

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Wholesale Competition in Regions with
Organized Electric Markets

Docket Nos. RMO7-19-000 &
AD07-000-000

**COMMENTS ON THE
ADVANCED NOTICE OF PROPOSED RULEMAKING¹
SUBMITTED ON BEHALF OF
POWER IN THE PUBLIC INTEREST**

SUMMARY

Power in the Public Interest (PPI) is a coalition of public power and consumer-owned utilities promoting electricity policies that enable delivery of reliable, cost-effective, and publicly accountable service to end-use consumers over the long term.² In general, PPI believes consumers have been deeply disappointed in electricity restructuring and price-deregulation, and thus we applaud the Commission for this inquiry into how operations under regional transmission organizations might be improved.

¹ Herein referred to as “ANOPR.”

² PPI’s participants are: Imperial Valley Irrigation District, Large Public Power Council, Municipal Electric Authority of Georgia, Northern California Power Agency, Public Power Council, Sacramento Municipal Utility District, Santee Cooper, Southern California Public Power Authority, and Tacoma Public Utilities.

These comments focus on some of the fundamental elements at issue:

- ◇ **The neither-fish-nor-foul nature of RTOs³.** The lines of public accountability in RTOs are inherently weak, placing an extra-heavy burden on the Commission to regulate them in the public interest.
- ◇ **The Commission’s obligation under the Federal Power Act to ensure that RTOs produce just and reasonable rates.** As part of this obligation, the Commission should engage in an *on-going* and rigorous review of prices in RTO regions, and their effect on *end-use consumer* prices—*compared to* more traditional cost-based systems and bilateral markets.
- ◇ **The consequences of marginal pricing and single-clearing-price auctions.** This central feature of RTO day-ahead markets guarantees that all plants needed in a given time period are paid the highest price bid by any participating plant. Many plant owners are paid amounts far above their incremental costs to supply power into these day-ahead (and hourly) markets. Not surprisingly, the owners of these plants find that supplying power through long-term, fixed-priced contracts is a comparatively less attractive business opportunity. Consumers, of course, pay the consequences. *The best way to encourage long-term contracting, a goal with which PPI agrees, is to constrict or remove opportunities for unwarranted profits in the day-ahead market.*

³ For the sake of brevity, these comments use “RTO” to refer both to regional transmission organizations and independent system operators, though some distinctions may be noted.

With respect to the four areas⁴ in which the Commission seeks comments, PPI's comments bear most directly on the second (improving opportunities for long-term contracting) and the fourth (responsiveness of RTOs). Because of the overarching repercussions of RTO governance on the other areas, we begin our discussion there.

COMMENTS

A. RTOs Have Inherently Problematic Lines of Accountability

RTOs are corporations with no stockholders, no citizen voters, and no end-use ratepayers to hold them accountable for costs in the usual way that these groups exercise cost and profit pressures on traditional utilities, whether investor-owned, municipal or cooperative.

RTOs are not subject to state regulatory authority (though a single-state ISO could be).

If a typical, regulated investor-owned utility spent money imprudently, its regulator could punish its shareholders by refusing to allow the utility to pass on these imprudent costs to customers through rates. Similarly, if a consumer-owned utility did not protect its ratepayers, it may lose its governors at election time.

The lines of accountability between an RTO and the people whose pocketbooks it affects are far weaker. Groups that used to have real power to protect customers and control costs, including state regulators and load-serving utilities, are now mostly reduced to advising and pleading with the RTOs on all aspects of their design and operation—and

⁴ “The four areas in which the Commission seeks comment are: The role of demand response in organized markets; Increasing opportunities for long-term power contracts; Strengthening market monitoring; and The responsiveness of RTOs and ISOs to customers and other stakeholders.” FERC News Release, Docket No. AD07-7-000 and RM07-19-000, June 21, 2007, p. 2, *bulleted formatting omitted*.

passing on the costs. In some RTOs, a diffuse system of membership-voting is allocated among competing stakeholder groups. These groups, however arranged, are not an adequate proxy for the public interest, even if they and the RTO management and staff are talented and well-intentioned.

The single entity left with real clout and ability to enforce the public interest is the Commission (as informed by the courts). And the primary way to enforce the public interest is to ensure that regardless of its governing structure, the RTO's service is reliable and its rates are just and reasonable. The burden of this responsibility falls especially heavily on the Commission, because of the loss or weakening of other lines of accountability.⁵

The Commission has noted⁶ the tension in RTO governance between, on one hand, 'independence from' and, on the other, 'responsiveness to' its stakeholders, and seeks to strike the best balance. In her concurring and dissenting remarks, Commissioner Kelly likens RTO boards to courts:

Currently, the independent board coupled with the stakeholder process, can be viewed as similar to the judicial model of governance. The stakeholders are like adversaries in a judicial proceeding arguing their cases to a disinterested judge, the independent board, which is capable of balancing the various equities in reaching a timely decision that is fair to all.⁷

⁵ It was the loss of state and local jurisdiction, and its concomitant role for citizens and ratepayers that motivated some regions to form *non*-RTOs, e.g., ColumbiaGrid in the Northwest, to improve regional markets while maintaining effective lines of accountability to end-users.

⁶ ANOPR

⁷ ANOPR Concurring and Dissenting remarks by Commissioner Kelly, p 3.

The problem is that the “judge” in this case is also operating the very system in dispute. Imagine a judge who is also the direct owner of a multi-billion dollar business with a staff of a 1000 employees who is trying to resolve a dispute about the business, and the analogy quickly begins to break down.

Nor is an RTO, even with stakeholders on its board, like a legislature. Legislatures don’t implement their own laws—the executive branch does.

But an RTO is not a regional government, either. (There’s no such thing under the Constitution as a regional government, with the exception of an interstate compact, which is not applicable here.) An RTO is not a government at all, and should not be expected to perform as one. Legally, of course, it is a “public utility,” for regulatory purposes, and that is the better way to think of it.

The truth is that an RTO is a singularly odd animal for an institution of any kind, but especially for one whose business is imbued with the public interest and huge financial interests.

The Commission has suggested⁸ a hybrid board in which a minority of board members hail from stakeholder groups. The Portland Cement Association proposes⁹ that a majority of board members come from consumer interests and regulators, but does not specify how customer-class and geographical representation (the main source of tension in allocation of costs) should be handled. PPI takes no position on these proposals at this time or on the Commission's authority to impose them. The difficulty in determining an appropriate allocation of seats on the boards, and how those votes would influence RTO practices, only serves to reinforce the importance of the Commission's role to ensure that rates are just and reasonable—regardless of corporate structure.

B. The Commission Should Rigorously Review, on an On-going Basis, Whether RTOs' Pricing Policies Deliver Net Value to End-Use Consumers

The Commission has many appropriate avenues for examining whether RTOs are in fact serving the public interest. One of them should be an *on-going*, active assessment of prices in RTO regions, and whether those prices would be lower, over the long term, under a more traditional, cost-based, bi-lateral market. Since one cannot prove the counterfactual (no region can be both “organized” and “traditional” simultaneously), the Commission will have to rely on an array of empirical and analytical evidence.

⁸ ANOPR , paragraphs 148-152.

⁹ Comments of the Portland Cement Association, filed in this docket August 17, 2007, pp 22-25.

After 10 years of various versions of competitive markets, an avalanche of empirical data and theoretical analyses is piling up. Moreover, the situation is dynamic, as RTO practices, state retail and environmental policies, and resources and technologies continue to change. This creates a *continuing* need to examine the evidence, as conditions change. It also requires a continued open mind.

The overriding question is whether RTOs produce net *consumer* value over the long term (but not so long that whole generations of consumers and businesses do not benefit). This means RTOs must create net value that actually flows through to end-use consumers. This in turn means, as the Commission has intimated,¹⁰ that the effects of entwined wholesale and retail systems must be evaluated holistically—with jurisdictionally appropriate actions to follow.

In the “Brief History” section of the ANOPR, the Commission notes that “by 2000, 24 states and the District of Columbia had enacted legislation or issued regulatory orders to restructure their electric industries.”¹¹ This information is now seven years old and much has changed since. States have repealed laws before restructuring could take effect (NV, NM, WV); never pulled critical triggers (OR, OK, AR); re-regulated (VA, MT); continued under price caps, thus avoiding market prices (OH, PA); legislated company-provided credits to blunt the effect of market prices (IL); judicially invalidated

¹⁰ ANOPR, paragraph 24.

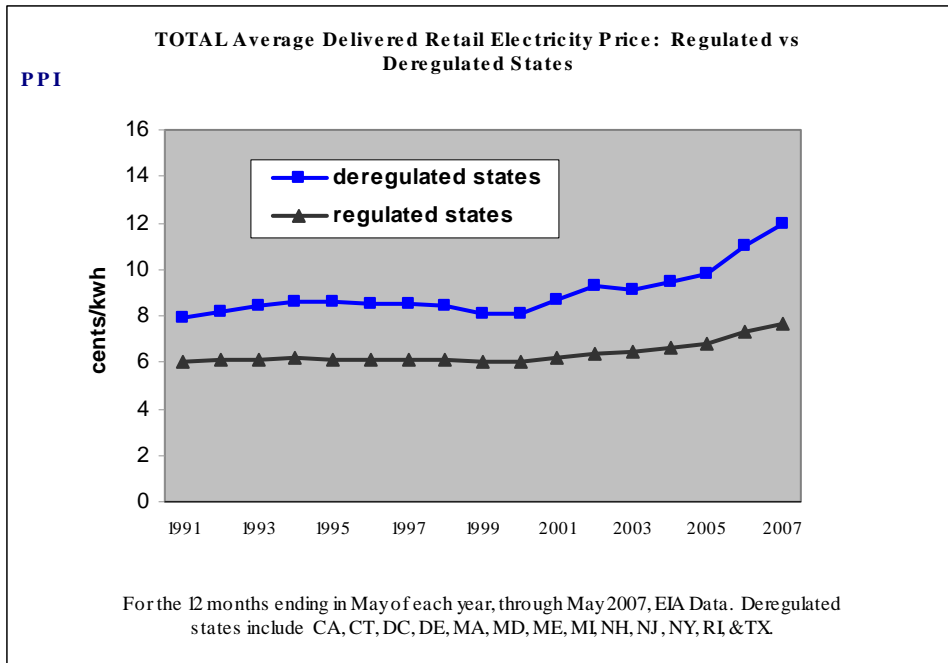
¹¹ ANOPR, paragraph 17, footnote omitted.

restructuring laws (AZ) and partially suspended retail access (CA). Overwhelmingly, what drove these states to act were the high prices they or their restructured neighbors were suffering, always in connection with an organized wholesale market.

Today, twelve states and the District of Columbia (CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, & TX) subject significant portions of their population/load to market prices, and *all* of these states participate in an RTO/ISO.¹² Prices and price-trends in this group, therefore, comprise the first place to look at how competition is working.

The graph below shows retail prices in this price-deregulated group, compared to prices in the rest of the states, which have regulated rates (including price caps). Prices are for the twelve months ending in May of each year, through May 2007 (the latest data available from the US Energy Information Agency). They are for total delivered cost (generation, transmission, distribution) to all customers in a state.

¹² For more discussion of the selection of these states, see PPI's website at http://www.ppinet.org/graph_construction.php. For summaries of state legislative and regulatory actions regarding restructuring see APPA's website at <http://www.appanet.org/aboutpublic/staterestructurlist.cfm>.

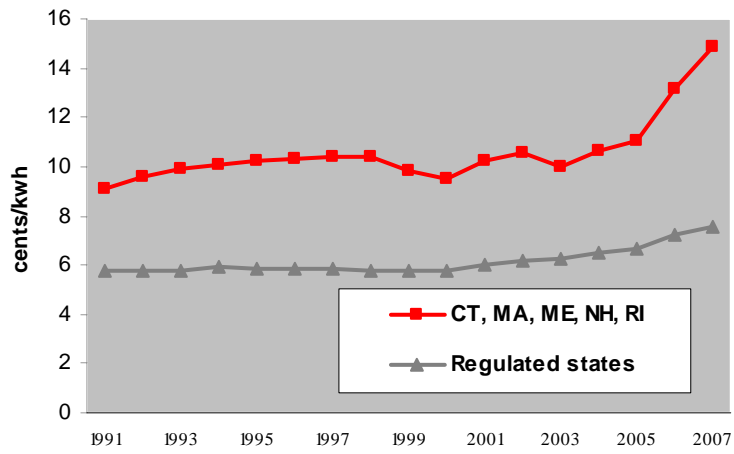


The gap in average price between the two groups has grown from roughly 2 cents in 2000 to over 4 cents today. This is not to say that deregulation/restructuring is responsible for the whole gap, or that the gap can be closed. The gap *does*, however, reveal the significant economic disadvantage suffered by customers in the price-regulated states, and the imperative for the Commission and the regions—whatever their resource mix—to ensure they are pursuing the most effective form of economic regulation of electricity.

The next graphs show the price-deregulated states broken down by RTO region:

PPI

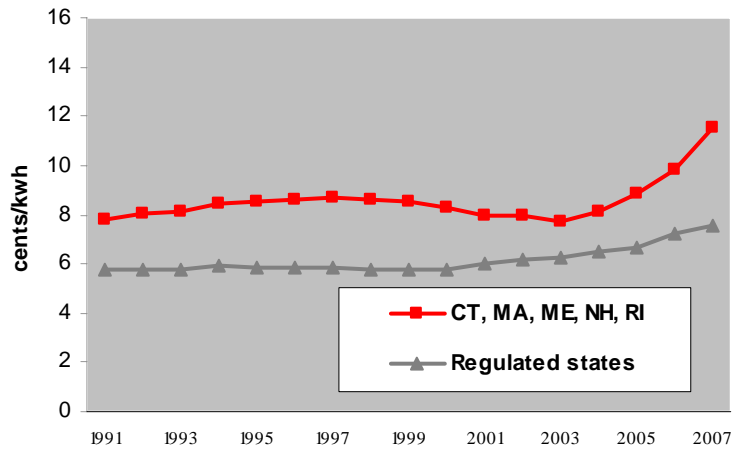
**TOTAL Average Delivered Retail Electricity Price:
CT, MA, ME, NH, RI vs Regulated States**



For the 12 months ending in May of each year, through May 2007, EIA Data. Regulated states include all states except CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, & TX.

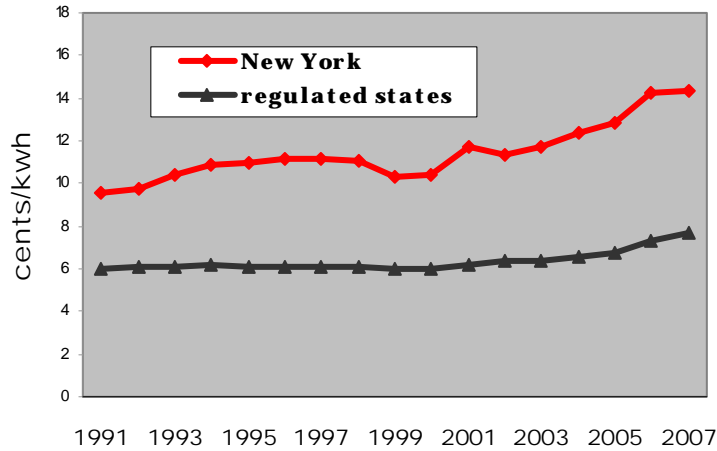
PPI

**TOTAL Average Delivered Retail Electricity Price:
CT, MA, ME, NH, RI vs Regulated States**



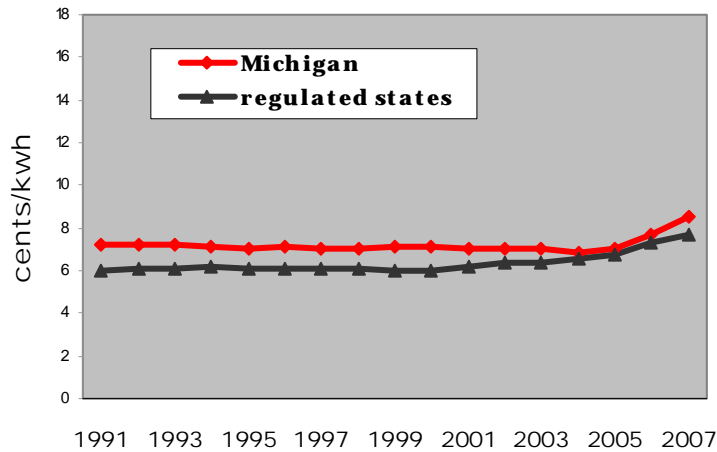
For the 12 months ending in May of each year, through May 2007, EIA Data. Regulated states include all states except CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, & TX.

**PPI TOTAL Average Delivered Retail Electricity Price:
New York vs Regulated States**

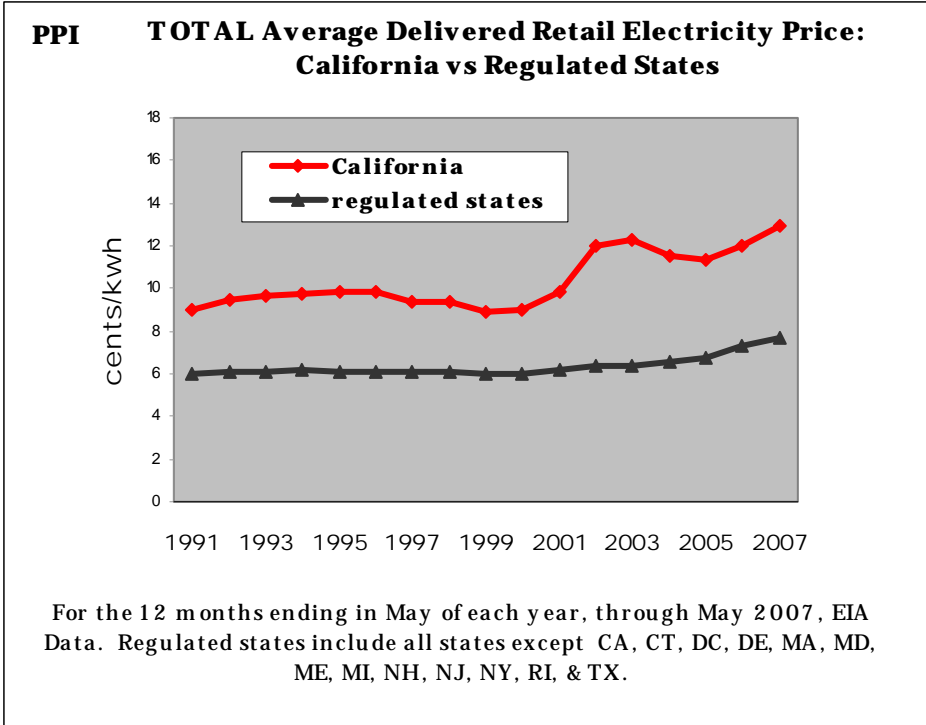


For the 12 months ending in May of each year, through May 2007, EIA Data. Regulated states include all states except CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, & TX.

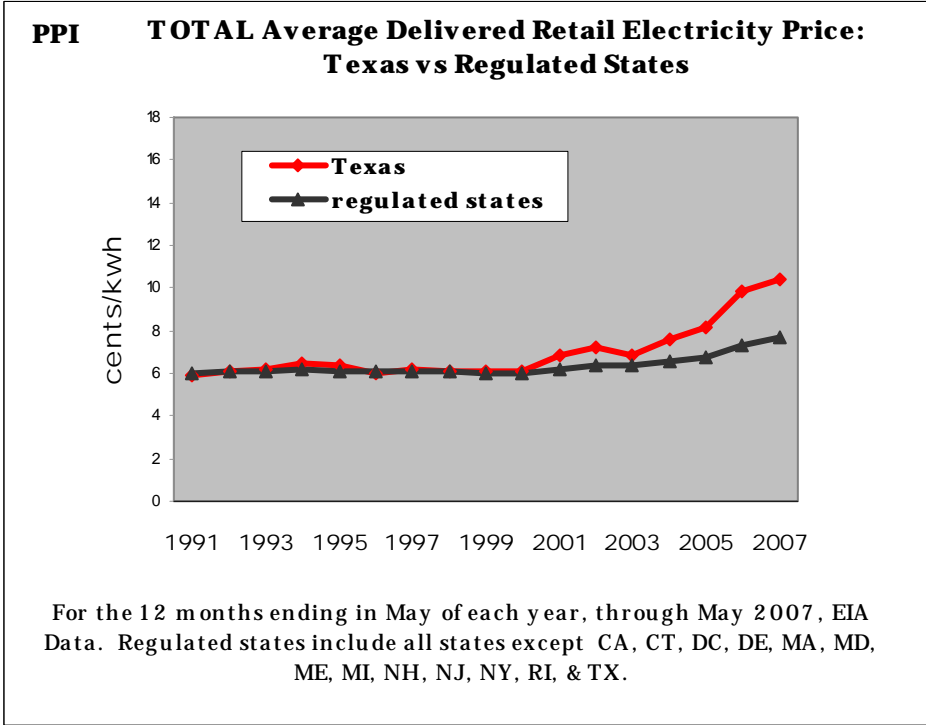
**PPI TOTAL Average Delivered Retail Electricity Price:
Michigan vs Regulated States**



For the 12 months ending in May of each year, through May 2007, EIA Data. Regulated states include all states except CA, CT, DC, DE, MA, MD, ME, MI, NH, NJ, NY, RI, & TX.



And, for the Commission’s non-jurisdictional interest:



C. In Particular, the Commission Should Examine the Consequences of RTO Marginal Pricing Policies and Should Consider Constricting Their Effects

Again, these charts are not offered as definitive proof of causation, but they are strongly consistent with the proposition—which should be more thoroughly considered—that RTO marginal pricing policies, market power, and open-access markets are driving up prices for ultimate consumers on a sustained basis. The Commission should pursue this question rigorously.

Some advocates claim competition *has* benefited consumer prices. The studies they cite, however, have been effectively refuted.¹³ Some claim that natural gas prices are the primary culprit, and that these high prices, over time, equally affect cost-based and market-based systems with the same resource mix. In a cost-based system, however, consumers pay *only for the gas that is used in the gas plants that serve them*. In RTOs, *all* resources get to charge the marginal bid (often based on natural gas prices), driving prices up all resources across-the-board. Worse, as Ken Rose's study¹⁴ has revealed, the marginal bid may exceed even the marginal cost of gas plants, indicating the possible exercise of market power.

¹³ An excellent, though not the only, collection of work on this subject can be found on the American Public Power Association's (APPA's) website, <http://www.appanet.org/aboutpublic/index.cfm?ItemNumber=16772>.

¹⁴ Ken Rose, "The Impact of Fuel Costs on Electric Power Prices," <http://www.appanet.org/files/PDFs/ImpactofFuelCostsonElectricPowerPrices.pdf>

Some advocates claim we haven't waited long enough for the inevitable cycling of marginal prices to below average price, at which time consumers in competitive markets will make up for what they lost, and consumers in cost-based systems will suffer. This crystal ball is unreliable, given the growing demand for resources worldwide and renewable energy requirements legislated by many states. On September 12, 2007, world oil prices topped \$80 per barrel for the first time.¹⁵ Absent a collapse in the economy (that drops demand for electricity), the marginal bid—whether based on natural gas, renewable resources, or collective market behavior—is likely to stay above average system costs for some time come. Nor is it clear that lower organized wholesale prices, should they occur, would flow through to end-use consumers. Moreover, time is no friend to consumers and businesses paying high prices *now*. It is unfair to expect them to foot the bill for a promised benefit they may not survive to see, if it ever comes at all.

As it pursues this inquiry, the Commission should consider ways to reduce and narrow the role of marginal pricing in organized markets, perhaps returning to cost-based power pooling. The Commission has sought ways to encourage long-term contracts, a goal with which PPI agrees. The flip side of long-term contracts is the day-ahead market. The best way to encourage long-term contracting is to constrict or remove opportunities for unwarranted profits in the day-ahead market, so long-term contracts are as attractive as they should be. The rigorous inquiry urged above should inform the Commission on the

¹⁵“For U.S., Now, \$80 Oil May Be Tough to Bear,” Wall Street Journal, Sept 13, 2007, <http://online.wsj.com/article/SB118960811819925155.html>

best way to proceed. PPI expects that others may make more specific suggestions, and we look forward to the continued discussion of this issue.

CONCLUSION

PPI commends the Commission for undertaking this inquiry and looks forward to continued discussion of the important issues the Commission has raised.

Respectfully submitted,

Power in the Public Interest

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