

June 26, 2006

Open Letter to Policymakers

Dear Policymaker:

As economists that have both followed and participated in the discussion on restructuring the electricity industry to support competitive wholesale and retail electricity markets, we prepared this letter to provide our views about the value of continued support for the development of competitive markets for electricity.

Among economists, it is almost universally accepted that well functioning competitive electricity markets yield the greatest benefits to consumers in terms of price, investment and innovation especially when regulated alternatives are no longer warranted. And, despite currently high electricity prices in many regions, driven by very high fuel input costs used to generate electricity, we are confident that well structured markets and robust competition are providing substantial benefits to electricity consumers. More importantly, these benefits will increase over time if an effective restructuring process and competitive market implementation program continue to receive support from policymakers. Unfortunately, recent reports have blamed rising electricity prices on industry restructuring. These reports fail to identify the primary cause of today's rising electricity prices --- dramatic increases in fuel costs at a time when retail rate freezes introduced as a transition to competition have come to an end. We are concerned that faulting competitive markets for today's high prices diverts the focus and resolve of policymakers to continue with restructuring and make further improvements in market institutions and design in order to provide consumers with the full benefits of competition.

First, competition and markets are not to blame for recent increases in electricity prices. The current high electricity prices are largely the result of dramatically higher fuel costs. During the period 2000-2005, the price of natural gas increased 375%, and the price of coal increased 30%. These are the two primary fossil fuels used for electricity generation. These increases have been magnified by the end of many retail price freezes that were put in place in many states as part of the transition to competition. Commodity price increases are being felt both in restructured states and in states with vertically integrated utilities. Retail prices have increased more in restructured states than in regulated states in the last year, largely because of their greater use of clean, natural gas-fueled generating capacity, but they increased less in restructured states in the previous few years. While there has been considerable publicity about sharp increases in electricity prices in restructured states such as Maryland and Delaware, where long-term retail rate freezes are expiring, we would point out that, during 2000-2005, regulated rates increased by 47% in Oklahoma and, since 2000, by 43% in Colorado, just to give two examples. No state, regulated or restructured, will ultimately escape the burden of the higher generation fuel prices we are experiencing now.

Second, properly structured, competitive markets shift the risk of bad business and investment decisions away from consumers by having the shareholders of competitive suppliers, and not electricity customers, bear those risks. Cost-of-service regulation clearly has its place in some aspects of the electricity industry such as distribution and transmission. However, where market forces can operate, as they have for electric generation, competition can shield consumers from construction and operating cost overruns. The shifting of risks from customers to suppliers

in a competitive market is a huge benefit for consumers in the long run since wiser investment choices and better cost control incentives will lead to more efficient outcomes.

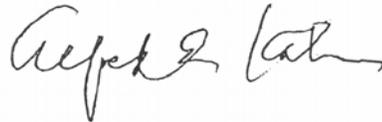
Third, restructured electricity markets are an efficient and reliable way to allocate resources, and there is growing evidence and convincing studies that show that consumers have saved billions of dollars in energy costs as a result of competitive markets when compared to the traditional regulation in effect before competition was implemented. The savings from competition are real dollars in the pockets of consumers, and those savings will continue after fuel prices retreat from their current high levels. In addition, there have been multiple new entrants and large gains in generator performance with competition. One estimate found that performance improvements from divested power plants produced enough additional energy to power more than 25 million households in the Eastern interconnect for a year. Customers are beginning to gain access to more tailored products and services. Credible price signals provide opportunities to develop a robust demand response that both has a significant price dampening effect and relieves the stresses and strains on the delivery systems. And, restructuring and competition have brought significant environmental benefits, with reduced emissions resulting from increased operating efficiencies, improved regional dispatch of generating resources, and the use of market signals to stimulate increased investment in transmission, emission control technology, highly fuel-efficient new generation and renewables.

In sum, despite the recent increases in electricity prices, policymakers should stay the course and continue to support restructuring and the evolution of competitive wholesale and retail markets for power. Competition is the very foundation of our nation's economy. Competitive electricity markets are relatively new and will continue to evolve. We urge policymakers to focus on making necessary improvements in market design and resist the temptation to reject competition for a return to heavy-handed regulation. We are persuaded that competition in electricity markets will stand the test of time and continue to provide visible customer benefits.

Sincerely,



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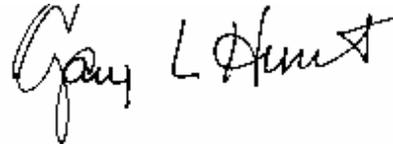
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