

Electric Industry Restructuring in Illinois at the 10-Year Mark

Retail Competition Beneficial to Illinois Consumers



Executive Summary

The retail electricity market in Illinois, celebrating its 10-year anniversary this month, is among the most robust nationwide, delivering millions in savings to energy consumers annually and estimated customer savings in excess of \$1 billion over the past 10 years. Besides providing tremendous savings to consumers, retail competition has produced other significant benefits that are often overlooked. The competitive market has driven efficiencies that translate into more choices for consumers, more efficient operation of generation and benefits for our environment. And the results are tangible. Since restructuring in 1997, Illinois consumers have enjoyed some of the following benefits:

- **Millions of dollars in savings to consumers.**
More than 50 percent of all the electricity used in Illinois is supplied by alternative electric suppliers. Over 75 percent of non-residential users and more than 90 percent of large customers, including schools and government agencies, are saving millions of dollars annually by competitively procuring electricity. And those savings are spreading steadily to smaller, non-residential electricity users as well.
- **Competition spurs innovation.**
With more than 30 alternative retail electric suppliers in Illinois, competition is driving creativity and innovation in product development. Consumers now have products and services available to them that are customized to their individual needs which did not exist in the regulated monopoly market. Some examples of those products include: real-time energy monitoring, renewable energy products and credits, access to online management tools, specialized hedging programs, market analysis, custom billing services and demand response and energy efficiency products.
- **Increased efficiency result in lower costs and increased reliability.**
The capacity factor for nuclear plants in Illinois has increased from 47 percent to 93 percent as a direct result of competition. This means Illinois doubled the output of its nuclear fleet and increased reliability at no cost to consumers.
- **New generation paid for by investors – not consumers.**
Restructuring shifted the risks of imprudent generation investments from IL consumers to investors where they belong. Since 1997, over 9,500 MW of gas-fired generation has been built in Illinois, and uprates at existing nuclear plants created an additional 900 MW of reliable supply – all at no cost or risk to consumers.
- **Competition is better for the environment.**
Competition increases the development of renewable power sources, such as wind and solar. Illinois' competitive market has attracted 1150 MW of wind power since restructuring. Competition has also increased conservation through energy efficiency and demand response products that thrive in competitive markets that provide appropriate pricing signals.

In short, retail competition has already provided meaningful benefits to all Illinois consumers and has provided substantial savings to Illinois businesses and government institutions. Plus, customer choice is flourishing. Now is the time to focus on and continue supporting policies that encourage and expand the development of competition for all customers.



History of Electric Competition in Illinois

TRADITIONAL RATE REGULATION AND VERTICALLY INTEGRATED UTILITY MODEL COMES UNDER FIRE

The movement to retail competition in Illinois was started by widespread criticism of the state's regulatory paradigm and utility structure and the resulting problems:

- Illinois rates were significantly above the national average with frequent double-digit rate increases
- Imprudent investments in generation plants and capital cost overruns
- Poorly run generation plants and service reliability issues
- Increased rates caused by above-market long-term PURPA contracts

Frustrated by the situation and the inability to choose a provider other than the utility, large industrial customers led the push for policymakers to restructure the electric industry and introduce competition.

GENERAL ASSEMBLY EMBRACES COMPETITIVE MARKETS AND RESTRUCTURES ELECTRIC INDUSTRY

In December 1997, the General Assembly enacted the Electric Service Customer Choice and Rate Relief Law of 1997 ("Customer Choice Act"), which significantly restructured the Illinois electric industry and provided a transition to competitive retail markets. The Customer Choice Act allowed alternative retail electric suppliers to compete against each other and the utility to service customers. Customer Choice for commercial and industrial customers was phased-in starting in October 1999 and for residential customers in May 2002. Under the Customer Choice Act, the Illinois Commerce Commission ("ICC") was charged to "promote the development of an effectively competitive electricity market."

The Customer Choice Act also led to both the consolidation and the end of the vertically integrated Illinois electric industry. Prior to the mandatory transition period (MTP), the state's largest utilities were vertically integrated and served their customers from their own generating plants. During the MTP, however, the utilities sold and transferred their generation plants, and engaged in mergers which changed the shape and make-up of the industry. The following major restructuring activities occurred:

- Commonwealth Edison ("ComEd") transferred its nuclear fleet to an affiliate, Exelon Generation (an Exelon subsidiary)
- ComEd sold its fossil-fueled plants to Midwest Generation
- CIPS merged with Union Electric, a Missouri utility, creating the holding company Ameren
- Illinois Power ("IP") sold its Clinton Nuclear Generating Station, and then was purchased by the energy company Dynegy, Inc.
- Ameren purchased CILCO
- Ameren purchased IP
- The Illinois service territory of Union Electric Company, an Ameren entity, was incorporated into the CIPS service territory
- The generating plants formerly owned by CILCO and CIPS were owned by an Ameren affiliate
- The fossil-fueled generating plants formerly owned by IP were owned by Dynegy
- The Clinton plant is owned by Exelon Generation

As a result of these radical changes, the state's four largest electric utilities were no longer vertically integrated, and the holding company Ameren operates the three formerly independent utilities



CILCO, CIPS and IP. The Ameren and ComEd service territories comprise approximately 98 percent of the State's retail customers.

In addition to the complete transformation of the electric industry, residential customers were given a 15 percent rate cut in August 1998 and an additional 5 percent reduction in October 2001. According to the ICC, these rate reductions were the largest in the county, which provided savings of \$4.5 billion. While residential customers received savings through the rate cuts, non-residential customers began receiving savings through customer choice.

COMPETITIVE MARKETS BENEFIT ILLINOIS CUSTOMERS

RETAIL COMPETITION IN ILLINOIS A SUCCESS

Electric restructuring and customer choice have been a resounding success in Illinois. Customer switching to retail electric suppliers, one measure of competition, has increased significantly in all non-residential customer classes in both the Ameren and ComEd service territories. According to the ICC Office of Retail Market Development 2009 Report, alternative retail electric suppliers competitively provide more than 50 percent of the total electric consumption of ComEd's and Ameren's customers. The Report states that over 74 percent of the commercial, industrial, governmental and other non-residential electric load is served competitively by retail electric suppliers. **Customer switching to competitive suppliers has more than quadrupled since 2006.**

More than 90 percent of large customers including schools, local government agencies, commercial, retail and industrial customers are taking service from someone other than the incumbent electric utility. Competition is spreading steadily to smaller, non-residential electricity users as well. Today, 56,000 schools, local government agencies, commercial, retail and industrial customers are buying competitive retail electric service. And all that shopping has resulted in a lot of savings – millions of dollars annually and an estimated 1 billion over the past 10 years.

Another measure of successful customer choice is the number of suppliers actively competing for business. As of December 2008, there were 30 retail electric suppliers actively selling service in Illinois with 19 in the ComEd service territory and 11 in Ameren's.

The large number of active retail electric suppliers, the substantial load being served by them, and the savings realized by the consumers as a result is a solid proof that customer choice and retail electric competition in Illinois is a success. But perhaps even more important than the numbers is the innovation that has resulted from competition. Businesses and institutions in Illinois have product and service choices that weren't even contemplated in the monopoly environment. Here are just some of the products that can be tailored to the customer's specific needs that are changing the way Illinois businesses manage their budget and costs:

- Electricity and related services packaged for customer's unique load requirements
- Long-term pricing products to hedge customer risk
- Electricity bundled with related services, e.g., energy management, energy efficiency, and demand response
- Renewable energy credits and power

Competition also empowers customers to create their own savings. The increased accuracy and transparency of electricity prices encourages active, thoughtful management of costs, e.g., shopping alternative suppliers, voluntary aggregation, increased conservation and demand management, investment in high-efficiency appliances.



More and more Illinois businesses and governmental units are realizing the benefits of retail competition and exercising their choice to shop for the energy supplier who offers them the best product to meet their individual needs.

WHOLESALE ELECTRIC COMPETITION: A CATALYST FOR THE DEVELOPMENT OF THE RETAIL MARKET

The organized, competitive RTO markets administered by PJM and MISO have made tremendous progress and have been a catalyst for the development of the Illinois retail market. Further, PJM and MISO have made great strides to support the development of renewable energy projects, demand response, and energy efficiency. These organized competitive wholesale markets have been the catalyst for the improved efficiency and attraction of new generation cited above. According to the American Wind Energy Association (AWEA), wind power has grown disproportionately in organized regional competitive markets. In the area of demand response, the price signals generated by PJM have fostered the widespread use of demand response. These competitive wholesale markets have been the reason for the increased operating efficiency and reliability of Illinois generating facilities – particularly the nuclear power plants.

RESIDENTIAL ELECTRIC COMPETITION: BARRIERS JUST NOW STARTING TO FALL

Although residential choice technically began in May 2002, significant barriers to competition have existed in the residential market that prevented the market from developing properly. Until December 2006, ComEd's and Ameren's residential rates had been reduced up to 20 percent and then frozen for a decade which did not reflect actual market prices. The Illinois retail market also lacked a number of "best practices" found in other markets to foster residential electric competition.

However, an often overlooked fact is that residential consumers are benefiting from competition through the wholesale market. That is, the Illinois Power Authority buys bulk power, on behalf of utilities like ComEd and Ameren, and passes the cost on to consumers at the lowest possible cost obtained from pitting competitive wholesale suppliers against one another. So in a very real sense, even without the same retail options enjoyed by commercial consumers, residential consumers are getting a market-driven, competitive price for power.

Recently, the Illinois General Assembly authorized a number of "best practices" including two key developments: One, the creation of the Office of Retail Market Development at the ICC to promote an effective competitive retail electricity market, particularly for residential and small commercial customers. Two, the Legislature required Ameren and ComEd to offer a purchase of receivables and utility consolidated billing (POR/UCB) program to competitive suppliers to encourage competition in the residential and small commercial market. The Commission has already approved POR/UCB tariffs for Ameren that will allow the service to be available in late October 2009. ComEd is expected to file shortly the required tariffs to implement POR/UCB and is targeting the availability of the service in late 2010.

Conclusion

The reason for the success of the competitive market is rather intuitive -- Competition works. Competition drives price down to its lowest practical level and demands efficiency and innovation of those who want to be successful. Having competitive marketers versus fully regulated monopoly utilities also puts the risks associated with capital investment on investors, not ratepayers. Under the old monopoly regulated scheme, consumers, not investors, were held captive to generation construction cost overruns for which the industry is infamous.



The Illinois General Assembly and the Illinois Commerce Commission deserve a great deal of credit for putting the state on a path toward successful competition and working diligently through the years to address the challenges and complexities of building a robust retail electricity marketplace.

There is still work to do to bring even more benefits to consumers. An increased focus on sustainable energy policies, Smart Grid, AMI deployment, and various new and innovative products and services are just some of the issues that will take the competitive marketplace to a new plateau.

Key Facts

Competitive Markets Provide More Reasonable Rates

- All Illinois consumers pay **LESS** now than in 1997
 - Illinois **residential** consumers
 - Paid 24 percent above the national average before restructuring—now pay 2 percent below
 - Pay 21 percent less now than in 1997, when adjusted for inflation
 - **All Illinois customers** combined
 - Paid 12 percent above the national average before restructuring—now pay 6 percent below
 - Pay 11 percent **less now** than in 1997, when adjusted for inflation
 - The **national average** for electric rates has risen 7 percent
- Monopoly states have greater rate increases
 - In percentage terms, retail electric rates have risen more rapidly in monopoly states than in those with retail electric competition. A few examples:
 - 12 percent increase for AEP in West Virginia
 - 30 percent increase for Progress Energy in Florida
 - 29 percent increase for Potomac Energy in Virginia

Competitive Markets Shift Risk from Consumers to Investors

- Investors—not consumers—bear the huge cost risks from generation construction in competitive markets
- Under a monopoly regulated scheme, customers, not investors, are held captive to generation construction cost overruns for which this industry is infamous.
- **A few examples of the ever-increasing estimates for new construction in monopoly states:**
 - Progress Energy’s proposed nuclear power plant in Florida has increased nearly fourfold, from \$3 billion to \$14 billion
 - Sunflower Electric Energy Corp. saw the price of their proposed 1,400 MW coal-fired Holcomb facility more than double to \$4.2 billion
 - Entergy revised its original cost estimate for its Little Gypsy unit by more than 50 percent from \$1 billion to \$1.55 billion in just four months

