

Competitive Energy Markets and Market Oversight

**A Presentation to the Joint Meeting of the
University of Houston Institute for Energy,
Law & Enterprise and the International
Association for Energy Economics-Houston
Chapter**

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December 12, 2002

Outline

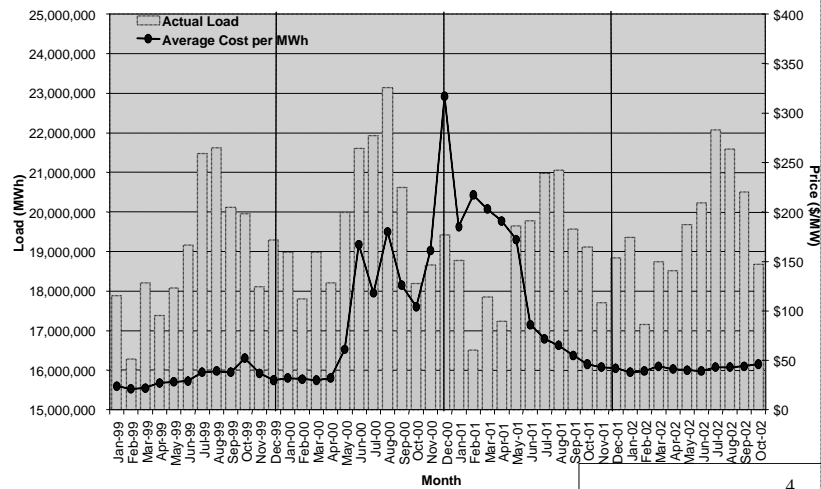
- I. California Crisis of 2000-2001**
- II. Need for Market Oversight**
- III. Market Oversight Objectives
and Functions**
- IV. Concluding Remarks**

California Crisis of 2000-2001

- ✍ How a \$7 billion turned into a \$27 billion electricity market within a year!
- ✍ Recent disclosure of Enron strategies in manipulating California Energy Market
- ✍ Allegations regarding Perot Systems' presentation on how to capitalize on existing electricity market design flaws

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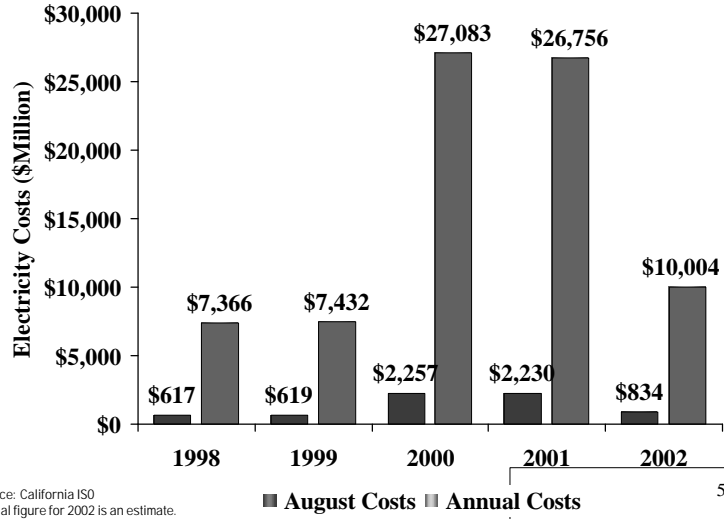
System Load and Average Cost to Serve Load Average monthly costs increased to \$300/MWh, from \$35/MWh



Source: California ISO

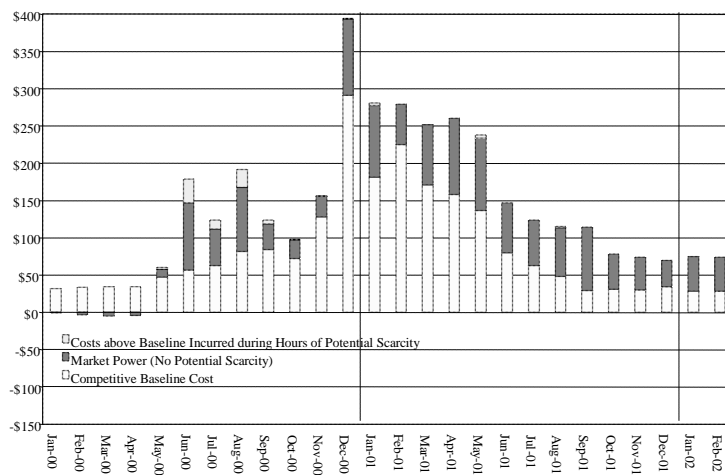
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California Electricity Costs 1998 - 2002



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Price/Cost Markup Forward and Real-Time Energy



Source: California ISO

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Other Notable Events of the Last Two Years

- ✍ Recent disclosure of wash trades by major energy companies
- ✍ On going FERC investigation of market manipulations by several major energy companies
- ✍ Admissions of questionable activities filed by Market Participants in response to recent inquiry by the Public Utility Commission of Texas regarding market manipulations

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Has Deregulation Failed?

Too early to affirm. However, the energy industry is facing a (hopefully) temporary crisis of confidence.

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**What Does the Industry Need
the Most?**

**Proactive attempts to
gain back the lost
confidence**

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Need for Market Oversight

** The establishment of strong
market oversight is the first
step to help restore
confidence**

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Need for Market Oversight

✍ There is insufficient competition in newly restructured electricity markets at this point:

- Market is in a transitional stage
- Inadequate price responsiveness by customers
- Too much local market power due to strategically located units and inadequate transmission infrastructure
- Inadequate customer education

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Need for Market Oversight: Federal View

- ✍ Independent market oversight is an essential element of electricity markets
- ✍ Federal Energy Regulatory Commission (FERC) Order 2000 required creation of Market Monitoring Units
- ✍ Recent FERC's NOPR regarding the Standard Market Design (SMD) requires more independence for Market Monitoring Units

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Need for Market Oversight: Texas View

- ✍ **Public Utility Regulatory Act (PURA), Section 39.157 and 39.155(a) require market oversight by PUC**
- ✍ **Market oversight is considered by the Commission as an essential element of a market in transition**
- ✍ **The Commission created the PUC's Market Oversight Division (MOD), in August 2000**
- ✍ **PUC recently created a Retail Market Oversight Section (RMOS) in the Electric Division**

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Market Oversight Objectives

- ✍ **Prevention:** by identifying and correcting market design flaws, we can reduce gaming, anticompetitive behaviors and market power abuses.
- ✍ **Communication:** by working closely with Market Participants, we can understand their operations and distinguish between legitimate and gaming activities.
- ✍ **Deterrence:** by investigating market power abuses and gaming activities and imposing penalties when harm is done to the market, we discourage market rule violations and unethical behavior.

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Market Oversight Functions

- ✍ Identify and address market design flaws, gaming opportunities and anti-competitive behaviors
- ✍ Assess generation adequacy and system reliability
- ✍ Closely work with Market Participants to implement solutions to problems
- ✍ Resolve disputes regarding anticompetitive behavior
- ✍ Assess the competitiveness of markets
- ✍ Maintain an informative website

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Potential Gaming Opportunities & Anti-Competitive Behaviors

- ✍ Exercise of market power to inflate prices
- ✍ Bidding strategies to create higher prices
- ✍ Manipulation of generation and transmission outages
- ✍ Manipulation of schedules
- ✍ Inaccurate resource plan information
- ✍ Price chasing and uninstructed deviation
- ✍ Creation of artificial congestion
- ✍ Unfair treatment of competitors

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Simple Rule in Market Monitoring

Good behavior is expected, but not assumed!

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Concluding Remarks

Deregulation is in progress

- 1. Customer choice is the right way**
- 2. Re-structuring of the energy industry rather than de-regulation is what should be expected as we progress to a fully competitive market**
- 3. Industry and regulators have to work together to create appropriate conditions for competition with:**
 - ⌘ Adequate safeguards for customers**
 - ⌘ A good set of market rules**
 - ⌘ Adequate and effective market oversight**

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PUC and Electric Restructuring

For more information on retail choice and deregulation

www.powertochoose.org

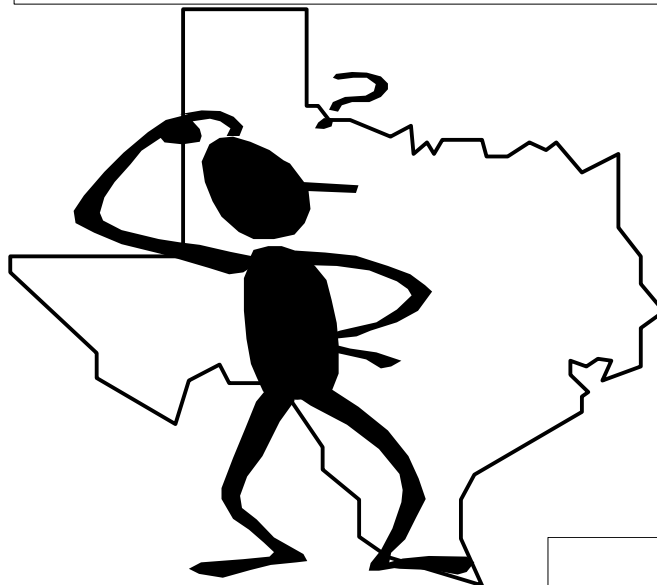
1-866-PWR-4-TEX

For general information

www.puc.state.tx.us

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Questions



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