

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Conference on Supply Margin Assessment
Screen**

Docket No. PL02-8-000

**MOTION TO INTERVENE ONE DAY OUT OF TIME
AND COMMENTS OF
THE ELECTRICITY CONSUMERS RESOURCE COUNCIL**

The Electricity Consumers Resource Council (“ELCON”) moves to intervene one day out of time and offers the following comments in connection with FERC’s August 23, 2002 notice establishing the above-captioned docket.

ELCON intervened in the AEP Power Marketing, Entergy Services, and Southern Company Energy Marketing dockets (ER96-2495-015, et al.) on December 21, 2001, after FERC’s announcement of the Supply Margin Assessment (“SMA”) market power screen. FERC subsequently delayed the effective date of the mitigation ordered in response to the application of the SMA, and solicited comments on the virtues of the new market power screen and the extent to which it should be applied.

In the ensuing eleven months since the initial application of the SMA, the Commission has debated the appropriate application of the SMA in a number of contexts. At FERC’s April 24, 2002 meeting, the commissioners deadlocked over whether the SMA should be applied to sellers participating in an RTO or ISO, with Chairman Wood and Commissioner

Brownell favoring a narrow application of the screen to those sellers not participating in spot markets run by RTOs and ISOs. Commissioners Massey and Breathitt argued that ISOs and nascent RTOs should prove they are free from market design imperfections before their participants are spared the application of the SMA. On July 31, 2002, the Commission released its Standard Market Design (“SMD”) NOPR, which includes a definition of market power and four types of mitigation: 1) local market mitigation; 2) a safety-net bid cap; 3) a resource adequacy requirement; and 4) independent monitoring by the ITP market monitor.

Commissioner Breathitt stated in her concurrence to the SMD NOPR:

I believe this proposed rule holds promise for solving the disagreements that we have today on the ability to exercise market power under our current methods for granting market-based rates. With these stringent new mitigation measures in place the Commission should reassess its reliance on the Supply Margin Assessment test and study the need for the 206 refund obligation.¹

The Commission’s August 23, 2002 notice in this docket acknowledged the split among commenters in the previous dockets regarding the extent to which the SMA should be applied in the context of RTOs and ISOs.² ELCON welcomes this opportunity to encourage the Commission once again to apply the SMA both inside and outside RTOs and ISOs.

COMMENTS

ELCON commends the Commission for undertaking a long-overdue reexamination of the “hub-and-spoke” market power screen. On January 25, 1990, ELCON filed comments expressing concerns over application of the simplistic 20-percent market screen test in

¹ Remediating Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design (“SMD NOPR”), 100 FERC ¶ 61,138, Breathitt concurrence, slip op. at 5 (July 31, 2002).

² ELCON also notes the Commission’s grant of market-based rate authority to Southern California Water Co. (“SCWA”), which exempted SCWA from the SMA screen because “the California ISO market will have a Commission-approved monitoring and market power analysis in place.” Southern California Water Co., 100 FERC ¶ 61,373 (Sept. 27, 2002).

the Public Service of Indiana (“PSI”) case, Docket No. ER89-672-000. Thirteen years ago ELCON advocated that FERC refrain from using a 20-percent market share (i.e., that a dominant firm is one that has a 20 percent or greater share of the market) as a reliable measure of market power. ELCON opposed the use of such bright-line rules with precedential implications in the context of an individual rate filing. FERC responded that ELCON need not be concerned about FERC setting such a precedent because FERC understood that a 20-percent-share market power screen by itself would not indicate lack of market power:

[W]e do not believe that any one type of evidence is sufficient for this analysis, and we will not rely on any mechanical market share analysis to determine whether a firm has market power. Thus, PSI’s market share is not, in itself, sufficient to guarantee that PSI lacks market power. Market concentration figures alone do not demonstrate the existence, or lack, of market power, . . .

Public Service Company of Indiana, Inc., 87 FERC ¶ 61,214 (June 28, 1990). At long last, FERC is proposing to update the screen to recognize the reality of transmission constraints and reflect that some “pivotal” suppliers are critical to specific markets.

FERC has abandoned the hub-and-spoke screen in favor of the SMA. The SMA test differs in two respects from the hub-and-spoke screen (whether a seller had a market share of 20 percent). It takes into account transmission constraints and focuses on whether a seller is “pivotal” in the market, i.e., has capacity exceeding the market’s supply margin (defined as surplus capacity above peak demand). Suppliers with “pivotal” capacity must undertake mitigation measures to prevent physical and economic withholding. As proposed, however, the SMA will not be applied to sales into an RTO or ISO with FERC-approved market monitoring

and mitigation. Such sales will instead be governed by specific thresholds and mitigation measures to prevent withholding approved for the market in question.

ELCON offers the following comments on FERC's proposed new policy:

- RTOs are at an early incipient market stage and it is premature to waive the SMA screen and rely on market mitigation measures to be adopted and implemented by fledgling RTOs;
- The RTO market monitoring function is an after-the-fact safeguard and does not obviate the need for application of the SMA up front; and
- Demand-Response is critical to mitigate market power.

I. RTOs Are Too Underdeveloped To Waive The SMA Test And Rely On RTO Mitigation Measures and Market Monitoring Units

The SMA market power screen should be applied in all areas of the country, even those with FERC-approved RTOs and ISOs, because as yet there are not workably competitive wholesale markets in any region. While RTOs are an important and essential pre-condition to large competitive wholesale markets, the mere formation of RTOs does not guarantee that the initial RTO market design will be flawless, or that all forms of market power are mitigated.

FERC's last comprehensive examination of the bulk power markets occurred in November 2000 when FERC Staff issued reports on bulk power markets in the Northeast, Midwest, Southeast, and Texas ("ERCOT"). FERC Staff identified a multitude of market problems and flaws with respect to every region but Texas. The flaws included market design, problems with transmission access, transmission load relief ("TLR") curtailment, calculation of available transmission capacity ("ATC"), and lack of standardized protocols, among other

deficiencies. The Staff summarized an overall picture of an industry in transition: “The issues pertain to regulatory or structural uncertainty, the uneven pace of change, and complex market designs that are still in flux. This, combined with a period of unprecedented economic growth and heavy demand on electricity, means that there is a great deal of stress on the current bulk power markets.” Staff Report to the Federal Energy Regulatory Commission on the Bulk Power Markets In the United States, Nov. 1, 2000, p. 3.

FERC’s concern to incent RTO formation may lead FERC to waive the SMA screen where power is sold into an ISO or RTO with Commission-approved market monitoring and mitigation. FERC commissioners’ remarks at the November 20, 2001 meeting where the SMA was announced reflected a concern to offer “carrots” as rewards for RTO membership. Given the lack of workably competitive wholesale markets and the immature development of RTOs to date, we believe that it is not appropriate to dispense with the FERC SMA screen when power is sold into RTOs. There is too great a risk that the generators and other suppliers can abuse the fledgling and imperfect RTOs that now exist as a shield to escape the more searching screen for market power that FERC proposes to adopt. In addition, RTO markets will likely use bid-based market devices that are more prone to gaming, especially if a robust demand response is absent from the short-term markets.

FERC took notice of the market design flaws extant in the currently approved ISOs and RTOs in the SMD NOPR:

In regions of the country where the separation of transmission from generation has been addressed through the creation of ISOs (which, in some instances, have placed nearly all load under a single tariff), market design flaws create inefficiencies in the marketplace and opportunities for the exercise of market power. Conflicting market rules and procedures in neighboring ISOs have created or perpetuated seams problems that impede the economic flow of power from one region to another. All of these problems have hindered the progress

towards competitive regional electricity markets. Standard Market Design is intended to address these problems.³

The Commission specifically noted that such market design flaws were not limited to just one or two markets:

In the regions where voluntary, organized ISO markets for energy, transmission and ancillary services have been established under the existing tariff, problems due to the design choices have been characterized as “market design flaws.” A market design flaw is a market rule – including product specification, bid format, auction rules and pricing rules – that allows distortions in the market prices or availability of a product or service, whether energy, ancillary services, transmission service or installed capacity. In the years since the ISO markets have been operating, dozens of market design flaws have been identified, ranging from minor problems that cause temporary inconveniences to major problems that require markets to be re-designed. No region has been exempt from market design flaws of one type or another.⁴

To further demonstrate its point, the Commission added Appendix C to the NOPR, which includes more than 20 pages chronicling “examples of undue discrimination and impediments to competition that continue to exist in the electric industry.”⁵

ELCON strongly supports the Commission’s efforts in the SMD NOPR to address the exercise of market power through the implementation of standard market rules. However, it may take years for the full SMD to take effect, and in the interim, we need the strong protection of the SMA to shield market participants from the exercise of market power.

It is not sufficient for FERC to approve untested market monitor proposals to have confidence that regions with RTOs will be workably competitive. First, the market monitoring proposals are likely to need substantial revision based on actual experience. Second,

³ SMD NOPR ¶ 37 (emphasis added).

⁴ Id. ¶ 88 (emphasis added).

⁵ SMD NOPR Appendix C at 1.

market monitoring by definition is an after-the-fact remedy when the Commission's goal should be to adopt ex ante screens to avoid market power.

RTOs are works in progress; the institution of market monitoring that is a critical RTO functionality is likewise evolving. FERC should apply the new SMA screen in every area of the country, because none has in place a workably competitive wholesale market which obviates the need for a stringent market power screen, consistently applied.

II. The Importance of Demand-Response To Mitigate Market Power Has Been Recognized

ELCON urges FERC to move ahead on demand-response to mitigate market power. As Richard Cowart, formerly with the Vermont PSC, observed during FERC's RTO week in October 2001:

The single most important act that FERC can take to moderate market power of generators is to structure market rules and transmission tariffs to develop the demand side of the market. FERC should explore every opportunity to reveal customers' demand curves and deliver the economic and reliability advantages of distributed and demand side resources to the grid.

This Commission has repeatedly observed, in the past year or so, that bringing demand side to the trading floor is essential to reveal the demand curve and put balance back into the markets. This is a very encouraging development. I just want to emphasize how important that same act is to controlling the exercise of market power. Trying to control market power without a meaningful demand side response is like trying to steer a car at high speed with a flat front tire. No matter how tight your grip is on the steering wheel, it's going to be a bumpy ride. You're going to be swerving, and there's a good chance you'll go off the road.

We've learned the hard way that supply side bidding rules concentration ratios, open access rules are just not enough to eliminate generator market power. We've learned the hard way that running around after the fact with market investigations, price caps, and administrative price reformations, however necessary

they might be in tough circumstances, is difficult and contentious and adds uncertainty to the market.

Comments of Richard Cowart, Director, The Regulatory Assistance Project, RTO Week, Afternoon Session, October 19, 2001. Professor Hogan and Professor Joskow agreed with Rich Cowart about the importance of demand bidding in their presentations during RTO Week.

On October 3, 2001, the FTC Bureau of Competition Staff issued a report titled “Competition and Consumer Perspectives on Electric Power Regulatory Reform.” The FTC Staff stressed that policies are needed in retail and wholesale markets that will increase demand-side responsiveness. FTC characterized the lack of demand-response as “one hand clapping.”

The FTC Staff Report observed that to date: “None of the restructured wholesale markets (California, New York, New England and the Mid-Atlantic states) allow retail or wholesale buyers to participate through flexible supply and pricing requests in wholesale electricity spot markets, although...these markets are starting to allow such participation.” FTC Staff Report, p. 37. FTC Staff commented that “[e]nhanced demand-side response can be expected to moderate wholesale spot market prices and price volatility, as well as improve reliability for electricity.” Id. at 38. The FTC Staff Report noted the benefits of demand-response:

Increasing the price sensitivity of demand also will help to constrain existing or potential market power in generation. This is true because a price increase will be less profitable for generators if it is passed through and retail buyers respond by reducing their consumption by a significant amount.

Id. at 41. All retail customers, not just large industrial load, will benefit:

Large retail customer participation in wholesale markets, coupled with variable retail pricing, would benefit all retail customers,

because the average price paid by all customers decreases as peak demand is reduced. These programs increase system reliability, mitigate the potential for price spikes during periods of peak demand and supply scarcity, and increase the opportunity for retail suppliers to add value to commodity reselling, as well as indirectly reduce the environmental impacts of electricity production. Moreover, real-time, demand-side participation by wholesale buyers and large retail customers of electricity can potentially mitigate existing electricity supplier market power and increase incentives to attract customers by lowering prices.

Id.

A competitive market must have both a supply and demand side. There cannot be a wholesale-only market that is workably competitive. ELCON urges FERC to expedite demand-response as an important tool to mitigate market power.

III. Good Cause Exists For ELCON's Motion To Intervene One Day Out Of Time

ELCON moves to intervene one day out of time. ELCON notes that the deadline for comments was reported as October 23, 2002 in the trade press.⁶ Given the one day delay, no party should be disadvantaged by this late filing.

DESCRIPTION OF INTERVENOR

The 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

⁶ See "Deadlocked Commission Asks for Another Round of Comments and Plans Technical Conference on Controversial SMA Market Power Screen," Foster Electric Report, Aug. 28, 2002, at 11.

products from virtually every segment of the manufacturing community. The member companies of ELCON consume approximately five percent of all electricity in the United States.

NOTICES AND COMMUNICATIONS

Notices and communications should be addressed to:

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Respectfully submitted,

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Dated: October 23, 2002

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Motion to Intervene One Day Out of Time and Comments of the Electricity Consumers Resource Council were today mailed to parties on the service list of this proceeding by U.S. mail, postage prepaid.

Dated at Washington, D.C., this 23rd day of October, 2002.

/s/ Kari Vander Stoep

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