

FILE

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 No. 09-90-EL-COI

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THE INITIAL COMMENTS OF AMERICAN MUNICIPAL POWER, INC.

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I. INTRODUCTION

On March 4 2009, the Public Utilities Commission of Ohio ("Commission") issued an Entry in the above-captioned proceeding ("Entry") which initiated this inquiry into the value of participation in regional transmission organizations ("RTOs"). Specifically, the Entry noted that Amended Substitute Senate Bill No. 221 ("S.B. 221") mandated that the Commission employ a federal energy advocate ("Advocate") to monitor the activities of the Federal Energy Regulatory Commission ("FERC"). The Entry also noted that R.C. 4928.24 requires the Advocate to:

examine the value of the participation of the State of Ohio's electric utilities in regional transmission organizations (RTOs) and submit a report to the Commission on whether continued participation of those electric utilities is in the interest of retail electric service consumers.

(Entry, p.1). Given this mandate, the Commission opened this proceeding to "invite public input from interested persons concerning various RTO issues that may impact the value of RTO participation for Ohio consumers." (Entry, p.2)

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Commenters were encouraged to respond to the attached Appendix A which consisted of two sections. The first section of Appendix A concentrated on “specific issues potentially affecting the value of participation in RTOs” (Entry, p.2). The second section of Appendix A invited “recommendations concerning alternatives to RTO participation” (Entry, p.2). Also, commenters were encouraged to “provide general remarks concerning whether RTOs have provided value to consumers in the State of Ohio” (Entry, p.2).

In accordance with the March 4 Entry, American Municipal Power – Ohio, Inc. (“AMP-Ohio”) now files these comments on the value of continued participation in RTOs.

## **II. BACKGROUND**

AMP-Ohio is a non-profit corporation organized in 1971. Currently, AMP-Ohio owns and operates electric generating facilities; provides wholesale generation, transmission, and distribution services; and coordinates, negotiates, and develops power supply options and interconnection agreements for its 126 Member municipal electric systems in 6 states. Eighty-one of AMP-Ohio’s Members are located in the state of Ohio. AMP-Ohio’s Membership represents over 500,000 retail customers across the states of Ohio, Pennsylvania, Michigan, Virginia, Kentucky, and West Virginia.

While neither AMP-Ohio nor its Members are subject to direct Commission jurisdiction, the issues at hand are of paramount importance to all who operate in RTO markets. AMP-Ohio and its Members operate in the footprints of the two RTOs covering

Ohio - the Midwest Independent System Operator (“MISO”) and the PJM Interconnection (“PJM”). Currently, AMP-Ohio supplies approximately 85% of its Members’ generation needs from these organized markets. These purchases consist of both baseload and intermediate capacity.<sup>1</sup>

AMP-Ohio has concluded that effectuating its current long-term supply model is made more difficult and burdened with additional risk due. Specifically, AMP-Ohio Members’ future electricity needs must be balanced with: 1) the reality of a carbon-constrained economy, 2) an increasing cost industry, and 3) flawed organized markets such as MISO and PJM. For these reasons, AMP-Ohio has embarked upon an asset acquisition program designed to mitigate these risks. Even after the program is completed, however, AMP-Ohio and its Members will still be dependent on organized markets for a portion of their electric supply. Accordingly, AMP-Ohio respectfully submits the following initial comments in this proceeding on the last of these identified risks – the state of the organized markets.

### **III. COMMENTS**

Under the Federal Power Act (“FPA”), it is the responsibility of the FERC to ensure that wholesale electric rates are “just and reasonable.” Historically, this statutory requirement was met, in substantial part, through active, cost-of-service rate regulation by FERC. In 1995, however, FERC abandoned its long-standing regulatory method and embarked on a new path that relies on competition in the wholesale electric generation markets as a substitute for regulation. FERC believed that market forces could better

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<sup>1</sup> Market purchases cover approximately 62% of AMP-Ohio Members’ baseload requirements. Market purchases cover approximately 95% of AMP-Ohio Members’ intermediate requirements.

serve the public interest and that customers would see lower prices, better service and innovation. This market evolution included the creation of RTOs and the ceding by FERC of increasingly greater responsibilities to the RTOs.

The original purpose of RTOs and other independent system operators was to improve the efficiency transparency and coordination of transmission system operations and reliability functions. The core objective of an RTO was to provide non-discriminatory, open access transmission service for electric generation transactions by requiring owners of transmission lines to divest operational control to the independent RTO in order to assure non-preferential use of their transmission lines to other sellers and purchasers of electricity. To carry out this responsibility, RTOs assumed functional control, but not ownership, of the high-voltage transmission system. The performance of these original functions became known as the work of “Day 1” RTOs.

Today, however, RTOs also run complex energy markets for a number of disaggregated energy products (*e.g.*, energy, capacity and ancillary services). RTO-administered markets are intended to provide a centralized marketplace in which these products can be bought and sold at prices established by so-called “competitive” forces. RTOs do not own the power plants that generate the electricity bought and sold in the market. However, RTOs develop the rules for administration of the markets, decide which generators will run and at what levels, grant (or deny) the transmission services needed for transactions to occur and run the billing systems for payments. These market functions have become the work of what has been termed “Day 2” RTOs.

## **A. Problems Arise From Day 2 Functions.**

Today's problems for buyers in RTO markets stem primarily from Day 2 functions such as those discussed below. In short, the implementation of Day 2 functions has resulted in opportunities for generation owners to earn excess profits via relatively high, and volatile, energy market prices, without adequate protection for consumers. These problems include:

- the greatly reduced role of cost-based rate regulation of rates;<sup>2</sup>
- the use of a single clearing-price auction where the highest price offered is paid to all generators selling into the market;
- the use of locational marginal pricing ("LMP"), which sets prices at higher levels, because limited transmission access necessitates that more expensive generators must operate and provide electricity in an attempt to use price differentials to incent transmission and generation construction; and
- limited or no data on the actual costs of the electricity generators, the prices offered for the sale of electricity and other essential information needed to determine if these markets bear any resemblance to competitive markets.

The specific problems noted above, and others, have created dysfunctional product markets. Electric generation owners in PJM now rely on several revenue streams to recoup the capital investment and operating costs related to their plant capacity. For example, PJM has added a capacity market to provide compensation to electric generators that dedicate their plants' capacity to serve the PJM region. The idea is to

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<sup>2</sup> FERC has instead granted market-based rate authority to many sellers of wholesale electric power, subject only to reporting and limited oversight requirements.

provide economic incentive for the construction of new generation investment as older plants are retired or put on hold as a result of supposedly deficient revenues. However, while these markets have resulted only in radically higher prices for wholesale electricity, the amount of new generation added in response to these higher prices is minimal by comparison.

In PJM's secondary generation capacity market (the "Reliability Pricing Model" or "RPM") PJM acquires future capacity needs through an on-going series of three-year forward auctions conducted with the generation suppliers (the "Supply"). Load interests, such as those of purchasers of wholesale electricity (the "Demand"), do not actively participate, but loads are administratively bid into the auctions via a demand curve developed by PJM. The shape of this demand curve reflects PJM's desired reserve margin<sup>3</sup> and the estimated cost for a new, hypothetical peaking plant to be built in the region. The auction clearing price is set at the intersection of the Supply and Demand curves. Loads will ultimately pay zonal capacity prices based on this clearing price plus locational adders to reflect capacity constraints in that particular zone. It is the experience of AMP-Ohio that the results of these auctions largely leave electric prices artificially high, without encouraging new electric generation.

#### **B. The Organization of Ohio RTO Markets Creates Difficulties.**

AMP-Ohio's experience consistently shows that the changes in wholesale electric markets implemented by federal regulators and RTOs produce results diametrically different from those promised. This is particularly so in Ohio. Over objection from Ohio interests, FERC approved an RTO configuration in Ohio that splits the state between

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<sup>3</sup> Reserve margin is the amount of capacity above the region's actual demand that PJM believes is appropriate.

MISO and PJM. The end result is a jigsaw puzzle of transmission organizations throughout the state.<sup>4</sup> This structure creates numerous seams issues related to operating within, and between, both MISO and PJM. These problems include the operation of multiple sets of tariffs, different market scheduling times, differing ancillary service rates and administrative fees, communication and coordination problems, inconsistent market rules and market power mitigation. These problems are particularly acute for AMP-Ohio, because AMP-Ohio Members operate within both MISO and PJM.

### **C. The Findings of the EMRI Must Be Considered.**

Concerns about organized markets led the American Public Power Association (“APPA”) to create the Electric Market Reform Initiative (“EMRI”) in March 2006 to perform detailed assessments of the problems in RTO markets and to propose needed reforms. Since its inception, EMRI has commissioned and released numerous studies to refute the supposed claims of consumer benefits made by the RTOs. The results of the EMRI studies have shown that, in general, there is “no reliable evidence that consumers are better off” with RTO markets. The EMRI studies also found that 1) supplier offers in these dysfunctional markets were often not tied to their marginal costs or fully explained by current fuel prices, 2) the pricing mechanisms employed by RTO markets neither ensure competitive markets nor prevent market abuse, and 3) the dramatically higher prices and seller profits in RTO markets have not resulted in significant levels of new generation and transmission investment.<sup>5</sup>

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<sup>4</sup> FirstEnergy and Duke Energy are located in the MISO territory; AEP and DP&L operate in the PJM territory; AMP Ohio members operate in both.

<sup>5</sup> More information on the EMRI can be found on the APPA website at: <http://www.appanet.org/aboutpublic/index.cfm?ItemNumber=16772>

In particular, AMP-Ohio encourages the Commission to consider EMRI's February 2008 study entitled "*Consumers in Peril: Why RTO-Run Electricity Markets Fail to Produce Just and Reasonable Electric Rates*"<sup>6</sup> ("*Consumers in Peril*"). In *Consumers in Peril*, EMRI concludes that "RTOs do provide services that have substantial value" (*Consumers in Peril*, p. v). These services include the non-discriminatory administration of open access transmission tariffs ("OATTs"), the elimination of "pancaked" transmission rates and the development of a more coordinated regional transmission planning process. The beneficial services primarily help to facilitate the Day 1 function on an RTO.

EMRI maintains, however, that these accomplishments have been overshadowed by the "high costs and dysfunctional nature" of the RTOs' Day 2 organized markets. The dysfunctional features of these markets are many.

For one, power prices are not connected to the sellers' actual costs of generating power. Under the LMP model, lower-cost generators are paid the same price as those with higher operating costs. A truly competitive market would have a closer reflection between price and cost, because a lower cost bidder lowers prices in order to increase sales.<sup>7</sup> However, the LMP model decreases competition, because electric generators have no incentive to decrease prices, even if their margins are high. This dysfunctional bidding mechanism keeps electric prices artificially high.

EMRI also has concluded that, not only must customers pay higher prices under the current RTO pricing regime, but there is no evidence that LMP pricing model leads to the construction of new generation and transmission facilities. This outcome undercuts the

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<sup>6</sup> This study may be found in its entirety on the APPA website noted above or at: <http://appanet.org/files/PDFs/ConsumersinPeril.pdf>.

<sup>7</sup> It should be noted that in a traditionally regulated market, costs also must be tied to prices.



theoretical basis for LMP pricing. Instead of creating new investment, the retention of additional dollars by lower cost electric generators has only created incentives for generators to withhold capacity in order to create artificial shortages that increase prices. Also, generators refrain from building otherwise-needed new generation capacity so not to reduce prevailing market prices and reduce current profits.

The operation by RTOs of Day 2 markets also has adversely impacted the availability and cost of power sold under bilateral contracts (individual contracts between a buyer and a seller). Because suppliers can extract very high prices in the RTOs' centralized markets, they have no incentive to offer power in bilateral transactions at reasonable prices. It is now quite unusual to see bilateral power supply contracts in RTO regions offered for terms longer than one to five years, or that are backed by specific electric generation units. Long-term bilateral contracts are increasingly difficult for purchasers to obtain under reasonable terms and conditions. This has taken away one of the principal sources of power supply historically relied upon by risk-averse municipal electric providers.

EMRI has concluded that further adverse effects of RTOs include:

- Electric consumers are paying billions in additional charges required by new RTO-run locational capacity markets, while it is still highly uncertain, at best, whether these markets will support future development of enough new generation facilities to meet demand.
- Regional high-voltage transmission facilities are essential to support wholesale power supply transactions; however, transmission capacity often is insufficient to

meet demand, and the associated transmission rates are therefore uncertain, due to substantial congestion charges imposed by the RTO.

- The administrative and software costs associated with new markets for previously cost-regulated product are very high, with little evident benefit to consumers and very little cost benefit analysis done to support such programs.<sup>8</sup>

These problems, which have been raised by EMRI and a number of other analysts, have greatly increased the complexity and risk faced by AMP-Ohio and other wholesale electricity purchasers in attempting to transition into RTO-run “competitive” electricity markets.

#### **D. The EMRI Road Map Should Be Followed.**

AMP-Ohio also encourages the Commission to consider EMRI’s subsequent February 2009 study entitled “*APPA’s Competitive Market Plan: A Roadmap for Reforming Wholesale Electricity Markets*”<sup>9</sup> (“*Competitive Market Plan*”) In *Competitive Market Plan*, EMRI “attempt(s) to remedy the absence of meaningful competition and consumer protections under the current RTO market model” (*Competitive Market Plan*, p.2). Further EMRI outlines a roadmap to creating a competitive wholesale electric market. Important features of EMRI’s roadmap include:

- Current RTO-run energy and ancillary services real-time and day-ahead markets would be replaced by an RTO-run “optimization” market.

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<sup>8</sup> All of these conclusions can be found in *Consumers in Peril*, at p. v. In particular, AMP-Ohio would encourage the Commission to pay close attention to the detailed discussions in *Consumers in Peril* relating to competition starting on p. 6 and the failures of RTO markets starting on p. 12.

<sup>9</sup> This study may be found in its entirety on the APPA website noted above or at: <http://www.appanet.org/files/PDFs/EMRICompetitiveMarket.pdf>.

- Offers to sell into the optimization market for both energy and ancillary services would be capped at generators' marginal costs of generation.
- Prices would be set initially using a cost-based, single clearing-price mechanism.
- The optimization market would contain a cost-based, day-ahead component for the purpose of generation resource commitment.
- FERC-jurisdictional generators entering into bilateral contracts with load-serving entities ("LSEs") in an RTO region would not be limited to charging cost-based rates. restrictions, but they could use market-based rates. Suppliers that make sales to LSEs through bilateral arrangements would be permitted to use market-based rates.
- Generators would be subject to a must-offer requirement into the optimization market for energy not already committed under bilateral contracts or owned generation arrangements (subject to forced outages, scheduled maintenance, and special rules for limited-run units).
- Existing RTO-administered locational capacity markets would be phased out, and capacity would be supplied through bilateral contracts entered into by LSEs with resource suppliers (both generation and demand response), LSE-owned generation arrangements and LSE-managed demand response.
- The RTOs would determine and implement overall resource adequacy standards applicable to LSEs within the RTO footprint. States would have substantial input into RTO development of regional transmission plans and regional resource adequacy requirements.

- RTOs would conduct centralized least-cost dispatch of generators based on actual operating costs. Generators and demand response providers would be paid based upon contracted prices for quantities sold through the bilateral market. For quantities sold through the optimization market, generators and demand responders would receive the cost-based market-clearing price.
- Financial transmission rights (“FTRs”) would be allocated to LSEs to hedge against transmission congestion charges. Long-term FTRs also would be granted to support longer-term (*e.g.*, 10-year) bilateral power supply arrangements and LSE-owned resources. Existing transmission rights would be maintained to the maximum extent feasible.
- RTOs would continue to ensure non-discriminatory open access to the transmission system.

AMP-Ohio submits that by adopting EMRI’s roadmap to more efficient wholesale markets, RTOs would better serve customers and offer more competitive prices for wholesale electricity.

#### IV. CONCLUSION

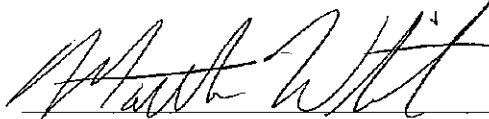
AMP-Ohio remains very concerned about the course of development in the organized wholesale markets in the Midwest. These concerns regard the market structure, procedures and processes for both MISO and PJM. Customers of these markets continue to see their costs increase without realizing the continually promised benefits of those same markets. As a result, AMP-Ohio must regretfully

conclude that current organized markets in the Midwest are not meeting the needs of their ultimate customers.

In reaching this conclusion, AMP-Ohio notes that the real “customers” of the RTO/ISO are not the asset owners (*i.e.*, the Transmission Owners, and the Generation Owners) nor are they the management of the RTOs and ISOs. The RTOs were created to serve LSEs and their customers. The establishment of regional markets is a means to an end, and not the end itself. Many of the elaborate and complex structures of RTOs do not provide real benefit to LSEs or their customers. The goal of enabling competition, just like the goal of regulation, must be to achieve “just and reasonable” rates for reliable wholesale electric power. Unfortunately, many of the rates resulting from the sale of electricity in the markets operated by RTOs are neither just, reasonable nor competitive. Additionally, adding insult to injury, the current organized markets despite the high prices produced do not encourage the necessary development of generation and transmission facilities.

For the reasons cited herein, and those additional arguments contained in the EMRI materials noted above, AMP-Ohio believes that the Commission should consider the recommended changes to the organized markets contained in the APPA’s *Competitive Market Plan*. In addition, the Commission should initiate a collaborative stakeholder process to investigate what actions can be taken to cure many of the dysfunctions in the RTO markets discussed in these comments.

Respectfully submitted,



John W. Bentine, Esq. (0016388)

E-Mail: [jbentine@cwslaw.com](mailto:jbentine@cwslaw.com)

Direct Dial: (614) 334-6121

Matthew S. White, Esq. (0082859)

E-Mail: [mwhite@cwslaw.com](mailto:mwhite@cwslaw.com)

Direct Dial: (614) 334-6172

Chester, Willcox & Saxbe, LLP

65 East State Street, Suite 1000

Columbus, Ohio 43215-4213

(614) 221-4000 (Main Number)

(614) 221-4012 (Facsimile)

**Attorneys for American Municipal Power-Ohio, Inc.**