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- Comments for Docket No, AD05-17-000
On Draft Report to Congress on Competition in the
Wholesale and Retail Markets for Electric Energy

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- Filing Date: June 23, 2006

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- The filing has been done electronically without the
Appendices, and in hard copy (1) with the
Appendices.

June 23, 2006

Federal Energy Regulatory Commission
Office of the Secretary
888 First Street NE
Washington, DC 20426

RE: Comments for Docket No. AD05-17-000

I. Summary

As a former Office of Management & Budget careerist for 26 years in the energy area, I was responsible for federal electricity subsidy programs. During that period, I completed a number of evaluations of the programs, their related subsidies and the subsidy cost to US taxpayers. Since leaving OMB, I have been and continue to be a consultant to federal agencies and to private sector clients including clients in the energy and electric industries. I am currently the President of OMB Professionals, Inc.

The hours and expenses that were incurred in putting this filing together were not paid for by the firm's clients. The content of this report and the views expressed herein are those of OMB Professionals, Inc. and not the firm's clients.

A review of the Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy disclosed that there is nothing in it on the existing deep and extensive federal electricity subsidies provided to certain types of utilities and not others. These subsidies have been identified and evaluated in a number of reports published by the General Accountability Office, Congressional Budget Office, Joint Committee on Taxation, Congressional Research Service, Office of Management & Budget, and the Department of Energy, Energy Information Administration and a qualified private economic consulting firm. While there are coverage and treatment differences among the reports, collectively the reports document that there are substantial federal subsidies being provided to certain types of utilities and the subsidies provide an unfair competitive advantage to the utilities that receive them. This advantage, in competitive wholesale and retail electricity markets, would result in unfair competition. Refer to page 6 and Attachment A-1 for a list of these reports.

The absence of any assessment of the unfair competition caused by federal subsidies given to certain utilities favored by the political process and not others is a deficiency in the draft report. The federal electricity subsidies are currently and will continue in the future to result in unfair competition. Deeply subsidized market participants have an unfair competitive advantage and this advantage will contribute to increases in their market share. The fact that the USG provides deep subsidies to certain utilities and not the others will impair all efforts to achieve fair and open competition in the electric sector. The following pages and referenced reports provide the evidence in support of the

conclusions contained in this filing. The competition report should deal with the subsidies as a major impediment to achieving fair and competitive electricity markets in the U.S.

II. Deep, Extensive Federal Electricity Subsidies

For the purpose of this paper a subsidy is defined as either a transfer of economic resources, directly or indirectly, or an exemption from requirements imposed by the federal government to certain types of electric utilities and not others that have the effect of reducing the benefiting utility's costs of providing electricity.

Table 1 and Notes to Table 1 (next page) includes a summary of the thirteen existing major federal electricity subsidies by the type of utility ownership that receive and benefit from them. The subsidies are grouped according to whether they 1) reduce the cost of capital or 2) reduce operating costs. These federal subsidies are both deep and extensive and substantially lower the cost of electric generation and distribution for the utilities that receive them. It is not just one or two subsidies but eight, nine, or ten and the cumulative effect is substantial. The following explains why and includes objectively done estimates of the impact of the subsidies on recipient utility capital costs and operating costs. Further, examples are included on how the subsidies may be resulting in unfair competition now and in the future.

As can be seen on Table 1, ten of the thirteen subsidies are provided to the nonprofit electric cooperatives, nine of thirteen to publicly owned utilities, eight of thirteen to DOE's Power Marketing Administrations, and eight to the Tennessee Valley Authority. None are provided to privately owned utilities.

Federally funded electricity related research and development programs are not included on the table because, if successful, the benefits accrue to all types of utility ownership.

Some claim that privately owned utilities get subsidies through the federal tax code. This claim has been considered and found not analytically valid for two basic reasons. The first and most important is that provisions in the federal tax code that allow for accelerated depreciation or tax credits may have the effect of lowering the rate of income tax paid but from 1999 to 2005 privately owned utilities paid \$46.0 billion in federal income taxes.^{1/} The other types of utilities paid none thus, the income tax exemption for the other types of utilities is a subsidy since they pay no federal income taxes. It is not for the privately owned since they pay substantial amounts of federal income tax and must recover that expense in the form of higher rates. The second reason is that accelerated depreciation is not a subsidy because it usually applies to most industries and is an across the board federal tax policy.

The thirteen subsidies on Table 1 have been group into two categories. Capital subsidies include A-F and operating subsidies include G-M. Both types directly reduce the cost of providing power. As can be seen on the table and accompanying notes the subsidies provided are extensive to those utilities that receive them.

Table 1

Federal Subsidies Provided to Electric Utilities by Type of Utility

Type of Federal Subsidy	Type of Utility				
	Rural Electric Cooperatives	Publicly Owned Utilities	PMAs	TVA	Privately Owned Utilities
Subsidies that Reduce the Cost of Capital					
A. Federal income tax exemption on interest on debt issued for investment	No	Yes	No	State Only	No
B. Federal loans or loan guarantees or implicit federal guarantees	Yes ²	No	Yes ³	Yes ⁴	No
C. Federal loan write downs or write offs	Yes ⁵	No	Yes ⁶	Yes ⁷	No
D. Technical and loan processing assistance	Yes	No	Yes	No	No
E. Federal disaster assistance (FEMA)	Yes ⁸	Yes ⁸	No	No	No
F. Clean energy 0% interest bonds	Yes	Yes	No	No	No
Subsidies that Reduce Operating Costs					
G. Federal income tax exemption ¹	Yes	Yes	Yes	Yes	No
H. Low cost federal hydro power	Yes	Yes	Yes	Yes	No ⁹
I. Federal income tax exemption on interest for debt issued for electricity purchases	No	Yes	No	No	No
J. Subject to SEC financial oversight	No	No	No	No	Yes
K. Subject to FERC financial oversight	No ¹⁰	No ¹⁰	No ¹¹	No ¹²	Yes
L. Subject to Federal antitrust statutes	Yes	No	No	No	Yes
M. Economic development grants, 0% interest loans	Yes	No	No	No	No

1-12 Notes are shown on the next page.

NOTES for TABLE 1

1. Privately owned utilities paid \$46.0 billion in federal income tax from 1999-2004 (Edison Electric Institute, Statistical Yearbook, Table 9.5 Detail of Taxes—Electric Department Only). Electric cooperatives, publicly owned utilities, PMAs, TVA paid none or an insignificant amount in the case of a few electric cooperatives. Electric cooperatives are exempt from federal income taxes as long as revenues from nonmembers do not exceed 15% of their total revenues. Certain nonmember revenues are excluded from this limit such as providing transmission services to nonmembers under open access rules. TVA makes annual payments to the USG but these are to repay a portion of the earlier appropriations given to TVA by the USG.
2. Rural Utility Service (RUS) provides 100% of project cost US Treasury, Federal Financing Bank (FFB) loans to mainly power supply cooperatives for new power plants and high voltage transmission investments. The loans are provided for 35 years at US Treasury interest rates plus 1/8 of 1% (12.5 basis points). RUS also provides loans at or below US Treasury interest rates for 70% or more of the cost of retail distribution projects. In addition, RUS has provided \$2.5 billion in 20 year term, interest only, FFB loans to the electric cooperatives owned private lender, the National Rural Utilities Cooperative Finance Corporation (CFC) at about 30 basis points over comparable maturity Treasury note and bond interest rates or significantly below its private sector borrowing interest rates. The CFC provides electric cooperatives with low interest construction financing for new power plants, for retail distribution system investments, and for other purposes. For FY-2006, authority to make new RUS electric loans totaled \$5.4 billion. As of 2004, RUS loans outstanding to electric cooperatives totaled \$26.5 billion. Source: 2004 RUS Statistical Report, Electric Borrowers). In addition, RUS via the FFB has loaned \$2.5 billion to the CFC. Sources: Department of Agriculture, Rural Utilities Service, Electric Programs website, FY-2006 Agriculture Appropriations Act, Rural Utilities Service.
3. There are five DOE Power Marketing Administration including Bonneville Power Administration, Southwestern Power Administration, Western Area Power Administration and Southeastern Power Administration. Bonneville Power is the largest and has \$12.7 billion in outstanding debt. Of this, \$6.3 billion is nonfederal project debt; the rest is US Treasury debt and appropriations totaling \$6.5 billion that have not been repaid. BPA's nonfederal project debt is mostly rated AA- by Fitch and this rating is higher than otherwise would be the case because BPA is a federal agency and has considerable cash flow from selling the power from its hydroelectric projects. Source: BPA 2005 Financial Report, pages 47-53.
4. TVA has \$23.3 billion in long term debt with various maturities. Source: TVA's 2005 Information Statement, page 25. TVA borrows at 25 to 35 basis points over comparable term US Treasury note and bonds interest rates and TVA's debt is rated AAA and is the highest rated debt in the electric utility industry. Refer to Appendix 10 for a comparison of IOU debt ratings versus TVA. This high rating and low interest rate is because TVA is a wholly owned USG corporation and the debt rating agencies (S&P, Moodys, Fitch) assume that if TVA defaults, the USG will step in and bail out TVA. If TVA did not have this status its debt rating would likely be significantly lower and the interest rates paid on its debt higher.
5. RUS has experienced loan defaults, loan write downs and bankruptcies for 14 of the 48 power supply cooperatives that borrowed from REA (now RUS), since 1985. RUS has lost or will lose an estimated \$13.3 billion on its electric loans. Federal taxpayers paid for these losses and they are a subsidy. Sources: GAO reports, bankruptcy documents, RUS Congressional testimony and letters, RUS Statistical Reports on Electric Borrowers from 1977 to 2004, and discussions with RUS personnel). Most of the generation capacity involved in these losses has remained with the power supply cooperatives that borrow from the RUS.

6. Historically, some of the federal appropriations that were used to build TVA's hydroelectric power facilities have been written off as a result of Congressional action.
7. TVA was given an interest rate related write down of \$3.2 billion in FFB debt that it owed in 2000. The debt write down cost the taxpayers \$1.2 billion according to the Treasury and was another subsidy provided to TVA by the taxpayers.
8. Electric cooperatives and publicly owned electric utilities are eligible for from 75 to 200% of the cost incurred to remove debris and restore facilities that are damaged as a result of disasters when the area is declared a federal disaster area. For the Katrina/Rita hurricanes of 2005, FEMA provided the electric cooperatives and publicly owned utilities in Louisiana, Mississippi disaster assistance funds totaling \$210.1 million covering about 90% of their cost of restoration. Source: FEMA letter dated December 19, 2005. Privately owned utilities are not eligible for FEMA disaster assistance. For Katrina/Rita privately owned utilities incurred substantial losses forcing one privately owned utility to file for bankruptcy. The FEMA disaster assistance subsidies provided to electric cooperatives and publicly owned utilities enabled them to avoid significant electric rate increases. Conversely privately owned utilities had to increase rates significantly to recover some of their Katrina/Rita related damage restoration costs.
9. Privately owned utilities receive very small amounts of low cost (ranging from 1 to 3.4 cents per kWh) wholesale federal hydropower from several PMAs. Some of this power must be passed through directly to certain retail customers. The vast majority of the low cost hydropower is provided to publicly owned utilities and electric cooperatives at their deeply subsidized cost of generation which is far below prevailing wholesale market prices. The DOE/EIA, Annual Energy Outlook, Table 73, Lines 2324-6 has the national average cost of wholesale power at 5.8 cents per kWh in 2005 or, far more than the cost based recovery rates charged by the PMAs. The difference between prevailing wholesale power rates in the regions that have PMAs and the PMA wholesale power cost recovery charge is a substantial subsidy.
10. The vast majority are exempt.
11. Southeastern and Southwestern comply with FERC's open access regulations on a voluntary basis. BPA is required to provide open access, nondiscriminatory service to all requestors using pro forma tariffs as approved by FERC. All PMAs have retained ownership of and control over their transmission assets.
12. TVA is subject to certain FERC review of its transmission rates and regulation on manipulative pricing and pricing information. TVA has retained ownership and control of its transmission assets.

Capital Cost Subsidies

The electric industry is one of the most capital intensive industries in the US economy. Having access to readily available low cost capital that is not available to all types of utilities is a major competitive advantage. One of the lowest cost capital sources is the US Treasury which is AAA rated by Standard & Poor's (S&P) and has the lowest borrowing cost in the US and world market economies. The utilities that receive this subsidy include; electric cooperatives (Refer to Table 2), PMAs, and TVA. They get two distinct advantages. The first is that Treasury interest rates on new loans are currently about 5% for 30 year maturities. Private utility investment grade bonds (BBB) utility bonds are currently 6.35% (Bloomberg, 6-15-06).

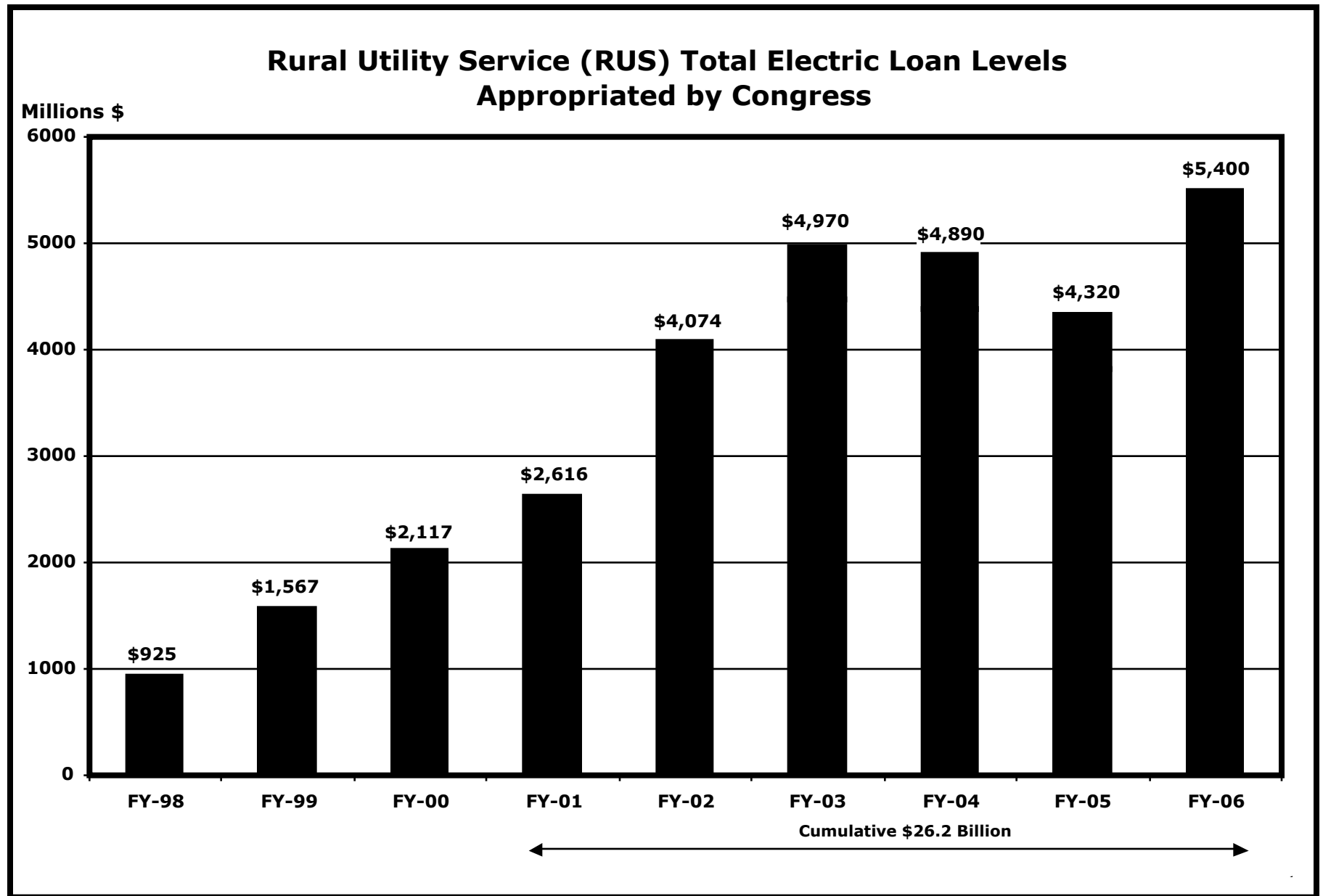
The second and most important advantage is that private utilities are required by debt rating agencies such as S&P, Moodys, and Fitch to maintain roughly a 50% equity and 50% debt financial structure (among other things) in order to maintain an investment grade rating of BBB(S&P). Equity costs far more than debt averaging about an 11% rate of return for 2005 for privately owned utilities based on state PUC rulings.^{2/} The electric cooperatives, TVA, public power entities and the PMAs are not required to maintain much equity since they are borrowing either directly from the US Treasury for 100% of project cost and the explicit support of the USG. As a result, they can finance 100% of project costs with debt at or near US treasury interest rates and have a much lower cost of capital compared to privately owned utilities.

Attachment A-2 includes a copy of a study completed in 1999 using an economic consulting firm's electric sector financial model. DOE/EIA, AEO estimates of capital and operating cost for a hypothetical combined cycle natural gas plant of 100 MW of capacity were assumed.^{3/} Estimates of capital cost taking into account any federal subsidies were then completed for each type of utility. The result was capital costs for cooperatives, public power, TVA, and the PMAs were 28 to 33% lower than for a privately owned utility. (Attachment A-2, page 4). Public power's capital cost was the lowest at 28% because the interest on public power debt is exempt from federal income tax to the bondholder. For a 30 year bond rated AA+, the interest rate is 4.43 % (Bloomberg 6-15-06) or significantly lower than Treasury bonds at about 5%. Public power entities also have the advantage of minimal equity financing although this can vary by entity.

The estimated cost of electricity out of the hypothetical natural gas plant gate was about 10% less for the subsidized utilities compared to a privately owned utility. (A-2, page 7) This is a major advantage lower cost advantage in the electric sector.

The federal subsidies included in this study's estimates were the federal loans, loan guarantees, implicit guarantees, the income tax exemption on state or local government bonds and the federal income tax exemption. Other subsidies including loan write downs (a decrease in the net present value of the loan) which have been given in the past to

Table 2



electric cooperatives, TVA and certain PMAs were excluded, FEMA disaster assistance was excluded and appropriations given to TVA several decades ago for capital investment in hydroelectric capacity that were never repaid were excluded. Adjusting for the much higher capital cost of a new pulverized coal fired plant, the percent advantage increases further. In a recent presentation to the 24th Annual LaSalle Fixed Income Symposium and Exposition, a senior TVA official touted TVA's AAA debt rating as the highest in the industry comparing it to the much lower rated debt of privately owned electric utilities. Refer to A-10.

Another major subsidy that reduces capital costs is FEMA disaster assistance for those areas of the country that are hit by hurricanes, flooding, ice/snow storms, and earthquakes. These are not infrequent events and the most recent hurricanes--- Katrina/Rita---did considerable damage to electrical systems in Louisiana and Mississippi. Public power entities and electric cooperatives in these two states were awarded \$210.1 million by FEMA in November 2005 or on average about 90% of the cost to replace the damage electrical facilities.^{3/} Privately owned utility facilities were heavily damaged in both states. They did not receive any funds from FEMA because they are not eligible for FEMA disaster assistance. One of the private utilities, Entergy New Orleans, with estimated losses of \$718 million, has filed for bankruptcy because of the massive losses incurred. To recover these losses a rate increase of 140% was estimated to be required. ^{4/} In comparison, the cooperatives and public power utilities will not have to increase their electric rates and all but one cooperative had electric rates that were lower than Entergy New Orleans prior to the Katrina/Rita damage.^{5/}

Both publicly owned utilities and electric cooperatives are eligible for clean energy bonds that were part of the Energy Policy Act of 2005. These bonds require that only the principal be repaid over 20 years. The interest is paid by giving the bondholder a tax credits that serves as an interest payments for the term of the bond. The bond proceeds are to be used for renewable energy investments that would include solar, wind, biomass, etc. On a net present value basis, the 0% interest feature on the proceeds of the bond amounts to a 40-45% capital grant which is a very deep subsidy. There are special purpose deep tax subsidies for renewable energy available to private firms including a 1.8 cent per kWh for wind production and a five year double declining balance accelerated depreciation. These deep subsidies have the effect of making investments in wind energy more attractive but they have not eliminated the payment of federal income taxes.

There are extensive capital subsidies provided to electric cooperatives, publicly owned utilities, the PMAs, and TVA. As noted above, just several of the subsidies provide a 28 to 33% capital cost advantage and a 10% lower cost out the plant gate advantage.

Operating Cost Subsidies

Operating subsidies G-M shown on Table 1 and provide benefits to all but the privately owned utilities. One of the more important subsidies is the G. federal income tax exemption which applies to both capital and operating. Privately owned utilities are

subject to a 34% income tax rate on their taxable income and this has resulted in payments of \$46.0 billion from 1999 to 2004. Refer to Table 1, Note 1 for source.

Another major operating subsidy is H. the preferential right to very low cost power from federal hydroelectric projects. The vast majority of this power is provided to electric cooperatives and publicly owned utilities from the DOE PMAs including Bonneville Power Administration, Western Area Power Administration, Southwestern Power Administration, and the Southeastern Power Administration. According to DOE EIA's 2006 Annual Energy Outlook, the national average cost of electric generation in 2005 was 5.8 cents per kWh.^{6/} The average price that most of the PMA s sold their power in 2005 at average rate ranges from 1.0 to 3.4 cents per kWh.^{7/} The difference between the EIA average wholesale power price estimate and the PMAs' selling price is a rough approximation of the recent market value of the federal subsidy. The PMAs by statute must recover their costs and only their costs in the rates charged. The electric cooperatives and publicly owned utilities have a legal preferential right to this subsidized power and receive the vast majority of it at very low rates of from 17% to 59% of the national average wholesale price included in the 2006 AEO.

Another operating subsidy is I. the use of federally tax exempt bonds to complete advance power purchases by certain public power entities. This subsidy has been available to public power agencies since 2003 based on a ruling of the Internal Revenue Service. Its use has increased rapidly. It allows a publicly owned utility to issue tax exempt bonds at interest rates below those of the US Treasury and then use the proceeds to complete advanced power purchases for many years into the future. This gives the utility a low cost way of insuring future electricity supply. Several of TVA's largest public power distributors have advanced purchased \$1.5 billion worth of electricity for 20 years from TVA. ^{8/}

Being exempt from SEC, (or partially exempt) FERC regulation and oversight by Department of Justice on antitrust matters reduces an electric utility's costs and increases its flexibility. The PMAs, TVA and most public power utilities are not subject to much of the FERC, SEC regulation or oversight. Refer to the Table 1, Notes for specifics. Nearly all privately owned utilities are subject all SEC, FERC, and DOJ regulations and oversight and incur significant expenses in maintaining compliance.

Another significant federal subsidy is the 0% interest loans and the grants that are provided by the Department of Agriculture, Undersecretary for Rural Development. These subsidies are provided through the Rural Economic Development Loans and Grants program to electric cooperatives to promote and encourage economic development in their service areas. The cooperatives make application for a given project and can be awarded either a grant or 0% interest loans for use in expanding an existing business or attracting new manufacturing facilities or industrial parks, new ethanol plants, industrial parks and many others. These grants and 0% interest loans have the effect of reducing the cost of electricity to the recipient. Using the grants or loans, a cooperative would be able to increase their electric sales in their service area. Privately owned

utilities may have similar programs but they are paid for by the ratepayers and not the federal taxpayers.

There are many electric utility federal operating subsidies provided to electric cooperatives, public power entities, PMAs, TVA but not to privately owned utilities. The cumulative effect of all the subsidies is substantial. The subsidies reduce the operating cost of providing electricity to their customers. These subsidy programs were started in the 1930s when there was no central station electric power available in the areas involved. The subsidies have been and continue to be expanded and increased and now conflict with national electricity policy which is to promote fair and competitive electric markets.

III. Market Value of Federal Electricity Subsidies

From the perspective of fair competitive electricity markets the important question about the 13 federal subsidies summarized in Table 1 is whether they are deep and substantial enough to provide an unfair competitive advantage to the benefiting utilities in either wholesale or retail electric markets or both. One of the more thorough, objective economic studies completed on this subject was done by the economic consulting firm of Putnam, Hayes Bartlett, Inc. and published in 1998. The studies were funded by the Edison Electric Institute. Separate reports were completed for electric cooperatives and publicly owned and TVA. A copy of each study is included in Attachments A-3, A-4, A-5 respectively.

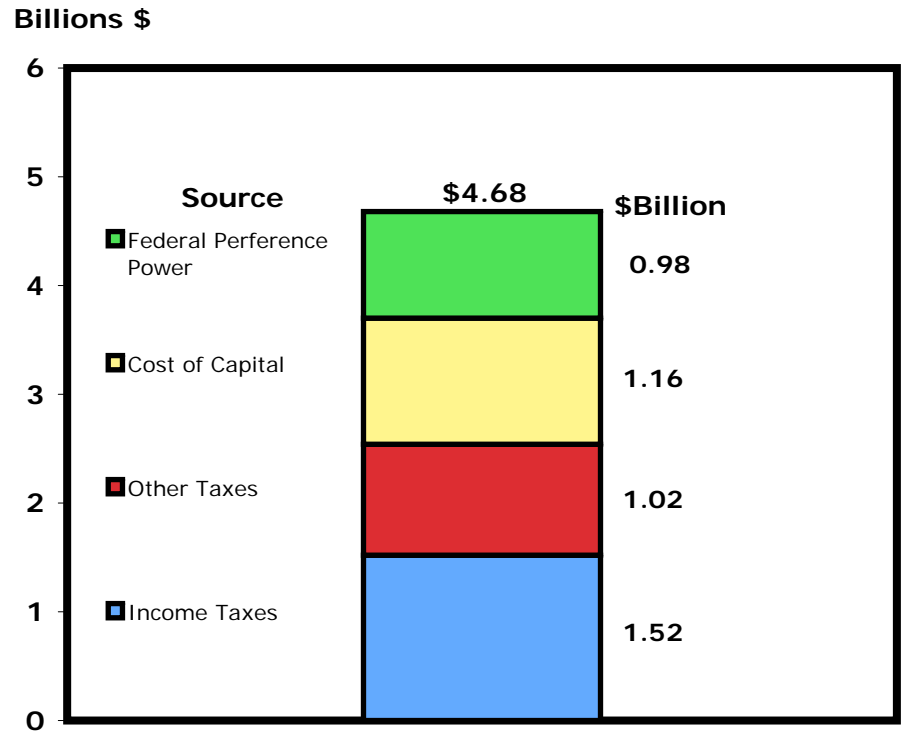
Tables 3 and 4 (next page) include the summarized results of each report. Since the data contained in each report is from 1997, the total value of the subsidies of \$4.68 billion annually for electric cooperatives and \$6.23 billion annually for publicly owned are substantially understated. The reasons include; new federal subsidies have been added or expanded since 1997 (See Table 1, Subsidies C, E, F, I, M) that were not taken into account by the study, the national market share of these utilities has increased making the income tax exemption more valuable(See Table 5), the annual amount of RUS lending has increased over fivefold from less than \$1 billion in 1997 to \$5.4 billion in 2006 Refer to Table 2. The market value of the low cost federal hydropower has probably increased relative to its cost.

As can be seen on Tables 3 and 4, the estimated subsidy per kWh sold by electric cooperatives was 2.17 cents and 1.63 cents for the publicly owned utilities in the 1998 study reports. This level of subsidy is major and would be significant in both wholesale and retail electricity markets.

Federal agency reports on electricity subsidies copiously document there existence and depth and have used similar approaches. These reports include:

- Department of Energy, Energy Information Administration, “Federal Financial Interventions and Subsidies in Energy Markets 1999: Energy Transformation and End Use”, May 2000;

Table 3 Magnitude of Electric Cooperative Subsidies 1998



Increase Required in Cooperative Utility Average Prices to Level the Playing Field

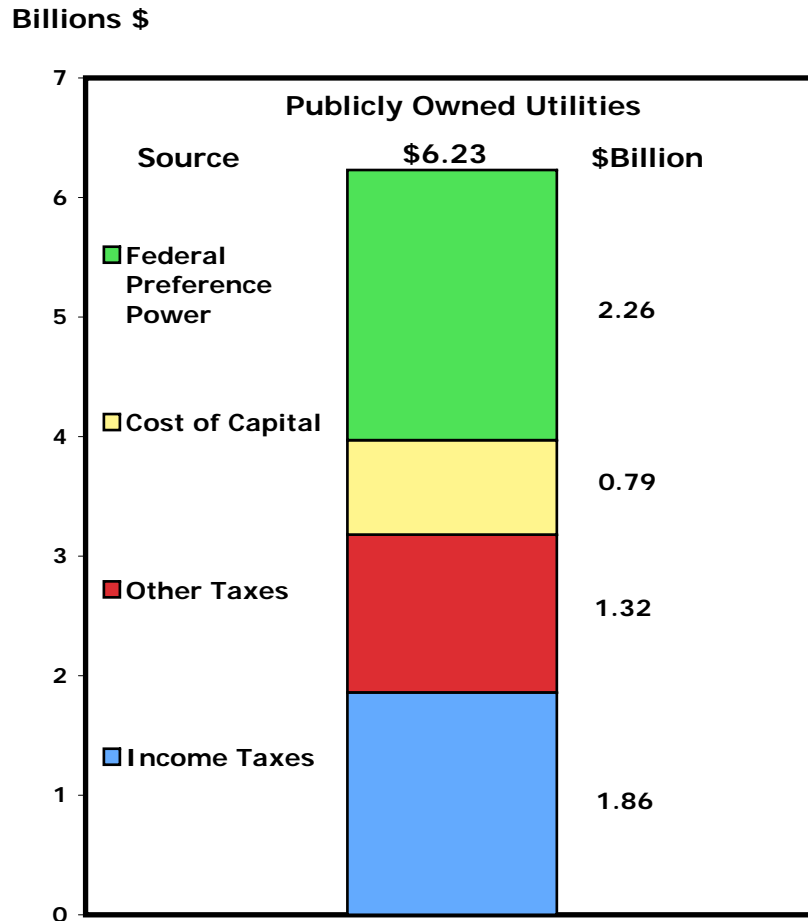
*** Increase in Average Price 2.17¢ kWh**

*** Percentage Increase in Average Price 19%**

Note: Totals may not equal sum of parts because of rounding. RUS loan losses are not included but cumulatively exceed \$13B

Source: Study done by the economic consulting firm of Putnam Hayes Bartlett Inc, "Subsidies and Unfair Competitive Advantages Available to Cooperative Utilities", August 1998, Figure ES-1, Table ES-1 p.IV

Table 4 **Magnitude of Subsidies for Publicly Owned Utilities**



**Table ES-1
Increases Required in
Publicly-Owned Utility
Average Prices to Level the
Playing Field**

Publicly Owned Utilities

*** Increase in Average Price
1.63¢ per kWh**

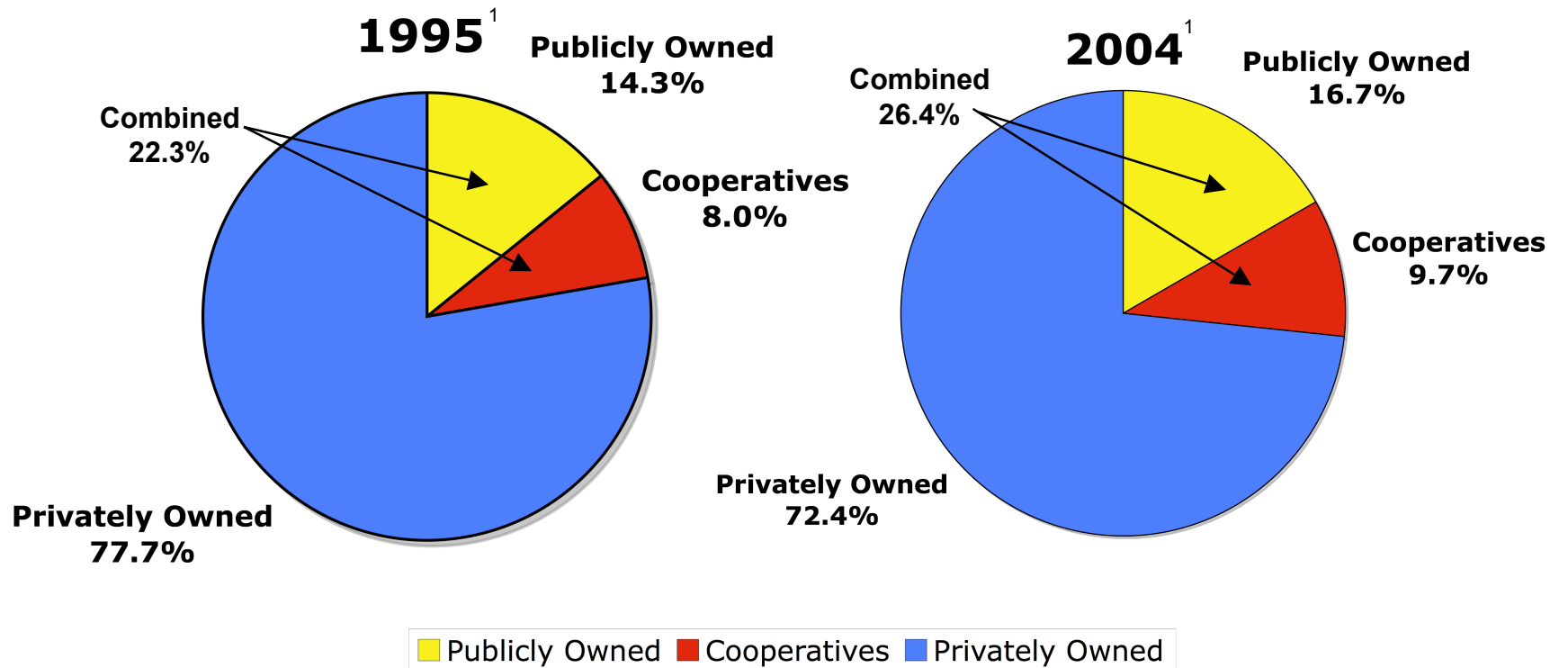
***Percentage Increase in
Average Price 20%**

Note: Totals may not equal sum of parts because of rounding

Source: Study done by the economic consulting firm of Putnam Hayes Bartlett Inc., "Subsidies and Unfair Competitive Advantages Available to Publicly Owned Utilities", August 1998, Figure ES-1, Table ES-1, p.IV

Table 5

U.S. Electric Market Share % By Type Utility 1995-2004 Retail Electric Sales Megawatt Hours



¹ Excludes Federal Share of 1.6% in 1995 and 1.2% in 2004

- Congressional Budget Office, “Should the Federal Government Sell Electricity? November 1997;
- Congressional Research Service, “Restructuring Electricity Markets, Public Power, and Tax Exempt Bonds, An Economic Analysis, June 1998;
- Joint Committee on Taxation, “Federal Tax Issues Relating to Restructuring of the Electric Power Industry”, October 1999;
- General Accounting Office, “Federal Electricity Activities”, 1997, GAO-AIMD-97-110 and 110A.
- Office of Management & Budget, “Estimates of Federal Subsidies Provided to Electric Utilities”, October 12, 1993.

For more reports on federal electricity subsidies refer to Attachment A-1.

The utilities receiving the federal subsidies may disagree with these studies claiming that: the subsidies are nonexistent, or the subsidies are needed to offset higher costs of providing electric service or, that privately owned utilities are deeply subsidized via the federal tax code. I have reviewed a number of their reports over the years and found none were objectively done nor did they provide reasonable measurement of the economic market value of the federal subsidies provided.

IV. Examples of Possible Unfair Competition

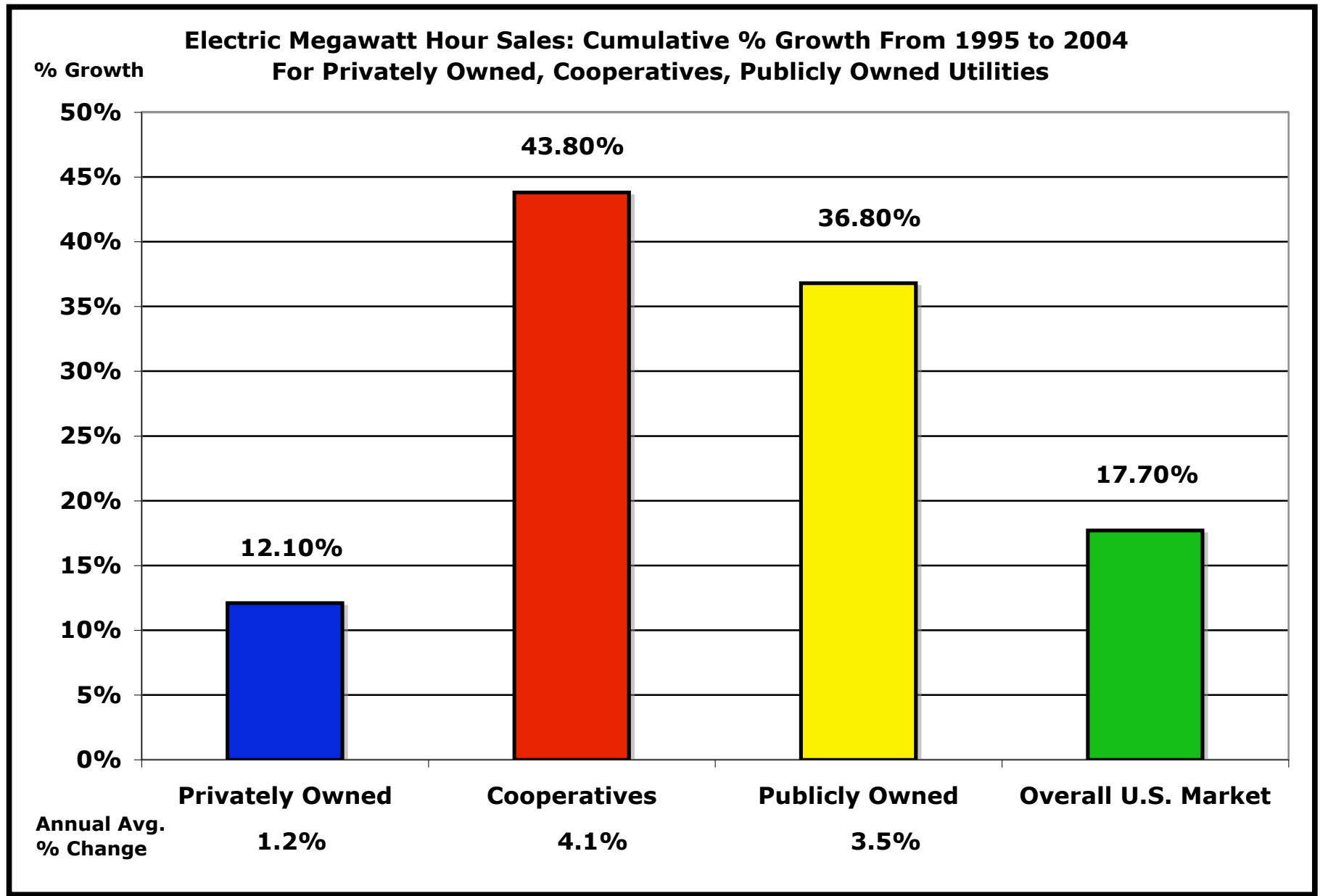
Examples of what appear to be the unfair competition at the wholesale and retail market levels that result federal electricity subsidies are discussed in the following. Several are discussed here to illustrate what appear to be the existing and growing unfair competitive advantages of subsidized utilities in US electricity markets. As more subsidies are added and existing subsidies are expanded and deepen annually by Congress the advantages increase.

Increased National Retail Electric Market Share

Based on DOE, EIA, Electric Sales and Revenue Report data from 1995 to 2004, the publicly owned utilities (excludes PMAs, TVA) and electric cooperatives have increased their share of the national retail market from 22.3% in 1995 to 26.4 % in 2004 on a megawatt hours sold basis. Privately owned utilities (IOU’s and privately owned power marketers) share declined from 77.7% to 72.4 % during the same period Refer to Table 5. A similar pattern of significantly increased in market share using electric sales revenue.

The average annual rate of growth from 1995 to 2004, on a megawatt hours sold basis was 4.1% for cooperatives, 3.5% for publicly owned, 1.2 % for privately owned and 1.7% for the overall US market. Refer to Table 6. If these trends continue over the next ten years, nearly one third of the retail market will be served by either an electric cooperative or a publicly owned utility.

Table 6



Source:DOE/EIA Electric Sales and Revenue Reports 1995-2004

Why are cooperatives and public power providers increasing their market share? The more important reasons include:

- Migration of and population growth in suburban and exurban metropolitan areas. Cooperatives, for example, serve in 31 of 36 metro areas in the US with total population over one million. Refer to Attachment A-6.
- Rapid growth in numbers second homes, retirement homes in recreational, remote areas that are served by cooperatives.
- Conversions or buyouts by public power and cooperatives of privately owned utilities using federally subsidized capital.
- Lower average national retail rates of cooperatives and public power utilities because of federal subsidies. Refer to Table 7.
- Effective use of federal subsidies to expand existing load and to attract new load including manufacturing facilities, commercial development and residential growth. Cooperatives use USDA grants and 0% loans for this purpose. TVA has a well developed new industrial site locator program that has resulted in TVA's direct sales increasing by 46% in the past 4 years. Refer to Attachment A-7.

Time has not permitted completing an assessment of how much each of these factors have contributed to the robust growth rates of the cooperatives and publicly owned utilities. However, the extensive and deep federal electric subsidies appear to be a significant contributing reason.

Average Retail Electric Rates for Selected States

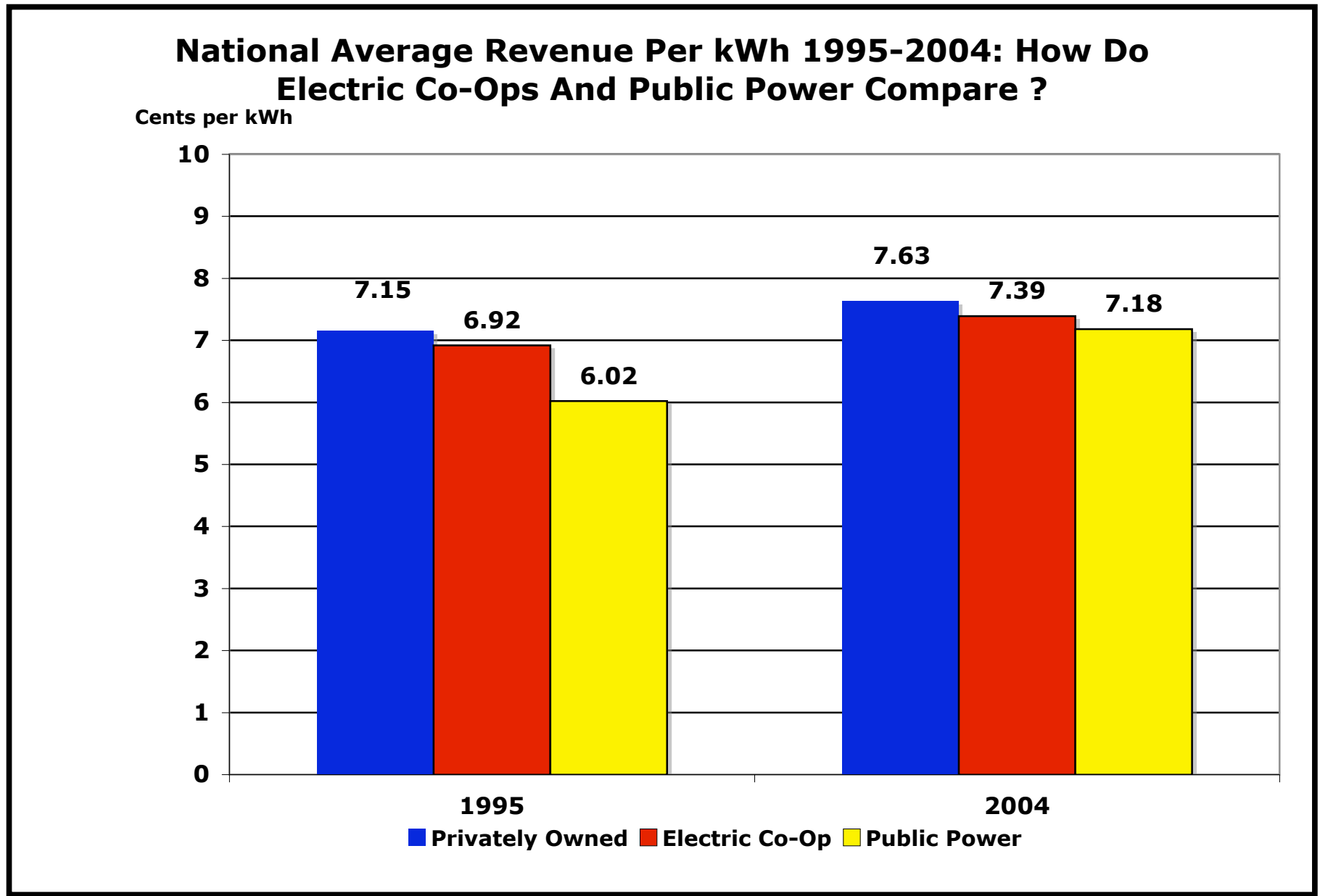
Another way to assess the impact of the federal subsidies is to compare the average retail rates among states that receive large amounts of federally subsidized power versus those that do not. When doing such a comparison one must also take into account the major differences among the regions and states therein for the cost of generation and other factors. But taking this difference into account, the influence of federal subsidies appears apparent and the result may be unfair competition. Shown below are selected states that benefit from extensive federal subsidies and those that do not. The average rates for each state are the average revenue per kWh (commercial, residential, industrial) are from DOE, EIA's Electric Sales and Revenue Report, 2003.

Selected States Without Extensive Federal Electricity Subsidies

▪ CT	11.31 Cents per kWh
▪ MA	11.68
▪ ME	12.37
▪ NH	11.98
▪ RI	11.62
▪ VT	12.82
▪ CA	12.00
▪ NJ	1069

Selected States With Extensive Federal Electricity Subsidies

Table 7



Source:DOE/EIA Electric Sales and Revenue Reports 1995-2004

▪ TN	6.55 Cents per kWh
▪ MS	7.60
▪ ND	6.49
▪ NE	6.47
▪ SD	7.47
▪ OR	7.06
▪ WA	6.31
US Average	8.70

The gap between the two groups of states is quite wide and subsidies do not account for all of the difference but federal subsidies account for a significant amount of it. For example, if BPA auctioned all its power to the highest bidders and provided transmission access where needed would the rates in Washington state average 6.31/kWh and would CA remain nearly twice as high? Do federal subsidies provide the cooperatives and publicly owned utilities in Washington state with a competitive advantage over other states with much higher electricity rates? A recent example of this was contained in an article in discussing how internet server farms are being located in Quincy, Washington because of its extremely low cost of power. 9/

Deeply Subsidized Generation Capacity in US Markets

On page 13, Table 1-5, U.S. Electric Generation Capacity 2004, of the Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy, publicly owned, electric cooperatives and Federal Power Agencies account for 213,305 MWs of capacity which is 20.7% of total U.S. capacity. There is over \$130 billion in outstanding subsidized debt related to this generating capacity and transmission facilities. 10/ This capacity has been deeply subsidized and has a lower estimated capital cost advantage of 28 to 33% for new gas generation and a greater advantage for new coal fired and nuclear generation.

There are unfair competition issues (wholesale and retail) that inherent to this capacity and the substantial amounts of subsidized capacity that is being added or planned to be added. Subsidized capacity is currently being sold into wholesale markets and the amounts are likely to increase in the future for the following reasons:

- A number of power supply cooperatives sell power to other than cooperative purchasers. In addition, the electric cooperatives trade group recently announced that \$35 billion in loans was needed from RUS for new building new power plants seeking \$6 billion in FY 2007 budget. 11/ This could amount to over 20,000 MW of new generating capacity being constructed over the next ten years. One major reason for this construction is the federal subsidies received by cooperatives. For the most part, RUS requires a cooperative to solicit through public announcement its future power requirements. The cooperative then has to evaluate the bid responses and make a determination as to whether their requirements can be met

at a lower cost by constructing newer capacity or buying it. The conclusion is often to build the capacity with a 100% of project cost Treasury FFB loan. Without deep subsidies, most likely far less of the 20,000 MWs planned would be built by cooperatives. This may be unfair competition!

Refer to A-8 for a copy of the RUS regulation section.

Second, the RUS allows a borrower to sell the unused portion (by its cooperative customers) of generation from a newly constructed plant for up to ten years for nuclear and less for coal or natural gas plants. RUS will allow a borrower to build a new unit in excess of its nearer term power requirements as long as future year projections show that the power will be used by cooperative customers. In the meantime this power would be sold into competitive wholesale markets. This appears to be unfair competition!

- TVA lost a lawsuit a few years ago for selling power over its statutory fence established in 1959. However, TVA appears to have a continuing interest in securing the authority to sell power over the fence. If such authority is granted and since TVA's power is subsidized this would appear to be unfair competition if it occurs. Refer to A-7.

Under a competitive market policy, the sale of this power appears to unfair competition because this power is from deeply subsidized generating and transmission capacity. Contrary to what is claimed by some, this power and its distribution cannot be restricted to self contained geographic area fiefdoms that are carved out for public power or cooperative power, etc. Some of this power is being sold into competitive wholesale markets and, in the future, these sales are likely to increase. Finally why would one as a matter of sound competitive market policy agree to a competitive market design structures with large areas that for the most part are based on past regulated monopoly policy.. A strong, competitive, flexible US economy needs a much better market design.

An earlier section contained a discussion of the trends in retail electricity markets and the increased and increasing retail market share of the publicly owned and cooperatives. One reason is lower electricity rates that result from the federal subsidies. Examples of this are the aluminum smelters in the Pacific Northwest, the locating large scale internet server farms in the same area, the competition for new industrial/commercial customer load from the increasingly competitive cooperatives, the success of TVA's new industrial facility sites program that has contributed to the tripling of TVA's direct sale volumes. Refer to A-7, TVA Investor Fact Sheet.

Conversions of areas served by privately owned utilities to areas served by publicly owned and sometimes cooperatively owned utilities.

In recent years, there have been a large number of proposed conversions throughout the United States. Nearly all the proposed conversions are to convert a privately owned

utilities or parts of privately owned utility service area to a publicly owned utility. Various reasons are given in support of the proposal to convert. But one of the most important underlying reasons is lower cost electricity and part of the lower cost would be achieved by taking advantage of the federal subsidies. A few of these conversions have been from privately owned utilities to cooperatively owned and once again federal subsidies were a significant factor.

The point here is that the playing field is not level because of the federal subsidies. In a competitive market that treats all competitors fairly and equally as a matter of policy this biased should not exist.

V. Conclusion/Recommendation

It is the aggregate effect of multiple and deep federal electricity subsidies that could be providing well over \$10 billion annually in economic market value to the publicly owned, TVA, PMAs, and the electric cooperatives. Subsidized utilities have over 20% of all US generating capacity and 26.4 % of US retail electricity sales. The publicly owned and electric cooperatives annual growth rates are about three times the growth rate of privately owned utilities and in just 10 years they could have a third of the total retail sales US market.

One reason for their growth is the cumulative benefit of multiple subsidies. Subsidized utilities have very ambitious plans to expand their generation capacity, transmission and market share---all of which if done will be at major cost to the US taxpayer.

A factual objective report on competition in the nation's electric markets should address this major issue of unfair competition potentially being caused by federally subsidized utilities. The draft report does not.

FOOTNOTES FOR TEXT OF FILING

- 1/ Edison Electric Institute, Statistical Yearbook, 2005, Table 9.5: Detail of Taxes – Electric Department Only.
- 2/ Average rate of return on equity approved by state PUCs for IOUs for 2004
- 3/ FEMA letter dated December 19, 2005 and related emails provided by FEMA to OMB Professionals, Inc. in response to a FOIA request.
- 4/ New Orleans Times – Picayune, “Bailout for Energy – A Shot in the Dark; No Easy Solution in Sight for N.O. Losses”, May 14, 2006, Jeffrey Meitrodt.
- 5/ DOE/EIA Electric Sales and Revenue Report, 2004.
- 6/ DOE EIA, Annual Energy Outlook, Table 73, Line 2324-6.
- 7/ Refer to the DOE website www.DOE.Gov and then to the link to each PMA. The rates are in the individual PMA's annual reports.
- 8/ TVA, 2005 Information Statement.
- 9/ Business Week, “Servers AS High As An Elephant’s Eye”, June 12, 2006. Page 73.
- 10/ The estimated \$130 billion breaks down as follows: RUS \$26.5 billion, TVA, \$23.3 billion, PMAs, \$14 billion, publicly owned \$70 billion.
- 11/ Electric Co-op Today, June 9, 2006, page 5.

Attachments to OMB Professionals, Inc. FERC Filing
Docket No. AD05-17-00

- A-1 List of other federal reports on federal electricity subsidies.
- A-2 “Economic Impact of Federal Subsidies Provided to TVA, PMAs, Publicly Owned Utilities, and Rural Electric Cooperatives on New Power Generation in Competitive Wholesale Electric Markets,” 1999, OMB Professionals, Inc.
- A-3 “Subsidies & Unfair Competitive Advantages Available to Cooperatively Owned Utilities,” Putman, Hayes & Bartlett, Inc., August 1998.
- A-4 “Subsidies & Unfair Competitive Advantages Available to Publicly Owned Utilities,” Putman, Hayes & Bartlett, Inc., March 1998.
- A-5 “Analysis of TVA Subsidies and Artificial Advantages,” Putman, Hayes & Bartlett, Inc., August 1995.
- A-6 “Analysis of Electric Cooperatives Serving Metropolitan Areas with Over 1 Million in Population,” OMB Professionals, Inc. 1999.
- A-7 TVA Website, June 20, 2006, TVA Investor Fact Sheet, TVA article entitled “Customer choice means change”.
- A-8 Copy of the section (Sec. 1710.254) on the RUS power supply lending program regulation that generally requires a prospective borrower to seek market bids for its future requirements.
- A-9 “Estimates of Federal Subsidies Provided to Electric Utilities.” Office of Management & Budget, 1993.
- A-10 “TVA Investor Advantages,” Briefing by John M. Hoskins, TVA Sr. Vice President, January 2006, To the 24th Annual LaSalle Fixed Income Symposium & Exposition.