You say monopoly;
I say monopsony

Monopsony Manipulation:
No Cost is Too High to Get Low Prices
HEPG
February 28-29, 2008
Boulder, Colorado
Who We Are

- Premier energy company headquartered in Baltimore
- North America’s largest competitive provider of power to wholesale, retail, commercial, industrial and governmental customers
- Major generator of electricity with a diversified fleet of power plants located strategically throughout the U.S.
- Leading gas marketer in the world
- Regulated distributor of electricity and natural gas in Central Maryland
Politics is the art of choosing between the disastrous and the unpalatable.

John Kenneth Galbraith

Overview:

- What are we talking about?
- Why are we having this conversation now?
- Is anyone seriously worried about the exercise of monopsony power?
- What are the risks of artificially lowering prices?
- What are the risks of ratepayer funding new generation?
Economics is extremely useful as a form of employment for economists.

John Kenneth Galbraith

• **Defining market power:**
  - The ability to sustainably and profitably alter prices from competitive levels
  - Rational behavior that leads to inefficient outcomes
  - Monopoly (supplier) power
  - Monopsony (buyer or load) power

• Setting the market price by a high bid is not the exercise of market power

• Attempting to reduce prices to competitive levels is not an exercise of market power
In theory there is no difference between theory and practice. In practice there is.

Yogi Berra

• **Goal of monopoly** power: driving up prices
  - Physical withholding
    - Curtailing supply
  - Economic withholding
    - Bidding higher

• **Goal of monopsony** power: driving down prices
  - Building or contracting for uneconomic generation
  - Withholding interruptible load
  - Curtailing exports
  - Increasing imports
It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.  

Adam Smith

Why is this suddenly an issue?

- Rising commodity prices
- Rising costs of new construction
- End of rate freeze service
- Shrinking reserve margins
- Heightened environmental concerns

→ Political pressure to do something!
In economics, the majority is always wrong.

John Kenneth Galbraith

Are we really worried about the exercise of monopsony power?

- **At FERC?**
  - Questions about the role of load participation in capacity auctions
  - Alternative price rule in New England
  - Minimum Price Offer Rule in PJM

- **In the states?**
  - Extending rate freezes
  - Rate stabilization plans
  - **New generation in rate base**
    - Pre-approval of development costs, return on equity, long-term contracts
  - Re-acquisition of divested generation
  - Eliminate or restrict customer choice
  - Creation of state power authorities
  - Windfall profit taxes
  - “Re-regulation”
Some states are concluding that:

- Higher prices make the status quo lucrative for existing generators rather than motivating them to spend money to build more, which would bring down prices.
- The market, as currently structured, has not incentivized the construction needed to maintain reliable service at reasonable prices.
- One option: long-term contracts
  - Perceived benefit to builder: insulates owner from risk that external events will render the investment unattractive in the market
  - Perceived benefit to PSC/utility: plants needed for reliability will get built; market prices may get lowered
  - Bottom line: transfers risks to captive ratepayers or a state agency with taxing authority
State A PSC Report:

The Overbuild Case (1200 MWs of combined cycle) produces a significant decrease in wholesale energy prices and a sustained reduction in energy and capacity prices for ratepayers.
However, this is not to say that incremental peaking capacity over the requirement is not economically beneficial to ratepayers. There are several benefits that can be identified, qualitatively or quantitatively, with regard to the so-called “overhang” capacity:

- it will put some competitive forces into play and mitigate the risk of market power;
- it will further reduce clearing prices in the auction;
- it will reduce the state’s share of the total system-wide costs paid in the auction;
- it will displace some of the resources with the priciest offers in the auction and shift them into the competitive energy markets, where their participation may potentially reduce the on-peak LMPs; and
- it will add flexibility to the State and utilities in steering some portion of the peaking capacity between the markets when economically feasible.

“Overhang” means the amount of quick start capacity that participates in the auction in excess of the requirements

An incremental increase in procured capacity would be beneficial as long as the incremental costs to procure are offset by the incremental benefits based on the clearing price; otherwise the ratepayers would be paying for contracted capacity above the market price.
Concentrated power is not rendered harmless by the good intentions of those who create it. Milton Friedman

**Artificially low prices are not good**

- Incent uneconomic use
- Promote inefficient/excess investment
- Focus on peaking rather than baseload investment
- Threaten reliability
- Skew towards certain technologies
Facts are stubborn things.

Risks of new generation

- Construction cost overruns
- Rising construction costs
- Fuel prices
- Carbon costs
- Environmental regulation
- Political risks
- Customer switching when unit is above-market
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