FAX

CITIZEN POWER

Public Policy Research Education and Advocacy

May 26, 2009

Public Utilities Commission of Ohio
PUCO Docketing
180 East Broad Street, 10th Floor
Columbus, OH 43215

Re: Case No. 09-90-EL-COI, *In the Matter of the Commission's Investigation into the Value of Continued Participation in Regional Transmission Organizations*

Dear Sir/Madam:

Please find enclosed an original and 10 copies of the Comments of Citizen Power in the above referenced case. A copy of this was also sent via facsimile to PUCO Docketing. Thank you for your assistance.

Sincerely,

Theodore S. Robinson, Esquire
Staff Attorney
Citizen Power
2121 Murray Avenue
Pittsburgh, PA 15217

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's Investigation into the Value of Continued Participation in Regional Transmission Organizations.	)	Case 09-90-EL-COI

COMMENTS BY CITIZEN POWER

Theodore S Robinson
Staff Attorney
Citizen Power

Citizen Power
2121 Murray Avenue
Pittsburgh, PA 15217
412-421-7029

I. Introduction

Citizen Power is a regional nonprofit, energy advocacy organization based in Pittsburgh. Since 1996, Citizen Power has been involved in the process to deregulate the pricing of electricity generation in Ohio and Pennsylvania. From the beginning, Citizen Power expressed concern that deregulation would not work. In our opinion, our fears have been confirmed by the current state of electricity markets, which have under performed traditionally regulated vertically integrated monopolies.

Citizen Power believes that electricity is not amenable to a market structure. Specifically, the facts that electricity is expensive to store, involves high capital costs, is an undifferentiated product, has very inelastic demand, and entails locational advantages for incumbent generation allow for the gaming of the market. Improved market design can reduce market manipulation, but at a price, since each market rule is a form of regulation that is expensive and difficult to implement. We believe that the higher prices seen in states with retail markets represents the fact the amount of regulation of the markets needed in order to prevent significant manipulation reduces the benefits of proper market function down to where the overall costs are greater then the benefits.[1] This Hobson's Choice, the inevitable exercise of market power on one hand and inefficient and costly markets on the other is to be expected as long as generators are allowed to sell their electricity at prices that are not tied to cost.

In our view, the best solution is a return to traditionally regulated vertically integrated utilities. However, a second best solution is to have the power supply markets limit the offers to sell to the marginal cost of production as proposed by the American

[1] Retail markets can be seen as a proxy for the RTO wholesale markets since the retail prices are highly correlated with the wholesale prices.

Public Power Association (APPA) in their *Competitive Market Plan: A Roadmap for Reforming Wholesale Electricity Markets.*[2] We propose that the Commission investigate the feasibility of transitioning to an Ohio-only RTO and adopting the APPA's Competitive Market Plan.

Response to RTO Inquiries

1. **Are FERC's Order 2000 goals and objectives being realized to promote efficiency in wholesale electric markets and to ensure that electric consumers pay the lowest price possible for reliable service?**

RTOs operate wholesale power markets and in some cases also operate locational capacity markets and ancillary service markets. However, they also are in charge of managing the electric system and providing transmission service. One of the main benefits of RTOs is that they, if operating properly, obtain power from the cheapest source. The mechanism used is based on the bids of all the different generators.

Although the overall picture has been mixed, several studies in recent years have made significant claim regarding the savings achieved from organized wholesale markets. One report by Global Energy Decisions' found that the value of organized wholesale markets to consumers in the eastern interconnect was $15.1 billion between the years 1999 and 2003.[3] A report by Christensen Associates Energy Consulting, LLC found that correcting for the unrealistic assumptions the estimated benefits become negative.[4] Another study by the Cambridge Energy Research Associates found that consumers paid

[2] *Available at:* http://www.appanet.org/files/PDFs/EMRICompetitiveMarket.pdf

[3] Global Energy Decisions, *Putting Competitive Power Markets to the Test The Benefits of Competition in America's Electric Grid: Cost Savings and Operating Efficiencies* (July 2005), Pg. ES-1. *Available at:* http://www.globalenergy.com/competitivepower/competitivepower-full-version.pdf.

[4] Kirsch, Laurence D. and Morey, Mathew J., Christensen Associates Energy Consulting, LLC, *Global EnergyDecision's "Putting Competitive Power Markets to the Test": An Alternate View of the Evidence* (November 2005), pg. 3. *Available at:* http://www.pulp.tc/Global_Energy_Decision_s.pdf

$34 billion less for electricity in the seven years since the beginning of deregulation.[5] This study, however, included in its benefits the price caps in certain residential states and did not include the costs from the deregulation crisis in California.[6] Again, if the study were adjusted toward reality, the result would most likely be negative. On the other hand, a study by the Technology Policy Institute found that wholesale rates in RTO member states have been $2 to $3 per MWh higher then those in non RTO states.[7]

It is clear that there have been additional costs related to RTO memberships that inevitably are passed along to the consumers, especially in states with retail choice. First of all, there are additional transmission costs associated with regional markets. The existing transmission system was built for the vertically integrated model and does not have the number of interconnections and the amount of transmission capacity necessary for regional markets. In 2005, the transmission congestion charges in PJM were $2.1 billion.[8] PJM's operating budget of almost $250 million per year is covered by these congestion charges along with other fees.[9] In addition, the greater distance between generation and load increases line losses.

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[5] Seth A. Blumsack, Jay Apt, and Lester B. Lave, Carnegie Mellon Electricity Industry Center, "Comments on Wholesale and Retail Electricity Competition," Paper prepared for the Electric Energy Market Competition Interagency Task Force and the Federal Energy Regulatory Commission Docket No. AD05-17-000 (November 2005), pg. 1-2. *Available at:* http://wpweb2.tepper.cmu.edu/ceic/pdfs_other/FERC_Comments_11_18_05.pdf

[6] *Id.*, pg. 2.

[7] Lenard, Thomas M. and McGonegal, Stephen, *Evaluating the Effects of Wholesale Electricity Restructuring* (September 2008), pg. 13. *Available at:* http://www.techpolicyinstitute.org/files/evaluating_the_effects.pdf

[8] Jay Apt, Seth A. Blumsack, and Lester B. Lave, *Competitive Energy Options for Pennsylvania*, (January 2007), pg. 72. *Available at:* http://wpweb2.tepper.cmu.edu/ceic/pdfs_other/Competitive_Energy_Options_for_Pennsylvania.pdf

[9] Seth A. Blumsack, Jay Apt, and Lester B. Lave, Carnegie Mellon Electricity Industry Center, "Comments on Wholesale and Retail Electricity Competition," Paper prepared for the Electric Energy Market Competition Interagency Task Force and the Federal Energy Regulatory Commission Docket No. AD05-17-000 (November 2005), pg. 14. *Available at:* http://wpweb2.tepper.cmu.edu/ceic/pdfs_other/FERC_Comments_11_18_05.pdf.

Secondly, the cost of power in markets is greater due to the use of single clearing price auctions. In 2006, natural gas was the marginal fuel in the PJM wholesale market 24.8% of the time even though it accounted for only 5.5% of the generation.[10] This means that coal and nuclear generation got paid natural gas prices almost a quarter of the time, a result that would not happen under bilateral transactions.

Third, the market may have to pay for the speculative behavior of some market participants. As an example, in PJM, a couple of hedge funds speculated on the future value of transmission rights. When their hunch turned out to be incorrect, they defaulted on the required payment, leaving PJM to make up for the shortfall in dispute.[11]

These costs do not represent the any excess costs associated with market power or any additional costs related to PJM's Reliability Pricing Model. Our belief is that wholesale markets provide valuable services in their management of the electric system. However, the operation of wholesale markets is expensive, difficult to monitor, and given the alternative of bilateral transactions, ultimately unnecessary.

5. **Are the RTOs' resource adequacy requirements and the resulting capacity markets (or, in the case of PJM, its Reliability Pricing Model and Fixed Resource Requirement) reasonable and providing benefits to Ohio's consumers? Are these policies effective in promoting needed resource investment and long-term contracts which could help finance such investment? Do these policies promote an appropriate level of investment that is consistent with the needs and preferences of Ohio consumers?**

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citing van Vactor, Samuel, "Flipping the Switch: The Transformation of Energy Markets", Ph.D. dissertation, University of Cambridge (2004), and Lutzenheiser, Margot "A Comparative Analysis of ISO/RTO Operating Costs", available at http://www.ppcpdx.org/Tx/main2.html.

[10] Rose, Kenneth, *The Impact of Fuel Costs on Electric Power Prices* (January 2007), pgs. 6, 10. *Available at*: http://www.appanet.org/files/PDFs/ImpactofFuelCostsonElectricPowerPrices.pdf.

[11] Statement of the American Public Power Association before the Pennsylvania Public Utility Commission's En Banc Second Public Hearing on "Current and Future Wholesale Electricity Markets" (November 2008), pg. 6 available at *http://www.puc.state.pa.us/electric/pdf/EnBanc-WEM/Timy-APPA110608.pdf* citing PJM News Release, "*PJM Completes Analysis of Recent Market Payment Default*" (December 26, 2007). *Available at* http://www.pjm.com/contributions/news-releases/2007/20071226-credit-default-news-release.pdf.

According to PJM spokesman Ray Dotter, prices are not elevated enough to spur investment, "If the revenue is not there, the plants don't get built and the lights go out."[12] Reliability of the electricity system depends on generation capacity keeping ahead of demand. The time that it takes to build generation, including the permitting process, can take years. Under a regulated vertically integrated system, future generation needs are assessed and the utility builds the generation. The cost of the needed generation is added to the price of electricity.

However, the requirement of excess capacity to meet peak demand is a separate good that must be provided for by the market if not provided for through regulation. Under a market approach, capacity will either be provided by the electricity market attracting generation, or a separate capacity market can be set up to provide the necessary level of capacity. This issue is tied to the general electricity markets since the more regulated markets are in order to limit the exercise of market power, the less likely that the electric markets will provide incentives for new generation. Stated another way, unless prices are artificially high because of market power, there is little incentive to build new generation.

Since electricity is a necessity, the consequences of inadequate capacity can be expensive for individual customers. In addition, because of the nature of electricity, the failure of supply to meet demand usually will affect large numbers of individuals through brownouts and blackouts. In this sense, capacity infrastructure acts like a public good, since every electricity user benefits from the capacity (which provides reliability) but no user would voluntarily pay for it. It also behaves like a public good since it would be

[12] Leonard, Kim "*State Power Costs Could Kill Jobs, Executive Says*," Pittsburgh Tribune-Review, 11/7/08. *Available at*: http://www.pulp.tc/html/state_power_costs_could_kill_j.html.

costly to deny the benefits of excess capacity to unique individuals who did not voluntarily pay for it.

If the electricity markets naturally provide enough capacity that reliability is not an issue, then capacity markets are not needed. However, evidence supports the supposition that electricity markets have not produced enough generation, especially base load. Apt, Blumsack, and Lave also point out that if the market is successful in forcing high-cost plants into bankruptcy and reducing excess capacity, then the electricity market would be short of capacity.[13] The current solution to this is that the FERC allows RTOs (such as PJM) to require utilities to purchase a certain amount of capacity, which cost the utility passes on to its customers through the price of electricity. It is a misnomer to talk of the "capacity market" when the utilities are required to purchase a certain amount of capacity. At the very least, this requirement creates a very inelastic demand curve in the capacity markets.

The question must be asked: if capacity is a public good, why do we have capacity markets at all? Traditionally public goods are provided by the government, either through government agencies or through contracting with private companies. Capacity markets seem like a very inefficient way to procure capacity, since they reward baseload generation assets, which typically run a majority of the time and thus get paid a majority of the time. The generation assets that actually provide the capacity margin, the peaking plants, are the only plants that actually need to be provided incentives. It simply does not make sense to pay for something when you do not have to. In addition, capacity markets

[13] Jay Apt, Seth A. Blumsack, and Lester B. Lave, *Competitive Energy Options for Pennsylvania*, (January 2007), pg. 26. *Available at:* http://wpweb2.tepper.cmu.edu/ceic/pdfs_other/Competitive_Energy_Options_for_Pennsylvania.pdf

are an additional opportunity to use market power, creating an incentive not to build additional generation.

In our view, wholesale markets will not develop the necessary amount of capacity to meet future need on their own. Eventually the lack of capacity will strain the reserve margin and allow for both increased opportunities for market manipulation and, in addition, decreased system reliability. On the other hand, capacity markets are an inefficient, roundabout, and expensive way to attempt to develop capacity because they pay all generation instead of focusing on the peaking units that actually provide the capacity margin. In our view, the best way to develop new generation is through a process in conjunction with vertically integrated monopolies. Failing that possibility, modification of the capacity market so that the units that provide the capacity margin are targeted would be preferred to the current PJM Reliability Pricing Model.

RTO Alternatives 2. Would it be reasonable, cost effective, and viable for the Ohio Commission to pursue the construct of an Ohio-only RTO?

The viability of developing an Ohio-only RTO is dependent upon a bunch of factors including the resolution of substantial economic, political, and legal issues. In our view, an Ohio-only RTO can provide significant value to Ohio's customers if the market mechanism is modified so that offers to sell are limited to the marginal cost of production as proposed by the American Public Power Association (APPA) in their *Competitive Market Plan: A Roadmap for Reforming Wholesale Electricity Markets.*[14] The Commission should move further to identify the feasibility of moving in this direction.

[14] *Available at:* http://www.appanet.org/files/PDFs/EMRICompetitiveMarket.pdf

Respectfully submitted,

Theodore S Robinson

Staff Attorney
Citizen Power

Citizen Power
2121 Murray Avenue
Pittsburgh, PA 15217
412-421-7029

May 26, 2009

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Citizen Power comments to the Commission's RTO Inquiries has been served upon the following parties via regular U.S. Mail, postage prepaid, this 26th day of May, 2009.

Theodore Robinson
Citizen Power

SERVICE LIST

Janine L. Migden-Ostrander
Consumers' Counsel
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485

Duane Luckey
Attorney General's Office
Public Utilities Commission of Ohio
180 E. Broad Street, 9th floor
Columbus, Ohio 43215

David F. Boehm, Esq.
Michael L. Kurtz, Esq.
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

Daniel Shields
Federal Energy Advocate
Public Utilities Commission of Ohio
180 E. Broad Street
Columbus, Ohio 43215