Recent CAPP Study Misses the Mark on Electric Competition

A recent study performed by the Cities Aggregation Power Product (CAPP) draws several flawed conclusions about the competitive electric market in the Electric Reliability Council of Texas (ERCOT). The following facts address the several of the misleading claims contained in the CAPP study.

Texas Electricity Prices and Natural Gas

CAPP claims that Texas residential ratepayers have endured price increases steeper than those in other states, and suggest that the price increases are greater than should be seen, even considering natural gas costs.

Even the same EIA data-set used by CAPP, however, shows that among states with predominantly natural gas-fired generation, Texas has the 6th-lowest average residential electric price. Plus, customers in the competitive areas of the state have the opportunity to choose from a range of offers that meet their needs -- many of which are lower than the statewide average.

See "Attachment 1: Texas Continues to Perform Well Compared With Other States Utilizing Natural Gas"

Texas Electricity Prices and Market Structure

CAPP blames electric price increases in Texas squarely on the competitive electric market. Yet there are Texas municipally-owned utilities and electric cooperatives that have similar prices to those seen in the competitive market. Meanwhile, many of those entities identified as currently having prices lower than competitive prices had lower prices before competition began, and have increased prices in similar magnitude to competitive areas.

See "Attachment 2: Electric Prices in Texas Have Risen Regardless of Market Structure"

Texas Electricity Price and Other States

Texas has not lost ground relative to other comparable states.

Just prior to the start of competitive choice in December 2001, Texas had the 14th-highest average electric rates in the country. According to the most recently available data from EIA, Texas is now one rank better. And, most importantly, customers in the competitive areas of the state have the opportunity to choose from a range of offers that meet their needs, including offers well below this statewide average.

See "Attachment 3: Texas Statewide Electric Price Ranking Has Improved Since 2001"

Price Benefits of Competition in Texas

Natural gas prices reached an all-time high in July, but they've subsequently fallen over the past few months. Because of the robust competition among multiple viable retail electric providers, residential electric price offers have fallen by over 20 percent. Moreover, many customers chose fixed price term plans before natural gas prices rose and therefore were completely insulated from the recent price volatility.

(continued)

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Recent CAPP Study Misses the Mark on Electric Competition

One of the greatest strengths of the competitive market is the ability to respond to changes in the market climate far more quickly than in a price-regulated market. This allows customers to enjoy the benefits of lower input costs sooner, rather than waiting for regulatory decisions to bring those savings to market. At no point does the CAPP study note the available choices and service options available to customers in competitive areas of the state and the positive benefit that can have for customers.

See: "Attachment 4: The ERCOT Competitive Market is Responding to Recent Drops in Natural Gas Prices"

Other Claims vs Facts

CAPP has chosen to compare data from 1999 with 2007, based on the supposition that the Public Utility Commission of Texas (PUC) held prices artificially high, with little reason to do so. Moreover, given how rapidly electric prices change in the competitive market, using 2007 as an end-date ignores the rapid decrease in electric price offers in the competitive market that met the sustained drop in forward natural gas prices in July 2008.

CAPP bases its findings on data collected by the Energy Information Administration (EIA), part of the U.S. Department of Energy. An analysis of the same EIA data by the Northbridge Group (*Embrace Electric Competition or It's Déjà Vu All Over Again*, October 2008) came to a completely different conclusion than CAPP, showing that rate increases in gas-dependent restructured and regulated states from 1997-2007 have tracked each other very closely.

In addition, at no point does CAPP consider the available electric offers in the competitive market. For example, in 2007 the average Texas statewide residential rate according to EIA was 12.57¢/kWh, yet customers in each competitive region had offers under 11¢/kWh available.

For further point by point analysis of the CAPP study, see "Attachment 5: CAPP Report - Claims vs. Facts"

The bottom line… Prices are Rising Nationwide -- But Not In Texas

Available prices in the ERCOT competitive electric market are falling significantly, a stark contrast to the national average which is rising and projected to keep rising. In fact, the average U.S. residential power price is expected to increase 9.4 percent in 2009, according to EIA, as noted in the attached *Dow Jones* story, which also notes that Texas could see decreases do to falls in natural gas prices.

In short electricity prices are going up in the rest of the nation, but electric prices in the competitive areas of the state continue to drop. The ERCOT competitive market has proven to be successful, giving customers and businesses a wide array of prices and services from which to choose.

See: "POWER POINTS: Electric Rates Firm Despite Commodities Drop," by Mark Peters and Cassandra Sweet, *Dow Jones,* October 27. 2008

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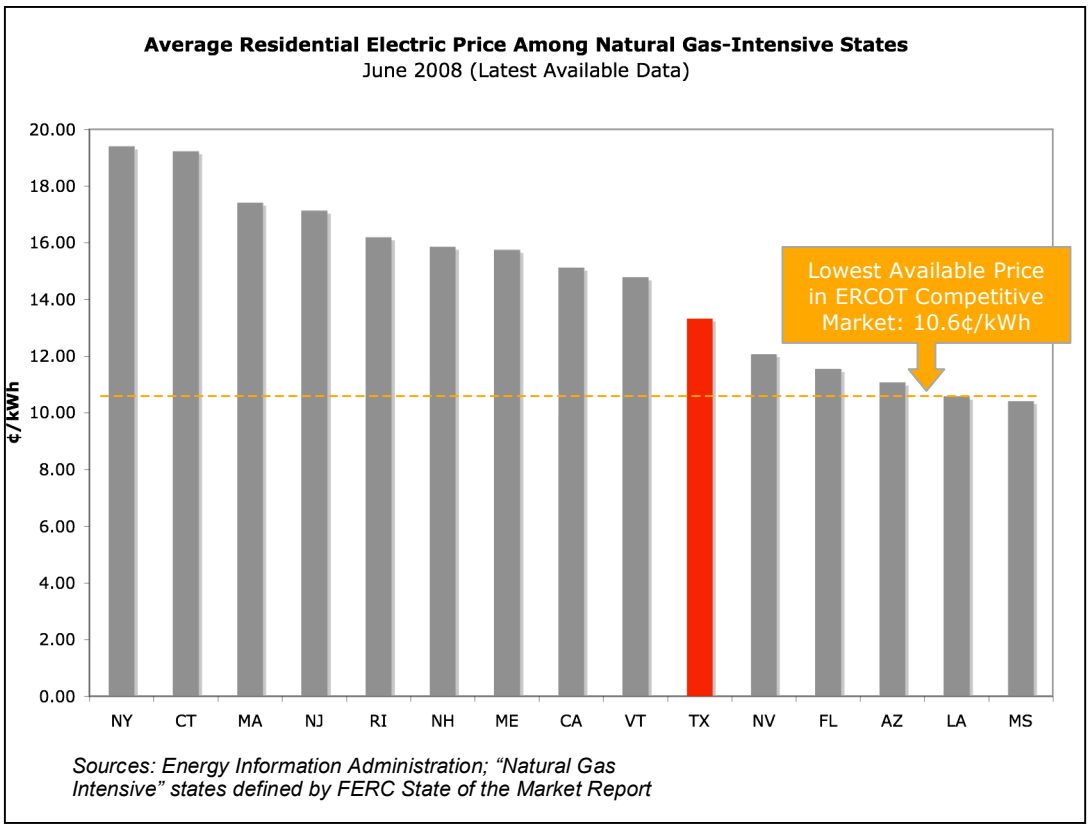
Competitive Retail Electric Market in ERCOT Continues to Work

Attachment 1: Texas Continues to Perform Well Compared With Other States Utilizing Natural Gas

- Electric prices are affected by the cost of wholesale power, which, in the ERCOT region, is largely dependent upon the price of natural gas. Among states with predominantly natural gas-fired generation, Texas has the 6th-lowest average residential electric price, according to the most recent EIA data. And customers in the competitive areas of the state have the opportunity to choose from a range of offers that meet their needs.



- In addition, just prior to the start of competitive choice in December 2001, Texas had the 14th-highest average electric rates in the country. According to the most recently available data from EIA, Texas has maintained the same ranking despite the run-up in natural gas prices since that time. And customers in the competitive areas of the state have the opportunity to choose from a range of offers that meet their needs.

Note: The EIA average statewide price includes competitive electric prices in ERCOT, as well as prices in areas outside ERCOT where electric competition has not been implemented.

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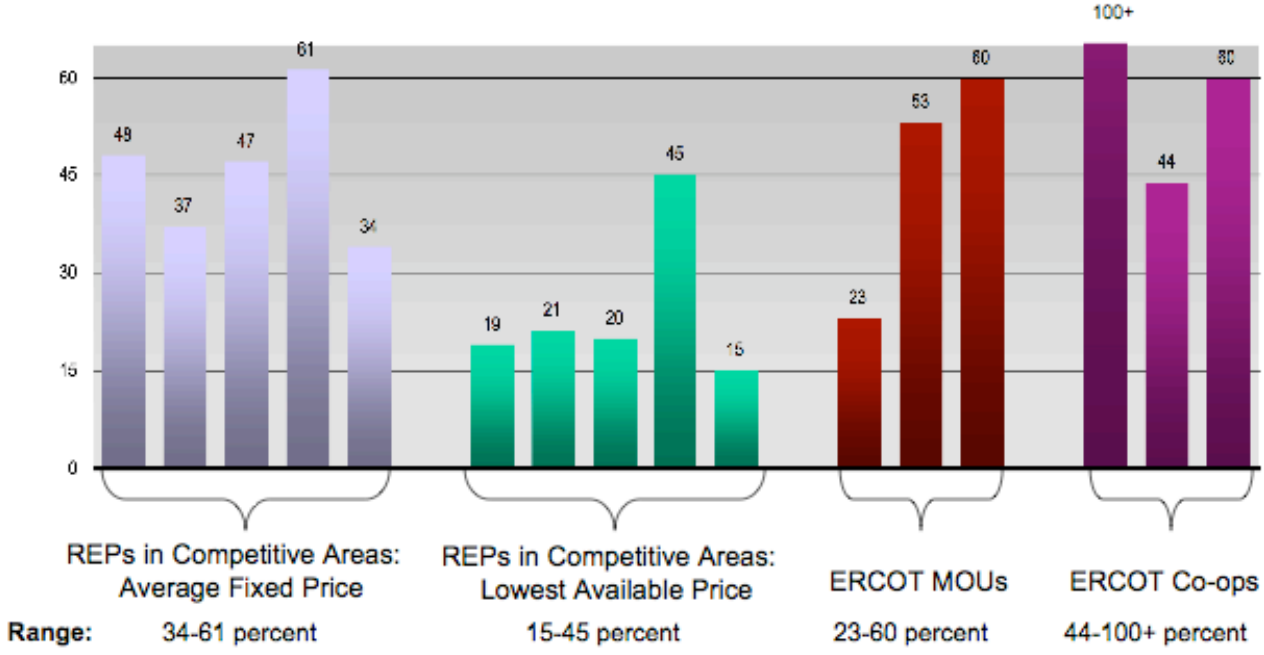
Competitive Retail Electric Market in ERCOT Continues to Work

Attachment 2: Electric Prices in Texas Have Risen Regardless of Market Structure

- Each service area has a host of factors that affect their prices, making it difficult to compare the input costs needed to determine retail electric costs. But costs and prices have risen in competitive areas, in areas served by Municipally owned utilities (MOUs) and in areas served by electric co-ops.



Note: Data represents latest available consistent data for both start and end points: REPs in Competitive Areas - October 2008; ERCOT MOUs and ERCOT Co-ops - September 2008
Source: Public Utility Commission of Texas; http://www.powertochoose.org

- In many cases there are Texas MOUs and co-ops that have similar prices to those seen in the competitive market. Meanwhile, many of the MOUs and co-ops identified as currently having prices lower than competitive prices had lower prices before competition began, and have increased prices in similar magnitude to competitive areas.

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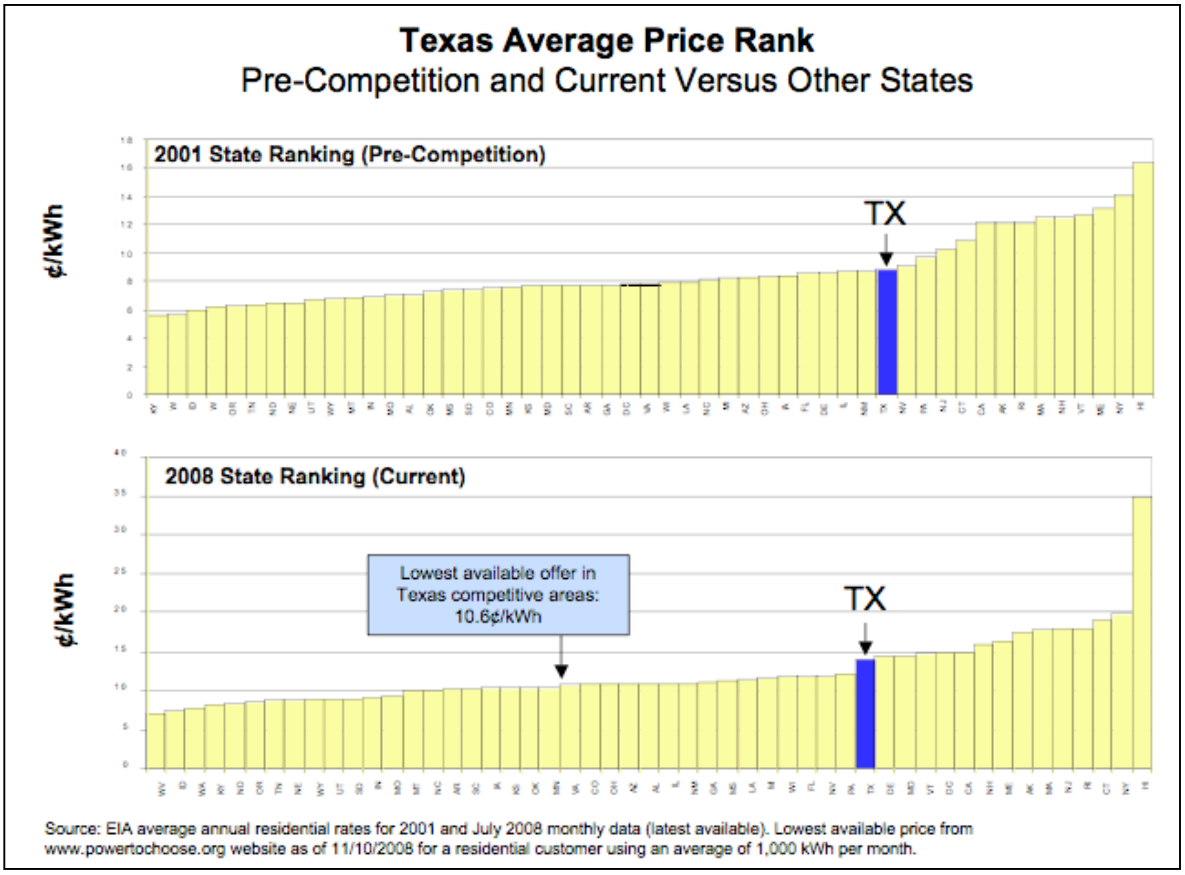
Attachment 3: Texas Statewide Electric Price Ranking Has Improved Since 2001



- Just prior to the start of competitive choice in December 2001, Texas had the 14th-highest average electric rates in the country.

- According to the most recently available data from EIA, today Texas now has the 15th-highest average electric rates in the country. And customers in the competitive areas of the state have the opportunity to choose from a range of offers that meet their needs.

Note: The EIA average statewide price includes competitive electric prices in ERCOT, as well as prices in areas outside ERCOT where electric competition has not been implemented.

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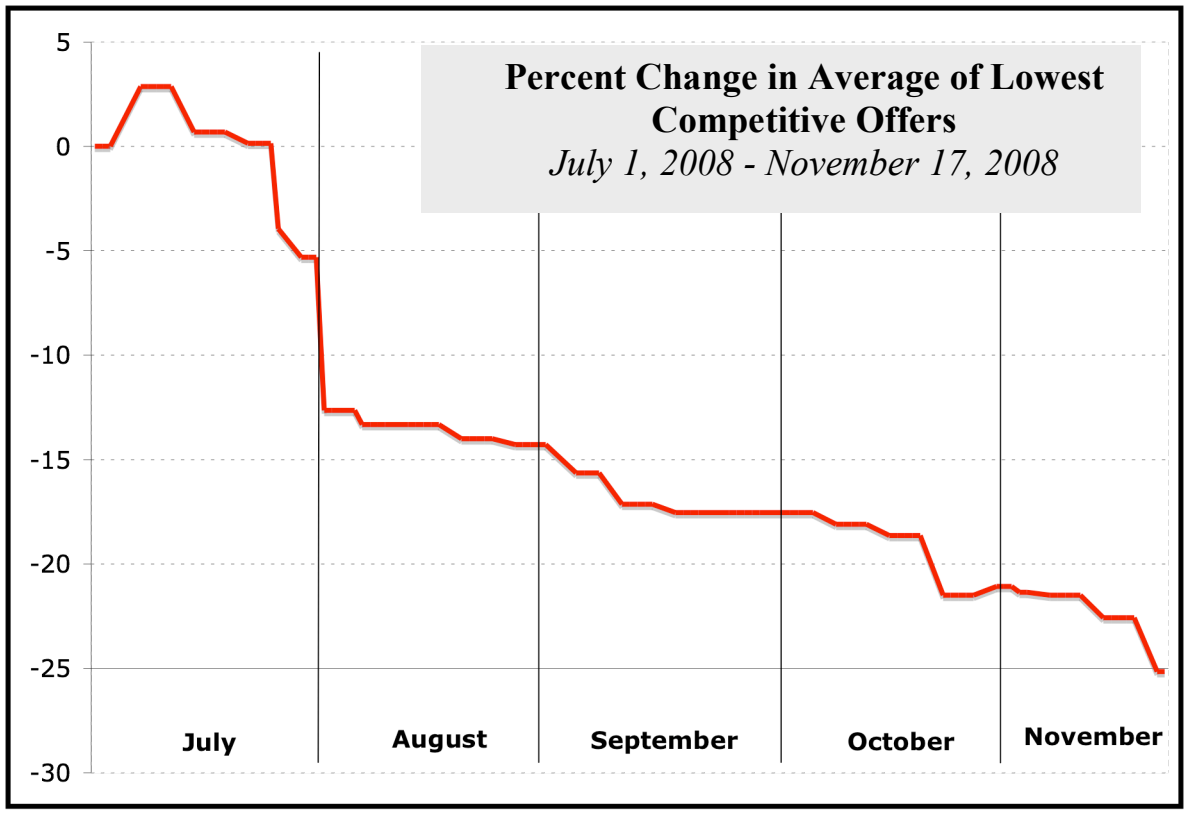
Attachment 4: The ERCOT Competitive Market is Responding to Recent Drops in Natural Gas Prices

- Natural gas prices reached an all-time high in July, but they've subsequently fallen over the past few months. Because of the robust competition among multiple viable retail electric providers (REPs), residential electric price offers have fallen by over 25 percent. Moreover, many customers chose fixed price term plans before natural gas prices rose and therefore were completely insulated from the recent price volatility.



- One of the greatest strengths of the competitive market is the ability to respond to changes in the market climate far more quickly than in a price-regulated market. This allows customers to enjoy the benefits of lower input costs sooner, rather than waiting for regulatory decisions to bring those savings to market.

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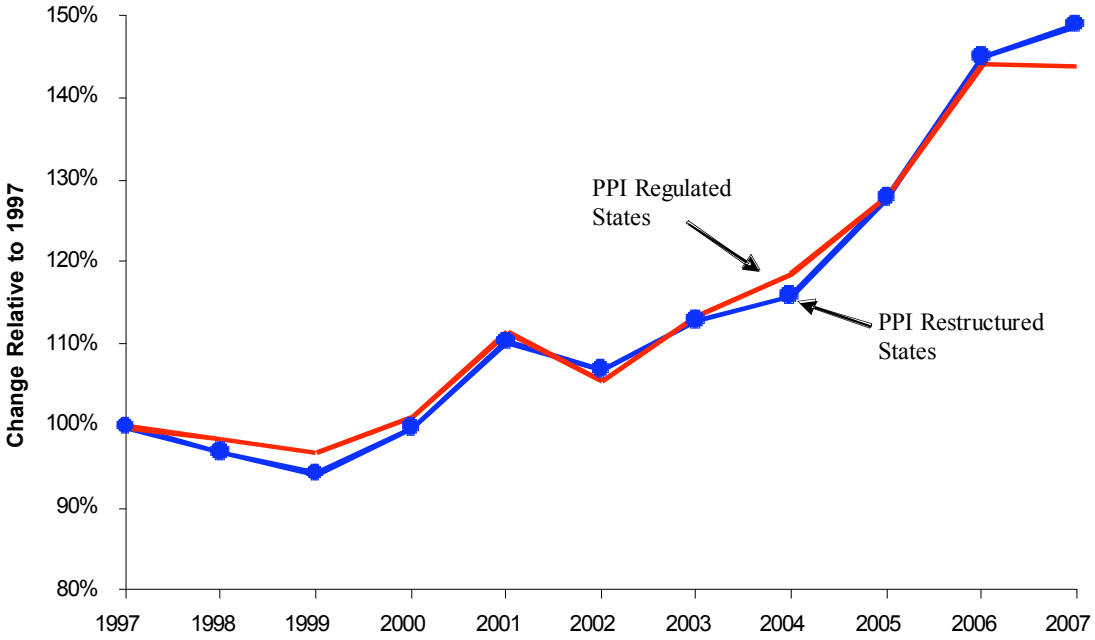
Attachment 5: CAPP Report - Claims vs. Facts

CAPP Report Claim	*The Facts*
"Contrary to a common misconception, Texas' dependence on natural gas to fuel many of its power plants cannot explain the state's poor showing. Even when considering natural gas, residents paid more under retail competition than they have paid in systems that never deregulated. Likewise, average residential prices have increased by a greater percentage in gas-dependent states with deregulation than they have in gas-dependent states without deregulation."	**Rate increases in gas-dependent restructured and regulated states from 1997-2007 have tracked each other very closely, as shown by the NorthBridge Group's analysis below.** Rate of Change in Nominal Electric Rates in Gas-Dependent PPI Restructured and PPI Regulated States, 1997-2007  Source : Edison Electric Institute, Historical Statistics of the Electric Utility Industry Through 1992; Energy Information Administration State -Level Spreadsheets, 1990 -2006 ; 2007 rates ar e from December 2007 Energy Information Administration Electric Power Monthly; Average rates are weighted by consumption in each state; Gas - dependent restructured states are from the ISO -New England, NY ISO, ERCOT, PJM East, and CA ISO market regions and include all PPI Restructured States except Michigan; Gas -dependent regulated states are defined as any regulated state where gas/oil generation comprises 30% or more of total generation output (FL, LA, NV, MS, and OK). *NorthBridge Group, pp. 37-38.* Note: "PPI Restructured States" and "PPI Regulated States" refers to the state characterization used in a recent analysis by Power in the Public Interest (PPI). The definition of restructured states is the same as used by Marilyn Showalter of PPI in her recent analysis "Trends in State Electricity Prices and Policies" July 2007. These states include CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, and TX.

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Attachment 5: CAPP Report - Claims vs. Facts

CAPP Report Claim	***The Facts***
"Although electric rates are up everywhere, in general rates have increased more steeply in deregulated states."	**The price increases in restructured states from 2005 onward can be primarily traced to the expiration of rate freezes coinciding with an increase in marginal generation costs, largely due to the rise in natural gas prices. Had natural gas prices not increased dramatically, the rate comparisons between restructured and regulated states may have appeared substantially different.** *NorthBridge Group, p. 36*
Using 2001 for a starting point in measuring how prices have changed is inappropriate because "rates in 2001 were unusually high because of the accelerated fuel charges and excess earnings that were specifically allowed because of deregulation…"	**The use of 2001 as a point of comparison simply reflects that this is the last year before competition started. No other date makes sense for analyzing Texas rates since competition began. The use of another point for comparison, such as 1999, is suspect, as shown below.** HL&P and TXU had entered into plans for 1998 and 1999 to reduce rates in anticipation of a competition bill in 1999. Docket No. 18465 provided that HL&P would provide for residential customers base rate credits resulting in a reduction in base-rate electric costs by 4% in January 1998 and by an additional 2% in January 1999. For small commercial customers, base-rate electric costs were reduced by 2% in January 1998. Similarly, TXU entered into a regulatory settlement in Docket No. 18490. For residential customers, base rates were reduced by 4% in January 1998 and by an additional 1.4% in January 1999. For small commercial customers (customers on the general service--secondary rate), base rates were reduced by 2% in January 1998. Base rates for all other customers were be reduced by 1% in January 1998.

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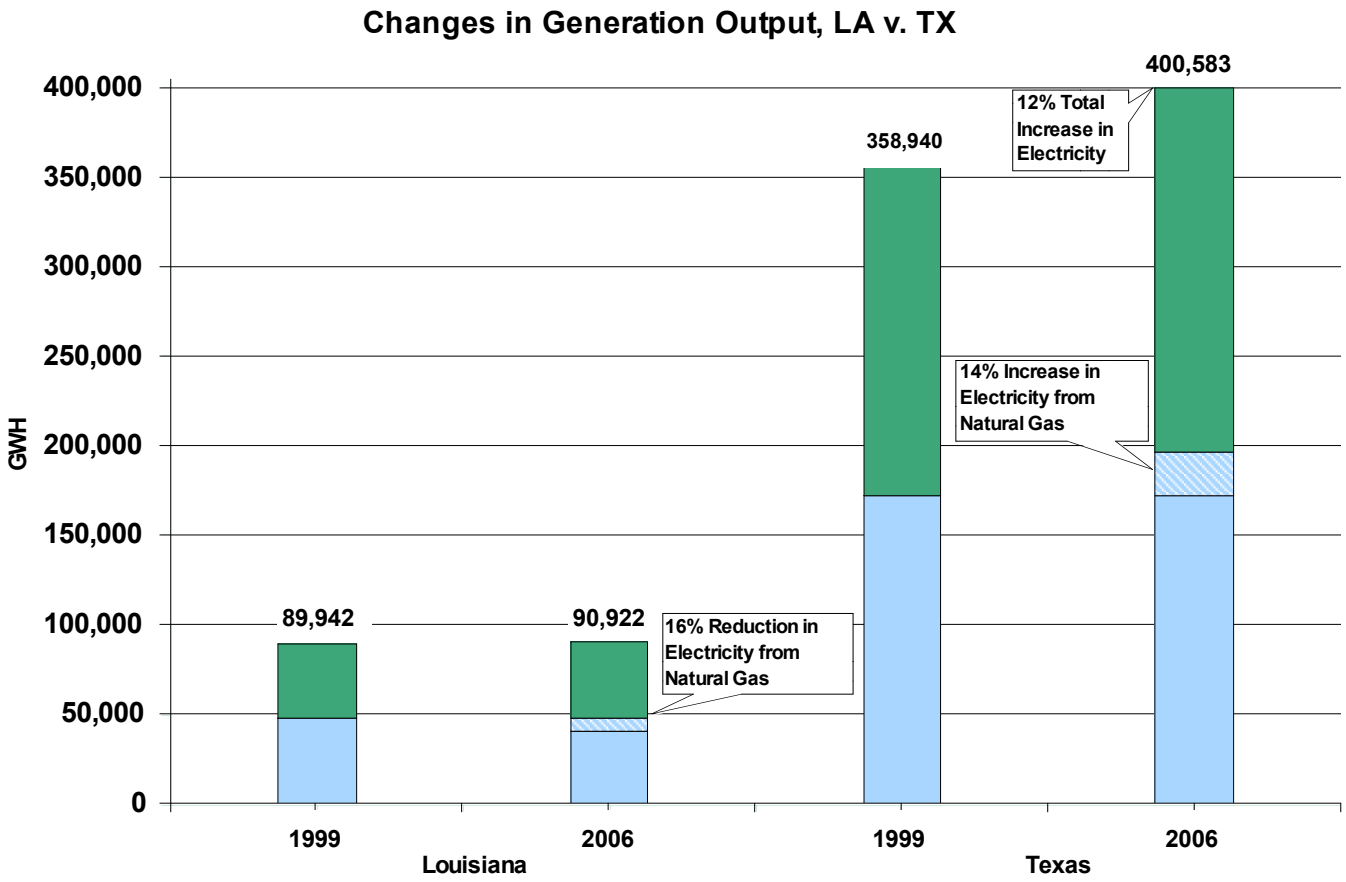
Attachment 5: CAPP Report - Claims vs. Facts

CAPP Report Claim	*The Facts*
Generation in Louisiana, a regulated state, is far more susceptible to natural gas prices than generation in Texas.	**Since 1999, total generation in Texas has increased by 12%, while growth in generation in Louisiana has remained flat. During this same time period, Louisiana has reduced its use of natural gas as a fuel source by 16% while Texas has produced 14% more GWh from natural gas.**



Source: 1990 - 2006 Net Generation by State by Type of Producer by Energy Source (EIA-906)

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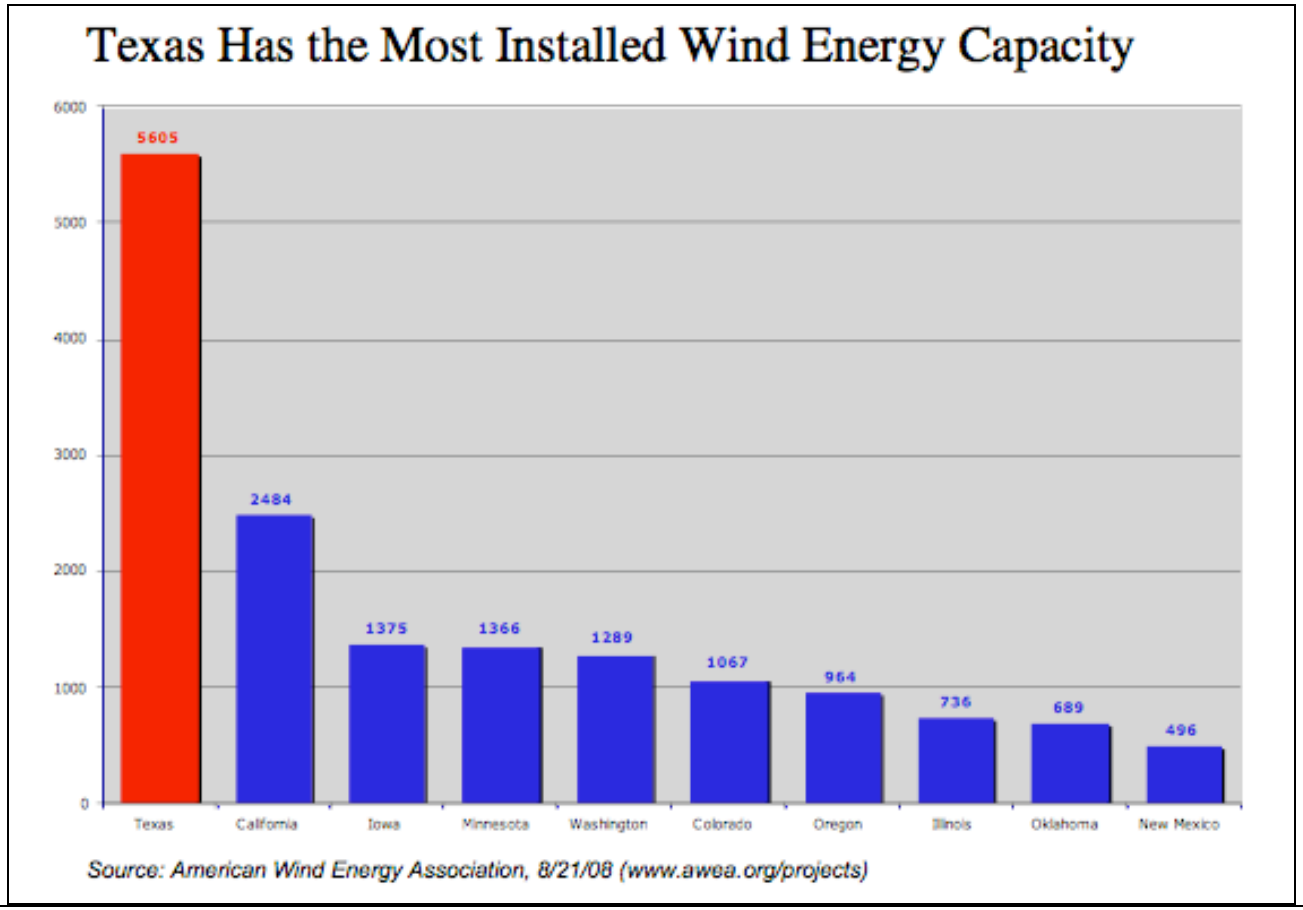
Attachment 5: CAPP Report - Claims vs. Facts

CAPP Report Claim	*The Facts*
Environmental Benefits? CAPP Report makes no findings…	**Texas is the national leader in renewable energy development. Almost all renewable resources in Texas were installed since the restructuring of the retail market.**



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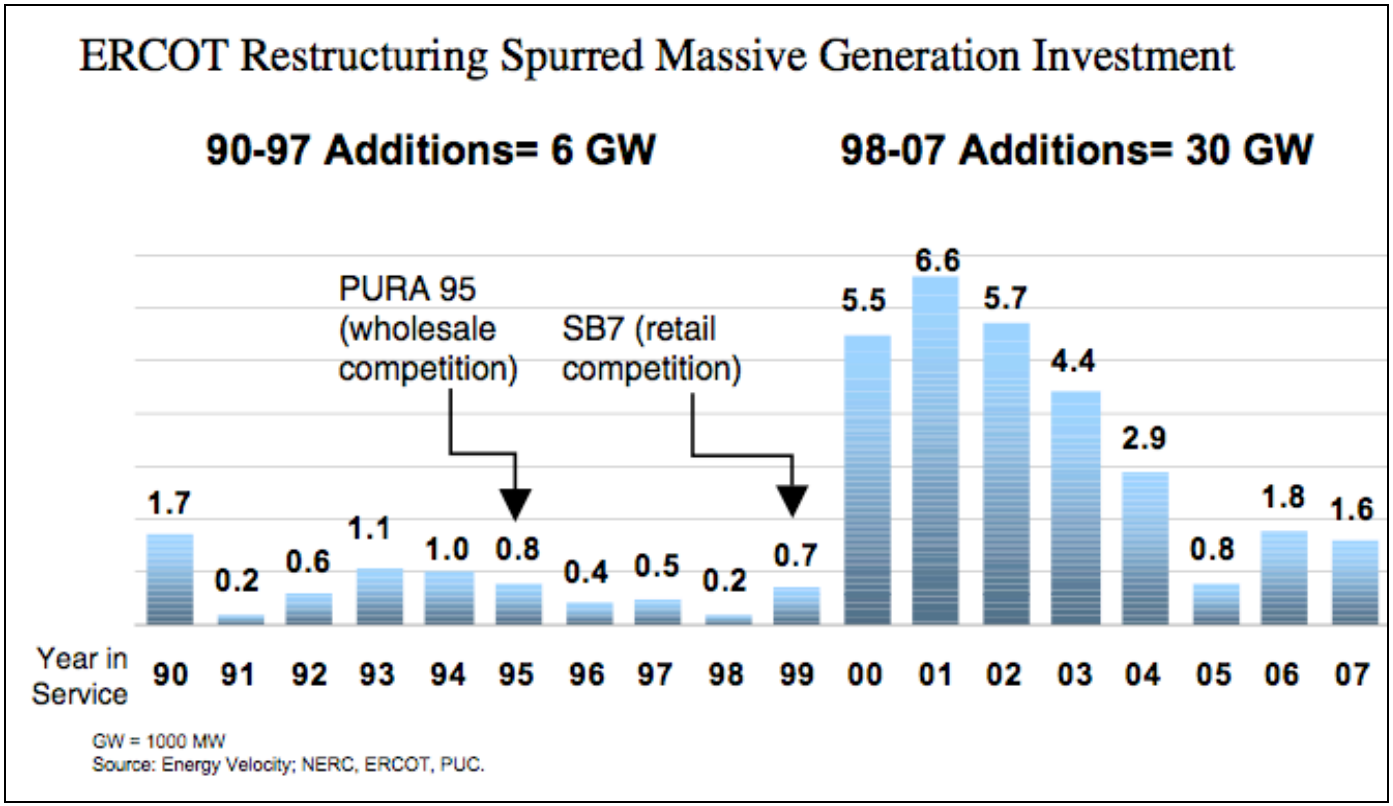
Attachment 5: CAPP Report - Claims vs. Facts

CAPP Report Claim	**The Facts**
Infrastructure Development? CAPP Report makes no findings…	**The Texas competitive market has been characterized by low barriers to entry, including expected price levels that support entry of new investment over time.** ERCOT restructuring spurred investment of about 30,000 MW of additional capacity between 1998 and 2007, compared with only 6,000 MW of additional capacity between 1990 and 1997. In addition, according to the Analysis Group study, even after factoring in mothballed and retired plants, the total generating capacity of ERCOT could be over 104,000 MW, up more than 88 percent since 1995. (*Analysis Group, p. 27)* 

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Attachment 5: CAPP Report - Claims vs. Facts

Sources:

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Analysis Group, *ERCOT Texas's Competitive Power Experience: A View from the Outside Looking In.* (October 2008)

Electric Reliability Council of Texas

Energy Information Administration

Energy Velocity

North American Electric Reliability Corporation

NorthBridge Group, *Embrace Electric Competition or It's Déjà Vu All Over Again*. (October 2008)

Public Utility Commission of Texas

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POWER POINTS: Electric Rates Firm Despite Commodities Drop
Mark Peters and Cassandra Sweet
Dow Jones
October 27, 2008

Energy prices have fallen sharply over the past few months, but cash-strapped businesses and consumers shouldn't hold their breath awaiting relief in their electricity bills.

The price of natural gas - which fuels about a fifth of U.S. power plants - has plunged from summer highs, but retail power rates won't quickly reflect this. Many utilities will proceed with planned rate hikes in coming months to cover the costs of maintaining their plants and recouping the higher fuel and power costs from the summer. Meanwhile, eastern U.S. coal prices remain substantially more expensive than at this time last year.

The U.S. Energy Information Administration has forecast average U.S. residential power prices to rise 6.2% this year and 9.4% in 2009, to 12.4 cents a kilowatt-hour from 10.6 cents a kilowatt-hour. The EIA forecasts similar increases in the commercial and industrial sectors.

At the same time, falling commodity prices and the credit crunch may well be priming the pump for higher electricity rates in years to come, if thinner profit margins and difficulties borrowing force power companies to cancel new plants. This could leave consumers exposed to rate hikes when the economy recovers and demand ramps back up.

Gas Price Pressures Wholesale Prices

U.S. natural gas prices have dropped by about 55% from their highs this past summer, to trade around $6.15 a million British thermal units Monday. Growth in domestic natural gas production has boomed over the past year and a relatively mild summer enabled the storage of ample supplies for the winter, dropping prices to around the same level as a year ago.

"There's a lag ... between when utilities actually incur higher fuel costs and when they pass them onto retail customers," said Tyler Hodge, an analyst at the EIA, which is the independent statistical arm of the Department of Energy.

Like gas, wholesale power prices have fallen from their blistering heights of the summer.

Spot prices for next-day peak power in the East Coast's PJM market have fallen from triple-digits this past summer to an average of about $58.02 a megawatt-hour. Spot peak power in Southern California has similarly fallen from around $100/MWh in the spring and summer to average around $53.28/MWh, $20 below a year ago.

Some of this decline is seasonal, as power consumption declines in the mild temperatures of fall, but lower gas prices have accelerated the decline. In many parts of the country, power plants that run on natural gas often set spot prices for wholesale power.

The Federal Energy Regulatory Commission expects U.S. forward wholesale power prices this winter to come in between 8% and 13% lower than a year earlier, except in the Northeast, where prices are expected to be higher because of transportation constraints for natural gas.

Any drop in consumers' power rates over the coming months will likely come in markets like Texas and California, where natural gas is the primary generation fuel, the EIA's Hodge said. But prices for coal - which produces about half of the power in the U.S. - remain well above last year's levels, so their recent decline from record highs this summer is unlikely to affect much change in power prices, he said.

If fuel costs remain at current levels or drop further, rate payers will eventually see their bills go down somewhat, but utility capital costs will create a floor for prices, said Michael Zenker, an analyst at Barclays Capital in San Francisco.

Generators Pinched, New Plants Derailed?

As power prices weaken, generators that sell their output to utilities and large industrial users at market prices could see profits decline and delay new projects.

The gap between wholesale power prices and the cost of generating power from a coal plant has narrowed, reducing margins from $30-$40 a megawatt-hour to $25 a megawatt-hour or lower, said Hannes Pfeifenberger, head of the energy practice at The Brattle Group, a Cambridge, Mass.-based consultancy.

"The financial fundamentals of coal plants have really shifted," he said.

Eastern coal continues to fetch prices well above a year ago on rising global demand and production difficulties in the key Appalachian region. A benchmark Eastern coal contract on the New York Mercantile Exchange settled Friday at $80.83 a ton, 70% higher than a year ago.

The changes in coal and electricity prices aren't likely to affect the margins of utilities and independent power producers immediately. Most have hedging programs to mitigate swings in fuel costs and power prices, often locking them in one to three years ahead. But as their contracts end, companies would start to see an impact if prices hold.

"It will have to be sustained over a longer period of time," said Glen Grabelsky, a managing director at Fitch Ratings in New York.

But the current dynamic is likely to affect new construction plans. If coal plants face dwindling margins, Pfeifenberger said, the incentive to build new ones evaporates.

The cost of capital is a consideration, as borrowing costs increase amid recent turmoil in global credit markets.

At the same time, coal-fired plant developers will have to factor in the cost of emitting heat-trapping gases blamed for climate change, as the likelihood of nationwide rules raising the cost of such emissions increases with a new presidential administration. Last year alone more than 50 proposed coal plants were canceled or delayed in the U.S., according to Innovest Strategic Value Advisors.

If enough new plants are put on hold or abandoned, the result could be tight power supplies that could pressure prices higher in the long run.

"It may take next summer and a round of hot weather, if we get tight markets, it would cause spot prices to jump," said Zenker of Barclays.