

**UNITED STATES OF AMERICA
ELECTRIC ENERGY MARKET COMPETITION
INTERAGENCY TASK FORCE
AND THE
FEDERAL ENERGY REGULATORY COMMISSION**

Electric Energy Market Competition Task
Force

Docket No. AD05-17-000

**Comments on Draft Report to Congress
Submitted by
Electricity Consumers Resource Council ("ELCON")**

American Iron and Steel Institute ("AISI"),
Association of Businesses Advocating Tariff Equity ("ABATE"),
Coalition of Midwest Transmission Customers ("CMTC"),
PJM Industrial Customer Coalition ("PJMICC"),
Industrial Energy Users - Ohio ("IEU-OH"),
Multiple Intervenors ("MI"), and
Wisconsin Industrial Energy Group, Inc. ("WIEG")

Introduction

The Electricity Consumers Resource Council ("ELCON"), [American Iron and Steel Institute ("AISI"), Association of Businesses Advocating Tariff Equity ("ABATE"), Coalition of Midwest Transmission Customers ("CMTC"), PJM Industrial Customer Coalition ("PJMICC"), Industrial Energy Users - Ohio ("IEU-OH"), Multiple Intervenors ("MI"), and Wisconsin Industrial Energy Group, Inc. ("WIEG")¹ (collectively "Industrial Consumers")], appreciate the opportunity to comment on the Task Force's Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy ("DR").²

¹ WIEG comments only in regard to wholesale issues.

² A description of each organization is appended at the end of our comments. On November 18, 2005, Industrial Consumers submitted extensive comments in response to the Task Force's October 13, 2005 Notice solicitation on wholesale and retail electricity competition.

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Industrial Consumers include national, regional, and state groups that represent the interests of large industrial end users and other large consumers of electricity. Our collective membership cuts across all manufacturing sectors with multiple major facilities in all regional markets—both restructured, “organized” markets and markets that continue to operate under traditional regulation.

A. Industrial Consumer Comments on the Task Force’s Observations on Competition in Wholesale Electric Power Markets

The Task Force interpreted its statutory responsibility as a mandate to answer the following question:

Has competition in wholesale markets for electricity resulted in sufficient generation supply and transmission to provide wholesale customers with the kind of choice that is generally associated with competitive markets? DR at 2.

After a lengthy and detailed review of each regional electricity market in the lower 48 states, and after consulting countless stakeholders, Industrial Consumers are not surprised that the Task Force seems as perplexed as we are with the status of wholesale electric restructuring in the United States. After at least ten years of effort to reform wholesale electric markets such that workable competition replaces cost-based rate regulation as the primary paradigm for setting the rates, terms and conditions of power sales and services in interstate markets, there is very little evidence that any tangible benefits have accrued to end-use consumers.³ To the contrary, Industrial Consumers submit that electric restructuring generally has yielded higher prices, reduced reliability and lessened power quality. In short, consumers are worse off under the “current” restructured markets than they were under the traditional regulatory construct.⁴

Successful competition is self-evident. End-use consumers see this every day in competitive industries. For example, the telecommunications industry is another previously regulated network industry that was recently restructured. Yet, telecom is clearly a winner for consumers of all sizes that use these services for their entertainment, personal, and business needs. The degree of innovation at the point of sale staggers the imagination, especially new wireless services and applications

³ Reforms to wholesale markets such as FERC Order No. 888 applied to all FERC jurisdictional states and are independent of specific actions by the states. Thus successful wholesale restructuring had the potential to provide benefits to consumers in all states regardless of whether a state took further actions to restructure retail markets.

⁴ While Appendix C of the Draft Report documents a series of cost-benefit assessments of industry restructuring, the Task Force correctly concludes that it “can be challenging to understand these studies’ sometimes contradictory results.” DR at 100.

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involving the Internet. We are certain that cost-benefit studies will show that average customer costs or bills have increased with competition because demand for new services has increased. The only unfortunate analogy in the electric industry is that average costs have also gone up but not because of new, exciting innovation that resulted in increased consumer demand. Rather, prices are higher because of improper market designs and regulatory “fixes” designed to protect generators. In fact many large industrial consumers believe that their options are fewer today—and at much higher cost—then under traditional regulation ten years ago.

The Draft Report does a good job summarizing many of the market-like attributes in the restructured “organized markets” that some advocates claim is evidence of workable competition. This includes greater price transparency (including “locational” price signals) and nondiscriminatory access to the grid. Yet, the Draft Report clearly warns that the intended results of competition are not evident. We agree. One example is the need by wholesale buyers (including many large industrial buyers) for competitive long-term contracts. The Task Force’s research shows that contracts of less than one-year dominated each of three regional markets they examined. DR at 58. A market that cannot provide long-term contracts is not customer focused. Customers need the ability to budget and plan on a multi-year basis. Longer-term contracts are also more likely priced closer to the assets’ average costs than to the often higher marginal cost normally reflected in shorter-term contracts. The Draft Report blames the failure for such forward contracting on at least three factors. First, “the very competitiveness of these markets cannot be assumed.” Specifically, the centralized (pool-like) market design of the organized markets “cannot guarantee competitive pricing, since there may be only a small number of sellers into or buyers from the pool.” Second, the market is illiquid and also lacking a futures market capable of hedging longer-term obligations. Third, transmission customers are unable to secure firm transmission rights for multiple years at a known price. DR at 58-59.

However, long-term contracts are alleged to be vulnerable to certain regulatory risks such as (1) abrogation by FERC, (2) bankruptcy of the supplier, and (3) the uncertainty associated with the retail load served under the contract. DR at 60-61. The Draft Report implies that the existence of these risks explains why forward contracting has not developed. Industrial Consumers disagree. The second and third risks are ubiquitous in our economy. Industrial Consumers face these risks all the time with their other suppliers and these risks are managed in the normal course of their businesses. The first risk is an example of the fact that regulation is incapable of providing absolute certainty. While there is some risk associated with FERC-approved contracts, the same or greater risk is associated with any revenue stream offered in short-term capacity markets (e.g., capacity credits); continued authorization of market-

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base rate authority; the rates, terms and conditions of any OATT; or anything else FERC approves today that a future commission may decide to reverse.

The Draft Report paints a generally bleak picture of prospects for new generation investments, and observes that in recent years investors have “generally favored traditional utilities over merchant generators when it comes to providing capital for large investments.” DR at 62. Part of the reason for this can be attributed to the collapse of the merchant generator sector resulting from a combination of too much new generation built on spec between 2000 and 2005, the run up in and increased volatility of natural gas prices, and the poor margins on sales into the organized energy markets such as PJM. Industrial Consumers believe that this situation may be permanent and reflects the fact that a workably competitive wholesale market has failed to develop. The market design of the organized markets that was the target market of many of these generators creates this problem and makes the security of the traditional utility’s rate base a safer option for investors—especially if other generation types are considered instead of natural gas fired units. The Draft Report is correct in observing that baseload units such as coal plants are harder to finance. DR at 63.

The Draft Report is correct in observing that price signals in the organized energy markets are distorted (by regulatory intervention) and this has a negative effect on the investment returns of generators, which, of course, suppresses new investments. DR at 64-65. The Draft Report also observes that the out-of-market compensation of reliability-must-run (RMR) units is a further distortion of price signals.

Industrial Consumers submit, however, that such regulatory “fixes” have been misdirected and generally reward existing generators without providing proper incentives for new investment, and all at considerable expense to consumers. For example, since the administratively-determined demand curve was adopted for the New York capacity market in 2003, no new applications for generation capacity have been filed. Clearly, despite promises to the contrary, the capacity payments are not resulting in new entry. Nevertheless, existing generators have eagerly pocketed the capacity payments. In addition, there is now a new, different capacity market mechanism approved for New England and another one under development in PJM, setting the stage for three different capacity market mechanisms in these adjoining ISO territories. One can only speculate at all the seams issues that will be created by this uncoordinated regulatory scheme.

The Draft Report emphasizes that transmission is “vital to the competitive options available to market participants,” but is no less charitable with respect to the prospects for new investment in transmission facilities. For example, the report notes that “[l]ess regulatory intervention in wholesale markets for generation may be

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necessary if transmission upgrades, rather than unrestricted high prices or capacity credits, are used to address concerns about future generation adequacy. DR at 66.

The Task Force believes that “[o]ne of the most contentious issues currently facing federal regulators is whether the different forms of competition in wholesale markets have resulted in efficient allocation of resources.” DR at 66. For example, the Draft Report observes that reliance on the open access provisions of the OATT in regions without organized markets (e.g., the Northwest and Southeast) does not eliminate the potential for discrimination in wholesale markets. As a result, “wholesale customer may remain dependent on local generation owned by one or only a few sellers and be denied the competitive options supplied by more distant generation.” In addition, “new suppliers have no means of competing with incumbent generators located close to traditional load.” DR at 66.

The Task Force observes that the auction-based pricing in the organized markets may create a “tension” between market-clearing prices and resource adequacy. Initially, Industrial Customers did not agree that market-clearing prices for energy are too low to maintain resource adequacy. As noted earlier, it is becoming painfully clear that new entry, which determines resource adequacy, is contingent on the ability to finance a project which, in turn, is dependent on long-term contracts. There is no reason to believe that removing price caps in the energy markets will provide investors with the degree of comfort needed to provide a long-term loan. Moreover, removing the price caps without addressing other infirmities in the energy auction process would not be appropriate. For example, many consumer groups question whether the “last accepted bid clears the market” energy auction design is fair to consumers, particularly when gas peakers clear the market an inordinate percentage of the time. When gas repeatedly clears the market, the benefit of a diverse stable of generating resources is lost in the bidding process. It makes no sense to remove price caps to allow low-cost generators to secure even greater revenues than those provided by the current LBMP market design.

The Draft Report identifies four policy options for mitigating this “tension” and thus encourage new generation entry.

First, introduce scarcity pricing (i.e., “unmitigated exchange market pricing”). In the organized markets, new entry is suppressed by the absence of scarcity pricing because of regulatory intervention. The market will respond to the removal of this restriction in two ways: (1) “the resulting price spikes will attract capital and investment,” and (2) “higher prices will likely signal to customers that they should change their decisions about how much and when to consume.” DR at 67-68. However the Task Force gingerly notes the following:

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Unfortunately, it is difficult to distinguish high prices due to the exercise of market power from those due to genuine scarcity. High prices due to scarcity are consistent with the existence of a competitive market, and therefore perhaps suggest less need for regulatory intervention. High prices stemming from the exercise of market power in the form of withholding capacity may justify regulatory intervention. Being able to distinguish between the two situations is therefore important in markets with market-based pricing. DR at 68.

Industrial Consumers believe that this statement is one of the most important observations in the Draft Report. Real scarcity prices—and therefore efficient price signals—are, in effect, prohibited in the current market design implemented by all FERC-jurisdictional ISOs and RTOs because of mandated price caps and price mitigation schemes.⁵ This denies the formation of a true competitive market and the efficient allocation of resources that comes with competition. What is in its place is an ever-evolving hodgepodge of regulatory schemes that cannot be rationalized with either traditional cost-based rate regulation or true competition. And with or without scarcity pricing, it is difficult to distinguish high prices due to “genuine” scarcity from the exercise of market power.

Industrial Consumers believe that the Task Force’s statement above confirms our own observations that wholesale competition in electric energy markets does not exist in any FERC-jurisdictional wholesale market.⁶ It does not exist because price signals are deliberately distorted and owners of both transmission assets and generation are capable of exercising market power. The elimination of these problems is a structural requirement of a competitive market that cannot be finessed with trial-and-error type behavioral fixes and subsidies to stimulate new entry into the market.

A second policy option to encourage entry is to leave the price caps in place and use artificial capacity payments (or “capacity credits”) to compensate for the suppression of scarcity pricing. However, the Task Force seems to question this option because, among other reasons, it is difficult to estimate the appropriate level of capacity payments necessary to incent investment “without over-taxing market participants and consumers.” DR at 68. Industrial Consumers believe that this grossly understates the problem because the joint ownership of generation and transmission is likely to make any reasonable payment ineffective. The Task Force is also concerned that capacity

⁵ We emphasize, however, that simply removing the existing price caps without addressing the other very significant problems in the Organized Markets will simply make a bad situation even worse.

⁶ Many industrial consumers are satisfied with the degree of competition in the ERCOT markets, which are subject to the jurisdiction of the Texas Public Utilities Commission.

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payments may be risky because the rules used to establish the payment level are in flux.⁷ The Task Force identifies other potential shortcomings of capacity payments:

If capacity payments are provided for generation, they may prompt generation entry when transmission or demand response would be more affordable and equally effective. Capacity payments also may disproportionately reward traditional utilities and their affiliates by providing significant revenues for units that are fully depreciated. Capacity payments also may discourage entry by paying uneconomical units to keep running instead of exiting the market. These concerns can be addressed somewhat by appropriate rules – e.g., NYISO’s rules giving capacity payment preference to newly-entered units – but in general, it is difficult to tell whether capacity payments alone would spur economically efficient entry. DR at 69.

Industrial Customers contend that the capacity payment plans currently in place present all of these problems. Fundamentally, they reward existing generation without providing incentives that spur new generation. Inasmuch as a long-term contract to provide capacity appears to be a financial prerequisite for construction of new generation, the question that must be asked is – why are we spending hundreds of millions of dollars in capacity payments to subsidize existing generator units?

A third policy option is to expand the transmission infrastructure. DR at 69. However, the difficulty associated with new transmission upgrades has become legendary. In April 2005, ELCON published a special report, “Problems in the Organized Markets,” that identified an adequate transmission infrastructure as an essential pre-condition to competition in electricity markets. The inadequacy of the existing grid needs no elaboration here – even the US Congress has weighed in on this issue in the Energy Policy Act of 2005. But it remains to be seen how and when the hiatus in transmission planning and construction will end because no policy tool or regulation will work that does not fully mitigate the market power of utilities that jointly own transmission and generation.

Finally, the Task Force considered regulatory planning (e.g., IRP) rather than market mechanisms for ensuring resource adequacy. This unfortunately gets back to the problems that spurred interest in industry restructuring in the first place: the tendency for over-investment, excessive spending and unnecessarily high costs, and the lack of accountability. DR at 70.

⁷ To date, all proceedings used to determine the height and slope of the “demand curve” have been highly contested and adversarial.

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In conclusion, Industrial Consumers generally concur with the Task Force's observations. We would add that the Draft Report presents compelling evidence that wholesale competition has failed, thus questioning whether existing market-based rate (MBR) authorizations remain just and reasonable. This concern is addressed in Section C below.

B. Industrial Consumers' Comments on the Task Force's Observations on Competition in Retail Electric Power Markets

The Draft Report seeks comments on how provider of last resort ("POLR") prices affect competition in retail markets. We suggest that the challenges that the Task Force faced in wrestling with whether the wholesale market is producing outcomes reasonably associated with competitive markets are the same challenges that must be overcome to provide conclusions about the effect of POLR prices on retail competition.

POLR service is, in general terms,⁸ a retail service mandated by regulation or law – not the outcome of an efficient market. POLR supply is an all-requirements supply of whatever capacity and energy is necessary to fill the demand of customers that are not receiving their full requirements from an alternate supplier.

The authority of state commissions to set prices for POLR service varies as a result of state law, the extent to which in-state suppliers have divested generation and Constitutional limits on the ability of states to preempt federal regulation or confiscate property without fair compensation. Alternative and incumbent suppliers have one thing in common when it comes to POLR pricing; they both appear to believe that high and higher POLR prices are good for consumers. Retail consumers, on the other hand, see things very differently.

As the Draft Report discusses, some states capped initial POLR prices as part of the transition plan for electric restructuring. The Draft Report fails to note that these initial caps were also designed to accommodate recovery of stranded costs at a time when every incumbent electric utility (high and low cost) projected that market forces would produce substantially lower prices and compromise their ability to recover capital invested as part of the regulatory compact. The initial POLR price caps were not simply designed to protect customers. The billions of dollars customers paid unavoidably for "stranded costs" prevented beneficial consumer access to alternate suppliers at a time when the wholesale market was offering some customer-friendly

⁸ Detailed specifications of POLR service vary from state to state. These detailed specifications affect the nature of the service obligation that any POLR supplier may be obligated to meet.

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alternatives. FERC's hand was also at work here as it threatened states to either address stranded costs or face the results of FERC's disposition of the issue.

As price caps expire, most of the pricing conventions that are being used by states to establish POLR prices include some reference to market-based prices.⁹ As states approach the expiration of their price caps, they frequently consider establishing POLR prices through an auction process where suppliers theoretically bid against each other to take on the all-requirements supply obligation. In practice, the bidding process tends to produce prices that mirror (with adjustments for load factor and other variables) the expected short-term prices for energy, as such prices are set administratively in organized markets. This tendency is the logical outcome of wholesale market designs where generators have the ability to bid their output into the organized market to capture a spot market revenue stream without the "headaches" that come with obligations to provide a supply to meet all the requirements of retail customers.

As POLR price caps expire, reliance on wholesale auctions to set retail prices simply works to make the dysfunction and other problems in the organized wholesale market more visible to state regulators and customers. In this context, FERC's practice of granting wholesale market pricing authority without regard to whether "competition" is up to the task of ensuring just and reasonable rates tends to make state regulators and retail customers sitting ducks for suppliers eager to see just how much they can enhance their revenue streams and cash flow. In practice, it is not possible to assess the influence of POLR prices on competition in the retail market unless and until there is real competition in the wholesale market and then the question has to be is POLR a constructive adjunct to a competitive retail market or a destructive influence. And as the Draft Report observes, it is not currently possible to tell if results in the wholesale market are consistent with those generally associated with competitive markets.

The obvious interrelationship between problems in wholesale markets and retail markets was recently noted by Pennsylvania Commissioner William Shane in a statement issued as Pennsylvania announced a formal process to examine how it might mitigate the harm expected to occur as Pennsylvania's price caps begin to expire:

There are other elements at work in the wholesale energy market which will cause "competitive" wholesale electric charges to be even higher than they are at the present time. The impacts of Locational Marginal Pricing (LMP) are being recognized and questioned by many early advocates of Electric Competition.

⁹ See, for example, Section 4928.14, Ohio Revised Code.

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Additionally, proposals to provide economic incentives for the installation of electric generation "capacity" through a new administratively determined pricing mythology, the Reliability Pricing Model (RPM), will result in significantly increased "competitive" market prices. These wholesale market price methodologies are under the jurisdiction of the Federal Energy Regulatory Commission (FERC). I am sure that the vast majority of Pennsylvania's consumers know little or nothing about these elements. They will continue to look to this Commission for answers and solutions, as they have in the past.

I certainly do not question the potential benefits to LMP from load shifting or other demand-side management initiatives. However, I do question whether it is reasonable public policy to make default service "ugly" simply to encourage fixed price offers from competitive Electric Generation Suppliers. This is manipulated competition, not the robust "free for all" competition we expect and sometimes get from American capitalism.¹⁰

What Industrial Consumers can tell the Task Force about "competition" in retail markets is that it does not exist. Industrial Consumers also believe that FERC and other federal agencies that govern energy issues are not addressing the problems that are producing rate shock for retail customers and sending signals that are so disorienting that investors and consumers alike. We further believe that the public interest has been harmed in the search for a market model that works to enable efficient competition in the electric industry. In the meantime, consumers are suffering and a backlash by state officials is breaking out as they attempt to assign blame for the unfortunate results of the attempt to restructure the electric industry.

C. The Absence of Wholesale Competition and the Continued Viability of Market-based Rate Authorizations

The Draft Report does not address the role that FERC's substantial and frequent approval of market-based rate (MBR) authority has played in the electric industry restructuring effort. While the Draft Report acknowledges the interdependency between the quality of price signals and quality of consumption/investment decisions, it is FERC or its agents the ISOs and RTOs that dictate the size, shape, quality and timing of any price signal sent to or from the wholesale electric market.

¹⁰ *Re: Motion of Commissioner Fitzpatrick, Policies to Mitigate Potential Price Increases*, May 2006-C-0012, Statement of Commissioner Bill Shane at 1-3 (Public Meeting, May 19, 2006) *See also*, Press Release, Pennsylvania Public Utility Commission, PUC Begins Discussion on Options to mitigate Potential Significant Increases in Electricity Prices (May 19, 2006), available Online at, http://www.puc.state.pa.us/general/press_releases/press_releases.aspx?ShowPR=1535.

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FERC's primary jurisdiction over wholesale electric rates (or "prices") also has the effect of making it very difficult for any state regulatory authority to remedy a problem created by FERC's policy and administrative choices regarding MBR.¹¹ Questionable grants of MBR authority to utilities or their affiliates with the ability to exercise market power can and have set in motion forces that can do substantial damage to state and local economies, transfer billions of dollars of wealth from consumers to suppliers, expose retail customers to rate shock and leave those injured without meaningful or timely remedies. Inappropriate policy choices—that the Task Force Draft Report identifies—deprive suppliers and customers alike of the fundamental trust and confidence that are essential conditions for an efficient market economy.

Industrial Consumers believe that the unabated approval of requests for MBR authority as a major contributing factor to the growing mismatch between the expectations anticipated from electric industry restructuring and the actual outcomes.¹² Given the long list of concerns identified in the Draft Report, one must question whether FERC can continue to rely on market pricing to meet its statutory obligations to serve the public interest especially by suppliers that face powerful economic incentives to exercise market power that ultimately defeats the very purpose of market pricing. This suggests that FERC's policies on MBR deserves the attention of the Task Force.

Section 205 of the FPA mandates that wholesale rates are to be "just and reasonable" and non-discriminatory. In *Farmers Union Cent. Exch. Inc v. FERC*, the court recognized the overarching significance of the FPA's "just and reasonable" standard by holding that "undocumented reliance on market forces" is insufficient to satisfy FERC's regulatory responsibility of insuring "just and reasonable" rates.¹³ Repeatedly, the United States Supreme Court has held that the means adopted by FERC to establish and authorize rates and charges are not controlling; it is the end result commanded by the "just and reasonable" standard that FERC must respect.¹⁴

Any grant of MBR authority must be conditioned on the existence of a competitive market and a finding that the applicant lacks, or has adequately mitigated, market power.¹⁵ In other words, if and only if there is a competitive market, the

¹¹ See *Pacific Gas and Electric Co. v. Lynch*, 216 F. Supp.2d 1016, 53 Fed. R. Serv. 3d 1376 (2002).

¹² Industrial Consumers do recognize that FERC recently has been looking more carefully at some requests for MBR and has denied or withdrawn approval in some very limited cases. We urge FERC to greatly increase these efforts.

¹³ 734 F.2d 1468, 1502 (D.C. Cir. 1984).

¹⁴ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 591 (1944).

¹⁵ See *State of California v. Coral Power, LLC et al.*, Case No. 02-73093, slip op. at 13132-13133 (9th Cir. 2004).

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[Commission] may rely on market-based rates in lieu of cost-of-service regulation to ensure that rates satisfy the just and reasonable requirement of the Federal Power Act.¹⁶ Under these and only these circumstances, market-based rates are deemed to be just and reasonable, based on the inference that voluntary transactions between willing buyers and sellers will do directly what FERC must otherwise seek to do indirectly.¹⁷ But rather than testing the end result by reference to the just and reasonable standard, FERC appears to rely on a means (competition) while ignoring the growing public outcry that workable competition is simply not there. This is placing the public interest in great and immediate peril.

FERCs belief that the creation of the organized markets is prima facie evidence of competition (regardless of the end result) is apparent from the press release that FERC issued on June 5, 2006 to announce the issuance of the Draft Report. The press release contains the following quote:

Enactment of the Energy Policy Act of 2005 marked an important threshold in U.S. electricity policy. For five years, we have had a national debate on whether competition is the right policy in wholesale power markets. The Energy Policy Act of 2005 reaffirmed that policy, and represents a national decision to stay the course. The interagency report reflects that decision.¹⁸

These statements are inconsistent with our interpretation of the Energy Policy Act of 2005.

While the Energy Policy Act of 2005 gave FERC some new regulatory tools to use to pursue the public interest – tools that might be applied in conjunction with market-based approaches to producing just and reasonable rates – Congress spoke about a much different and broader purpose in the title of the legislation (“To ensure jobs for our future with secure, affordable and reliable energy.”)¹⁹ States like Maryland, Illinois,

¹⁶ See *La. Elec. Light & Power Authority v. FERC*, 141 F.3d 364 (D.C. Cir. 1998).

¹⁷ *Coral* at 13133 [citing *Texas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)]

¹⁸ Press Release, Federal Energy Regulatory Commission, Interagency Task Force Seeks Public Comment on Competition Report to Congress Under EPCA (June 5, 2006).

¹⁹ Congress also tried to send FERC an instructive message in the sense-of-Congress language included in Section 1236 of the Energy Policy Act of 2005. In this Section, Congress noted the strong objections by many States to a proposal to develop and implement a locational installed capacity mechanism in New England and specifically referred to the states’ concerns that the proposal would “impose high costs on consumers and have a significant negative economic impact.” Here and elsewhere in the Energy Policy Act of 2005, Congress confirmed that nothing in the Energy Policy Act of 2005 should be construed by FERC or anybody else as a suggestion that Congress had rescinded the just and reasonable rate standard.

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Pennsylvania, New York, Virginia, Connecticut, Delaware, Maine and Ohio are struggling to manage the substantial problems created by electric prices too high to tolerate and prices so unpredictable that capital investment must be encouraged with subsidies or recovery assurances, FERC continues to pursue an agenda that assumes that any problem associated with resource adequacy can be solved by increasing prices.²⁰ It appears that the agency simply does not believe that the source of these

²⁰ The current fascination with price signals seems to be predicated on assumptions that information collection systems, billing systems, pricing conventions, cost allocation procedures, invoicing practices and collection techniques are capable of conveying price signals that convey meaningful information about investment or consumption choices. These assumptions are not based on real world conditions. Many of the unbundled components that affect the ultimate delivered price of electricity are billed to market participants by simply dividing a revenue requirement by a participant's load ratio share. For example, in a recent case (FERC Docket Nos. ER04-691-71 and EL04-104-65) involving questions about the method that should be used to refund overcollected marginal losses, the Midwest ISO provided a data response (by letter dated June 8, 2006) and telling insight regarding the practical limitations that affect the search for the perfect price signal and, if found, the ability to convey any such signal:

Upon further study, the Midwest ISO has determined that its systems are unable to track, in MWh terms, and cannot otherwise estimate, adequate and reliable Market Participant-specific data on marginal, average or actual losses. Consequently, the Midwest ISO is not in a position to provide the requested Market Participant data to the Commission.

Pursuant to the Commission's approval of the EMT as the basis for the Energy Markets, the Midwest ISO has established and used systems and procedures that track, analyze and use operational data in accordance with financial transactions through a pool rather than physical, "contract path" market design. As a result, the Midwest ISO designed its systems neither to monitor nor document physical losses per Market Participant on a MWh basis whether such losses are characterized as marginal, average or actual.

Instead, the Midwest ISO administers Energy Markets with aggregate loss data; it is not a system of bilateral trades. In Energy Markets, loads (and other demand) buy energy from the market and generators (and other suppliers) sell into the market - without matching each particular buyer to any particular seller. Consequently, the system was never designed to track what a specific load is buying from a specific source, and what losses are caused on the margin. Any attempt to calculate the marginal losses caused by a specific Market Participant would require an essentially arbitrary "pairing" of suppliers and loads.

Given the financial nature of the Midwest ISO's Commission-approved market design, the Midwest ISO does not allocate marginal losses or actual losses by Market Participant. Pursuant to Section 40.6 of the EMT, the marginal losses revenue *surplus* is eventually allocated to each Market Participant in each Balancing Authority by a load ratio share after initial allocation of the total marginal losses surplus among Balancing Authorities as individual loss pools. The allocation of surplus, however, is done in dollar terms, not in megawatt-hour terms. Moreover, the surplus allocation is fundamentally different from

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problems has other origins – namely the continued ability of utilities to exercise market power.²¹ Policy makers need to come to grips with the problems that existing markets and regulatory practices are creating.

FERC's duty is to "ensure that market-based rates are just and reasonable."²² Just and reasonable rates are defined as rates that are neither " 'less than compensatory' nor 'excessive.' "²³ Just and reasonable rates should strike a "fair balance between the financial interests of the regulated company and 'the relevant public interests, both existing and foreseeable.' "²⁴ Justice Scalia stated that FERC must recognize when exercising its power under the FPA that protecting the utility customer should be the overriding concern.²⁵ "The Federal Power Act's primary purpose [is] protecting the utilities customers."²⁶ These statutorily mandated pro-customer objectives require FERC to discharge its obligation to ensure that rates are just and reasonable, regardless of the means.

In ignoring demonstrations of significant flaws in the organized markets, FERC has effectively shifted the burden of proof regarding the existence/absence of competition. Approval of MBR authority for all intents and purposes has become the default outcome, not an outcome dependent on a demonstration that the exercise of such authority will produce just and reasonable rates. Even though FERC cannot lawfully grant or extend MBR authority without substantial evidence that a competitive market, capable of producing just and reasonable rates, exists for customers as required

the calculation and allocation of marginal losses or actual losses caused by each Market Participant.

²¹ FERC's quest for the ideal price signal also seems out of touch with common sense and practical concessions that are made so that customers can afford to maintain utility services. As a result of rapid increases in energy costs, utilities, state regulators and residential consumer advocates have increasingly urged smaller customers to take advantage of budget billing programs so that they can better budget and pay for their utility services. While it may be theoretically interesting to see what customers might do when exposed to hourly or other time-differentiated price signals communicated in real time, other and more important priorities drive to outcomes that average utility costs over a 12-month period no matter how "sophisticated" FERC's price signal design might become.

²² *Order Revoking Market-Based Rate Authority, Establishing Hearing and Settlement Judge Procedures, and Terminating Section 206 Proceeding*, 113 FERC ¶ 61,124 at P 2, (2005) (November 3 Order).

²³ *Id.*, See also 16 U.S.C. § 824d(a).

²⁴ *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984).

²⁵ See *Electrical Dist. No. 1 v. F.E.R.C.*, 774 F.2d 490 (D.C. Cir. 1985).

²⁶ *Id.* at 493.

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under the FPA, the process of granting MBR authority appears to accept without question that just and reasonable rates are a necessary outcome of organized markets.²⁷

In an “end result” context, the Draft Report’s observations are most instructive. The central question presented by the Draft Report asks if competition has resulted in the sufficient generation and transmission to provide customers with the kind of choice that is generally associated with competitive markets. The Draft Report tells us that the Task Force found this question challenging and it does not answer the question with a “yes” or “no”. Instead the Draft Report provides observations about alternatives and cites comments and concerns gathered from written comments and interviews. The Draft Report confirms that the wholesale market lacks liquidity and that customers are not able to secure long-term contracts. It provides statistics showing that investment in the transmission grid has fallen off in recent years and reports that retail customers are unable to find alternate suppliers. The Draft Report describes the rate shock that is occurring in retail markets as retail customers are put in the direct path of FERC’s price signal.

²⁷ The Draft Report does not support the view that just and reasonable rates are a necessary outcome of organized markets. For example, as reviewed above in Section A, it discusses the role of organized markets and the use of uniform price auctions (at pages 58 and 59) in conjunction with an examination of complaints about the lack of long term contract opportunities, noting the competitive concerns that arise when one subset of generators has the ability to set the auction price:

In addition, the very competitiveness of these [organized] markets cannot be assumed. For example, over ten years ago, FERC requested comments on a wholesale “PoolCo” proposal, which was the predecessor entity to today’s organized electricity market with open transmission access. At the time, the Department of Justice generally supported the emerging market form but warned: “The existence of a PoolCo cannot guarantee competitive pricing, since there may be only a small number of significant sellers into or buyers from the pool. The Commission should not approve a PoolCo unless it finds that the level of competition in the relevant geographic markets would be sufficient to reasonably assure that the benefits of eliminating traditional rate regulation exceed the costs.”

The fact that the market-clearing price in organized exchange markets may be established by a subset of generators depending upon demand and transmission congestion heightens the competitiveness concern in the organized markets. At one end, generators with high costs do not have much impact on the market prices when there is low demand and low transmission congestion, and conversely, generators with low costs do not have much impact on the market-clearing prices when there is high demand and high transmission congestion. There is a wide range of market-clearing prices between these two end points based on the diversity of generator costs available in each region. Indeed, some commenters specifically cited to recent studies of the electric industry that argue that a larger number of suppliers are needed to sustain competitive pricing in electricity markets than are needed for effective competition in other commodities.

DR at 58-59 (internal citations omitted).

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As discussed above, FERC's ability to rely on MBR authority is tied to its obligation to affirmatively demonstrate that administratively-designed, organized markets are producing just and reasonable rates and suppliers cannot exercise market power. The Draft Report's examination of the investment and consumption decisions may not permit its authors to say one way or the other if the results are results that might be generally associated with a competitive market. Industrial Consumers believe the results are obvious – there is no real competition in markets in which we operate. In this context, the Draft Report should also question whether FERC's process for approving MBR authority is capable of determining if existing market-based rates or any renewal of such rates is compatible with the FPA's just and reasonable requirement.

D. Conclusion

Industrial Consumers generally concur with the Task Force's observations – as far as they go. However, we urge the Task Force to take yet another very important step in its final report and arrive at a conclusion regarding whether real competition in either wholesale or retail markets exists at this time anywhere in the US. Moreover, the Task Force should urge the responsible agencies to address market design problems that are plaguing the wholesale energy and capacity markets.

Industrial Consumers believe strongly that the Draft Report presents compelling evidence that attempts to stimulate either wholesale or retail competition in electricity have failed. As an example, any basic economics text or course begins with an assertion that competition requires an interaction between supply and demand. Industrial Consumers commend the Task Force for pointing out that such an interaction does not exist in the electricity "markets" in the US. In the organized markets, suppliers (generators) simply interact with the ISO/RTO "markets." At an absolute minimum, the Task Force should state in its Final Report that to be competitive, electricity markets must be double-sided, the ability to exercise market power must be mitigated, there must be adequate market monitoring to protect the interests of consumers, and transmission congestion must be greatly reduced if not eliminated.

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DESCRIPTION OF THE PARTIES TO THIS FILING:

Electricity Consumers Resource Council (ELCON) is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community and many ELCON members operate PURPA qualifying cogeneration facilities. The member companies of ELCON consume approximately five percent of all electricity in the United States.

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American Iron and Steel Institute (AISI) is the principal trade association of the North American steel industry. Its member companies account for about seventy percent of the new steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity may constitute as much as twenty percent of the manufacturing cost of a steel mill product.

Association of Businesses Advocating Tariff Equity (ABATE), formed in 1981, represents the interests of large volume energy users in Michigan. ABATE intervenes in Michigan Public Service Commission proceedings to bring utility rates closer to the cost of service, to permit customers to choose their energy suppliers, and to ensure a reliable, competitively priced energy supply for the state. Where appropriate, ABATE examines the overall revenue requirements as well as the tariffs and conditions of

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service of Michigan's utilities. ABATE also represents members before the Federal Energy Regulatory Commission.

Coalition of Midwest Transmission Customers (CMTC) is an ad hoc coalition of large industrial end-users of electricity. All CMTC members operate one or more manufacturing facilities in the Midwest and purchase electric delivery service or bundled electric service from at least one of the transmission owners encompassed by MISO. CMTC members consume more than three billion kilowatt-hours of energy annually. CMTC is also a member MISO.

PJM Industrial Customer Coalition (PJM ICC) is an ad hoc coalition consisting exclusively of large commercial and industrial end-users of electricity. PJMICC members operate manufacturing and institutional facilities throughout the expanded PJM footprint, which encompasses all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and the District of Columbia. Several PJMICC members also operate manufacturing and institutional facilities located in parts of Virginia and North Carolina encompassed by the conditionally approved PJM South region. PJMICC member companies consume more than 10 billion kilowatt-hours of electricity annually. Several PJMICC members are currently also voting participants of the PJM Members Committee and actively participate in the PJM committee structure.

The Illinois Industrial Energy Consumers, (IIEC), is an informal association of industrial companies created to maintain an on-going presence before the Illinois Commerce Commission, the Illinois General Assembly, and the Federal Energy Regulatory Commission in order to communicate and act on issues relating to electricity, gas, and water regulation and deregulation, from the large industrial perspective in Illinois. The group has maintained the concept of *ad hoc* intervention groups to participate in individual electric, gas and water utility ratemaking matters as applicable before the Illinois Commerce Commission and the Federal Energy Regulatory Commission.

Industrial Energy Users - Ohio (IEU-OH) is a non-profit trade association of large OHIO energy consumers that spend collectively over \$3 billion per year on electricity and natural gas for their plants and facilities located throughout Ohio. IEU-Ohio's members employ over 250,000 people in Ohio. IEU-Ohio has been an active participant in state federal regulatory proceedings involving issues that affect the price and availability of utility services.

Multiple Intervenors, New York (MI) was formed in 1972. For more than 30 years the organization has participated in rate cases and generic proceedings before the

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New York Public Service Commission and the Federal Energy Regulatory Commission on both electric and gas issues. Multiple Intervenors acts as the representative of its members at the New York state independent system operator's management business, issues and operating committee, and related working groups. Multiple Intervenors sponsors educational meetings twice a year.

Wisconsin Industrial Energy Group, Inc. (WEIG) is a voluntary association of companies, which are large users of energy in Wisconsin. Organized in the 1970's, WEIG represents many of Wisconsin's largest employers in advocating with the State Legislature, the Governors office, the Public Service Commission of Wisconsin and the Federal Energy Regulatory Commission to support policies and actions that will ensure the reliable and affordable energy supplies needed to grow the statewide economy and create jobs.

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