

Harvard Electricity Policy Group

Forty-Third Plenary Session

Panel: “Wholesale and Retail Electricity Market Models:
Will They Mesh Well or Cancel Each Other Out?”

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Is the “Sky now Falling”?

How do we address the perceived failures of retail and wholesale electric markets while ensuring adequate generating capacity going forward?

Late 2004

- “Retail Competition is for Everyone”
- Main themes: competition can work for all customers; touted success of shopping in N. Ohio; advocated for a “portfolio approach” for the Standard Service Offer (SSO)

A lull in retail shopping in Ohio

- Dramatic decline in retail shopping in N. Ohio since January 06
- Retail structural problems
 - * Remnants of past regulatory decisions – e.g., unbundling; RTC
 - * Rate Stabilization Plans (RSPs) – rate increases w/o the ability to bypass

A lull in retail shopping in Ohio

- The “new regulation” of generation in Ohio
 - * Under CGE’s RSP, distribution customers could be forced to pay for the purchase of a generating plant
 - * AEP seeks pre-approval for construction/recovery of an IGCC plant – 100% CWIP and no cap on construction costs
 - * No true corporate separation

The retail “nether world” - Ohio

- Ohio retail consumers face a “gray” world somewhere between full regulation and full competition where only the utilities seemingly prosper
 - * FE’s 1st Qtr 06 profit increased 38% even with a deferral of their increased fuel costs
 - * Current rates are considered “sacred” but utilities increased costs are readily added in (without significant review) and recovery is guaranteed (through the nonbypassable restrictions imposed on the SSO customers)
 - * No relief from competitive providers who can’t “compete” with flaws in retail structure and flawed wholesale market as well

The wholesale “nether world”

- News is full of stories about short-term wholesale auctions resulting in large percentage increases to customers trapped on the SSO in a variety of restructured states
 - * e.g., Maryland
 - * OH has seen wholesale auctions that have failed to generate acceptable bids

The Wholesale “Nether World”

- Reflects short-term market prices
- Does not provide incentives for construction of new baseload capacity
 - Scarcity problem:
 - Growth in demand
 - Plant retirements
 - Environmental regulations
 - Unit age
 - How do we finance new construction under deregulation?
 - Traditional financing
 - Consumers

The wholesale “nether world”

- Litany of concerns with the state of wholesale market development in the Midwest
 - * Dependence on a Uniform Clearing Price (in LMP markets) that often is based on sky-rocketing gas costs
 - * Stalled Joint and Common Market
 - * Lack of long-term transmission rate design for Midwest

The wholesale “nether world”

- * Lack of long-term bilateral contracts
- * Increased transmission costs – both for RTO operations (including capacity markets that don’t guarantee new capacity) and transmission improvements
- * And the list could go on!!!

What do we do now?

- **Certainly retail competition cannot succeed without a viable wholesale market**
 - * Obviously, those of us who promoted retail competition dramatically underestimated the work that needed to be done to provide such wholesale markets

What do we do now?

- First, and foremost, the work needed to fully develop the wholesale markets must be completed in a timely matter
- Second, the **Competitive Procurement of Generation (CPG)** must become a reality
- * Concept works whether retail price is determined through competition or by administrative (or regulated) means

What do we do now?

- * Focus on long-run supply and demand-side portfolios that are competitively-bid
- * Establish resource diversity goals that satisfy your particular state's needs/goals
- * Use a “laddered” approach that utilizes both short-run and long-run assets
- * Develop creative tools to incent construction of new generation

What do we do now?

- Benefits include:
 - * promotion of wholesale competition;
 - * incents the construction of new baseload capacity while also using competitive forces to achieve the least-cost for this new generation;
 - * promotes supply diversity;
 - * enhances energy efficiency efforts

What do we do now?

- Focus on further improvements to wholesale market; cost-effective transmission enhancements; and, the **CPG** will allow for customers to pay the lowest possible rates **in the long-run**
- In a “choice” state, such a focus also allows the final decision on whether retail competition should actually proceed (or retail regulation should return) to be postponed until a truly fair determination can be made

What do we do now?

- In a regulated state, such a focus allows for the least-cost generation portfolio to be employed
- In the **short-run**, we may be forced to acknowledge that an immature wholesale market – itself a “work in progress”, will further exacerbate poor retail markets in “choice” states and result in higher SSO prices
 - * Prices will go up in regulated states as well for many of the same reasons

What do we do now?

- The OCC has been actively involved in the debate on wholesale market development and the removal of retail impediments and pledges to continue those efforts in the future
- At the same time, the OCC has committed to further developing the **CPG** concept (briefly discussed herein) in a generic and an Ohio-specific manner