

An Evaluation of the McCullough Research Report on New York's Wholesale Power Market

Executive Summary

In March 2009, a joint public hearing was held by two committees of the New York State Assembly on the use of the Uniform Clearing Price market structure. At the hearing, a report was introduced by McCullough Research, criticizing the use of the competitive markets introduced into the wholesale electricity industry in New York and other states a decade ago. The New York Independent System Operator (NYISO), a not-for-profit corporation that administers those markets, provided testimony during the course of this hearing on the benefits competitive markets have provided the citizens of New York since the energy industry was “deregulated.” The chairs of these committees requested the NYISO submit official written comments as to the merits of the conclusions drawn by the McCullough report. The Analysis Group was requested by the NYISO to provide this evaluation.

It is the conclusion of the Analysis Group that the McCullough report, in numerous ways, is deeply and fundamentally flawed. This document discusses these flaws, which are summarized below.

- ***McCullough ignores the fact New York's electricity prices were high under the traditional regulatory approach idealized in the report.*** McCullough fails to mention in 1990, prior to competitive markets, New York had the highest electricity prices of all 48 states in the Continental U.S. In 1996, the same year New York regulators called for a new system of regulation of the state's electric industry, New York had the second-highest electricity prices. (See Page 2)
- ***New York's high electricity prices in the mid-1990s were a principal reason why the state decided to restructure its electric industry.*** The Report criticizes New York for having abandoned its traditional utility cost-of-service regulatory model, but fails to mention that the states, like New York, that sought another regulatory approach did so because they had such high prices at the time. (See Page 2)
- ***The report ignores one of the primary reasons why New York's electricity prices are high: the overall mix of fuels in New York relative to other parts of the country.*** The states with relatively low electricity prices are states with a high percentage of their power produced by coal; that was true in the 1990s, and it is true today. Many coal-dependent states did not restructure their electric industries, in part because prices were already low. By contrast, New York State produces only 15 percent of its power from coal. (See page 3)
- ***Natural gas prices have nearly quadrupled since the introduction of wholesale electricity prices. In addition, largely because of New York's rigorous environmental requirements, all of the recent power plants built in the State have been fueled by natural gas.*** Natural gas delivered to power plants rose from \$2.85 per million cubic feet (“mcf”) of natural gas in 1999, to \$10.81 per mcf in 2008. Given the dependence of the state on natural gas-fired generation (particularly in New York City and Long Island), these underlying price increases for natural

gas have greatly affected power prices in the state. (See page 4)

- ***New York's consumers no longer have to pay for power plants in utility rate base.*** Prior to New York's adoption of its restructured power market, the utilities owned most of the power plants in the state. The utilities charged rates to consumers that included "rate base" amounts to compensate the utilities for having built and maintained the plants, including a return on investment. In today's electricity spot markets administered by the NYISO, a plant that runs infrequently due to poor operating performance or high operating cost is not compensated except for when it runs. (See page 4)
- ***McCullough leaves the false impression that electricity prices in New York's electric energy markets are not competitive by pointing to a \$1,000-per-megawatthour bid.*** By suggesting that this bid is routine ("every day") and reflects a "gaming the market," McCullough leaves the false impression that this bid is routinely selected by the system operator to produce power and leads to price spikes and other price distortions in consumer prices. For example, during 2008, not a single bid of this level was selected in New York's energy markets, and thus never set the energy price. The offers represent potential output of plants used only occasionally for emergency power purposes. (See page 5)
- ***The Report fails to mention New York's wholesale electricity spot markets are heavily regulated.*** The tariffs and rules under which these markets operate are actively regulated by the Federal Energy Regulatory Commission ("FERC"). The markets are actively monitored by internal and external watchdogs with access to bid information and details of power plants. Consumers are protected by three levels of market monitoring and oversight: the internal market monitoring group within the New York system operator; an external consultant who monitors the markets; and FERC's Office of Enforcement. (See page 6)
- ***McCullough fails to mention that if suppliers were only paid at their marginal costs, valuable renewable power resources like wind farms, would have a much-harder time entering New York's power market.*** If wind farms were compensated only for their marginal cost, then they would be paid virtually nothing for the power they supply into the state's energy market. And yet, New York highly values their power for their absence of undesirable emissions, especially greenhouse gases. Under McCullough's formulation, a wind project could not recoup its investment, and New York would be severely challenged to achieve its important statewide renewable energy policy goals. (see page 6)
- ***McCullough fails to mention that electricity price information is much more transparent today than it was a decade ago.*** Previously, under traditional utility regulation and under the "New York Power Pool" system owned and operated by the state's electric utilities, it was extremely difficult if not impossible for the public to get access to the kind of information now published routinely by the NYISO. Today, the public can access abundant data on power demand, power supply, and prices, for locations throughout the state. (see page 6)