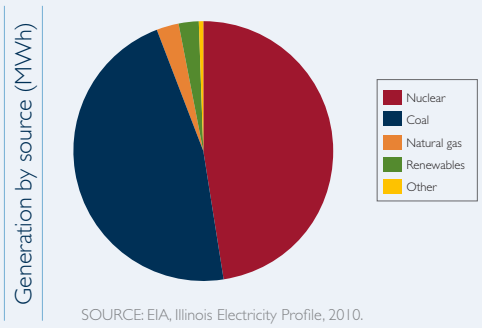
Deregulation in Illinois has—ironically—relied heavily on significant government intervention to control costs and encourage customer switching.

Summary

Illinois is an important state to review in the context of state experiments with electricity deregulation for two reasons. First, the deregulation process was protracted and highly controversial, and included years of legislative debate as well as a high-profile complaint and intervention by the state attorney general. Second, the turmoil associated with deregulation in Illinois—political, legislative, rate volatility, and other—reflected a lack of confidence in the ability of deregulation to ensure affordable, reliable power. This led Illinois policymakers to create new public entities and expanded roles for government in the purchase and sale of electricity in Illinois, essentially adding more regulation. Furthermore, it is not clear whether the recent price trends in Illinois are the result of deregulation, these new roles for government, or simply the result of current low natural gas and wholesale power prices.

History and Profile

- Deregulated in 1999 with commercial and industrial customers
- Regional transmission organization (RTO)/independent system operator (ISO): PJM and MISO
- Organized wholesale energy and capacity markets (PJM) and energy market (MISO), both under FERC jurisdiction
- Electricity sales (MWhs): 144,760,674 (#6 in nation)
- Average electricity price (cents/kWh in 2010): 9.13 (#24 in nation)



SOURCE: EIA, Illinois Electricity Profile, 2010.

Issues

Protracted Deregulation Process

Like many other states, Illinois went through a protracted process to deregulate its electric industry. It began in 1997 when the initial deregulation law was enacted and required the state's two investor-owned utilities, ComEd and Ameren, to spin off their generation to affiliated or unaffiliated companies. ComEd and Ameren continued to provide delivery of power and serve customers that did not select an alternative supplier. Retail access was initially limited to commercial and industrial customers in these service areas but expanded to residential customers.[1]

Deregulation did not take off as expected in terms of customer participation. The decade-long rate cap mandated in Illinois (which ended in January 2007) was one of the longest lasting rate caps in the nation, and it effectively discouraged alternative suppliers from entering the market. Through 2011, switching among residential customers was nearly non-existent. There was, however, a notable increase from 2011 to 2012—from 2% to about 22%, respectively—due in part to municipal aggregation efforts as discussed further below. Initial participation by small to medium-sized non-residential customers was also limited. In 2005, the state cautioned that the rate of switching among these customers was only around 5%. Participation among all types of customers has grown over time, however, particularly since 2011, and current levels are quite high in Illinois. According to the ABACCUS report for 2012, 22% of residential customers, 81% of medium-sized non-residential customers, and 93% of large customers had switched.[2]

TIMELINE

1997—Electric deregulation law passed

1999—Retail access available to some commercial and industrial (C&I) customers

2001—Retail access available to all C&I customers of investor-owned utilities

2002—Retail access available to residential customers

2007—Rate cap expires and prices surge; state attorney general files complaint against wholesale suppliers for market manipulation and excessive power prices; new legislation enacted that mandates $1B in rate relief for customers and creates Illinois Power Agency to procure power

2008—Residential customers first switch to alternative suppliers (participation low)

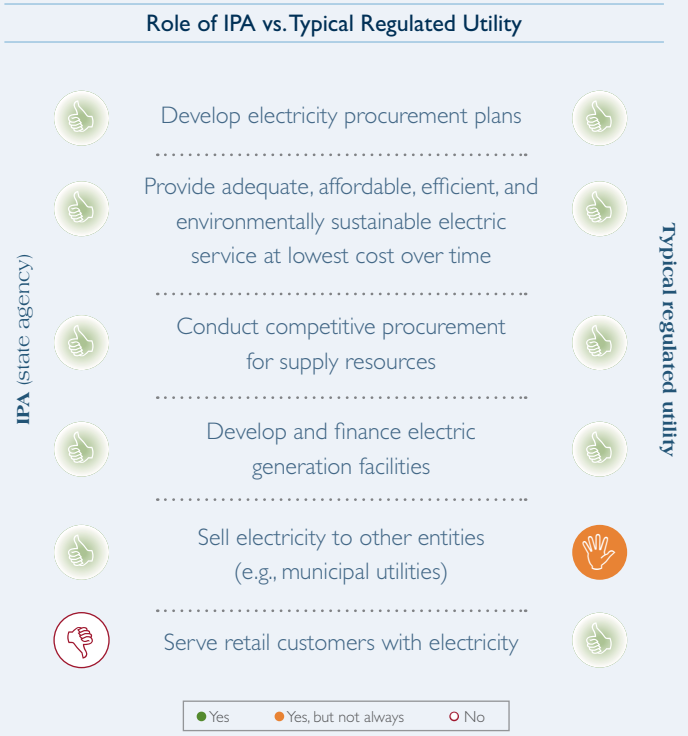
2010—Local governments authorized to aggregate load and solicit bids for sale and purchase of electricity

2012–13—500+ local governments pass referendums for municipal aggregation

Expanded Role for Government

In addition to mandating rate freezes, discounts, and customer refunds during the transition to deregulation, the Illinois legislature stepped in to create a new independent state agency, the Illinois Power Agency (IPA), to oversee the "electricity planning and procurement processes for residential and small commercial customers of Ameren and ComEd."[3] The IPA was created "in response to significant consumer electricity cost increases resulting from a utility-managed reverse auction process."[4] The utility auction process was eliminated as part of this reform and the new agency became responsible for procuring power; ensuring reliable, adequate service at the lowest total cost over time; and developing new resources, including coal, renewable energy, and others financed with state bonds. The legislative charge of the IPA is strikingly similar to the role of a regulated electric utility (see below), including the ability to develop generating facilities, except that the IPA is not permitted to sell directly to retail customers.

The IPA credits itself with lowering and stabilizing electricity prices in Illinois.[5] The agency reported in 2011 that its procurement activities have resulted in $1.64 billion in total savings for consumers since 2009.[6]



SOURCE: Public Sector Consultants using information on IPA's mission and objectives from the *Annual Report FY 2012* and Public Act 095-0481.

Although proponents of deregulation argue that one of the key benefits is providing customers the ability to choose their supplier, many deregulated states have seen limited participation by residential and small commercial customers.[7] In the first decade under deregulation in Illinois, participation by such customers was almost non-existent. In response to these trends and recognizing the need to make deregulation "work," Illinois enacted legislation to promote the ability of local governments to arrange for the sale and purchase of electricity. These municipal aggregation programs effectively allow the local government to make the "choice" on behalf of their residents (and sometimes small businesses). That is, local governments aggregate customers in their respective jurisdictions in order to supply power. Individuals must proactively "opt out" of the program in order to avoid switching their service. The IPA facilitates municipal aggregation by negotiating and supplying the power.

Municipal aggregation in Illinois has been widely adopted but is still new. As of May 2013, a total of 529 communities (including Chicago) passed referendums for municipal aggregation.[8] The 2012 ABACCUS report states that an estimated 60% of "switching" by residential customers in the state was due to municipal aggregation, according to the Illinois Commerce Commission. That percentage appears to have increased since 2012, given the number of local governments with active municipal aggregation programs initiated since 2012 and their associated populations. The state publishes the total number of customers that switch providers, but does not break down switching rates for customers under aggregation versus those that switch suppliers on their own. Nonetheless, there are more households in areas with municipal aggregation (with a supplier under contract) than the total number of residential customers that have switched as of the first quarter of 2013.[9] This suggests that municipal aggregation is driving a large portion of the current switching activity in Illinois.

Of those local governments that have selected suppliers, the rates appear attractive (averaging 4.55 cents/kWh),[10] but these rates were negotiated during a time of depressed wholesale prices and they have limited terms. While the experience with aggregation to date appears positive and has improved the customer "switching" statistics in Illinois, the track record is short. Moreover, aggregation raises important policy questions: Is this an appropriate role for local governments?[11] Will this approach stay in favor once market conditions fluctuate? And will these customers simply return to the incumbent utilities when that happens?

Affordability

Cuts in retail rates of up to 20% were mandated as part of the transition to deregulation in Illinois, and rates were frozen for a decade.[13] Prices surged when price caps expired in 2007, resulting in considerable political turmoil. Customers experienced double- and triple-digit increases in their electric bills in 2007, with allegations from the state attorney general that customers would be paying an extra $4.3 billion from 2007 to 2009 because of manipulation of prices by wholesale suppliers (including affiliates of ComEd and Ameren) in the electricity auction used to set the utility rates under deregulation. The state's complaint alleged that the deregulated generation affiliate of ComEd was charging the utility three times its actual cost to generate electricity to serve the utility's customers.[14]

After considerable squabbling in the state legislature over how to handle the rate increases, the state eventually brokered a deal in 2007 for major rate relief and other reforms with ComEd and Ameren to provide consumer refunds and credits totaling $1 billion. This was used to help offset some of the price increases.

Rate Shock in Illinois

Prices soar from 2006 to 2007 following expiration of rate cap.

ComEd

- 26–56% jump in residential prices from 2006 to 2007
- 60–70% increase for large commercial and industrial customers with some very large customers experiencing increases of over 100%

Ameren

- 49–125% jump in residential prices
- 80–130% increase for large commercial and industrial customers

Illinois has seen electricity prices come down, hovering around the national average—likely a function of the surplus capacity in wholesale markets and low commodity prices.[15] As seen elsewhere, including Michigan, the prices are largely a function of the initial rate freezes/caps and commodity prices, not the market structure (i.e., deregulation).[16] The Illinois Power Agency also purports to have played a key role in stabilizing prices.

> *"Five million Illinois residents are unnecessarily paying electricity prices that are double the actual cost of generating electricity…"*
>
> —Lisa Madigan, IL Attorney General, March 15, 2007[12]

As generation supplies tighten in the eastern United States with the retirement and retrofitting of older coal plants and if natural gas prices increase, regional wholesale prices could escalate and increase retail rates in Illinois.[17]

Conclusion

State and local governments have taken on expanded roles related to the purchase and sale of electricity in Illinois that suggest a fair amount of government intervention under deregulation. The government is essentially serving in critical roles traditionally provided by a regulated utility. This intervention is in response to what appears to be a perceived inability or lack of confidence in deregulation to ensure affordable, reliable service and bring about real competition. The initial trigger for state intervention in power procurement was the alleged market manipulation and excessive prices of wholesale suppliers in 2007. The state played a key role in investigating these issues and ultimately mandated refunds to customers in order to temper these rate increases. For local governments, the lack of customers electing to switch suppliers and the desire to stimulate competition has led to local governments effectively making this decision and negotiating prices for their residents. These state and local government roles bring into question whether this is a truly deregulated industry. Rather, it appears that the framework in Illinois has relied on new forms of market-based regulation, some of which have not been fully tested under alternative market conditions.

Endnotes

1. See Distributed Energy Financial Group, LLC, December 2012, *Annual Baseline Assessment of Choice in Canada and the United States* (2012 ABACCUS: An Assessment of Restructured Electricity Markets). Available: www.competecoalition.com/files/ABACCUS-2012.pdf (accessed 7-1-13). The ABACCUS report indicates that retail access was planned for 2002 for residential customers but moved up to late 1999/2000.

2. Distributed Energy Financial Group, LLC, *Annual Baseline Assessment of Choice*, p. 60.

3. Illinois Power Agency (IPA), *Fiscal Year 2012 Annual Report,* December 1, 2012. Available: www2.illinois.gov/ipa/Documents/Annual-Report-Illinois-Power-Agency-FY2012.pdf (accessed 6-5-13).

4. IPA, *Fiscal Year 2011 Annual Report.* Available: www2.illinois.gov/ipa/Documents/IPA_Annual_Report_2011_final.pdf (accessed 6-5-13).

5. IPA, *Fiscal Year 2011 Annual Report*, Executive Summary.

6. Ibid.

7. Surveys also suggest that, in general, many customers are not interested in selecting an alternative supplier.

8. A referendum is required to determine whether the aggregation shall be structured as an "opt out" program. For a list of communities, see Plug In Illinois, *List of Communities Pursuing an Opt-Out Municipal Aggregation Program* (updated June 28, 2013). Available: http://pluginillinois.org/MunicipalAggregationList.aspx?ob=1(accessed 7-1-13).

9. Illinois Commerce Commission, April 29, 2013, Electric Switching Statistics as of March 2013. Available: www.icc.illinois.gov/electricity/switchingstatistics.aspx (accessed 6-24-2013). Over 2.8 million customers have switched providers as of March 2013 and the number of households within areas with municipal aggregation with suppliers selected exceeds 3 million based on the 2010 U.S. Census. See also Plug In Illinois, *List of Communities Pursuing an Opt-Out Municipal Aggregation Program*.

10. Average calculated by Public Sector Consultants.

11. The IPA cautions local governments that "This is a multi-million dollar contract on behalf of constituents: protections for you (the municipality) and residents beyond the minimum in the law are desirable—and potentially necessary." Illinois Power Agency, March 2012, *Illinois Municipal & County Electric Aggregation: What Do I Need to Know?* (Web conference presentation). Available: www2.illinois.gov/ipa/documents/MunicipalAggregationMarchWebinarIPAPresentation3-12-12.pdf (accessed 6-13-2013).

12. Press release, March 15, 2007, "Attorney General Madigan Alleges Price Manipulation in 2006 Electricity Auction: Complaint Seeks Reduction in the Price ComEd and Ameren Pay for Electricity." Available: www.illinoisattorneygeneral.gov/pressroom/2007_03/20070315.html (accessed 7-2-13).

13. Distributed Energy Financial Group, LLC, May 2006, Annual Baseline Assessment of Choice, p. 57; Illinois Commerce Commission, *Competition in Illinois Retail Electric Markets in 2005*. Available: http://ipu.msu.edu/resources/pdfs/Commission-Reports/IL-Competition%20in%20Illinois%20Retail%20Electric%20Markets%20in%202005.pdf (accessed 7-1-13).

14. Complaint by the People of the State of Illinois, Illinois Attorney General Lisa Madigan v. Exelon Generation Company, LLC, et al., March 15, 2007, p. 10. Available: www.illinoisattorneygeneral.gov/pressroom/2007_03/FERC_Complaint_public.pdf (accessed 7-15-13).

15. Potomac Economics (Independent Market Monitor for MISO), June 2012, *2011 State of the Market Report for MISO Electricity Markets*, pp. i-v. Available: https://www.midwestiso.org/Library/Repository/Report/IMM/2011%20State%20of%20the%20Market%20Report.pdf (accessed 6-6-13).

16. See Public Sector Consultants, November 30, 2006, *Electricity Restructuring in Michigan: The Effects to Date of Public Act 141 and Potential Future Challenges*. Available: www.pscinc.com/Publications/tabid/65/articleType/ArticleView/articleId/225/Electricity-Restructuring-in-Michigan-The-Effects-to-Date-of-Public-Act-141-and-Potential-Future-Challenges.aspx (accessed 7-1-13); see also Joint Response from DTE Energy, Consumers Energy, and MEGA, on Overall Question 1 (Structural Drivers of Electric Rates) and Electric Choice Questions 9 and 11, April 25, 2013. Available: www.michigan.gov/energy/0,4580,7-230--293322--,00.html (accessed 7-2-13).

17. Potomac Economics, p. v. See also, Monitoring Analytics, LLC (Independent Market Monitor for PJM), State of the Market Report for PJM, May 16, 2013. Available: www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2013/2013q1-som-pjm.pdf (accessed 6-6-13).

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