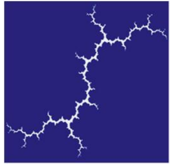

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Remarks of Ezra D. Hausman, Ph.D.

APPA Press Briefing - June 16, 2011

Go Bruins!

I admire your willingness to cover this complex but extremely important issue. Flawed energy market designs have cost consumers billions of dollars per year, but they cannot be easily reduced to punchy headlines. One suspects that this, like the inscrutable structure of credit-default swaps, may be by design.

The focus of our report is electric generating capacity markets, and the ways in which these markets have failed consumers and the environment, while enriching generation owners.

Synapse represented state consumer advocates during the long, hot summer RPM settlement process in 2006. We have supported them during the uphill battle for the full and fair inclusion of low-cost, clean, demand-side resources in New England and PJM. We have helped states in opposing rule changes that would hamstring them from protecting their consumers from high costs and threats to reliability.

It is a pleasure working with APPA on real market solutions that will compensate generators fairly while protecting statesø rights and consumersø pocketbooks.

PJMøs so-called Reliability Pricing Model, in particular, is built on a foundation of flawed assumptions and glaring conflicts of interest. The first flawed assumption is that independent generators can and will take multi-decade, billion-dollar risks in response to a one-year guarantee of capacity revenues. Consumer advocates and states repeatedly pointed out this fallacy during the settlement process, but generators fiercely opposed our proposals for long-term price guarantees for new resources.

The outcome of the recent long-term capacity RFP in New Jersey proves this point: When offered long-term contracts, numerous investors came forward with reasonably-priced offers to build capacity where it is needed most. This was despite the fact that RPM has consistently failed to attract new generation in these same areas, despite high capacity prices. Long-term guarantees provide a workable incentive for new generationô short term guarantees simply move ratepayer money into the pockets of incumbent generation owners.

The second flawed assumption is that generation owners will invest in new resources against their own economic interest. High capacity prices in constrained areas are sustained by shortage. The entities that could most easily respond to these so-called price signals are earning windfall profitsô based on shortage. Third parties could hypothetically enter these markets, but they too know that the high prices will evaporate as soon as the shortage is resolved. The only entities that

are truly motivated to respond are those with consumer interests at heart, such as the states themselves.

This is why state representatives insisted, as part of the RPM settlement, that the right of states to order new generation for reliability purposes be preserved. Without this guarantee, there would have been no settlement. Today we see the wisdom of this position, as incumbent generators work to eliminate state prerogatives and to protect their windfall profits.

Our report describes capacity markets as õIncenting the Old, Preventing the New.ö With the important (and hard fought) exception of new demand-side resources, we find that this is exactly the impact of RPM. To protect billions of dollars in excess profits each year, look for the generation interests to continue to oppose anything that brings new, clean, efficient and affordable generating capacity into the regions that need it most.

I commend APPA for highlighting this important if complex issue for public power and for consumers. I also commend members of the press for your efforts to communicate these issues in a way the public can understand.