BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of the Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company, for approval of a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated With Reconciliation Mechanisms and Phase In, and Tariffs for Generation Service	)))))))))	Case No. 07-796-EL-ATA Case No. 07-797-EL-AAM

MOTION FOR LEAVE TO INTERVENE OF
THE ELECTRIC POWER SUPPLY ASSOCIATION

Now comes the Electric Power Supply Association (EPSA), who in response to the Ohio Public Utilities Commission staff comments on September 21, 2007, presents comments as to the application filed by the Ohio Edison Company, Toledo Edison Company, and the Cleveland Electric Illuminating Company (jointly FirstEnergy) in the above styled proceeding. Further, pursuant to Section 4903.221, Revised Code and Rule 4901-1-11 of the Ohio Administrative Code, EPSA moves for intervention in the above styled proceeding as a full party of record.

EPSA is the national trade association representing competitive power suppliers, including generators and marketers.[1] These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities

[1] The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

serving power markets. EPSA seeks to bring the benefits of competition to all power customers.

EPSA is intervening late in this proceeding because EPSA's comments respond directly to the September 21, 2007 Ohio Public Utilities Commission Staff Report (Staff Report) in this proceeding, not particularly to FirstEnergy's proposal. The Staff Report raises sweeping policy questions about wholesale competition in general and the use of any competitive bidding processes. EPSA's interests in this proceeding and the reasons supporting this Motion to Intervene are set forth in the attached Memorandum in Support. EPSA will accept the record in this proceeding as it stands, and accordingly, its intervention out of time will not delay this proceeding nor prejudice any other party.

Respectfully submitted,

Nancy Bagot, Vice President of Regulatory Affairs
Tara Ormond, Manager of Regulatory Affairs
Electric Power Supply Association
1401 New York Ave, NW
11th Floor
Washington, D.C. 20005

Memorandum of Support

RE: In the Matter of the Application of the Ohio Edison Company, The Cleveland Illuminating Company, and the Toledo Edison Company, for Approval of a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications Associated with the Reconciliation Mechanisms and Phase In, and Tariffs for Generation Service.
Case Nos. 07-796-EL-ATA and 07-797-EL-AAM

In accordance with the procedures established in the above-docketed proceeding, the Electric Power Supply Association (EPSA) submits this memorandum of support for the record in response to the September 21, 2007 Ohio Public Utilities Commission Staff Report (Staff Report).

EPSA is the national trade association representing competitive power suppliers, including generators and marketers.[2] These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities serving power markets. EPSA seeks to bring the benefits of competition to all power customers.

The Staff Report points out that first and foremost, the Commission "needs to focus on whether or not the prices resulting from the Competitive Bid Process (CBP) proposed by the FirstEnergy companies can be relied upon to be just and reasonable."[3] EPSA agrees. In fact, EPSA asserts that a competitive bidding process, like the one advanced by FirstEnergy, is one of the most effective steps to ensure just and reasonable rates for Ohio consumers.

---

[2] The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

[3] Staff Report, p. 1.

The staff report goes on to challenge supporters of the auction proposal to "demonstrate that a wholesale market on which it will rely for electricity is sufficiently competitive."[4] And further, that the structure of spot market and uniform clearing price auctions within the state are sound. EPSA agrees that these fundamental market structures are essential to realizing the full benefits of a competitive wholesale electricity market. In combination with a competitive procurement process, like the one FirstEnergy has proposed, consumers will be afforded the most reliable, efficient and cost-effective supply options.[5] These market fundamentals are present in Ohio and in the greater MISO and PJM regions.

I. Competitive Wholesale Markets

The staff report is based upon the erroneous assumption that competitive wholesale markets have failed.[6] The only apparent basis for this assertion is the false premise that market-based rates in Maryland and Illinois have increased due to wholesale competition. In fact, the rate increases in those states are based on multi-year rate freezes that ended recently and coincided with substantial fuel price increases, not due to a fundamental failure of wholesale competition.[7] Maryland

[4] Staff Report, p. 9.

[5] For more information on building a robust, transparent, competitive procurement process, see EPSA's Competitive Procurement Guidebook, available at: http://www.epsa.org/forms/uploadFiles/4A2700000003.filename.EPSA_Debt_Equivalency_Report_Final_070705.pdf

[6] On page 6, the report notes, "The failure of retail markets in Ohio reflects the failure of wholesale markets to discipline prices to reasonable levels."

[7] The Illinois Customer Choice and Rate Relief Law of 1997, 220 Ill. Comp. Stat. Ann. 5/16-101 (2004), froze retail rates through the end of 2004, and the freeze was extended through the end of 2006. In Maryland, the Electric Customer Choice and Competition Act of 1999 led to restructuring transition case settlements which, for Baltimore Gas & Electric customers, capped rates and SOS provisions from the initial date of customer choice (July 1, 2000) until July 1, 2006.

and Illinois are the only examples given in the Staff Report to demonstrate "the failure" of wholesale competition. These states demonstrate nothing but the ill-effects of artificial rate stabilization mechanisms, which are completely unrelated to the state of competition in the wholesale market. Rather, if Staff were correct, than the flaws in the wholesale market would have resulted in extreme rate increases in other states as well. That is not the case. According to PJM's *2006 State of the Market Report*, "PJM real-time energy market prices decreased in 2006."[8]

In fact, studies have shown that wholesale competition has actually saved customers billions of dollars in restructured states, even in states like Maryland. A 2005 study by Global Energy Decisions, Inc., "Putting Competitive Power Markets to the Test," concluded that competitive wholesale power markets in the eastern United States and Canada produced at least $15.1 billion in customer savings during 1999-2003 in the Eastern Interconnection alone.[9] Another recent study done on Maryland specifically found that even with the recent end to the rate stabilization mechanisms, Maryland residential customers saved approximately $1.8 billion over the 1999-2006 period.[10] Competition not only results in reasonable

[8] "The simple average system LMP was 15.2 percent lower in 2006 than in 2005, $49.27 per MWh versus $58.08 per MWh. The load-weighted LMP was 15.9 percent lower in 2006 than in 2005, $53.35 per MWh versus $63.46 per MWh. The fuel-cost adjusted, load-weighted, average LMP was 5.6 percent lower in 2006 than in 2005, $59.89 per MWh compared to $63.46 per MWh." *2006 State of the Market Report*, Volume II: Detailed Analysis, March 8, 2007 by the PJM Market Monitoring Unit, page 32. Available at http://www2.pjm.com/markets/market-monitor/downloads/mmu-reports/2006-som-volume-ii.pdf.

[9] *Putting Competitive Power Markets to the Test: The Benefits of Competition in America's Electric Grid: Cost Savings and Operational Efficiencies*, prepared by Global Energy Decisions, July 2005, page ES-1. Available at http://www.globalenergy.com/competitivepower/competitivepower.pdf.

[10] *An Empirical Assessment of the Benefits of Competition in Wholesale and Retail Electric Market,* Prepared by Bates White, LLC (May 2006).

and clear rates for customers, but it also assures the most reliable and efficient market possible.[11]

Wholesale competition itself is not the problem. Artificial rate stabilization mechanisms do not allow the market to reflect true prices and thus create perverse results in retail rates. If rates rise substantially when Ohio's rate stabilization mechanisms expire in December 2008, wholesale competition is not to blame. Rather, higher market prices would reflect the sudden impact of costs that have mounted gradually over the years under the rate caps.

II. Uniform (or Single) Clearing Price Auctions

A uniform clearing price auction is used for the spot market in all RTOs and ISOs approved by the Federal Energy Regulatory Commission (FERC). The price determined by this auction is paid to all suppliers regardless of their individual bids, covering only that power needed to meet real-time or day-ahead demand that is not already under contract.

The Staff Report criticizes uniform clearing price auctions, stating that they are not competitive because all generators receive the same clearing price regardless of their cost.[12] An alternative commonly advanced is the pay as-bid auction. [13] Many critics of the uniform clearing price auction argue that an "as-bid" system, in which generators are paid what they bid, not the price bid by the marginal supplier needed for reliability, would reduce wholesale prices. While

[11] See above referenced Global Energy Decisions Study.

[12] Staff Report, p. 9.

[13] Under the pay-as-bid auction design, generators are paid the amount they actually bid rather than a uniform clearing price. In this case, the unit selection process is the same as described above, but each winner is paid exactly what it bid.

attractive on the surface, those seeking an “as bid” system mistakenly assume prices bid in an “as-bid” auction would be the same as those presently bid in the uniform clearing price auction, resulting in an overall lower average price.[14] In comparison to the pay-as-bid system, the uniform clearing price auction produces lower prices, greater transparency and market efficiency.

Uniform clearing price auctions rely on operating costs and are accordingly economically efficient, resulting in lower overall costs to consumers. A uniform-clearing-price market, the most common wholesale electricity market (as well as the pricing mechanism used in most other commodity auctions across the economy), encourages generators to offer their electricity at their "margin," their breakeven point for variable costs.[15] On the other hand, a pay-as-bid market encourages generators to offer their electricity at the expected market price. Knowing they will be paid only the price they offer, generators must offer a price high enough to recover both fixed and variable costs. Such bids reflect “market guesses,” and hence lack transparency.

Not only is this a question of pricing, but it is also a question of which model produces a more efficient market. The uniform clearing price auction encourages suppliers to structure their bidding behavior based on their marginal operating costs so that they can be selected for dispatch and be paid the clearing price. In a uniform clearing price auction, then, the lowest cost providers earn a contribution

[14] Thomas L. Welch, *The Most Effective Way; Market prices send investors clear signals to invest in the most efficient means for producing electricity,* Public Utilities Fortnightly (October 2006), p. 20.

[15] *Competitive Bidding Behavior in Uniform-Price Auction Markets,* published in the Proceedings of the Hawaii International Conference on System Sciences, January 2004 by Peter Cramton, University of Maryland.

to fixed cost recovery, while the higher cost generators (for instance, a gas peaker that sets the clearing price at the time of higher demand) earns little or no contribution to fixed costs. As a result, the uniform clearing price auction directly drives market efficiency by incenting generators to reduce their operating costs to increase their contribution to fixed costs. In fact, the uniform clearing price auction creates an important price signal as to what types of generation are needed in a particular region.

By contrast, in a pay-as-bid construct, all bidders, including coal and nuclear units, are incented to bid above their marginal operating costs because that is the only way they can be assured, if their bid is accepted, of recovering their fixed costs. All bidders will attempt to predict what the marginal clearing price will be and bid that amount. Given perfect information, the pay-as bid auction construct would yield the *same* result as the uniform clearing price auction. However, given the fact that information is imperfect, bidders in the pay-as bid auction will generally overestimate the clearing price in their bid guess, and prices to consumers will actually increase. Economists almost universally agree that in many supply and demand scenarios, pay-as bid prices will exceed a clearing price established through marginal cost based bids.[16]

Finally, a uniform clearing price auction is more transparent to regulators, facilitating the detection and remedy of market power abuses and promoting

---

[16] *BLUE RIBBON PANEL REPORT -- Pricing in the California Power Exchange Electricity Market: Should California Switch from Uniform Pricing to Pay-as-Bid Pricing? A study commissioned by the California Power Exchange*, by Alfred E. Kahn, Cornell University; Peter C. Cramton, University of Maryland; Robert H. Porter, Northwestern University; Richard D. Tabors, MIT, January 23, 2001. Available at http://www.cramton.umd.edu/papers2000-2004/kahn-cramton-porter-tabors-blue-ribbon-panel-report-to-calpx.pdf.

demand response initiatives. The Staff Report expressed concern about the ability to detect market power abuse and the lack of demand response in the state;[17] the uniform clearing price auction provides the transparency necessary to help regulators identify market power abuse and bolster demand side response. Suppliers who bid to drive up the clearing price risk having their bids rejected and their plants not running at all, or at a much lower percentage of capacity. In a pay-as-bid auction, generators need to bid all their costs, including fixed cost recovery, since there is no other opportunity to recover these costs. This leads to all inclusive, non-transparent bids which can be significantly in excess of marginal cost but also invulnerable to second guessing by market monitors, as a unit's bid is expected to include opaque fixed cost factors. This type of bidding makes an abuse of market power difficult to detect and leads to inefficient dispatch decisions. Moreover, a uniform clearing price auction, since it establishes a market clearing price based on the last highest bid needed to serve consumers, sends an accurate price signal to consumers of the true cost of meeting the last increment of demand. A pay-as-bid auction gives customers a weighted average cost signal that does not encourage demand response and other conservation measures.

III. Competitive Bidding Processes

It is clear that Ohio has the right structures in place to be complemented and enhanced by a competitive bidding process for meeting default retail customers' power needs. The Staff Report does not seem to condemn competitive procurement processes in and of themselves, but expresses concern that a

[17] Staff Report, p. 12.

competitive procurement process will be prone to "gaming" and "tacit collusion."[18] The allegations that open competitive bidding processes would invite gaming because suppliers could gain significant knowledge about one another's bidding strategies are incorrect. There will be independent oversight of both the market, through the market monitor and the bidding process through the state auction administrator. Further, the alternative to competitive bidding – monopolistic sole sourcing – is not a viable solution to meeting supply needs in a manner that assures efficiency. Fears of gaming and collusion should be laid to rest, as the market monitoring structure remains sound and the alternatives such as sole sourcing are in fact rooted in the exercise of monopolistic market power.

There is independent oversight of the bidding process and the market participants. The Staff report conveys uncertainty about the ability of market monitoring units to function because of the recent activity in PJM and FERC's ANOPR proceeding, which seeks to restructure the rules governing market monitors. Although there have been allegations of anomalies within the PJM region recently, FERC has ruled that there were no tariff violations and that the PJM tariff was administered in a just and reasonable manner.[19] Stakeholders within PJM are working to come to a settlement on how best to restructure the market monitoring unit although the current structure remains effective, just and reasonable. As for FERC's ANOPR,[20] which seeks to strengthen federal market monitoring policies, it

---

[18] Staff Report, p. 12.

[19] See *Allegheny Electric Cooperative, Inc., et al. v. PJM Interconnection, L.L.C. and Organization of PJM States, Inc. et al., v. PJM Interconnection, L.L.C.,* 120 FERC ¶ 61,254 (2007).

[20] See Advanced Notice of Proposed Rulemaking, *Wholesale Competition in Regions with Organized Electric Markets,* 72 Fed. Reg. 36,275 (July 2, 2007), FERC Stats. & Regs. ¶ 32,617 (2007).

states no intention of allowing for a lapse in market monitoring in the interim period while improvements are formulated and put in place. To the contrary, it seems to indicate incremental refinements to the market monitor's functions. EPSA does not see any legal or factual basis for the concern raised by the Staff Report. Finally, the competitive bidding process will be overseen by yet another independent administrator at the state level. The independence of the auction should not be an issue, as the potential for gaming and collusion will be well monitored.

The alternative to a competitive bidding process is sole sourcing of resources. This eliminates the threat of collusion only because there is only one resource from which to procure electricity. This will not protect customers from artificially inflated prices, nor will it provide the transparency needed for market monitors to work effectively. Sole sourcing would be a step backwards for Ohio's electricity markets, and removes the ability for supply options to be market tested for efficiency, cost and reliability.

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., October 12, 2007.

NEBagot

____
Nancy Bagot, VP of Reg. Affairs