Top wholesale power rates lead to jolts

Texans often receive high bills from replacement providers

By TOM FOWLER

Sixty miles separate Richard Thompson's northwest Houston home from the Newgulf power plant in Wharton County, but for much of June it might as well have been plugged directly into his backyard electric meter.

Thompson was one of thousands of Texans moved to higher-priced power plans on an emergency basis in the last two months when their providers went out of business. According to state rules, the rates charged by replacement providers can be based on the prices power plants like Newgulf and others bid into a small segment of Texas' wholesale power market.

Overnight Thompson's price per kilowatt-hour went from 11.8 cents with the now-defunct retailer National Power to 31.7 cents with CPL Retail Energy. During the 19 days last month he had to wait before he was switched to a lower priced plan, he ran up a $385 bill.

"I absolutely did not expect to pay that much for service," Thompson said. "I really felt that the rate should have been more reasonable."

On a number of occasions in recent months, power from Newgulf, operated by Houston-based Suez Energy, has been sold at the highest rate allowed by state law, $2,250 per megawatt-hour, according to data released by the Electric Reliability Council of Texas, the state's grid operator. That includes June 2, when Thompson was facing his highest rates.

Suez acknowledges the price it bid into the wholesale market was well above where that market typically trades — in the $100 to $200 range on most days.

But the Newgulf plant can only operate for about 800 hours per year because of environmental regulations and needs to recoup its costs in a relatively short period. The bids were only accepted for short periods, too, for a few 15-minute intervals.

The strategy isn't prohibited by ERCOT, and Suez isn't the only power plant operator to bid at the market cap. In fact, it's intended to encourage the development of more power plants to feed growing demand, according to observers.

But when combined with the recent spate of retail company failures it can leave individual customers exposed to the full force of highly volatile energy markets like no other power market in the country.

Five failures

Five retail electric companies in Texas have been forced out of business since May for a combination of reasons.

Wholesale prices have risen because of the run-up in the price of natural gas, Texas' main generation fuel. Some companies failed to hedge properly against those increases by entering into long-term wholesale contracts. And sudden price spikes sent some cash-strapped companies scrambling to meet financial obligations to the grid operator.

The large price spikes, which first showed up in April but struck repeatedly in May and June, were fueled mainly by weaknesses in how ERCOT manages power line congestion. Officials have since made system tweaks that appear to have kept the spikes at bay.

But for the 40,000 customers whose retailers went out of business, the damage was already done. Under a system designed to avoid power disconnections, customers were transferred to a handful of retailers — called providers of last resort — that agree to take on customers on short notice in such circumstances.

Since those retailers might have to handle sudden influxes of new customers by buying power on the daily spot market — rather than through lower-cost, long-term contracts — they are allowed to charge a rate based on the full price of the spot market plus a 30 percent premium.

Not every provider of last resort charged the full price allowed during the recent spate of company failures. Reliant Energy, for example, gave customers a rate around 21 cents per kwh. But most consumers still were exposed to the same fierce market that helped bring down their former electric providers.

While the price of electricity has climbed in many states this year, the prices in Texas are among the highest because of the way its market is structured.

Texas' wholesale market pays all providers the highest bid accepted at auction, even if they bid lower. Other states use similar systems, but Texas producers went on a building spree of gas-fired plants in the 1990s, when natural gas was cheap. More than half of the state's power plants now run on gas, which has gone from as low as $4.25 per British thermal unit in 2006 to more than $13.50 earlier this month.

Wholesale and retail prices have followed suit.

More significant, however, is that in most regions of the country, power companies are paid a fee simply to have plants available, even if they aren't running. These so-called "capacity payments" are not large — $40 to $60 daily per megawatt, for example, in an 11-state region running from New Jersey through Virginia called PJM. This is called a capacity market.

In Texas the Public Utility Commission decided to operate an "energy-only" market. Instead of a guaranteed minimum payment for generators, power plant operators can bid to offer power to the system at prices as high as $2,250 per megawatt. Most of the time such a bid wouldn't be accepted, but in times of high demand it might.

Charles Griffey, senior vice president for market design and regulatory affairs for Reliant Energy, draws an analogy to flood insurance in comparing capacity and energy-only markets.

"A capacity market is like insurance you pay a premium for every year. In an energy-only market, you just pay the cost of the flood event during the one in 10 years when it occurs," Griffey said.

Capacity markets are less volatile, but they also are less efficient and may appear to cost ratepayers more day to day because of the regular payments for power that isn't needed.

Energy-only markets are designed to induce power plant operators to build that extra capacity because of the potential for big profit during periods such as a Texas summer when that extra power is in demand.

Vulnerable to manipulation

But such markets also are vulnerable to price manipulation.

Robert McCullough, a Portland, Ore.-based consultant who works for utilities and their customers involved in electricity disputes, says the energy-only market could tempt market manipulation efforts, such as generators withholding power from the grid to narrow the gap between supply and demand and make it more likely a high bid will be accepted.

He points to Project Stanley, a scheme carried out by Enron and other companies in the late 1990s when the Canadian province of Alberta opened its wholesale power markets to competition. Officials there allege that the companies conspired to withhold power to make it appear that the supply and demand of Alberta's electricity system was off balance.

One company then drove up the price with "hockey stick" bids — a large amount of power bid at one price followed by a relatively small amount of power at a much higher price, which appears on a graph as a steep upward line like the profile of a hockey stick.

When the market accepted the much higher price, all generators, including those who bid lower, reaped the benefits.

McCullough said he isn't accusing any companies of manipulation in Texas.

Rob Minter, head of government and regulatory affairs for Suez, said his company's bids — which included the $2,250 per megawatt bid for just 10 megawatts on June 2 — are legitimate efforts to get the best price for power from a plant that is limited in how often it can run.

The company typically operates the Newgulf plant during what the industry calls the "shoulder months" in the spring and fall, when many power plants are down for maintenance but demand still can soar with Texas temperatures.

"Those are the days when we might be most likely to be called on," said John Henderson, Suez's head of merchant management. He said the company likely will lose money on some of those days if its bids aren't accepted but make it up on days when it bids successfully.

'Play the lottery'

Dan Jones, ERCOT's independent market monitor charged with policing the state's power system, said he's more concerned about companies withholding power from the market than hockey-stick bids.

In fact, TXU Energy was accused by the PUC of withholding power in 2005, a claim it has denied and is fighting in court.

Jones also said bidders at the market cap run a risk of pricing themselves out of the market and losing money. "If they're willing to play the lottery like that every now and then, they're allowed," Jones said.