

Electricity Market Reform; APPA's Journey Down the Wrong Path

- APPA's proposals are at odds with experience and reflect misunderstandings of how the RTOs and electricity markets work. LECG examined the experience of establishing electricity markets in various regions of the country, noting how various "reforms" embraced by APPA have been tried and discarded in the past.
- Attempts to provide nondiscriminatory open-access transmission without incorporating the RTO-based, organized, open spot market with locational pricing have not succeeded. These failures, such as the 2000-2001 Western energy crisis brought on by California's failed initial market design, have been dramatic and unambiguous, and the combined evidence supports continuing refinements of the prevailing RTO market design, not restricting the functionality of these markets.
- APPA does not acknowledge the special characteristics of electricity that underpin these markets or the experience that led to the prevailing market design used successfully in regional markets across the country.
- RTOs operate on a reliability foundation common throughout the industry. RTOs run day-ahead and real-time electricity markets to support reliable operations and capacity markets to support adequate investments. This market model has evolved over time, is sound and is endorsed by the International Energy Agency.
- APPA's *Competitive Market Plan* proposal reflects a continuing *ad hoc* search for a workable redesign. APPA's various redesign proposals have changed because their proposed solutions are unworkable. The resulting series of proposals often resurrect flawed approaches already considered and rejected, or tried and failed.
- Proposals to unravel this successful market model threaten the investment required to maintain system reliability and promise to complicate the ability of independent market monitors to police against anticompetitive behavior and potential manipulation. The math doesn't add up, and APPA's formula would lead eventually to shortages.
- Reliability is at stake: APPA's proposals would create an unworkable framework and impossible dilemma for RTOs and the regions they serve. For instance, spot market prices would be suppressed, reducing incentives for generators and demand-side response to be available when most needed. Spot prices would be even further below levels needed to support investments.
- APPA's framework would eliminate the revenues necessary to support investment in generation facilities required to maintain a reliable electricity system. It cannot reduce total electricity prices by dismantling the RTOs' capacity payment systems while simultaneously suppressing spot and contract prices. The revenues to meet the investment requirements must come from somewhere.
- Despite APPA's concern about prices in RTO markets, every objective analysis finds that spot market prices are insufficient to support long-term investment needed to meet growing demand and maintain reliability.

- For example, over the nine years from 1999 through 2007, the market monitor for PJM estimates that average energy market revenue under economic dispatch for a combustion turbine peaking unit was \$16,401 per MW-year compared to an average fixed cost charge of a new unit of \$75,158 per MW-year. The difference of \$57,757 per MW-year is the missing money. There is no magic formula that allows APPA to escape this equation.
- There is nothing prohibiting suppliers and load-serving entities from contracting today. Long-term contracts are an important part of the RTO electricity market.
- APPA's complaint is not that bilateral contracts aren't possible and fully accommodated by today's RTOs – but rather that suppliers won't agree to terms APPA's members prefer. APPA claims this is because suppliers can always sell into RTO spot markets, and spot prices are inflated by excessive supplier offers setting the clearing prices. But RTO Market Monitors have periodically evaluated and rejected these claims, and FERC has agreed.
- The connection between contracts and expected spot prices over the life of the contract is an expected feature of properly functioning RTO markets. Rather than being evidence of failure of the market design, the connection between contracts and spot markets is a sign that the RTO markets are functioning as designed.
- The RTO markets should not be replaced with failed or untested alternative market models that ignore the many lessons already learned.
- Dismantling RTOs would incur a multibillion-dollar cost. Expectations that alternatives to the RTO market model will result in lower prices for consumers are unproven and illusory. Untested alternative market designs should be viewed with skepticism and could cost consumers billions of dollars.
- A first-order estimate of the asset purchase costs utilities would face if they were forced to reacquire sufficient generation for a reliable dispatch indicates the purchase costs for the PJM region would be more than \$130 billion.
- Taking a conservative view of the additional hurdles to least-cost operations and inter-area trading imposed by a contract-scheduling framework, the study found that costs would increase by at least \$2.47 billion in energy costs alone over the next 10 years, compared to the current PJM "RTO as is" case. If the PJM electric demand consumers were paying market prices for all their energy requirements, their energy purchase costs could increase by over \$1.3 billion per year, or \$13.6 billion over 10 years.