



**Post-Conference Comments of  
The Electricity Consumers Resource Council  
On the Investigation of Terms and Conditions of Public Utility  
Market-Based Rate Authorizations**

Docket No. EL01-118-000

The Electricity Consumers Resource Council (ELCON) submits these comments in response to the debate at the March 11 Staff Conference on Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations.

ELCON offers the following arguments in response to the concerns expressed by commenters that generally oppose the Commission's proposals in Docket No. EL01-118-000:

- If anticompetitive behavior (such as physical or economic withholding) is occurring in the wholesale markets, then FERC has an obligation to correct such behavior through the imposition of refund obligations and other appropriate remedies. We urge the Commission to act swiftly and in a manner that does not undermine continued development of the bulk power markets. Any concerns that a refund obligation will cause uncertainty about the risk of investing in needed infrastructure are baseless as long as the Commission acts quickly and firmly. Clearly articulated rules—even involving potential penalties—reduce regulatory risk. Uncertainty is created when the rules (and the consequences of violating those rules) are not set in advance. That is all the Commission can do. It is not the Commission's responsibility to reduce investment risk by shifting price risk to customers and condoning prices that are not just and reasonable.
- Therefore, we support the proposed tariff amendment requiring: "As a condition of obtaining or retaining market-based rate authority, the seller is prohibited from engaging in anticompetitive behavior or the exercise of market power. The seller's market-based rate authority is subject to refunds or other remedies as may be appropriate to address any anticompetitive behavior or exercise of market power."

- Equally important, FERC has a duty to correct flawed market structures. For example, there is almost universal consensus that workably competitive wholesale markets require robust demand response. While pilot programs have been established in certain areas (New York ISO), no credible market for demand response exists today in any market including markets facilitated by approved ISOs or RTOs. Thus, the prices set in those markets may not be just and reasonable. ELCON strongly supports the Commission’s efforts to correct this problem.<sup>1</sup>
- There is no way, at this time, to identify all examples of economic or physical withholding, or other forms of anticompetitive behavior or exercise of market power. The wholesale markets are relatively new and new forms of trading behavior, both competitive and anticompetitive, are emerging as traders gain experience with these market structures. It is essential that a substantial refund risk be in place to act as a deterrent against truly anticompetitive behavior and the exercise of market power.
- The burden of proof that a supplier did not engage in economic and/or physical withholding is with the supplier. When a supplier is suspected of such behavior, it must fully document any legitimate environmental, operational and/or reliability factors that created the perception of anticompetitive behavior or the exercise of market power.
- The inclusion of “legitimate and verifiable opportunity costs” in any assessment of a supplier’s full incremental costs will rapidly lead the Commission down the slippery slope of administratively determined prices—which are more appropriately called “rates.” If this is the direction the generators want to go, then we suggest that a more efficient, transparent, and less burdensome approach would be the simple restoration of cost of service regulation.
- The refund risk must be limited to the party engaging in anticompetitive behavior or the exercise of market power. In bid-based markets with uniform price auctions, other suppliers, including loads providing demand response, benefit from the same market-clearing price. These parties should not be subject to the refund requirement

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<sup>1</sup> ELCON is encouraged by the proposed treatment of demand resources in the “Working Paper on Standardized Transmission Service and Wholesale Electric Market Design.”

since their decisions to enter the market were based on the expected price in relation to their opportunity costs (such as the cost to shut down a factory) at the time such decisions were made. As a practical matter, refund-related relief should not be tied to specific transactions.

Finally, the March 11 Staff Conference seemed like déjà vu all over again on the issue of generation adequacy. The parties representing generators were making the same dire warnings of capacity shortages as did their regulated predecessor companies almost twenty years ago during a series of Congressional investigations (the so-called “When Will the Lights Go Out?” hearings). And the generators even get the same help from the same Wall Street firms that benefit from the commissions and profits from investment deals.

For example, in 1985, a senior vice president for Standard & Poor’s testified that:

What does matter is that the increasing risk and declining productivity of capital in the industry mean that there are safer investment opportunities, yielding better returns elsewhere. In short, regulated electric utility plant is becoming a lousy capital investment for rational investors.

The implications of this should be obvious. Unless the industry is able to earn a return on its investment which is competitive with comparably risky investments outside the utility arena, good utility management will not commit capital to invest in additional plant. They won’t commit that capital because they won’t be able to raise it economically in capital markets where investors, and not regulators, have the power to determine required returns.

If capital is not available to support the industry’s ultimate construction needs, and if the various forecasts of slow load growth that some of us hear today are wrong, and if efforts to implement load management, encourage additional conservation or develop alternative sources of electricity fail, then some areas of the country may well have a long hot summer to look forward to one of these years.<sup>2</sup>

Congress never acted on this warning and correctly recognized that many utilities were way over their heads in a misguided construction program and were looking for a public bailout. Thus, Standard & Poor’s fear never materialized. In fact, by the late ‘80s the industry was faced with a glut of overcapacity, and as a result of that glut, billions of dollars in “stranded costs” were subsequently allocated to retail ratepayers.

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<sup>2</sup> Statement of Douglas Randall, Standard & Poor’s Corp., *Electric Power: Potential for Shortages in the 1990s*, Hearings Before the Committee on Energy and Natural Resources, United States Senate, July 23 and 25, 1985, p. 1039.

At the March 11 Staff Conference, Mark Jacobs of Goldman Sachs repeated the same concerns from two decades ago:

In light of current market conditions, raising external capital has become more difficult and more costly. There has been no shortage of bad news for investors in this sector. The electric industry competes broadly with other industries for capital from the investment community. We believe that these two concerns would tend to cause investors to redirect their investment dollars to other sectors and have a further negative impact on the ability of the industry to raise external capital and the cost of such capital that is critical to finance the construction of new electric generation facilities.<sup>3</sup>

ELCON urges the Commission to ignore this challenge to its efforts to promulgate prudent policy on market power. We suspect that a repetition of the past is in the making and a new glut of merchant generators that are ill suited to market needs may be emerging. Many of these plants are being built in the wrong locations with respect to loads and are predominantly gas-fired. The developers and investors of those plants have assumed those risks.

What has not changed in the last several decades is the endless attempt to use regulatory devices to shift market risk to retail customers when markets sour. Generators pursue these devices on a number of fronts in addition to their opposition in this proceeding to any market rules that expose them to real competition. This includes their aggressive pursuit of hopelessly-flawed capacity markets and growing exercise of market power within those markets by economic and physical withholding.

The argument that high prices today justify the need for new electric generating facilities is not necessarily true. Relatively high prices do not provide such a price signal if today's spot prices provide no information about the level of prices in the future. Today's prices may be driven solely by weather or outages. If it takes two to three years to build a new merchant power plant, the most appropriate price signal will be revealed in forward contracts that extend over that time period and beyond. Thus, a liquid forward market is prerequisite for reducing planning uncertainty, not high spot prices.

The new class of merchant generators has such promise, but from a consumer perspective that is beginning to disappear. Like their regulated brethren of the past, they seem

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<sup>3</sup> Prepared Comments of Mark M. Jacobs, Goldman, Sachs & Co., Conference on Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, March 11, 2002.

to claim that their investment risk should be borne by retail customers, yet the risk is still so high as to warrant higher returns on investments. In real markets, you can't have both.

Respectfully Submitted,

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