Rigged electricity market strikes Illinois

The state has an oversupply, but prices have increased 142-fold

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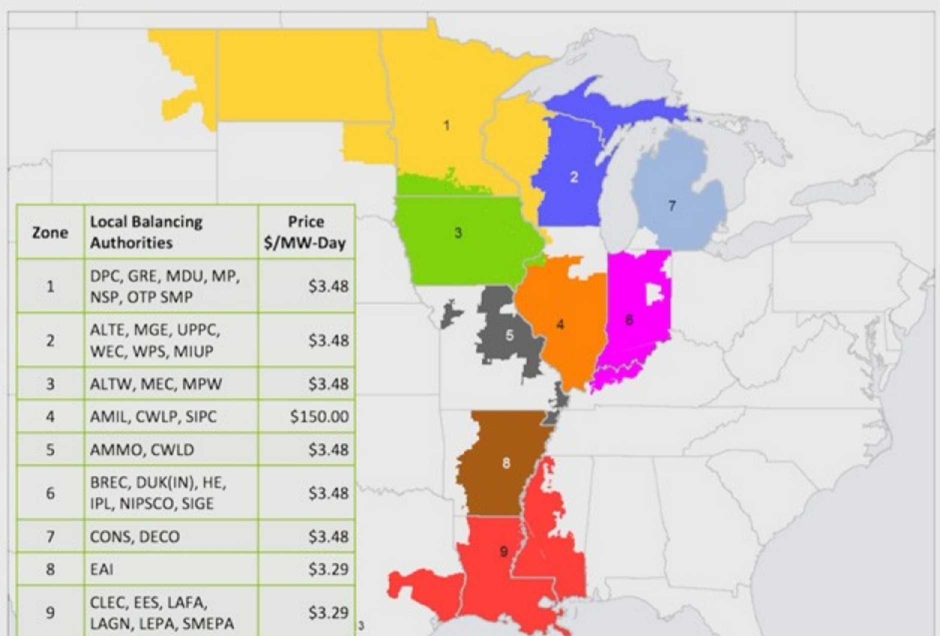
Everyone knows prices should fall when supply exceeds demand. That's economics 101 So how do we explain an April electricity auction with abundant supply in which prices increased 142-fold?

Two years ago, the price to guarantee that central and southern Illinois electric power plants would be available when needed — what's known as the capacity market — was $1.05 per unit of power. It rose to $16.75 in last year's auction and in April soared to $150.

The $150 applies to Zone 4 of the Midcontinent Independent System Operator (MISO), which runs the so-called market for 15 states and parts of Canada. The highest price in MISO's other zones was less than $4.



2015/2016 Auction Clearing Price Overview

Zone	Local Balancing Authorities	Price $/MW-Day
1	DPC, GRE, MDU, MP, NSP, OTP SMP	$3.48
2	ALTE, MGE, UPPC, WEC, WPS, MIUP	$3.48
3	ALTW, MEC, MPW	$3.48
4	AMIL, CWLP, SIPC	$150.00
5	AMMO, CWLD	$3.48
6	BREC, DUK(IN), HE, IPL, NIPSCO, SIGE	$3.48
7	CONS, DECO	$3.48
8	EAI	$3.29
9	CLEC, EES, LAFA, LAGN, LEPA, SMEPA	$3.29

(Source: MISO)

Midcontinent Independent System Operator (MISO)

Demand totaled eight of the zone's more than 13 megawatts of generating capacity. Economic theory holds that in a competitive market the $1.05 price from two years ago should be flat or falling, perhaps to mere pennies. Instead, the auction will cos the typical Zone 4 residential customer $130 more over the next 12 months.

capacity auction prices absurd. “This is another sign that the electricity market is not working for Illinois consumers, and we need to get to the bottom of it,” Kolata said. CUB urges people to send petitions to the Federal Energy Regulatory Commission (FERC).

Perverse signals

Zone 4’s price spike was especially curious, because it has an abundance of coal- and uranium-fueled plants that must run flat out around the clock. That augurs lower prices. So how could prices spike to $150 despite a massive oversupply of power? The simplest and most obvious explanation is that the auctions MISO and other regions use to price electricity are not really markets, but schemes to generate massive profits at the expense of customers.

The problem begins with flawed economic dogma that clueless legislators enacted into law. Numerous auction results show that high prices send a perverse signal: Restricting the capacity to generate electricity maximizes profits.

Next is the problem of market rules to prevent manipulation. The rules are weak and so easily gamed that even with abundant supply, the Zone 4 auction produced huge price increases.

Regulators are supposed to be on the lookout for signs of manipulation. Those signs are as bright as the Las Vegas Strip at midnight. But the regulators, many of whom come from the energy industry, wear sunglasses at night.

Three petitions call on FERC to throw out the auction results. Lisa Madigan, the Illinois attorney general, and the consumer group Public Citizen say that the $150 price violates the cardinal principle of utility law: “just and reasonable” prices for consumers balanced by “just and reasonable” profits for owners. By contrast, the $150 capacity charge was “highly excessive, unjust, unreasonable and unduly discriminatory,” Public Citizen asserts.

FERC’s new chairman, Norman Bay, must abandon the pro-utility and anti-customer policies of his predecessor.

Public Citizens' brief quotes Zheng Zhou, MISO's manager of economic studies, who expressed concern over the Houston electricity company Dynegy Inc. expanding its fleet of power plants so that it owns half the Zone 4 generating capacity.

Zone 4 demand cannot be met without power from Dynegy. This means Dynegy can orchestrate its bids to inflate the clearing price to such a high figure that even if some of its eight power plants lose out, the overall fleet will enjoy robust profits.

Dynegy threatened to switch from MISO to PJM, another so-called market, "unless MISC changed its capacity-market rules to more closely align with PJM's far more lucrative arrangement," Public Citizen's brief stated. Dynegy maintains that the oversupply of capacity in Illinois will soon turn into a shortage as existing plants are retired unless capacity prices are raised.

Robert McCullough, a utility economist hired by Attorney General Madigan, explained in an affidavit that two-thirds of Zone 4 capacity is needed to meet demand and Dynegy owns half of total capacity, so the market cannot be fully served, or cleared, without Dynegy. That makes Dynegy the pivotal supplier, giving it leverage over pricing.

"A pivotal supplier is effectively equivalent to a monopolist," McCullough writes. "Since th market cannot clear without its participation, it can set whatever price it chooses."

McCullough's affidavit could be used in any first year economics course to explain the difference between the theory of markets setting prices and the reality of how corporations lobby for government rules that let them drive up prices.

Just and reasonable?

Dynegy spokesman Micah Hirschfield replied that the company "follows and respects all the rules, tariffs, and obligations in the markets and areas where we operate. Dynegy offered all of its megawatts" in the auction and noted that Independent Market Monitor declared "the auction results are reliable and participants' behavior was in line with all tariff rules and procedures."

That is entirely true. The problem is that it ignores Dynegy's inherent power to set the price because demand cannot be met, known as clearing the market, without Dynegy power plants, which means Dynegy's bids set the price.

In theory electricity markets should produce better prices than government regulation of monopoly electric utilities that both generate and deliver their own juice. But so far the empirical results show power is cheaper and more investment takes place in states with traditional regulation.

One solution to auction-price manipulation would be limiting ownership in each market to a single power plant, since any bid that was too high would result in zero revenue for that owner. Another solution would be to allow fleets of plants, but only groupings too small to manipulate prices.

FERC's new chairman, Norman Bay, must abandon the pro-utility and anti-customer policies of his predecessor, Cheryl LaFleur, who continues serving as one of the five commissioners. Fortunately, there are signs that he will do so. Bay is the former FERC enforcement director, while LaFleur is the former CEO of the National Grid electric utility.

I will continue to keep a close watch on whether Bay lets such institutionalized corruption in the electricity markets continue or stops it by adopting new auction rules that actually implement the "just and reasonable" standard.

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