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.