UNITED STATES OF AMERICA
BEFORE THE
FEDERAL TRADE COMMISSION

COMMENTS REGARDING	)	V010003
RETAIL ELECTRICITY COMPETITION	)	

COMMENTS OF ENRON CORP.

I. Introduction

On February 28, 2001, the Federal Trade Commission (the "Commission") issued a notice inviting public comments on the results of different state regulatory policies in conjunction with restructuring retail electricity markets. The notice explains that the Commission intends to update its earlier report to discuss the "advantages and disadvantages of different regulatory approaches and, if warranted, areas in which federal legislative or regulatory action may be desirable."[1]

In response to the Commission's notice, Enron Corp. ("Enron") respectfully submits the following comments regarding the benefits and drawbacks of various state deregulation policies as well as the pressing need for federal intervention in specific areas. Enron welcomes this opportunity to comment on regulatory approaches affecting the retail electricity markets, a subject that is particularly timely in light of recent developments in wholesale and retail power markets in California and the entire Western region of the United States.

As one of the world's leading energy and communications companies, Enron has been a strong proponent of regulatory reforms that facilitate competition in wholesale and retail energy markets. Enron is the largest wholesale power marketer in North America; its wholesale business includes the marketing and delivery of physical commodity as well as financial and risk management products. Enron's retail business provides integrated energy outsourcing services to commercial and industrial customers throughout the United States, including the sale of physical commodity in states that have retail access. Enron is currently licensed to supply power to retail customers in 17 states that have implemented retail competition laws or programs.

As an early advocate for pro-competition policies in retail electricity markets, Enron has actively participated in numerous state legislative and regulatory proceedings addressing the subject. As a licensed retail supplier in many states, Enron has experienced first-hand the structural and regulatory barriers associated with participating in these new markets. The ensuing discussion draws upon these experiences and identifies specific areas where state policies have succeeded, where they have failed, and

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[1] *Staff Report: Competition and Consumer Protection Perspectives on Electric Power Reform* (July 2000).

where federal action is clearly warranted. Rather than answering every question, Enron has highlighted the areas where the need for regulatory reform is most pronounced.

II. History and Overview

In this section Enron responds to the following questions posed by the Commission:

- *What were the expected benefits of retail competition?*
- *What factors or measures should the Commission examine in viewing the success of a state's retail electricity competition program?*

It has been nearly five years since the Federal Energy Regulatory Commission ("FERC") embarked on its landmark rulemaking (Order No. 888) to facilitate wholesale competition in the nation's electric power markets by mandating "open access" on the interstate transmission system.[2] Since then, virtually every state in the country has opened some form of legislative or regulatory policy investigation into retail electric competition. Currently, fourteen states have implemented such policies, and nine others are at various stages of implementation.

Most states that have adopted retail competition policies did so out of concerns over existing or anticipated rate levels and a desire to allow retail customers the ability to gain access to competitive wholesale market prices.[3] In addition, some states explicitly recognized that a competitive market would lead to new technologies and innovation in retail electric services and provide buyers and sellers with appropriate price signals.[4]

Despite these legitimate policy objectives, however, most states implementing retail competition policies have appeared overly driven by a desire to guarantee short-term rate decreases, and the success or failure of these initiatives has had little or no bearing on the level of competitive activity. Rather, success has been measured by whether or not retail rates for some or all consumers are demonstrably lower for a temporary period of time, *even if it has been achieved at the expense of competition.* In some cases, consumers

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[2] See *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. P 31,036, 61 Fed. Reg. 21,540 (1996), *clarified*, 76 F.E.R.C. 61,009 and 76 F.E.R.C. 61,347 (1996) ("Order 888"), *on reh'g*, Order No. 888-A, FERC Stats. and Regs. P 31,048, 62 Fed. Reg. 12,274, *clarified*, 79 F.E.R.C. 61,182 (1997), *on reh'g*, Order No. 888-B, 81 F.E.R.C. 61,248, 62 Fed. Reg. 64,688 (1997), *on reh'g*, Order No. 888-C, 82 F.E.R.C. 61,046 (1998); *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. P 31,035, 61 Fed. Reg. 21,737 (1996) ("Order 889"), *on reh'g*, Order No. 889-A, FERC Stats. & Regs. P 31,049, 62 Fed. Reg. 12,484 (1997), *on reh'g*, Order No. 889-B, 81 F.E.R.C. 61,253 (1997).

[3] For example, in California, the Legislature's stated objective was to "create[] a new market structure that provides competitive, low cost and reliable electric service...." AB 1890 at § 1(a).

[4] Mass. G.L., c. 164, § 1(g).

essentially financed their own short-term rate reductions because utilities were allowed to defer costs for later collection. Or even worse, decision makers have attempted to fully insulate consumers from market forces, even if it exposes customers to future costs well exceeding the temporary gains achieved through such policies.

Unfortunately, the temporary gains that some consumers reap from such shortsighted policies are far outweighed by their long-term costs. As discussed below, the situation in California dramatically illustrates the consequences of such policy miscalculations. After three years of insisting that Californians be insulated from market price signals, the State's consumers now face extraordinary rate increases and the absence of alternative suppliers to whom they can turn. In Massachusetts, incumbent utility restructuring plans promising double-digit rate decreases won approval over protests by competitive suppliers such as Enron. Now, at the end of a so-called "transition period," Massachusetts' consumers are paying increased rates and they are finding few or no alternative suppliers left in the market. The consequences of these policies have been both predictable and predicted: retail markets have not developed, non-utility marketers have made few inroads to retail electric markets, utilities have maintained their monopoly status, and consumers have been denied the benefits of competition.

By now, it should be clear to all observers that several overarching principles must guide state and federal officials to promote competition in retail electric markets:

- ***Effective competition in wholesale power markets is an essential prerequisite to bringing consumers the full benefits of retail competition.*** All entities seeking access to the interstate transmission system must be treated fairly and equally, and federal regulators should eliminate preferences that allow incumbent utilities to favor their own generation resources or sales services.

- ***Retail market design should reflect rational social and economic policy, not political expediency or compromise with a monopoly incumbent's interests.*** The regulatory obligations of incumbent utilities should be redefined and limited to "wires only" transmission and distribution ("T&D") services.

- ***All customers should be served by non-utility, competitive providers, including those who "choose not to choose."*** Transition and default generation service should be supplied and priced through competitive processes. Incumbent utilities should no longer be engaged in merchant generation functions.

- ***Demand responsiveness should be encouraged through rates and programs that provide consumers with appropriate price signals.*** Retail rates that attempt to insulate consumers from price volatility discourage suppliers from making necessary investments and providing load reduction and risk management services.

- ***The development of new merchant power plants should be encouraged, particularly in those areas of the country facing supply shortages.*** Regulatory reforms should reflect a balance between environmental concerns and the need to meet increasing energy demand. Wholesale price caps should be avoided because they discourage generation investment.

To Enron and many others, the success of retail competition policies must be measured by the degree to which the policies facilitate, rather than inhibit, market entry and competition among non-utility suppliers. Generally, the simplest and most telling measure to gauge the success of state policies is by identifying the number and characteristics of consumers who switch to alternative suppliers. If a state establishes policies that maximize the prospects of competition, there is very little reason to doubt that consumer benefits will follow. Competition is superior to economic regulation in putting downward pressure on consumer prices, shifting the economic risks associated with generation investment to suppliers, and leading to the development of new energy services.

III. Consumer Protection Issues

As a general matter, Enron believes the best consumer protection measure a state can adopt for its citizens is a well-functioning competitive retail market. While regulation can provide a safety net for consumers in some areas, competition yields far superior protections than the old regime of price regulation. Under the old system, consumers shouldered the risk of bad investment decisions; under competition, shareholders bear those risks. Under the old system, consumers had little or no recourse when their electric utilities failed to meet their expectations or needs as long as the utilities met minimal service obligations. With competition, consumers will be free to choose their power supplier and the level of service that best meets their needs. The old system discouraged innovation; the new competitive model promises to deliver efficiencies through the convergence between information technologies and newer, clean sources of energy supply. Consumers will realize the benefits of these transformations only when regulatory reforms are adopted that allow them to do so.

- *What efforts were made to educate consumers about retail competition?*

Enron believes that consumer education programs can be a valuable component of state retail access initiatives. However, such programs provide little or no value to the public unless a state adopts policies that will actually facilitate a competitive marketplace. Unfortunately, several states have expended substantial public funds on education programs, but failed to implement policies that were necessary to promote competition. The best way to enhance consumer awareness of retail competition is through polices that will promote market activity. Competitive energy suppliers will also play an important role in educating consumers because most are acutely aware that it will be essential to build a customer base, consumer loyalty and good will in order to succeed in the retail market.

- *Is there a need for federal assistance to deal with consumer protection enforcement?*

Enron believes that most states are fully equipped to deal with consumer protection issues through state public utility commissions and attorney general offices. Most states that have adopted retail competition programs have included specific measures designed to protect consumers against "slamming" and other abuses. Moreover, these states have adopted codes of conduct that generally address the need to protect and keep customer information confidential as warranted by individual circumstances. While generally Enron supports measures that will enhance consumer confidence in retail electricity markets, most existing state consumer protection law and utility-affiliate codes of conduct provide adequate safeguards.

While it is clear that states should play a lead role in the area of consumer protection, federal authority is both appropriate and necessary in some areas where state officials lack the necessary authority. These areas include enforcement of open access requirements on the transmission and distribution systems, the monitoring of wholesale power markets, and authority to review mergers that may have an impact on competitive markets. In most areas, FERC has adequate authority to fulfill these roles, although additional regulatory authority may be warranted in some areas. These issues are discussed below in Section IV.

In addition to these measures, the establishment of "Uniform Business Practices" can provide another important mechanism to safeguard consumers from unauthorized switching. As discussed in the next section, Enron supports efforts to standardize the processes used to switch customers as both a consumer protection measure and a way of facilitating market entry for alternative suppliers.

- *Has aggregation enabled consumers to benefit from retail competition?*

Load aggregation lets small consumers gain access to competitive pricing by minimizing supplier transaction costs and by allowing suppliers to make informed resource and risk management decisions. Load aggregation can be arranged by consumers (*e.g.* through buying coops or trade associations) or by regulatory decision (*e.g.* default or provider of last resort service). It is essential to design regulatory policies that promote these arrangements so that small consumers can receive the benefit of competitive market pricing.

IV. Retail Supply and Price Issues

In many states, the adoption of retail competition policies has been accompanied by a mandate that utilities reduce rates for some period of time before and/or after the retail market has opened. This has been achieved through a bundled service that is sometimes labeled "transition" or "standard offer" service. As the Staff Report notes, the pricing mechanism for this service is often tied to the utility's recovery of stranded generation costs, and it also determines the so-called "price to beat" that new entrants

must offer to consumers. In states where the incumbent utilities have been permitted to offer these discounted rates before or after opening the retail market, the dampening effect on competitive activity has been profound. Competitive retail suppliers have been essentially priced out of the market before competition has been allowed to proceed.

- *What difficulties have suppliers encountered in entering the market?*

Although Enron has encountered some logistical problems with entering new retail markets, which are discussed below, these pale in comparison to more fundamental economic barriers created by regulatory structures that have made it difficult or impossible to profitably compete in retail markets.

Largely due to these economic disincentives created by regulatory and legislative decision makers, the level of competitive activity in most states reveals that only a very small percentage of customers are purchasing power from non-utility, alternative suppliers. In addition, those customers that have switched are primarily large commercial and industrial customers. For instance, in Massachusetts, one of the first states to implement retail restructuring legislation, less than 1% of the state's consumers have switched suppliers.[5] Despite vigorous protests by Enron and others, state officials authorized incumbent utilities to offer customers below-market "standard offer" rates during a so-called "transition" to competition. The utilities were effectively allowed to use these standard offer rates as a means of fending off competition. Now, consumers are confronted with the very outcome Enron predicted - rising rates and few alternatives in the marketplace – and consumer dissatisfaction is high. To make matters worse, Massachusetts' consumers were forced to finance these temporary rate reductions; beginning in 2004-5, utilities are expected to begin recouping hundreds of million in dollars of deferred power costs.[6]

- *Have customers switched to new suppliers? How is entry affected by the price of the provider of last resort service or for default service? Have state-mandated rate reductions prior to the start of competition affected retail competition?*

Some states have been more successful in attracting alternative suppliers to serve retail markets, but even there competitive activity has been modest. As many industry observers have recognized, Pennsylvania has been the most successful in attracting competitive electric suppliers to serve retail customers. The primary reason for this is that customers who switch suppliers receive a "shopping credit" that was set high enough to encourage competition. However, the number of consumers switching to alternative suppliers in Pennsylvania remains well below 50%.

Even in states such as Pennsylvania where switching rates have been high compared to other states, the customers entering the retail market are primarily large commercial

[5] The switching rates in Massachusetts are available at www.state.ma.us/doer/pub_info/migrate.

[6] "Utility Rate Cuts Fail to Materialize after Deregulation in Massachusetts," Boston Globe (November 10, 2000).

and industrial customers.[7] Enron and other national energy companies are successfully marketing energy "outsourcing" services to large commercial and industrial customers. Typically, these services include facilities management and financial risk management products, in addition to the supply of physical commodity. The economic incentives for large customers to switch suppliers are generally higher than those for small customers. The challenge will be for state regulators to develop regulatory structures that enhance opportunities for all customers to receive these benefits. By far the most critical first step in this process is to remove incumbent utilities from the merchant generation function entirely and allow competitive energy suppliers to compete for aggregated small consumer loads by assuming the role of "provider of last resort" or default service provider.

In addition to the significant regulatory barriers created by these pricing schemes, there are logistical barriers that impede market entry. Enron supported and actively participated in the development of the Uniform Business Practices for the Retail Energy Market document that was published in November 2000.[8] This document was the product of an unprecedented partnership between members of the Edison Electric Institute (EEI), the Coalition for Uniform Business Rules (CUBR), the National Energy Marketers (NEM) and the Electric Power Supply Association (EPSA). This diverse group developed a consensus-driven set of recommended business principles and practices to guide the interaction of various market participants. These practices represent efforts by the various participants to balance the interests of customers, suppliers and utilities and cover a wide range of issues and processes necessary to establish a competitive retail energy marketplace and to implement retail access.

The Uniform Business Practices (UBP) developed through this collaborative effort do more than promote competition and facilitate interactions between suppliers and utilities; they will directly benefit the consumer. They will lower costs for all market participants, ease market entry, and offer more information for all market participants. As a result, consumers will have more choices and better opportunities to recognize the value of a competitive marketplace. The UBP will facilitate market entry, stimulating the growth of innovative products and services.

Enron strongly supports and urges states to implement these Uniform Business Practices. Recognizing changing market conditions and experience gained over time by the retail energy industry, Enron also supports the establishment of an independent national Energy Standards Board to support the maintenance, update and refinement of UBP and associated standardized electronic transactions. This independent organization should provide for due process in the development and maintenance process, while also assuring adequate and equal representation of all market participants.

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[7] The Pennsylvania Office of Consumer Advocate indicates switching rates of 5.29% to 31.8% in the service territories of the state's three largest utilities. The majority of those switching are large customers. *See* Pennsylvania Electric Shopping Statistics, January 2001 (available at www.electrichoice.com/public/media).

[8] A copy of these UBP can be obtained at www.ubpnet.org.

V. Market Structure Issues

The questions addressed in this section relate to the inexorable link between wholesale markets and the efficacy of state retail competition policies. Simply put, consumers will not realize benefits from retail competition policies unless federal authorities do their part to promote an open and fair wholesale power market.

- *How has the development of Regional Transmission Organizations (RTOs) affected retail competition in the state? What is the relationship between the state's role and the Federal Energy Regulatory Commission's role in transmission system operation in the state?*

Through the issuance of Order No. 2000, FERC has encouraged transmission-owning utilities to voluntarily relinquish operating authority over their transmission facilities to independently managed RTOs. It is clear that RTOs can play an important role in facilitating competitive markets by minimizing grid balkanization and eliminating utility ability to discriminate against competing market participants seeking access to the transmission system. A well-structured RTO can also enhance system reliability and encourage appropriate transmission investments. However, FERC has declined to compel utilities to participate in RTOs. Moreover, FERC has not explicitly required that all uses of the transmission grid be put under the RTO's tariff pursuant to the same rates, terms and conditions of service. FERC should strengthen the current RTO initiative by addressing these issues. Specifically, FERC should mandate that all jurisdictional utilities join a fully-functional FERC-approved RTO by a date certain. FERC should also require that all uses of the transmission system, including transmission used in bundled retail sales, be taken under the RTO's OATT pursuant to the same rates, terms and conditions as all other uses of the system.

- *Do firms that have provider of last resort or default service obligations receive preferential transmission treatment? If so, how does this affect wholesale electric competition? How and by whom should retail sales of bundled transmission services (i.e., retail sales of both energy and transmission services) and retail sales of unbundled transmission be regulated? What should the state's role be on overseeing wholesale transmission reliability?*

Under the current rules, FERC allows utilities that serve so-called "native load" to gain preferential access to the interstate transmission system by exempting from the OATT the transmission service used by utilities to serve their native load. This exemption undermines competition in wholesale power markets and ultimately weakens retail electric markets. FERC took an important step in the right direction with the adoption of Order No. 888. However, because FERC did not require utilities serving native load to take the transmission service used for that service under the OATT, there is no open and fair competition in wholesale power markets and will not be unless the native load exemption is eliminated.

For those states that require retail unbundling, the potential for discrimination still exists in certain circumstances. For example, if a utility has a continuing role as provider of last resort, the utility can still abuse transmission access if it is not required to utilize the OATT to provide this service. If the utility is able to serve customers as provider of last resort under the "native load exception," and thus avoid using the OATT, then the utility retains the ability to discriminate against other transmission customers in favor of its own uses of the transmission system. Unbundling alone is not the answer. Until federal officials remove this native load exception, states should explicitly require their utilities to take all service under the OATT, subject to the same rates, terms and conditions as all other users of the system.

The Supreme Court is addressing the extent of FERC's jurisdictional authority. Pursuant to Order No. 888, FERC determined that states should regulate all aspects of "bundled" retail transactions, including the interstate transmission component, but that FERC had exclusive authority to regulate *unbundled* retail transmission. Several parties appealed this aspect of the FERC's decision. Some parties, including Enron, believe that FERC has exclusive authority over all interstate transmission, including transmission services associated with bundled retail sales. On the other hand, several states challenged FERC's finding that it has authority to regulate unbundled retail transmission services. The U.S. Circuit Court of Appeals for the District of Columbia upheld FERC's jurisdictional demarcation, but the U.S. Supreme Court recently granted certiorari to review these aspects of Order No. 888. Enron believes that FERC can and must exercise jurisdiction over all interstate transmission in order to avoid grid balkanization and anti-competitive conduct.

- *To what extent did the state identify transmission constraints affecting out-of-state or in-state generation prior to the start of retail competition? Is the state capable of remedying these transmission constraints, or is federal jurisdiction necessary?*

As evidenced by recent developments in California, the inability or unwillingness to address transmission constraints before retail competition is implemented can have profound consequences. It is clear that states cannot be expected to resolve these issues and that federal jurisdiction is essential. Consistent with rules for certification of natural gas facilities, FERC should be given siting authority over all new transmission. In addition, other federal agencies and tribunal governments should streamline regulatory processes to enable expedited construction of new energy infrastructure.

VI. Other Issues

- *What measures has the state taken to make customer demand responsive to changes in available supply? Has the state provided utilities incentives to make customers more price responsive?*

Some states are beginning to recognize the importance of allowing consumers to gain access to real time energy prices as a mechanism for reducing demand during peak

periods. However, most state-sponsored demand reduction programs fail to fully compensate consumers for the market value of their demand. Historically, demand-side programs have been administered by utilities through ratepayer-subsidized programs that allow only a small percentage of customers to reap the economic benefits of demand reductions. Consumers should have the right to gain access to regional demand markets through exchanges or RTOs in order to receive the full economic value of demand reductions. State and federal policies should encourage these programs.

- *How prevalent is the use of distributed resources within a state? What barriers do customers face to implementing distributed resources?*

Increasingly, consumers are exploring ways to install distributed generation ("DG") to enhance reliability and lower their reliance on volatile short-term energy markets. Although predictions about DG penetration in next several years vary, it is clear that in the long-term the industry landscape will change substantially as a result of the decentralized sources of energy supply. Consumers who want to install self-generation today face a myriad of regulatory barriers, including: (i) retail tariffs that limit or prohibit such installations; (ii) standby rate design structures that remove economic incentives; and (iii) the lack of interconnection standards ensuring access to the grid. Many utilities have intentionally erected these barriers, which have gone unnoticed by regulators until recently. The Department of Energy recently prepared an excellent discussion of these issues.[9] Some of these barriers can and should be addressed at the federal level, most notably interconnection. Other issues will have to be addressed by the states, such as barriers created by retail tariffs.

- *What specific jurisdictional issues prevent state retail competition programs from being as successful as they might be?*

Retail electricity competition can offer consumers innovative services and products stimulated by an open market. In order for competitive suppliers to succeed in retail markets, however, they will need to achieve economies of scale that extend beyond any single state's border. To reap the full benefits of competition, retail markets need to be developed and implemented fairly, efficiently *and uniformly*. So far, the retail competition policies adopted by various states are anything but uniform. Each state has implemented its own version of retail competition, frequently with no effort to coordinate policies with neighboring states, creating a complex and confusing patchwork of regulations and tariffs. There is a pressing need for federal restructuring legislation that recognizes the regional and national scope of electric markets, and to standardize the rules under which retail competition will be permitted to go forward. It makes no sense for fifty states to implement fifty different sets of rules, each laden with protections that serve only the parochial interests of incumbent utilities. This type of state-by-state "deregulation" process will continue to move slowly and tilt the playing field in favor of the incumbent utilities. Congress can and should pass retail restructuring legislation to allow effective retail markets to develop sooner, more fairly, and more uniformly.

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[9] *See Making Connections, Case Studies of Interconnection Barriers and their Impact on Distributed Power Projects* (May 2000). The report is available at http://www.doe.gov/bridge.

In addition to the need for uniformity, there is a pressing need to expand FERC's jurisdiction to address transmission grid problems, including authority to site interstate transmission facilities. Although constraints on the transmission system existed before competition policies were adopted by FERC and various states, these new policies have heightened the need to increase transmission capacity in many areas of the country. States cannot be expected to serve this role, especially because they lack the mandate to consider the need to build transmission capacity from a regional or national perspective.

Conclusion

Enron commends the Commission for opening this investigation into retail electric competition policies. Retail competition will yield substantial benefits to consumers and the nation's economy, but only if state and federal officials adopt and implement sound public policies and regulatory structures. States should be encouraged to develop policies that remove incumbent utilities from all merchant generation functions. In addition, Enron urges the Commission to recognize and highlight those areas, described above, where additional federal authority is necessary to promote open and fair competition in wholesale and retail markets.

Respectfully submitted,

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