
Report on FERC's Camp RTO, Day 5

A. Friday morning, 10/19: Market Monitoring; Or, What Do You Do When Good Markets Go Bad?

Everyone was in favor of an independent market monitor, but differed on what exactly constitutes independence. A panelist suggested that RTOs should not have a market monitoring function because RTOs create and participate in markets, so the function should reside in the state commissions. (This suggestion seems peculiar, inasmuch as the California ISO is alleged to be rigging the market upwards so that the high-cost, long-term power purchases by the California DWR won't look so stupid.) Other panelists thought that the states don't have enough money to handle market monitoring, and that the market monitor should reside in the RTO, but with "independence" from the RTO (and with direct access to FERC). All agreed that the market monitors should standardize what data are collected and the form in which the data are collected.

The most controversial suggestion was made by Anjali Sheffrin, the Director of Market Analysis for the California ISO. She suggested a simple test: if the rolling 12-month average of prices is 20% above what the price would be under traditional cost of service, then the market would be defined as broken. She noted that the whole point of generation dereg is to get the price of electricity below what it would have been under traditional regulation. [Ed. note: Sell power below its cost plus a reasonable rate of return? Gee, that makes sense. Dust off your bankruptcy lawyers . . .]

A marketing rep attacked this idea. After all, the point of entering the New World is to get beyond the old way of doing things, and it is clearly counterproductive to compare how electric consumers do in the New World with how they would have done in the Old World. The marketer blamed the loads for existing market imperfections. Markets would work far better if consumers immediately had to face spot market prices, no matter how high those spot prices are. The marketer said that we must investigate "load gaming" as well as generator gaming. Load gaming apparently occurs when purchasers in the market appeal to the regulatory/political process when the purchasers notice that they are being fleeced by the generators. [Ed. note: Remember the civil disorder in San Diego when consumers were immediately faced with high spot market prices? By the way, these last two paragraphs show the great lies about dereg. "40% rate reductions", my eye. Screwing the consumer is the end result.]

Considerable debate ensued about how much enforcement authority the market monitoring function should have (police power vs. whining to FERC), and about how much information the market monitor should be able to extract from generators and market participants. Panelists noted that acquiring and disseminating too much info can be counterproductive. For example, the information put out by the various California market monitoring units was useful in allegedly helping to rig prices. ("Transparent markets" are great if you are trying to maintain a cartel -- you can check whether the cartel members are sticking to the cartel agreement.) There seemed to be consensus that the market monitoring function should be able to keep much information and analysis private, although this raises issues about accountability.

There were, inevitably, a lot of excuses made for California. The likely protections provided by the market monitoring function can be inferred from these excuses. Basically, the "analysis" is that although there may have been some gaming in the California market, the thing that really drove prices up so high was the "perfect storm". The weather was so uniquely extreme and awful in the west during the period of high prices that it completely messed up the power markets. There was a terrible drought in the Pacific Northwest (ignoring the fact that the drought didn't start until several months AFTER the power market went crazy, and the fact that the power market collapsed even as the drought in the northwest worsened). There was a simultaneous terrible heat wave in the southwest (which was apparently somewhat accurate in the desert southwest and much less true in California). The "analysis" ignores the fact that prices stayed very high even on days when there was relatively little air conditioning load in the west during the summer of 2000.

B. Friday afternoon: Mitigation of Market Power

The two most influential academic theoreticians involved in the development of electrical deregulation were on the panel: William Hogan and Paul Joskow. Both said that it is important to get the market structure right. (One hopes that Hogan no longer believes that making everybody bid into and out of a mandatory spot market PX, with financial "contracts for differences" to mimic long-term contracts, is the right way to design the market structure).

Hogan advocated price caps on existing gas-fired generation, but not on new generation. This approach was tested both in the oil and in the natural gas markets during the Carter Administration, and many of us remember how well that worked. Hogan blamed many of the initial west coast problems on the fact that California had price caps while the rest of the region did not. Hogan opined that we are in the worst of all possible worlds; we have lost the advantages of the vertically integrated utilities, yet we haven't gotten to the benefits of deregulation.

Joskow noted that by establishing large regional RTOs, we are establishing huge monopolies with a structure that we are not used to regulating. He said that not enough attention is being paid to how we will manage and regulate RTOs. He pointed out that RTOs really are a new life form with no equivalent in the gas or rail industries. (Actually, a transco called, "Railtrack", that owned rail track was established in Great Britain. It recently went bankrupt after several train crashes that were blamed on poor track maintenance.)

Joskow said that the "independent monitoring authorities" established by the RTOs would require a substantial staff of economists, auction experts and "financial engineers". He pointed out that FERC would have to increase its staff in the same areas in order to work with the "independent monitoring authorities". [Ed. note: It's up to you Gentle Readers to determine whether having to hire more economists is a Good Thing or a Bad Thing.]

The panel generally thought that after-the-fact mitigation (i.e., refunds if generators are overcharging) is inferior to getting markets right and working out mitigation measures ahead of time. Panelists admitted that there are circumstances where refunds might be necessary.

The panelists thought that the clearest signal of gaming is withholding capacity from the market. There was discussion about whether uniform rules regarding market power should be established. A panelist who works on market power issues for the New York ISO said that different RTOs have different market power problems, so imposing uniform rules might not be wise. An objection to this is that having different mitigation measures in contiguous areas might lead to arbitrage. One panelist wondered whether a tx organization was the best place to look at generation market power (because the reflexive response of a tx organization to a problem likely will be to build more tx).

One panelist cited with great approval, as an example of a demand side response to price signals, none other than the example of Kaiser Aluminum's resale of BPA power. He declared, "We want as much of that as possible". [Ed. note: %#\$&@ that!]

A regulatory commissioner from Minnesota distinguished himself by saying, in supporting rapid development of RTOs, "You can't make an omelette without breaking eggs." He thus is the only panelist to buttress his support for RTOs by quoting Leon Trotsky.

In the report of Day 2 at Camp RTO, Car Talk mentioned the discussions of FTRs (or equivalent). What the panelists supported was a financial rights model for the tx system, not the physical rights model that RTO West is considering. [Ed. note: The difference will be explained in a later Car Talk.]

CONGESTION MANAGEMENT

The purpose of the meeting was to resolve issues and tweak the parts of the proposals that parties "couldn't live with". The highlight of the meeting was when one participant interrupted another to say that the problem with the group is that no one has a chance to complete a sentence before being interrupted (and of course the group jumped in to agree before the person had the chance to complete his sentence).

The group discussed the three potential options for solving the over-allocation problem. The first uses the flow-based physical rights model that the group spent the last five months working on. The second two are based on an injection and withdrawal model, and use a financial component to deal with the over allocation of rights.

One of the two injection/withdrawal models borrows from PJM (the first, and currently largest, RTO covering Pennsylvania, New Jersey, Maryland, Delaware, Virginia and the District of Columbia). Next week the group will meet with two individuals who have extensive experience with the PJM model. The hope is that they will be a useful resource for the group (many members of which are wary of implementing a PJM-like model in the Northwest). Specifically, Seabron Adamson, Frontier Economics of Boston, will present the briefing and Andrew Ott, General Manager of Markets Coordination, PJM Interconnection, will answer questions, about the PJM Locational Marginal Pricing (LMP) model.