one study noted, “[W]hile the restructuring era dawned with great hope that regulatory innovations, and the incentives provided by competition, would dramatically improve efficiency and great lower consumer costs, that hope was largely illusory.”⁶

Many states imposed rate caps immediately after deregulation, but upon expiration of those caps, retail consumers’ bills skyrocketed. While fuel costs caused electricity rates to rise nationwide in the early 2000s, rates in deregulated states rose by a greater percentage than those in states with traditional cost-based regulation. In states such as Illinois, Maryland, Ohio, and Pennsylvania, residential retail customers faced rate shock. In Illinois, retail customers saw their bills double or triple after rate caps were lifted. Maryland electricity rates were slightly above the national average before deregulation, the disparity increased following deregulation. Rate increases in some areas of Maryland ranged from 40 to 80% following the rate caps. In Texas, studies show that retail customers in areas with traditional regulation, such as Austin and San Antonio, paid an average of \$288 per year less for electricity than customers in deregulated regions. The increased electricity rates forced some industrial concerns, such as an Alcoa

² USA Today, April 21, 2007.

³ California, Montana, Oregon, and Virginia.

⁴ Arizona and Arkansas.

⁵ Nevada is currently considering a constitutional amendment similar to Proposal 51. In Nevada, an amendment initiated by the public must receive a majority of votes in two general elections held in even-numbered years. Nevada’s proposed deregulation amendment passed in 2016, and now must face the voters again in 2018 before it can become effective. If passed, the amendment will become effective in 2023.

⁶ The U.S. Electricity Industry after 20 Years of Restructuring, Bornstein, Severin and Bushnell, James, Energy Institute at Haas, May 2015 at p. 3. The authors note that fuel prices, especially the price of natural gas and the development of new technologies has had a larger impact on electricity prices than deregulation.

smelter in Maryland, to close.⁷ In Pennsylvania, Allegheny Technologies announced that it would not invest \$400 million due to rising electricity costs.⁸ Other states, such as Illinois, have faced job losses when generation facilities close or cut the number of employees.

In addition to overall increases in retail rates, deregulated states have also faced substantial price volatility, which is particularly concerning to states with many residents living on fixed incomes, such as Florida. In deregulated markets, prices fluctuate depending upon the level of demand. On peak days and months, therefore, rates can skyrocket. Studies show that electricity is an inelastic good, with people finding it challenging to decrease their power consumption during peak periods. Deregulation has not affected the inelasticity of demand, but has simply forced retail ratepayers to assume the risks of price volatility. For example, during the Polar Vortex in early 2014, customers of some retail suppliers in Connecticut, New Jersey, and Pennsylvania saw their bills increase by more than 200%. When wholesale power costs spike, as they did during the Polar Vortex, retail suppliers must bear those costs and will attempt to pass those costs on to their customers. In the past few years, the drop in the price of natural gas has moderated electricity price increases, but there remains no evidence that deregulated states fare better than fully regulated ones with respect to retail rates.

Deregulation has failed to bring about the promised price decreases for many reasons. The primary issue probably relates to the fact that generation markets in the country have not become truly competitive. Even in states with more than a handful of retail providers, those providers tend to offer similar services and buy their power from the same wholesale providers; as one study noted, the product being sold is very narrow and homogeneous, so it is difficult for

⁷ The Failure of Electricity Deregulation: History, Status and Need Reforms, Slocum, Tyson, Director, Public Citizen's Energy Forums, March 2007, at p.8.

⁸ *Id.*

retail service providers to develop truly “new” services.⁹ Most generation resources are owned by a few large companies and wholesale electricity rates are subject to less regulatory oversight by the Federal Energy Regulatory Commission. FERC almost always permits wholesale power sales to be made at market-based rates and does not examine the actual rates charged by wholesale power sellers. While a few very large electricity consumers may have the expertise and knowledge to negotiate with these large generating companies, the vast majority of retail customers – including retail and small commercial customers – do not. As a result, small retail customers face the brunt of the increased rates that result from deregulation.

Florida would face the same issues faced by other states that have pursued deregulation, but may face additional obstacles in providing true retail competition and lower rates. Florida is a peninsula, which makes it more difficult for power to be transmitted to the state from other regions and more difficult to obtain the fuel necessary for in-state generation resources. Very recently, interstate natural gas pipeline capacity to Florida has increased, but it remains unclear whether the state has sufficient capacity to serve all needs at peak times. Florida may be more likely than other states to face price volatility in a deregulated market, due to the supply constraints it faces.

In sum, the experience of other states demonstrates the deregulation increases retail rates and rate volatility and often those increases have been dramatic. Rate benefits, if any, have been few and fleeting. Florida will face the same rate problems if it enacts Proposal 51.

B. Reliability in Deregulated States Has Suffered and Customer Service Has Not Increased.

In states with traditional cost-of-service regulation, the “regulatory compact” and long-term system planning ensure resource adequacy and reliability of electric service. That is,

⁹ Boornstein & Bushnell at p. 10.

regulated utilities are required to plan for and obtain the necessary electric energy and generation capacity to reliably serve electric load within their service territories and, in return, the utilities receive rates sufficient to cover the costs of doing so, including an appropriate rate of return. These obligations include the necessity of securing adequate reserves to meet reliability requirements.

Deregulation destroys the regulatory compact with respect to generation resources. Generators no longer have a guaranteed revenue stream that will cover their operating costs or the costs of providing sufficient energy and capacity to meet reserve obligations. Generators in retail choice markets have fewer opportunities to enter into long-term contracts with customers or end-users. Moreover, construction of a generation facility is highly capital-intensive. Most generators will be in operation for decades and require a revenue stream to recover costs throughout that time period. In contrast, retail electricity consumers are generally unwilling to enter into long-term contracts with suppliers. Retail consumers want the ability to “shop around” for better deals or to return to service from the incumbent utility if the price is right. As a result of the difficulty generators face in obtaining a sufficient revenue stream over the long-term, generators have little incentive to construct additional facilities. In fact, generators are likely to obtain higher prices for their output if supply does not greatly exceed demand. Resource adequacy and reliability, therefore, can suffer in deregulated states. One study indicated that “deregulation is associated with a significant increase in [outages] (around 15-18%) over time.”¹⁰

Texas is a good example of concerns regarding reliability. In February 2011, Texas experienced rolling blackouts due to insufficient generation to meet demand, and the state narrowly missed additional blackouts in January 2014 during the Polar Vortex. Texas’ reserve

¹⁰ The study examined outages from 1990-2013. U.S. Electric Utilities and Deregulation: Trends, States’ Choice, and Political Environments,” Claire S.H. Lim, Cornell University, August 30, 2016, at p. 24.

margin fell after older plants were retired, because the revenue received by generators through Texas' markets was inadequate to justify investment in new generation assets. In Texas, generators were paid only in the energy markets, and those payments were insufficient to encourage the construction of new plants. While generators could earn thousands of dollars per MWh at peak, payments were typically in the \$30-\$100 per MWh range, and power purchase arrangements rarely exceeded a few years in length.¹¹

To the extent that deregulated states require generators or incumbent utilities to maintain adequate resources to meet reliability obligations and ensure reliable service to the public, the cost of these requirements will simply be passed on to retail customers. Thus, retail customers may face the worst of both worlds in that they will pay the higher and more volatile rates that result from deregulation while also bearing the costs of ensuring reliable service.

Nor is there evidence that retail customers in deregulated states receive better customer service than customers in states with traditional regulatory structures. For example, states with traditional regulation have installed far more smart meters than states with retail choice. In 2014, states with traditional regulation had installed smart meters for over 43% of their customers, while retail choice states lagged at about 22%.¹² Similarly, residential customers in traditional states are more likely to enroll in demand response programs than residential customers in retail choice states. As a result, residential customers in traditional states have saved more energy through demand response programs than residential customers in deregulated states.¹³

¹¹ More recently, declines in the predictions regarding peak load in Texas have improved estimates of Texas' future reserve margins.

¹² Retail Choice in Electricity: What Have We Learned in 20 Years, Christensen Associates Energy Consulting, prepared for Electric Markets Research Foundation, Feb. 11, 2016 at p. 28.

¹³ *Id.* at pp. 26-27.

Customer satisfaction is no higher in states with retail choice than states with traditional regulatory systems.¹⁴ While deregulated states tend to offer more services such as dynamic pricing or green power options, services of this type can clearly be offered pursuant to traditional cost-of-service regulation with appropriate input from regulators, customers, and utilities. The Arkansas Public Service Commission pointed to rate hikes as a result of deregulation and reported that “few if any increases in service quality would be anticipated to offset the price increases.” As a result of these developments, Arkansas never implemented deregulation.

Given that deregulation degrades service reliability and does not provide improved customer service, it appears that customers in retail choice states pay higher rates for poorer quality service. Clearly, Florida residents will not be well-served by following this path.

C. Deregulation Will Require Florida to Address Several Complicated Issues and Will Be Difficult, If Not Impossible, to Unwind in the Future.

Florida has investigated retail choice before. In 2000, then-Governor Bush created an “Energy 2020 Study Commission” that looked into the issue. The Study Commission’s report identified a number of issues that would have to be resolved before Florida can deregulate electricity markets. Those issues remain crucial today.

For example, would incumbent utilities be forced to divest themselves of their generation assets? If so, over what time period should divestiture occur and how should gains and losses on the sale of the generation plants be treated? Many deregulated states forced their utilities to sell their generation facilities and have regretted that action. Asset sales can result in stranded costs, especially in situations in which the sellers are forced by law to sell. As the incumbent utilities constructed and invested in the generating facilities for the benefit of Florida retail customers with the approval of the Florida Public Service Commission, stranded costs will be borne by

¹⁴ *Id.* at p. 33.

retail ratepayers. Texas ratepayers paid billions of dollars in stranded costs in the early 2000s. In Maryland, a settlement addressing one incumbent utility permitted the recovery of over \$500 million in stranded costs. Furthermore, if the generating facilities are sold to out-of-state companies that will be selling the power at wholesale to retail service providers, the Florida Public Service Commission will no longer have jurisdiction over the facilities or their wholesale rates.

Some states that mandated divestiture are now examining whether their utilities should re-enter the generation market, through the re-purchase of generation facilities, through construction of new facilities, or riders or other subsidies to encourage plants to stay on-line. Ohio attempted to protect baseload coal and nuclear plants from retirement through power purchase agreements between the incumbent utilities and the subsidiaries that owned the plants, but those agreements were rejected by FERC. Ohio then turned to a distribution modernization rider to provide one utility with the revenue needed to maintain service. Many similar plants throughout the country are currently experiencing financial difficulties, and some experts believe that “unplanned re-regulation” is beginning to occur.¹⁵ This option is expensive, and again those expenses will likely be assessed to retail ratepayers. The bottom line is that divestiture is a significant step that cannot be reversed without the incurrence of substantial costs.

Another important question involves the scope of the Public Service Commission’s authority following deregulation. How extensive should regulation of retail choice providers be in order to ensure consumer protection? A number of states have experienced trouble with retail choice providers. In New York, the state Attorney General discovered that retail energy suppliers engaged in the following practices: misrepresentation of the level of savings the

¹⁵ Statement of then-Acting Chair LaFleur. Ms. LaFleur noted that states are pursuing generation subsidies for various reasons, but that many states now wish to influence their power mixes.

customer would experience, switching customers' energy suppliers without authorization, misrepresentation of the cancellation rights included in contracts, improperly renewing contracts without authorization or notice. Other states have received similar complaints regarding retail suppliers' failure to live up to promises made to consumers. Low income and disadvantaged citizens may face additional issues regarding retail choice providers, and they may be more likely to face the loss of electric service than in a traditionally-regulated environment. The PSC will have to consider whether retail service providers should be required to provide the type of low income assistance provided by incumbent utilities, as well as other consumer protection concerns. In one utility's service area in New York, the Public Service Commission had information indicating that 84% of low income customers would have received lower bids from the incumbent utility than they received from their retail service provider.¹⁶

In order to avoid the price volatility that many deregulated states have experienced, should the Public Service Commission impose limitations on rate fluctuations? In addition, what will be scope of the incumbent utility's responsibilities to be the "provider of last resort ("POLR")?" Should any entity that chooses a supplier other than the utility be allowed to return to POLR service and at what price? These questions are crucial to incumbent utilities, who must be able to plan to serve their customers over the long-term and will find it difficult to do so if they must agree to serve anyone who switches providers and then elects to switch back. If the incumbent utilities have been required to divest their generation assets, how will they provide POLR service and how will rates for that service be established?

Finally, but perhaps most importantly, as described above, many deregulated states have faced issues regarding service reliability. How will Florida ensure that it has adequate

¹⁶ *Proceeding on Motion of the Commission to Assess Certain Aspects of the Residential and Small Non-residential Retail Energy Markets in New York State*, New York Public Service Commission, Case No. 12-M-0476, Comments of Eric T. Schneiderman, Attorney General of New York State, at p. 14.

generation resources to provide reliable service to all retail customers in a deregulated market or if divestiture is required? In addition, fuel diversity can be an important factor in ensuring reliable electric service. This issue is currently at the forefront of discussions before FERC, given the recent DOE NOPR on resilience issues and the problems faced by coal and nuclear facilities in some markets. In a deregulated market, Florida is unlikely to be able to require a diverse portfolio of generation facilities, which may affect reliability in the state. Similarly, Florida may be unable to fully address environmental concerns if it loses the ability to require the development of certain types of generation resources.

CONCLUSION

As shown above, other states' experiences with electricity deregulation demonstrate that it is not a panacea for concerns regarding the provision of retail electric service. As a result of the lack of success of deregulation, additional states have been reluctant to deregulate. Florida should be similarly reluctant. The Constitution Revision Commission should not adopt Proposal 51.