Obscure electricity charge enriches power sellers

By Jay Hancock
October 24, 2010

A few years ago, grid administrators outside Philadelphia changed the rules for selling wholesale electricity in such a way that Maryland consumers will end up paying an extra $5 billion or so for their kilowatts from 2007 to 2014. More than half of that — almost $3 billion — is coming from customers of Baltimore Gas & Electric.

If a $5 billion tax had been enacted, there would have been a loud public debate. But unlike a proposed tax, what we can call the Maryland electricity surcharge was never discussed or approved by elected officials. Instead, it was set up behind closed doors by technocrats heavily influenced by the companies that generate and sell electricity.

If people knew where the money goes, a debate might be acrimonious. At least taxes pay for fire departments, homeland defense and other items that benefit the public.

The $5 billion Maryland electricity surcharge, on the other hand, is extra profit for Constellation Energy, Mirant Corp. and other generation companies that operate in this state and nearby.

The money was supposed to lure those companies and others to build generation plants, thus easing electricity shortages.

But the generators haven't been built. At least not in Maryland. The theory has failed here.

Meanwhile, the surcharge is costing the typical BGE household an average of $175 per year, according to a calculation I made with the help of the Maryland Office of People's Counsel, which represents consumers in utility matters. That'll go up to $240 from mid-2013 to mid-2014. (I'll discuss this number and others mentioned in this column — they're derived from PJM, regulators and independent consultants — on my blog: baltimoresun.com/hancockblog.)

This surcharge is buried in your monthly electricity bill. But it doesn't pay for electricity. It doesn't pay for poles and wires or meter readers. It's mostly pure profit for generation companies — on top of the profits they already make for selling you electricity, industry analysts say.

"It is a joke," says Robert McCullough, an economist and energy consultant hired by the Illinois attorney general to analyze similar electricity charges in that state. "We can say without any question that it is completely outlandish."

The Maryland electricity surcharge, the subject of Public Service Commission hearings a few days ago, is another way in which electricity deregulation has hammered consumers and businesses.

In 2006, BGE households got hit with the notorious 72 percent price increase. The next year, the generation surcharge, approved by federal regulators to achieve what the industry likes to call "revenue adequacy," raised BGE prices even higher. More recently, the surcharge has kept electricity costs from falling as far as those for other kinds of energy.

"I don't think it's a good deal for consumers," says James F. Wilson, an energy economist who has analyzed the surcharge in detail. "I can't think of any other industry where people fret about 'revenue adequacy.' To me that sounds like money."

The surcharge was created through PJM Interconnection, a nonprofit organization in Valley Forge, Pa., which manages the grid in Maryland and a dozen other states. Working closely with energy companies, PJM sets the rules for the wholesale market in which BGE and other utilities buy electricity to resell to end users.

Starting in 2007, PJM radically changed how utilities pay to reserve time at generation plants to ensure that they'll have access to megawatts. (Think of a personal seat license at M&T Bank Stadium. You pay once to claim the seat and again to use it.)

Instead of locking up generation capacity several months in advance, utilities had to bid for it three years ahead of time. New auction rules also ensured that generation capacity would become extra expensive in areas that import large amounts of electricity from other states. Few regions rank higher in megawatt imports than BGE territory.

People were shocked when the first auction results became known in 2007. Capacity prices spiked tenfold.

Don't worry, said PJM. This is the way it should work. The sticker shock would "send pricing signals that will attract investment in new capacity resources where they are most needed," PJM executive Andrew Ott said at the time. And that would make capacity prices and generation prices go down.

But it didn't happen. There have been no major generation plants built or started in Maryland. The recent collapse of plans by Constellation Energy and EDF Group to build a third reactor at Calvert Cliffs underscores the failure.

While high capacity prices have induced some users to cut electricity use (that's capacity, too, as far as the grid is concerned), central Maryland still imports a huge amount of electricity. And in the capacity auction for 2013 and 2014, prices to be paid by consumers rose to near-record highs.

The extra money, meanwhile, became a rich flow of gravy for generation companies such as BGE parent Constellation, which owns major plants in Maryland. Without lifting a finger except to lobby PJM, the companies got a whole new source of revenue.

"Capacity Market Auction Results Are Bullish" for Constellation, wrote a Citigroup analyst after the first results became available in 2007. Nothing has changed. Constellation recently boosted its profit outlook because of "better than expected [capacity] auction results." Constellation and Mirant are among the five "biggest winners from the step-up in capacity pricing," Credit Suisse analysts wrote this year.

Defenders would have you believe that the surcharge is the product of impersonal, beneficial market forces.

"It's not like we made an arbitrary rule change that cost Maryland more money," Ott, PJM's senior vice president for markets, said in an interview. "There's a physical limit to the system," he said, and that raises the price of capacity in places where it is scarce.

"The current auction process does a better job of capturing the true cost of electricity capacity," says Martin V. Proctor, Constellation's senior vice president for energy policy. "It benefits everyone to know the real price for electricity."

This is a crock. A price determined by a highly stylized auction, following arcane rules and assumptions, which constantly change under the influence of the sellers, is not the real price. For example, PJM overestimated electricity demand in recent years, causing customers to pay through the nose for future capacity that wasn't needed.

Like love and patriotism, the free market is often invoked as cover for mischief and abuse. But there is no free market in electricity.

Free markets need competition, but Constellation and Mirant control 85 percent of Maryland's generation. Free markets need ease of entry for suppliers, but getting permits to build a Maryland electricity plant takes years. Free markets need good information for buyers, but PJM is a black box.

No free market worthy of the name would require hundreds of bureaucrats in Valley Forge to administer it. Capacity payments? Other industries haven't even heard of them.

There is "some frustration on our side of things in terms of understanding how all this is supposed to work," PSC Chairman Doug Nazarian said at the recent hearings on capacity payments.

He's being coy. The commission understands very well that capacity payments aren't working, that Maryland families and businesses are paying billions — call it a tax, call it a surcharge — for nothing.

Maryland electricity isn't really deregulated. It's just regulated in a different way — a way that stacks the deck for power sellers. With no response from federal regulators to fierce protests over the capacity surcharge, it may be time for Maryland to take control of its future by ordering up its own electricity plants.

Article URL: http://www.baltimoresun.com/business/bs-bz-hancock-psc-grid-hearings-20101024,0,5744251.column