

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Conference on Supply Margin Assessment

AEP Power Marketing, Inc., AEP Service Corporation, CSW Power Marketing, Inc., CSW Energy Services, Inc., and Central and South West Services, Inc.

Entergy Services, Inc.

Southern Company Energy Marketing L.P.

Docket No. PL02-8-000

Docket Nos. ER96-2495-016,
ER97-4143-004, ER97-1238-011,
ER98-2075-010, and
ER98-542-006 (Not Consolidated)

Docket No. ER91-569-018

Docket No. ER97-4166-010

Comments of the
Electricity Consumers Resource Council (ELCON)

Dated: January 6, 2004

The Electricity Consumers Resource Council (ELCON) respectfully submits the following comments (five pages total) in response to the Commission's December 19, 2003 Notice of Technical Conference On Supply Margin Assessment Screen and Alternatives.

Since 2001, ELCON has been a strong supporter of the Commission's proposal to abandon the "hub-and-spoke" generation market power screen and replace it with a "pivotal" supplier test called the Supply Margin Assessment (SMA) screen to assess requests for market-based pricing authority. The purpose of either screen is to determine if the applicant—by failing the screen—has the ability to exercise market power by its control or ownership of generation. The SMA screen was to be applied to all sales other than those in markets operated by ISOs or RTOs with FERC-approved market monitoring units. The Commission's original SMA Order on November 20, 2001 Order (97 FERC ¶ 61,219) applied the new screen to three suppliers—

affiliates of AEP, Entergy and Southern Company—and each supplier individually failed the SMA screen for electricity sales within their respective control areas. The SMA Order also directed that market power mitigation procedures be placed in effect including a requirement that transactions not be market-based but consummated on a “split the savings” basis.¹

ELCON filed comments in support of the SMA Order on December 21, 2001. In those comments we noted that ISOs and RTOs, and their market monitoring and mitigation functions, are at an early incipient stage of their development and that it would be premature to waive the SMA screen for suppliers within ISOs or RTOs. We also commented that competitive markets must have both a supply and demand side, and urged the Commission to expedite markets for demand response as an important tool to mitigate market power.

The Commission subsequently delayed the implementation of the mitigation measures in the SMA Order pending the completion of a technical conference. On August 23, 2002, the Commission issued a notice establishing Docket No. PL02-8-000 (“Conference on Supply Margin Assessment”) to provide interested parties with an additional opportunity to comment. ELCON filed comments on October 23, 2002 that repeated its recommendations in the December 21, 2001 comments.

On December 19, 2003, the Commission issued a notice scheduling the technical conference for January 13 and 14, 2004, and requested written comments on a Staff Paper (“Technical Conference on Supply Margin Assessment Screen and Alternatives”) attached to the notice. This paper sets forth possible revisions to the SMA screen as well as possible alternatives to the SMA screen and revisions to SMA mitigation that would be imposed on those

¹ The SMA screen was also intended as an “interim” measure pending the completion of a new generic rulemaking on potential new analytical methods for assessing markets and market power.

that fail the adopted screen. The revisions and alternatives in the Staff Paper were prompted by widespread (but mainly supplier) criticism of the SMA Order.

The Current Market Context for Generation Market Power Screening

ELCON continues to support the need for a strong, effective generation market power screen that is applicable within ISOs and RTOs, and to control areas outside organized ISOs or RTOs. The electric industry in the United States is in a sorry state of arrested development—even the most successful ISOs or RTOs are structurally flawed and immature as competitive markets. The threat of horizontal market power (including the potential for tacit collusion) is as strong as ever with or without RTOs. Unregulated generators and marketers that are typically the affiliates of traditional utilities, and increasingly the dominant players in ISO/RTO markets, seek to exercise their considerable market power in bid-based markets by economic or physical withholding and other gaming strategies. While FERC has recently taken important steps to outlaw such practices, its ability to actually police or mitigate such gaming strategies is, at best, a work in progress because of the continued absence of meaningful markets for demand response in any ISO or RTO and other structural necessities. Outside of ISOs and RTOs, traditional utilities continue to use their ownership and control of transmission assets (and regulated generation) to exercise market power. Thus, some form of generation market power screen is needed in both situations.

Specific Recommendations

ELCON offers the following recommendations specific to issues addressed in the Staff Paper:

1. Application of the SMA or any other generation market power screen should not be a form of punishment for utilities that fail to form or join RTOs. This would otherwise belittle the real problem of generation market power which is broader in scope than assumed in the 2001 SMA Order. The Commission has recognized that it has ample statutory tools for coercing RTO formation.²
2. As suggested in the Staff Paper, spot market mitigation may encourage forward market development by eliminating any bias in spot markets for “prices” consistently above cost of service. Forward market development is essential if the goal of FERC’s pricing policy is workable competition in wholesale markets.
3. As an alternative to finding the perfect screen—and delaying its deployment until one is found—we urge the Commission to require that several screens be used and tested on an experimental basis, particularly in the context of ISOs and RTOs that have FERC-approved market monitors and there is recognized market dominance. Thus, the merits of each of the alternatives proposed in the Staff Paper could be determined by simply testing them in actual practice. Until empirical evidence suggests otherwise, an applicant will be subject to mitigation if it fails at least one of the tested screens.
4. Control areas that operate outside organized ISOs or RTOs should be required to have independent market monitors (IMM) that perform the screening and mitigation. The IMM would ensure data confidentiality required for mitigation. Market-based pricing authorization should be withheld from any supplier (and its affiliates) that refuse to

² See, for example, *The New PJM Companies*, 105 FERC. ¶ 61,251 (Nov. 25, 2003); and ELCON’s October 9, 2003 Post-Hearing Comments in Docket No. ER03-262-001 *et al* (“The New PJM Companies”).

support and fund the IMM. The boundaries of the IMM's authority should encompass the regional market and not just the border around each control area.

5. Generation market screens should be applied on a short time-frame basis. Screens adopted by ISOs and RTOs can be immediately applied on an hourly basis. IMM established for control areas outside operating ISOs or RTOs should determine the most workable time basis for applying the screens. In either case, data intensity should never be an excuse for less than full enforcement of the Federal Power Act as suggested in the Staff Paper.
6. Screening should err on the side of triggering too many failures rather than too few because spot market mitigation is a hold-harmless backstop from the perspective of retail consumers. The split-the-savings requirement allows transactions involving “pivotal” supply resources to be priced at cost of service. Cost of service was the industry standard for decades and amply compensates owners.³ There is no entitlement to market-based prices that are consistently inflated (above cost of service) because of structural flaws in the marketplace (*e.g.*, absence of demand response).
7. We reject arguments that spot market mitigation is harmful to retail consumers. The windfall that the retail ratepayers of utilities that successfully exercise market power may receive because margins from “off-system sales” are passed through to ratepayers is just that – a windfall. Other ratepayers served by the buyers of the power are harmed. All retail ratepayers benefit—or, at least, held harmless—when pivotal supplies that fail any screen are priced at cost of service.

³ In fact, many suppliers (*i.e.*, traditional utilities) actively resisted efforts to promote wholesale (and/or retail) competition because they feared that under such conditions market prices would tend to levels below cost of service.