Remarks on the State of Competitive Electricity Markets

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The following remarks were prepared for delivery at a debate between Mr. Kavulla and Commissioner James Danly of the Federal Energy Regulatory Commission, on the question: "Resolved: The Markets are Irredeemably Broken," with Mr. Kavulla taking the negative position, expressed below. The debate was held at a general session of the Annual Meeting of the National Association of Regulatory Utility Commissioners in La Quinta, California.

Let me thank my opponent in today's debate for his intellectual tenacity and extraordinary candor, and for his public service. Commissioner Danly has almost single-handedly transformed FERC's open meetings from perfunctory exercises in wielding the regulatory rubber stamp into "Must-See TV." He raises the bar on the practice of regulation, and I am honored to call him a friend.

That being said, my friend is dead wrong on today's resolution. And I will begin in my negation of it by addressing the unavoidable implication of the affirmative side. Today, the markets in restructured jurisdictions perform—however imperfectly—an important function: using a heads-up competition between generators to discipline costs, while delivering investment sufficient to meet the demands of customers for energy, subject to standards of reliability.

If those markets are irredeemably broken, it must follow that this function be returned to the only other paradigm it has ever known, where a local monopoly tells a regulator what it should be given permission to do, and then (if the regulator allows it) rates are set, investment costs are entered into the utility rate base, and the very real business risk inherent in this sector shifts largely from that monopoly to a captive base of ratepayers.

This latter model is inferior in many respects—the efficient deployment of capital, reliability, political accountability, and consumer protection—and each of these elements deserves an honest comparison between "monopolies" and "markets."

Efficient Deployment of Capital

It is often said that utilities are able to raise capital and ensure investments that might not be made if left to a market because the utility has a monopoly on the back of which to finance this spending. Obviously, this is true. If you let a utility rate-base its capital investments, it will build anything you want it to: a power plant or a pyramid.

The problem is that the risk of the long-term economic performance of these investments become—almost immediately—the problem of ratepayers once it is rate based.

This simply is not the case in competitive markets, where an investor who improvidently buys a power plant that fails to perform or is forced (even through no fault of its own) into an early retirement, nevertheless owns that risk and eats those stranded costs. The performance of PJM in this regard has been remarkable. A decade ago, PJM's market led to billions in investment of new and refurbished resources totaling over 41,000 MWs of new and incremental additions, against the backdrop of nearly the same number of MWs retiring.[1] This changeover coincided with a 70 percent reduction in CO2 emissions.[2] This was all done even while energy prices fell by more than 40 percent.[3]

I would challenge anyone to find me a utility monopoly that achieved the same turnover in capital at so substantial a net gain to consumers.

Reliability

Critics of markets point, then, to reliability, and how a utility will be sure to keep the lights on. Let's talk about that. Where the affirmative side sees an "obligation to serve," I see a "single point of failure" when it comes to reliability.

This is borne out by Winter Storm Elliott last year. Many parts of the eastern United States – markets and monopolies alike – faced this severe weather, but only one business model had blackouts: the monopolies, which failed to deliver adequate resources from Tennessee to the Carolinas, despite the import of power *from competitive markets* during the crisis. Meanwhile, none of the restructured RTOs lost power.[4]

But Texas, the monopolists say. ERCOT is a notable RTO where a major blackout did occur two-and-a-half years ago during Winter Storm Uri. You should know that there are two business models in the ERCOT market of Texas. One is the utility service territories that are fully open to competition in the generation and retailing of electricity. The other remains a monopoly that engages in planning to equip itself with adequate power supplies during times of scarcity. During Winter Storm Uri, the latter—the monopolies in ERCOT—had higher rates of forced outages in their fleets of power plants than did the competitive power providers.[5]

The point is: Integrated Resource Planning and monopoly does not save you from reliability challenges, indeed they may merely serve to reinforce whatever assumptions you are be laboring under, and those assumptions might be wrong.

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[1] Analysis based on: Monitoring Analytics, *Quarterly State of the Market Report for PJM: January through September* (2023), Table 5-6 Generation capacity changes, p. 332, https://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2023/2023q3-som-pjm-sec5.pdf.

[2] Federal Energy Regulatory Commission, *Technical Conference on Resource Adequacy in the Evolving Electricity Sector, Statement of PJM Interconnection* (March 23, 2021), Figure 1 PJM system average emission rates, p. 4, https://www.pjm.com/-/media/library/reports-notices/testimony/2021/20210323-ferc-capacity-tech-conference-testimony.ashx.

[3] *Ibid*, Figure 2 Total wholesale costs, p. 4.

[4] FERC, NERC, and Regional Entity Staff, *Inquiry into Bulk-Power System Operations During December 2022 Winter Storm Elliott* (October 2023), p. 7-8, https://www.ferc.gov/media/winter-storm-elliott-report-inquiry-bulk-power-system-operations-during-december-2022.

[5] Michelle Michot Foss, Pat Wood III, and Brett Perlman, The Texas Freeze Out: Electric Power Systems, Markets and the Future (June 2021), p. 4, https://www.ourenergypolicy.org/resources/the-texas-freeze-out-electric-power-systems-markets-and-the-future/.

Political Accountability

So it is a bit rich that pro-monopoly commentators often rely on the supposed accountability of a singular monopoly as a *raison d'être*. I would grant that a monopoly is hypothetically more subject to accountability than a diverse set of competitive market participants, but this is not Americans' lived reality. No electric utility franchise has been revoked any time in recent memory, seemingly no matter the severity of the offense, even when utilities have become—to use two notable examples of just the past five years—the deadliest corporate felon in American history[6] or have had a leading role in the biggest political corruption scandal of this century so far.[7]

There's not accountability for the really big things, and there also is not a consistent pattern of accountability for the day-to-day things either. Not a single monopoly utility has faced a substantial disallowance coming out of Winter Storm Elliott. The reason, I suppose, is that they were undertaking "good utility practice" or behaving "prudently" in their operations of rate-based facilities, and so should not face financial consequences for their objective failure.

By contrast, in RTOs, when you as a power generator agree to deliver your power and fail to do so, your excuse does not matter: You are obliged to buy out your position at the real-time cost of energy[8] and, if you have sold your capacity, pay a significant penalty for your failure to deliver.[9]

Consumer Protection

Finally, let us speak about the impact to customers of competition. Competitive markets have been exceptional in this regard.

In states that permit customer choice, residential, commercial, and industrial customers alike have seen prices decline from when these markets opened—on average decreasing more than 18% between 2008 and 2022. By contrast, prices have risen in the 35 jurisdictions that have retail monopolies, significantly outpacing inflation.[10]

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[6] Vanessa Romo, NPR, "PG&E Pleads Guilty On 2018 California Camp Fire: 'Our Equipment Started That Fire'" (June 16, 2020), https://www.npr.org/2020/06/16/879008760/pg-e-pleads-guilty-on-2018-california-camp-fire-our-equipment-started-that-fire#:~:text=Pacific%20Gas%20%26%20Electric%20pleaded%20guilty,of%20Paradise%20in%20Northern%20California.

[7] U.S. Attorney's Office, Southern District of Ohio, "Press Release: Former Ohio House Speaker sentenced to 20 years in prison for leading racketeering conspiracy involving $60 million in bribes" (June 29, 2023), https://www.justice.gov/usao-sdoh/pr/former-ohio-house-speaker-sentenced-20-years-prison-leading-racketeering-conspiracy.

[8] *See*, e.g., *PJM Operating Agreement*, Schedule 1, Sec. 3.2.1.

[9] *See*, e.g., *PJM Open Access Transmission Tariff*, Attachment DD, Sec. 10A.

[10] Retail Energy Supply Association, Figure 12 Inflation-adjusted weighted average percentage price change by customer class, choice vs monopoly states, 2008-2022, updated from the work in *The Great Divergence in Competitive and Monopoly Electricity Price Trends* by Philip O'Connor and Muhammad Asad Khan (2018), https://www.resausa.org/wp-content/uploads/2023/09/3-Figure-12-Restructuring-Recharged-New-Master_2023-MD-7AUG2023-updated-.pdf.

It is not just long-run averages. We are seeing increasingly frequent price blowouts in the wholesale power and gas markets.

When this happens, regulated monopolies pass through these costs to consumers through the trackers and adjustment clauses you are all familiar with. Meanwhile, competitive retailers stand behind the fixed-price product they sold to customers, with no subsequent opportunity to surcharge them. After Uri, this meant residential customers in regulated monopolies racked up a tab of $15 billion for a few days' worth of gas, amounting to 3-5 times the level of rate impact compared to customers served by competitive retailers.[11]

The tough reality is this: It does not matter whether you are a regulated or competitive electricity business; if you use gas as fuel, you are participating in the same price-deregulated market for your fuel. Wouldn't the choice to reverse course on electricity competition also require FERC to re-regulate the price of natural gas in the public interest? I ask Commissioner Danly: How far does his commitment to this resolution extend?

Risks to the Successes of Competition

Taking a step back, let me agree with Commissioner Danly on a point of significant concern: Specifically, around the question of whether RTOs are a dependable channel for investment. Because I will grant him that there is a world in which markets *may not* be up to that job.

Not letting markets do the actual work prescribed to them is a serious and growing problem. We count on these markets to produce investment, but if other policies become the binding constraint on investment, what does that mean for the integrity of these markets? Even some states that chose to restructure have since signed or dragooned their utilities into signing long-term contracts for power plants, rather than letting energy markets do the work of capital formation. Many of those long-term contracts for offshore wind are now collapsing,[12] and it will be up to RTOs to fill the gaps through market-based investments. Wouldn't it have been better in the first place to rely on the market to produce these investments?

There is also sometimes a mismatch between the RTOs' rhetoric and actions. One RTO released a white paper recently that signals very serious reliability challenges, saying new entry might be insufficient to keep up with expected retirements and demand growth by 2030. Yet in one capacity-depleted zone, when an auction was held that predictably resulted in temporarily higher prices, the RTO petitioned FERC to re-run the auction to come up with a better (lower) result.[13]

[11] Guy Sharfman & Jeffrey Merola, *Beyond Texas: Evaluating Customer Exposure to Energy Price Spikes: A Case Study of Winter Storm Uri, February 2021, Updated Version for the Most Recent State Actions* (August 2022), p. 6, https://www.nrg.com/assets/documents/energy-policy/_2022/beyond-texas-evaluating-customer-exposure-to-energy-price-spikes.pdf.
[12] Eduardo Garcia, Reuters, "Cost crunch prompts mass rethink of US offshore wind contracts" (September 13, 2023), https://www.reuters.com/business/energy/cost-crunch-prompts-mass-rethink-us-offshore-wind-contracts-2023-09-13/.
[13] Ethan Howland, Utility Dive, "PJM seeks mid-auction capacity market rule change to address anomaly that led to 'unjust' price" (December 22, 2022), https://www.utilitydive.com/news/pjm-capacity-auction-rule-change-delmarva-ferc/639405/.

Outrageously, FERC—over Commissioner Danly's objections[14]—granted this request. [15] RTOs can't have it both ways, and if their prices become a function of their preferred political interests, they will in one important respect cease to be different than the monopolies they replaced.

So, Commissioner Danly, I grant you that there is some hypothetical point in the future where I fear I would have to move to your side of this debate—even if the objections I have lodged around the alternative remain.

But for now, and having been fortunate in my short career to see both the dysfunction of markets and the even greater dysfunction of what they replaced, I will negate the resolution and thank you all for your time and, again, James, for your service to our nation, both at FERC and elsewhere.

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[14] Commissioner James Danly, *Item E-14: Commissioner James Danly Dissent Regarding PJM Interconnection, L.L.C.,* Docket Nos. ER23-729-001 and EL23-19-001 (July 27, 2023), https://www.ferc.gov/news-events/news/item-e-14-commissioner-james-danly-dissent-regarding-pjm-interconnection-llc.

[15] 182 FERC ¶ 61,109, *Order on Proposed Tariff Revisions and Dismissing Complaint*, Docket Nos. ER23-729-000 and EL23-19-000 (February 21, 2023), https://www.pjm.com/directory/etariff/FercOrders/6683/20230221-er23-729,%20el23-19.pdf.