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You Are Too Stupid To Understand Electricity Prices Say Utilities CEOs

Jay Yarow | Mar. 12, 2009, 12:23 PM |  2Tags: [Electricity](#)

The market for electricity might be more dense and secretive than the financial markets [argues EE News today in a story](#) about rising electricity prices in Connecticut. They're not kidding, check out the explanation of how electricity's price is determined in New England:

For more than a century, electricity prices were regulated to cover utilities' costs and yield a reasonable profit. In New England, as in other managed energy markets, short-term wholesale electricity prices are determined in a competitive bidding process, with generators offering various amounts of power at prices they choose. Prices also rise when congestion on power lines prevents cheaper power from reaching New England. That congestion factor is added to the bidding through a "locational marginal pricing" formula.

Put simply, ISO New England -- the region's grid manager -- chooses the lowest bid first, then the next lowest, and so on up the "stack" of bids, until there are enough bids to supply the power needed for each hour of the day. Generators are expected to bid the immediate "marginal cost" of producing one more unit of power based roughly on their operating costs, says McCullough. The highest bid selected "clears the market," and all generators selected receive this price regardless of what price they bid.

This bizarre system is perfect for being gamed. Some providers put in excessively high bids to create windfall profit opportunities. The most disturbing thing of all is that consumers have so little control over what happens to electrical prices.

The story quotes multiple executives saying electricity pricing is "complicated." Darn right it is. But because utilities won't clearly explain what's happening, perhaps for fear of being exposed, consumers are expected to just accept on face value what's happening to them. With the coming changes in energy, consumers might not accept higher prices for much longer.

But complexity means that when electricity prices rise, consumers are left with "trust me" assurances from regulators and monitors, market critics say. And when prices go really high, a backlash has followed against the system itself, as in Connecticut's case.

Consumers will face dramatic electricity price increases again if plans proceed for a huge buildup in renewable energy, expansion of the transmission grid, and a cap-and-trade regime to control greenhouse gas emissions, industry leaders warn. The market for a cap-and-trade system has the potential to add another byzantine layer of rules on top of already complex wholesale electricity markets today. That could accelerate public bafflement and outrage as prices rise.



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Rich H said:

Mar. 12, 12:29 PM

Where is Obama on this injustice? Nothing? Did they all vote for him too?

Ratepayer said:

Mar. 13, 9:26 AM

It's called marginal pricing. If there are 10 seafood restaurants in Boston, all serving lobster, and enough people to fill 7 restaurants want lobster, are willing to pay up to X, and they choose where to dine based on price alone... then the 7 least expensive lobster places will be full and the last three, empty. The equilibrium price for a lobster dinner is set at the seventh restaurant and the first six could raise their prices up to that price without impacting demand. That's the same as how this works.

In business, you're allowed to take advantage of producing at a cheaper price... you sell at the prevailing market price. This isn't some evil conspiracy - it's established and commonplace economic theory - marginal pricing.

Furthermore, plants don't control the commodity prices of the natural gas they buy and burn any more than you control gasoline prices when you fill up your sedan at the local station. It's a global commodity market.

I do understand the frustration with rising costs. However, the productive reaction is to reduce demand and focus on new supply.

