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BEFORE THE
FEDERAL TRADE COMMISSION

Comments Regarding Retail Electricity Competition	)	V010003

Comments of the Alliance for Retail Energy Markets
Regarding Retail Electricity Competition

Pursuant to the March 6, 2001, Notice Requesting Comments on Retail Electricity Competition Plans issued by the Federal Trade Commission, the Alliance for Retail Energy Markets ("AReM")[1] hereby submits its responses to certain of the questions raised in the Commission's Notice. AReM members have been fundamentally involved in the retail electricity market in California and believe their collective experiences can assist the Commission in its consideration of the advantages and disadvantages associated with different approaches to retail competition, as well as areas in which additional federal legislative or regulatory action may be desirable.

AReM first wishes to commend the Commission for its issuance of the March 6 Notice. The advent of true retail competition has the potential to bring many benefits to electricity consumers throughout the nation. The Commission's efforts to investigate this topic and determine how it should be implemented has the potential for developing a more uniform format for retail competition which can be implemented efficiently throughout the country.

[1] The members of AReM serve most of the 150,000 California customers who have chosen a competitive electric provider. AReM's members include AES NewEnergy, Inc.; Commonwealth Energy Corp.; Enron Energy Services, Inc.; Green Mountain Energy Company; The New Power Company; Shell Energy Services; and Strategic Energy, L.L.C.

At the same time, however, there is a right way and a wrong way to implement and foster retail competition. AReM members have unfortunately experienced the latter situation in California, although their affiliates in other states have been more fortunate. Our comments are essentially comprised of three sections. First, we suggest to the Commission three principles which should be adopted as it moves forward with actions designed to protect the interests of retail electricity consumers. Second, we provide a cautionary explanation of how retail competition was stymied and frustrated in California, explain the benefits which could, and should, have flowed to California consumers and why the lack of a vibrant retail market has contributed to the current electricity market meltdown in that state. Third, we compare and contrast that experience with developments in other states. In providing this information we have attempted to respond to several of the questions raised in the March 6 Notice. However, rather than itemizing the questions separately, AReM has elected to provide a narrative description discussing these topics.

I. Certain Fundamental Provisions Must Be Adopted to Encourage Effective Retail Competition Which Benefits Consumers.

AReM notes that the need to foster a vibrant retail market should be a paramount and fundamental concern of the Commission. Competition in retail electricity services is a critical part of a comprehensive effort to deregulate the electricity industry. Moreover, AReM urges the Commission to recognize that the problems which have been observed in the wholesale electricity market were neither caused nor exacerbated by the retail direct access market. To the contrary, retail competition has enabled many customers to avoid the pricing fluctuations in the wholesale market which have been so problematical. The electricity market cannot be competitive, unless *both* the wholesale and retail electricity segments of the market are

competitive. The supply of electricity is largely a function of the wholesale market, and demand a function of the retail market. In order for the electricity market to be optimally efficient, supply and demand must both be able to respond to competitive price signals.

AReM strongly believes that all customers, both small and large, can best be protected through the development of a vibrant and competitive retail market. A significant failing of the existing market in California was that the California Public Utilities Commission ("CPUC") did not take all of the steps necessary to foster such a market. This observation has been made strongly by the Market Surveillance Committee ("MSC") of the California Independent System Operator Corporation ("ISO"). In its September 6, 2000 report entitled, "An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Markets," the MSC stated that:

> Market design changes must be implemented to alter the incentives faced by several classes of market participants. Our recommendations are:
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> . . .
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> • Enact a regulatory structure conducive to robust retail competition. Financially or legally separate the regulated "wires" portion of UDC operations from the unregulated "supply" portion of UDC operations. Set a fixed default provider retail rate and default provider obligation for UDCs. Make the fixed rate available to all final customers, but allow UDCs and other competitive energy service providers to compete with additional retail rate plans that encourage price-responsive final demand.

AReM concurs with the MSC's recommendations and urges this Commission to adopt the following two fundamental principles which must be met in order to establish a market that allows for retail competition to develop and flourish:

- First, the rate charged to default customers must be strongly linked to actual wholesale costs.

- Second, the retail rates paid by default customers must include all of the associated retail costs incurred by the default utility provider.

Several states have attempted to implement certain of these principles with varying degrees of success. Section II of these comments describes the causes for the retail market failure in California while Section III discusses the differing approaches in New Jersey, Pennsylvania and Texas. In addition to the foregoing fundamental principles, AReM also urges the Commission to consider the following issues as it moves forward with actions designed to protect the interests of all consumers:

A. Small customers deserve a known, fixed default electricity price which is based on the actual wholesale cost.

Local distribution utilities procure electricity on a "default" basis for customers that have not opted to purchase electricity from a non-utility provider. Traditionally, the utility passes all of its supply costs on to its default customers. Most frequently, customers only learn what those costs are after they use the energy. Utilities should be required to offer a fixed price to small customers so they know in advance what their costs will be and can make rational comparisons of other options such as energy efficiency or alternative providers. When supply costs exceed published tariff rates, the utility adjusts its rates with true-up mechanisms called balancing accounts. This approach subjects customers to a balloon payment liability for prior-period costs. AReM believes that small customers should not be exposed to such after-the-fact payment obligations.

B. Large customers should be required to secure their own electricity supply.

Just like small customers, industrial users have the option of purchasing electricity from non-utility providers. Many large customers already take advantage of these alternatives. Electric prices in the wholesale market fluctuate on a frequent, even hourly, basis. At any given point, wholesale prices will be greater or less than the posted utility tariff rate. Industrial users can take advantage of these differences by changing their electric provider -- buying power from

wholesale markets at times, and switching back to utility supply at other times. Large users can save money this way, but in the process, impose additional costs on small default customers.

In the natural gas market, utility tariff structures in California prevent large customers from engaging in this kind of activity. As a result, small customers are protected from large customers swinging on and off of default service. AReM believes that small customers deserve similar protection for their electricity costs. In order to be fair to large customers, a phase out period should be provided to allow them to transition to a competitive supplier.

C. Default service for small customers should be subjected to competition.

In most states, including California, utilities currently provide both electric distribution service and default retail service. However, default service does not have to be provided by the utility. Entities other than the incumbent utility may be able to provide default service at a lower cost or with better service than the utility, while satisfying all consumer protection requirements. AReM believes that bringing competition to default service will yield the best default service for small customers. Eventually, this competition will enable the utility to withdraw from the default role.

AReM believes that having the incumbent utilities retain a retail service role also threatens reliability and efficient operation of the distribution system. If their monopoly responsibility pertained solely to the operation and maintenance of the distribution system, customers would not be exposed to power pricing fluctuations due to utility purchasing practices. They would instead be served by competitive retail suppliers who would have both the complete ability and a strong incentive to fully hedge their purchases to guarantee reasonable power pricing, as discussed in Section II.A.2. below. The utilities would be able to concentrate their efforts on maintaining and operating the most efficient, safe and reliable distribution system

possible and not have those efforts impaired by any financial strain caused by their power purchasing activities, as may currently be the case.

II. How Retail Competition Was Stymied and Frustrated in California and Contributed to the Current Electricity Market Meltdown.

The California experience is a story of missed opportunities. The state's failure to promote a healthy and robust retail market led to extreme pricing fluctuations in the wholesale market. It has restricted the availability of competitive alternatives to the investor-owned utilities' high-priced reliance on short-term purchases. In so doing, it has harmed the economic well-being of millions of California consumers and handicapped the state's ability both to attract and retain large commercial and industrial customers. The following sections provide further detail with regards to why retail competition has failed to work in California.

A. The State of California Should Have Promoted Competition in Order to Mitigate Pricing Fluctuations.

An effective retail market can alleviate the pressures on consumers and help mitigate the pricing fluctuations in the wholesale market. There are several reasons why this is so:

1. Effective retail competition increases the number of buyers in the market.

The California power market currently is characterized by a limited number of buyers, with the utilities (and now the State itself) purchasing the overwhelming share of available supplies to meet the needs of their bundled service customers. This limited number of buyers means that the utilities' actions have a disproportionate effect on market prices. Increased retail competition would mitigate this effect, by adding more buyers and increasing the volumes purchased by those buyers.

2. Retail competition offers greater hedging opportunities for end-use customers.

Retailers have greater flexibility than do utilities to offer hedging products to end-users. The differences in the way in which retailers serve customers vis a vis the way the utility serves its customers make it clear why the retailer is apt to forward hedge. If a retailer enters into a contract to deliver energy at a fixed price of 6.5 cents/kWh for one year, the retailer would buy (either on a physical or a financial basis) products to ensure that the retailer could meet the terms of its contract with its customer.

In that way, the customer assumes no risk but gets exactly what it agreed to. Meanwhile, the retailer has managed its risk through forward contracts and other risk management tools to fulfill the contract. By contrast, the California utilities were continually concerned that if they had entered into forward contracts, the CPUC might at some point in the future determined that decision to be unreasonable. This effectively left both the utility and the customer in an open, unhedged position and was a primary factor in the utilities' financial meltdown.

3. While a utility has to be concerned about the reasonableness review aspects of its hedging decisions, retailers have no such concerns.

Retailers in fact have greater incentives to hedge as an effective way to manage the risk inherent in power transactions. There is significant evidence that those end-users who were astute enough to have hedged their purchases in advance of this summer, enjoyed extremely significant savings when contrasted with other ratepayers. An effective retail market with greater customer penetration would have greatly increased the opportunities for ratepayers to avoid market price fluctuations.

4. Retailers have greater incentives to offer demand responsiveness products.

As part of their hedging strategies, retailers wish to see peak demand mitigated, so that they are not forced into the short-term spot market to meet customer demand. The risks of such

spot market price volatility provides a clear incentive for retailers to offer effective demand responsiveness products.

In conclusion, an effective and vibrant retail market can mitigate price volatility in wholesale markets by increasing the number of active buyers and the volumes purchased by non-IOUs; by offering greater hedging opportunities to end-users; and by offering more demand responsiveness products to end-users.

B. Why Has Retail in Competition in California Not Been Successful?

There are essentially four reasons why the benefits of a vibrant competitive retail market have not been fully realized in California. First, economic incentives to new competitors were severely restricted, making it extremely difficult to compete in the state on a profitable basis.. Second, institutional barriers to entry by non-incumbents were not eliminated. Third, there was a fundamental lack of price transparency which made it next to impossible for new market participants to price their products competitively. Fourth, the decision by the State of California to become a major wholesale purchaser of power has led to the probable suspension of direct access privileges and an abandonment of the principles of customer choice and free competition.

1. Pricing Barriers to Competition

The CPUC allowed individual consumers to purchase electricity from entities other than their distribution utility. But while that step was necessary, it did not prove to be sufficient to create *meaningful* competition. Why? Because when the doors were opened to ESPs to provide retail energy and related services to end-users, the price against which the ESPs were competing, and that customers could compare, was the wholesale cost of generation.

First and foremost, default rates were severed from the actual cost of service incurred in the wholesale market. The combination of a frozen retail rate structure and the legislatively

mandated requirement to pay its utilities $30 billion of stranded costs on an accelerated schedule meant that there was no room in the utility rate structure to permit a reasonable profit-making opportunity for new competitors. The so-called Competition Transition Charge to reimburse the utilities' stranded costs was calculated on a residual basis by subtracting the current wholesale price of power, as measured by the price of the California Power Exchange, from the frozen generation rate. Therefore, even though the first two years of wholesale competition resulted in an average price less than half of the approximately seven cents/kWh frozen generation rate, all of the savings went directly to the coffers of the utilities' corporate parents. None of these savings flowed through to ratepayers.

Second, customers who opted for direct access received what was known as the PX credit. However, it clearly did not reflect the cost of providing a default retail energy service to end-users. Rather, it was comparable to asking a gas station attendant to compete against the refinery cost of gasoline.

Utility generation rates for bundled service customers should conceptually represent "retail service costs." The rate should include, in addition to wholesale commodity costs, fully allocated amounts for all of the utility's cost elements incurred in connection with the provision of electric commodity to retail customers, such as salaries, office space, benefits, consultants, legal fees, and any number of normal business costs that all competitors have to incur. That is, the rate should be the full retail rate for commodity electricity service. Retail service costs should appropriately include a wide range of costs that are currently embedded in the UDCs' distribution rates.

Historically, the California utilities have bundled all their costs together from generation through transmission, distribution and retail and then marked up the total costs by their

authorized rate of return on rate base. Because California has not required these costs to be separated from their historical bundling, currently, all of the UDC's retail costs remain buried in the charges for other services, specifically, distribution rates, thereby understating the true cost of their retail energy services.

The process for the UDCs and the ESPs starts the same -- they both have to buy their power in the wholesale market. After that, it diverges significantly. UDCs collect the costs of procurement, such as load forecasting, scheduling, risk management, reading meters, printing bills, marketing, account management, providing customer service, collecting bills and all the salaries, pensions, benefits, furniture, office space, computers, data base systems, telephones, support staff and other costs used to support these functions from distribution rates that all customers pay, regardless of whether they get their retail service from the UDC or from an ESP.

In addition, the UDC distribution rates include other general costs of doing retail business in California, such as legal, regulatory and legislative staff and services to support the UDCs retail electric business, taxes, working capital, and more. By contrast, ESPs must cover the costs of those services by adding a mark-up to their wholesale cost of power. In essence, consumers who chose an ESP paid twice for the retail function. The inclusion of these costs in the distribution rates payable by <u>all</u> customers, rather than solely by those customers who remain with utility service, constituted a highly significant barrier to retail competition in California.

2. Institutional Barriers to Competition

Institutional barriers to entry by non-incumbents were to be eliminated by transforming the state's investor-owned utilities ("IOUs") into neutral transmission and distribution ("T&D") wires companies, albeit with a passive "price-taker" default provider role. However, this did not occur. Although California made great strides in bringing competition to generation and the

wholesale electric markets, on the retail side of the business, traditional bundled service continued to be the norm for the overwhelming majority of California customers.

There was and is a distinct incumbent advantage in retail electric markets, both in California and other states. Quite unlike most markets, competitors in retail electricity must attack established UDCs that provide almost everyone in their territories with retail service and often have favorable reputations among consumers. Newcomers must compete on more than price alone to successfully attack the "brand equity" of existing UDCs. One consulting study of a major (unnamed) utility determined that a national energy marketer offering a five percent discount to utility customers will garner only 2 percent of the market, but one offering a 20 percent discount will get 17 percent.[2]

An ESP must price its products attractively, make the investments needed to inform consumers about its presence, persuade them to switch, and establish a reputation for itself. UDCs have strong brand equity that requires substantial investment by ESPs if it is to be overcome. If regulation itself imposes further costs on newcomers, but not incumbents, the barrier to entry will be even higher. Investments that develop reputations may be necessary to filter out low-quality newcomers, but there is no economic case for maintaining inefficient regulatory policies that are remediable.

The utilities' efforts to implement direct access were marked by efforts to frustrate new competitors. For example, when the CPUC first directed the utilities to submit proposed tariffs for implementing competition, a review of the filings revealed two fundamental facts. First, the proposed competitive tariffs were vastly dissimilar from one another, causing new market

[2] Eric Almquist and Susan Piotroski, "The Power of Brand Equity: Exploiting a Singular Incumbent Advantage," *The Electricity Journal* 12 (Mar. 1999), 86. The authors did not state the time period necessary for the reported changes in market shares to occur.

entrants to have to essentially learn a different set of rules for every utility service territory. Complaints about the economic inefficiency of such a system were ignored by the utilities. Secondly, a review of the tariffs revealed that each utility had proposed various stumbling blocks and obstacles to the implementation of competition. Only through the efforts of a concerted coalition of new market participants and various customer groups was the CPUC convinced of the need to implement a uniform statewide tariff for competition.

However, after achieving this success, new competitors were then confronted with a variety of utility operational and procedural requirements which delayed and frustrated the implementation of competition. A key example was the requirement that commercial and industrial customers who wanted to elect direct access had to have an interval meter costing thousands of dollars, even though no such requirement was in place for bundled service. On the residential side, a combination of consumer protection requirements (3 day cooling off, mandatory service of terms and conditions) and utility operational issues (processing time for Direct Access Service Request review and only changing over at meter reads two months into the future) led to unacceptable lead times of 3 to 4 months after a customer had signed up.

The results of all these institutional barriers were predictable. For example, as of July 1, 1999, 15 months after the start of retail competition in California, only 1.4% of the customers, or 13.3% of the load, in the three UDC service territories had chosen direct access. By March 15,2001, however, these numbers had plummeted to include only 1.2 % of the customers and 2.9% of the load. And now, due to spiraling wholesale costs, the lack of price transparency and the financial inability of the investor-owned utilities to provider direct access customers with the full credit which they are due, energy service providers ("ESPs") in California have turned most of their customers back to utility bundled service. In addition, the initial enthusiasm among

prospective ESPs to enter the California market was observe to dim considerably. Of over 200 ESPs that initially registered to provide services in California, the vast majority never became active in the market. Perhaps a more telling fact is that there is not a single ESP currently offering power to residential customers other than "green" or renewable energy.

Th reasons for this dismal performance is obvious. Under the market structure adopted in California, it was impossible to offer generic power to residential customers at a price that both benefited the customer and covered the ESP's costs. Renewable energy was an exception to this general rule because of a 1.5 cent per kilowatt-hour customer credit incentive from the California Energy Commission and because some customers were willing to pay more for environmentally friendly power.

3. Barriers Caused by Inadequate Price Transparency

Moreover, there was inadequate price transparency for default retail energy service. This caused bundled service customers to have difficulty with comparing their existing price with the proposed prices from new competitors. It also made it difficult for new competitors to price their own products. The result was that prospective customers simply demanded a discount from whatever generation rate their incumbent supplier might provide, despite the fact that the default rate was not based on the wholesale cost of power.

The importance of transparency of price was greatly discussed in the CPUC's vision of competition. With accurate price signals, customers can make informed decisions about when to use electricity as well as using substitutes for electricity such as investments in demand side management. The overall economic efficiency of the electric power system will be enhanced if customers see accurate price signals.

However, the utility's actual generation rate (the PX price) that California default customers paid was actually very difficult to calculate. It was a blend of the utilities' purchases in the day-ahead, day-of, hour-ahead, block-forward and imbalance markets. However, even the UDCs did not know what the actual rates would be until several months after the customer actually used the power due to billing lags associated with ISO and PX settlement processes. Each additional procurement option available to the utilities requested made this calculation more complex, and less observable to the customer.

For example, the CPUC decision allowing the utilities to use the PX block forward market in procuring power made the calculation more complex and less transparent to the customer. Allowing the utilities to procure power from additional PX markets, or from outside the PX, also made the calculation even more complex and less transparent to the customer. The recent collapse of the PX has essentially eliminated any transparency, causing ESPs to return most of their customers to bundled utility service. In essence, the lack of adequate transparency has caused the retail market to have gone full cycle - from no competition, to limited competition, and back to no competition.

C. The State of California Should Have Promoted Competition Because Retail Competition is Still Desirable Even When Wholesale Market Prices Are High.

If California had already developed a robust retail electricity market before wholesale prices began to climb in the summer of 2000, there would have been multiple retail suppliers in the state, serving customers in the service territories of the state's three investor-owned utilities. The utilities' exposure to high wholesale prices would have been significantly reduced for the simple reason that their respective power procurement responsibilities would have been reduced.

Moreover, should an individual retail supplier have encountered financial problems, the presence of multiple market participants would have rendered such an occurrence essentially

meaningless to the overall market structure. The remaining market participants would have picked up the slack and the financial problems of a single supplier would have been a mere blip on the radar screen, with no impact on consumers. The utilities' purchased power undercollections would have been significantly reduced and their slide toward possible bankruptcy would have been averted.

D. Conclusion

California essentially offered retail competition in name only rather than offering its residents meaningful retail choice. By doing so, the state stunted the growth of new products and services, penalized customers who exercised the options that were available, and prevented the realization of the lowest-cost electric service. In essence, the California market has reverted back to its former monopoly state, squandering the millions of dollars spent and the ingenuity put forth by multiple stakeholders to bring competition to Californians.

III. Other States Provide Insights Into the Importance of Meeting the Two Basic Criteria for a Competitive Retail Market.

There are two fundamental principles which must be met in order to establish a market that allows for retail competition to develop. First, the rate charged to default customers must be strongly linked to actual wholesale costs. Second, the retail rates paid by default customers must include all of the associated retail costs incurred by the default utility provider. Several states have attempted to implement certain of these principles and the following sections discuss their relatives successes and failures.

A. New Jersey

The markets in New Jersey serve as an example of a state that has successfully performed the task of separating retail costs, yet failed to establish a strong linkage between retail rates and

the wholesale market cost of power. The New Jersey Legislature passed the Electric Discount and Energy Competition Act (the "New Jersey Deregulation Act") on February 9, 1999. The legislation directed the New Jersey utilities to provide, "shopping credits applicable to the bills of their retail customers who choose to purchase electric generation service from a duly licensed electric power supplier". (New Jersey Deregulation Act at § 4

The New Jersey legislation has been implemented by the Board of Public Utilities through restructuring agreements with the incumbent utilities that specifically addressed retail cost separation.[3] Unfortunately, both of the markets discussed above have struggled to develop into fully competitive retail markets because of a failure to link the retail default rates to the actual wholesale market. Each of the utility service territories operate under frozen retail rates with no mechanism for adjustments due to fluctuations in the wholesale market.

This has resulted in a breakdown in the development of retail markets in New Jersey. In fact, the New Jersey markets are stagnant with very limited offerings from competitive providers. New Jersey demonstrates the importance of adequately addressing *both* of the central requirements of a competitive retail market. The future of the market in New Jersey will hinge on taking the achievements on retail cost separation and combining them with a properly structure default service rate that is directly tied to the actual cost of service in the wholesale market.

The fundamental flaw in New Jersey has been that there is no link between the shopping credits and the wholesale markets. The shopping credits were fixed, based on wholesale prices

[3] Public Service Company of New Jersey, reached a restructuring agreement which the Board of Public Utilities (BPU) approved April 21, 1999. The Stipulation sets a shopping credit inclusive of an allowance for the cost of energy, capacity, transmission, ancillary services, losses, taxes and "retail adder." GPU Energy, another New Jersey utility, also reached a settlement, approved by the BPU May 19, 1999, in which the shopping credit is inclusive of an allowance for the costs of energy, capacity, transmission, ancillary services, losses and taxes, plus an "incentive" or "retail adder" in order to enable customers to shop.

and forecasts from two years ago. Simply including appropriate overhead costs has not overcome the significant run-up in wholesale energy prices that occurred shortly after the shopping credits were fixed in 1999. Without an appropriate index to wholesale prices, New Jersey customers will not see the true cost of electricity and any significant move in the market will halt competition.

B. Pennsylvania

The Pennsylvania Public Utility Commission has also approved company-specific settlements that establish shopping credits which encourage consumer shopping for electricity. However, like New Jersey, Pennsylvania had notable success in recognizing the importance of separating retail costs, but failed to adequately reflect changes in wholesale power costs in the default retail rates of the incumbent utilities. The Commission's landmark decision in this regard involved PECO Energy Company. On December 11, 1997, the Commission directed PECO to establish a shopping credit. By including in the shopping credit an increment to the wholesale power price, the Commission recognized that its approach, "avoids creating a de facto monopoly that delivers temporary and short-term rate cuts. It creates real incentives for electric suppliers to compete for customers and for customers to shop for electricity. As such, this decision will create a market featuring both many buyers of electricity and many sellers of electricity." (Order at p. 44).

However, the Pennsylvania experience to date shows the most of the market activity in terms of customers shopping, switching, and achieving savings occurred during the early opening stages of the market and that recent movements in the wholesale market have largely paralyzed the retail market. Just as in New Jersey, many suppliers are unable to offer customers retail service because the artificially established retail default rate offered by the incumbent utility does

not reflect the upward movement in wholesale power market prices. As in California, artificially set retail default rates can have a serious negative impact on the financial health of the incumbent utility provider. Further, failing to link the default rate to the actual cost incurred to serve the customer will significantly undermine the development of a competitive retail market.

The existence of the rate caps with no adjustment for wholesale market price fluctuations has resulted in the break down of competitive markets in Pennsylvania. While the spirit of the legislation and the model was good, without a mechanism by which shopping credits are adjusted to reflect changes in the wholesale market cost of power, the lack of price transparency that contributed to the failure of the California market is also prevalent in this region.

C. Texas

Texas is a state where the proposed new system appears to have a number of encouraging elements which should facilitate retail competition. The Texas Electric Choice program starts this year. Texas Senate Bill 7, passed in 1999, eliminates the monopoly by investor-owner utilities in the state. Customers of these utilities now have the power to choose their own Retail Electric Provider ("REP"). The Texas Electric Choice program kicks off this year with the Pilot Program and becomes fully implemented on January 1, 2002.

The Texas restructuring law mandates a rate reduction of 6% off 1999 rates for all customers with peak demand less than 1,000kW. This reduction is called the "Price to Beat" (PTB). A consumer's current affiliated utility must offer the PTB and can not offer a higher or lower rate. Only non-affiliated REP(s) can offer consumers greater savings. In this manner two objectives are achieved. First, prices are reduced at least 6% for all customers. Second, the utilities' costs of procuring and marketing power are totally accounted for in a separate entity. This means that the retail rates paid by default customers must include all of the associated retail

costs incurred by the default utility provider, so that new REPs in the state will not have to cope with hidden subsidies in the utilities' transmission and distribution rates.

Another major advantage of the Texas law is that large customers are required to shop for their power from alternate retail suppliers. The PTB is not applicable for customers with peak demand above 1,000kW. These customers will need to evaluate competitive offers from REP(s) to meet their energy needs. Furthermore, the rate charged to default customers is strongly linked to actual wholesale costs.

III. Summary and Conclusion

The Commission's March 6 Notice observes that, "Competition among market participants will ordinarily provide customers with the benefits of lower prices than would otherwise prevail, higher quality products and services, increased variety of products and services, and enhanced rates of innovation. Effective competition may not develop instantaneously, however, after decades of pervasive regulation and local franchised monopolies. Moreover, the effectiveness of competition may be affected greatly by the rules that govern the operation of the market and that provide incentives to guide market participants' behavior." AReM fully concurs with this observation, noting that California made several errors in its adoption of rules which frustrated and stymied the creation of a truly competitive retail market.

Institutional barriers to entry by non-incumbents were not eliminated. Economic incentives to new competitors were severely restricted, making it extremely difficult to compete in the state on a profitable basis. There was a fundamental lack of price transparency which made it next to impossible for new market participants to price their products competitively. And finally, the decision by the State of California to become a major wholesale purchaser of power has led to the abandonment of the principles of customer choice.

AReM believes that retail competition in California's electric market has been severely handicapped by these various factors. So long as the utilities can shield their retail services from competitive pressures, they maintain the ability to be profitable and prevent the profitability of their competitors, ensuring that in the long run, competition will not survive. So long as a utility is pitted against competitors for profitability, as opposed to acting in a facilitation role, development of the market will be minimized. So long as a utility is able to control the market, benefits to consumers will also be dictated solely by the innovation of the utility.

Regardless of the experience in California, it is clearly possible for states to successfully implement retail competition in deregulated electricity markets. The experiences in both New Jersey and Pennsylvania, in particular, stand as an example of the positive results which can flow from retail competition. Even with their respective setbacks, those states have done a far better job that did California in furthering the interests of retail competition. The forthcoming experience in Texas is likely to demonstrate the many benefits which can flow to electricity consumers when deregulation is implemented properly.

Markets offer choices. In markets, people can more easily obtain information about numerous potential buyers or sellers they might deal with. This information includes bid and offer prices, relevant contract terms, quality of goods offered, and reputations of parties. Because markets lower the costs to buyers of finding and negotiating with sellers (and vice versa), both parties can enjoy greater gains from their economic activities. The Federal Trade Commission should take steps to recommend uniform policies which should be adopted by states that intend to move towards retail electric competition. Such action will be beneficial for two primary reasons.

First, it will enable states to avoid the glaring errors which other jurisdictions, particularly California, have committed in their efforts to deregulate their electricity markets.

Second, it will promote economic efficiency by having standardized practices which will facilitate new market competitors entrance into deregulated electricity markets in the differing states.

Respectfully submitted,

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