

New APPA Report Shows Need to Step Down From Ivory Tower

Report Contradicts RPM Buyers Complaint; Focus Should Be on Solutions

At a time when policymakers and stakeholders should be concentrating on practical solutions to the nation's urgent electricity challenges, particularly given high and rising input costs for both existing and new power plants, it is unclear what the latest American Public Power Association (APPA) report by Northeastern University Professor John Kwoka is designed to accomplish. ("Barriers to New Competition in Electricity Generation," June 2008)

Areas of EPSA Agreement with Some of the Report's Assertions

The report actually contains several points with which EPSA agrees. We are heartened to read the warning that "Unpredictable changes in future regulatory policy that alter the likely revenue stream from a project add to uncertainty about the prospects for covering its initial costs." (p 26) Similarly, the report says that, "A second oft-cited concern would be where regulators adjust price ex post explicitly for the benefit of a favored party, or when they abrogate contracts because the contracts have resulted in unappealing outcomes (e.g., high price to favored parties)." (p 27) The RPM Buyers Complaint filed at FERC on May 30, 2008, clearly qualifies as a request for the type of ill-advised regulatory action that the report advises against because it would increase investor uncertainty.

EPSA also agrees with the report's comments on the adverse impact of bid caps in organized markets. As to bilateral regions, EPSA agrees on the anti-competitive effects of preferential treatment by vertically-integrated utilities as to available transfer capacity and transmission planning. As the report states, "The effect of such actions is to further raise the probability of a lack of transmission or its availability on nondiscriminatory grounds." (p 31) EPSA and APPA members often work on the same side of efforts to address these barriers imposed in the bilateral regions.

In addition, the report correctly notes that environmental uncertainty stems from the lack of final federal climate change legislation. The report states that "specific levels of [greenhouse gas] controls and hence their effect on construction and operating costs are unknown.... In anticipation of such controls, investment capital for new coal plants is becoming harder to secure." This statement underscores why Congress should enact mandatory federal climate legislation consistent with EPSA's principles that treats all generation sources fairly on a level playing field.

Competitive Suppliers are Investing in New Power Generation

Despite these areas of agreement, the report contains several flaws. For starters, the report mistakenly asserts that competitive suppliers are unable or unwilling to invest in new generation. For example, the report states that "a number of real-world factors have impeded entry," which has limited competition and investment in new generation. (p. 3) By contrast, several pages later the report admits that 74% of all new capacity additions between 1996 and 2004 were made by competitive suppliers. (p. 14) The new construction in the early 2000s clearly shows that, while region-specific barriers to entry can be lowered, they were not insurmountable and in fact the market worked as "this surge represented a response to demand and supply forces." (p. 15) The report, however, disparages this high level of investment by calling it a "market mistake of major proportions." (p. 14) Thus, the report appears to be internally inconsistent, criticizing competitive markets when the author's opinion is that supplies were "too high" or "too low" without including the benefits when decisions are made by market participants largely at the investor's risk.

The report mistakenly suggests that natural gas would not have been the fuel of choice in the last build out had it not been for competitive wholesale markets. In fact, even rate-regulated utilities built natural gas generation because of lower natural gas prices, the fuel's environmental benefits after enactment of the Clean Air Act Amendments of 1990, quicker construction times and lower capital costs. Actually, competitive suppliers deployed more efficient combined-cycle plants to compete with older, less efficient gas-fired units built by vertically-integrated utilities.

Contrary to the report's implication that barriers to entry are precluding needed investment today, APPA's own data shows that non-utility and other competitive suppliers are currently leading the power sector in planned capacity additions. APPA's published data shows non-utility generators are responsible for 48.8% of new electric capacity under construction. Furthermore, these generators account for more than 80% (19,867 megawatts) of capacity already permitted and more than 72% (75,000 megawatts) of all proposed capacity.¹

The report does not reflect current reserve margin figures for several regions of the country. According to the report, ERCOT will dip below a 10% reserve margin this year and will drop to 5.8% in 2010. In a report released just last month, ERCOT indicated that its current summer reserve margin is 13.8% and will reach 17.3% in 2010 thanks to the addition of 5,062 megawatts of new capacity (not including wind). The most recent capacity auction in PJM resulted in commitments to build nearly 4,000 megawatts of new generation. As a result of the auctions held to date PJM is not expected to fall below the 15% reserve margin requirement through 2012, when it will have an 18.1% reserve margin. The report's table on reserve margins appears to be based only on what NERC terms "committed resources" and by not capturing all competitive power sources likely overstates any reserve margin shortfalls.

According to the report, "Investment in new transmission capacity has stagnated, raising the prospect of no improvement or even further deterioration over the next several years." (p. 31) To the extent transmission investment has "stagnated," this has occurred as much if not more so in key vertically-integrated regions. More importantly, this assertion fails to account for a recent increase in transmission investment. NERC reported in 2007 that the number of transmission lines is expected to increase 8.8% over the next decade, a 30 percent increase from 2006, saying, "Looking at the next five years, the pace of proposed transmission projects in the U.S. appears to be accelerating..."² For example, \$9.3 billion has been invested in transmission improvements since 2000 in PJM. In 2007 the PJM board approved an additional \$2.1 billion in transmission additions and upgrades.³

The report concludes by stating that "restructured electricity markets are characterized by substantial uncertainties – indeed, possibly greater uncertainties than under regulation – all of which have delayed or deterred entry by competitive suppliers." (p. 36) This assertion is refuted by looking at many proposed new projects by existing and new power suppliers. This assertion is also upside down; competitive suppliers face much greater barriers in vertically-integrated regions than in organized markets. Uncertainties in organized markets can be reduced by heeding the report on bid caps and the importance of not changing capacity prices after the fact. Finally, re-regulation is not the answer. Bernstein Research recently documented that "regulated utilities [will] require further large rate increases" to recover escalating fuel costs, replace plants that retire, and comply with federal carbon legislation. This will result in double-digit rate increases and a regulatory response that will make it difficult for rate-regulated utilities to sustain profit levels and stock market valuations.⁴ EPSA remains committed to working to improve organized markets and bilateral regions to ensure reliability and affordability in a carbon-constrained world.

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EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers.

For more information go to www.epsa.org.

¹ American Public Power Association, "APPA Report on New Generating Capacity: 2008 Update," February 2008.

² North American Electric Reliability Corporation, "2007 Long-Term Reliability Assessment: 2007-2016," October 2007, p. 18

³ PJM Interconnection, "PJM Board Authorizes \$2.1 Billion in Transmission Additions, Upgrades," October 17, 2007.

⁴ Hugh Wynne and Stephen Zhang, "U.S. Utilities: The Long View, Part 2 – The Strong Headwinds Faced by Regulated Utilities," *Bernstein Research*, May 14, 2008.