The messed-up wholesale electricity market

By Jay Hancock,
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Tomorrow's column calls on Maryland authorities to stop totally relying on the deregulated wholesale electricity markets and look closely at ordering BGE and other utilities to buy megawatts directly from private companies that will build new generation plants. We've been abused by deregulation for 10 years; it's time for the state to start determining its own fate. The column grew out of a symposium last week in Washington sponsored by the American Public Power Association, trade group for government-owned utilities, which has been very good about identifying and criticizing deregulation problems.

I kicked off the day by summarizing the woes of Maryland and BGE customers under deregulation. (As usual in these situations I got no compensation from APPA for the talk.) Here are my notes from the speech:

"Improving RTO markets." That’s an optimistic title for this symposium. I can’t tell you so much how to improve them, but I can tell you how screwed up they are from the perspective of Maryland.

For a decade Maryland residential and commercial ratepayers have been dealing with botched deregulation and a wholesale market that is sharply tilted in favor of incumbent generation companies and speculators. Between them deregulation and the flawed PJM market have cost Maryland tens of billions of dollars in excess electricity charges.

Like other states we had the Enron lobbyists, we had the blue-sky portrayals of falling prices and surging investments. But of all the states that deregulated, Maryland had about the lowest electricity prices. So it had the most to lose. My memory could be bad but I think BGE residential prices were about 7 cents/kWH, bundled.

We had a decent fleet of regulated coal and nuclear plants that were sold to Mirant, in the case of Pepco, and transferred at book value to an unregulated affiliate in the cast of BGE. Instantly Marylanders became much more exposed to the vagaries o the PJM wholesale market, subject to price caps that expired after a few years.

The BGE case was particularly galling because parent Constellation Energy collected $1 billion in stranded costs for the Calvert Cliffs nuclear plants, then saw the fair value of the plants double or triple as the decade progressed. In the latter part of the decade, thanks to PJM’s single clearing price and the energy bubble, natural gas was setting the marginal price for megawatts much of the time in PJM.

As a result, Constellation was selling nuclear-generated electricity that cost perhaps 3 cents kwh to produce for 9 or 10 cents. In the days of regulation that low cost would have been passed on to ratepayers. In the days of deregulation and RTOs Constellation shareholders raked off huge economic benefits. And of course the stranded cost-charge, the argument that nuclear plants would prove to be uneconomical in a deregulated environment, was proven one of the biggest crocks ever foisted on the public. But it was too late to do anything about it.

But this so-called “dark spread” between nuclear generation costs and the RTO clearing price was only one way Maryland electricity customers have been getting abused.

Marylanders are paying billions extra in what to my mind are unwarranted capacity charges to incumbent generation companies. Some of you may be familiar with PJM’s adoption of a forward capacity market a few years ago. In a highly stylized, artificial auction process, capacity prices soared after the new regime was adopted, especially for central Maryland, where there are generation shortfalls and transmission constraints.

I figure PJM capacity charges are costing a typical BGE residential customer $175 a year, again, enriching incumbent generators while doing little to solve central Maryland’s capacity problem. The promised new generation hasn’t appeared. Capacity prices haven’t come down. We’re paying through the nose.

Total, all-in prices for residences went over 12 cents per kilowatt-hour in 2008.

I guess it’s hard to blame the generation companies. Why should they build new capacity when it would mess up the present system in which they get paid for merely existing? But it demonstrates a highly flawed wholesale system -- I won’t call it a wholesale market because, as Robert McCullough keeps pointing out to me, real markets don’t require 400 PJM bureaucrats to set the rules.

We need to talk about PJM volatility and risk affecting innocent civilian ratepaying bystanders. A few years ago a New York hedge fund had a trade blow up that ended up sticking PJM members with $80 million in extra costs. In this instance the fault wasn’t PJM’s. It had been pleading with FERC for enhanced capital requirements for these highly leveraged trading vehicles, to no avail. I assume FERC has tightened up the requirements, but it wouldn’t surprise me to hear that they haven’t.

During the financial meltdown in 2008, one of Maryland’s premier corporate citizens came within an inch of bankruptcy thanks to leveraged wholesale energy bets. Constellation Energy, which had hired many of the trading pros from Enron, had to be rescued by Warren Buffett and then by the French, at huge expense to its shareholders. It remains a very open question whether Maryland’s inadequate ring-fencing at the time would have protected Constellation’s BGE subsidiary and its customers from bankruptcy trauma.

These are just the risks and abuses that we know about. Given the opacity of PJM’s black box, the meager participation in its auctions and the shenanigans that we know energy traders are capable of, it would be very surprising if there weren’t abuses of bid rigging, market power, dispatching irregularities and other problems. The Enron abuses came to light largely because of the company's bankruptcy and legal discovery in subsequent lawsuits. In the absence of such an extraordinary situation in PJM and the other RTOs, similar outrages -- if indeed they're going on -- are unlikely to be exposed.

So good luck in improving the RTOs, and pardon me if I'm skeptical. The markets aren't just, they aren't reasonable, and FERC seems as intransigent as ever on fixing this.

Sorry for the negativity. Let me close on a more positive note. Amid the turmoil and change in electricity markets the past two decades, the American Public Power Association has been a beacon of intelligence and an inspiring advocate, not just for its members but for ordinary ratepayers everywhere. Given the vested interests of the investor-owned utilities and generation companies, APPA is one of the few honest information brokers for journalists like me and activists trying to shed light.

The questions being asked here today are relevant to electricity buyers everywhere, not just publicly owned utilities, and its great that APPA is asking them. I'm going to stick around to hear what all the smart people gathered here today think the answers might be. Thanks for listening. It should be an interesting day.

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