

FILE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Commission's)
Investigation into the Value of)
Continued Participation of Ohio's)
Electric Utilities in Regional)
Transmission Organizations)

Case No. 09-90-EL-COI

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REPLY COMMENTS OF PJM INTERCONNECTION, L.L.C. IN RESPONSE TO THE
COMMISSION'S INVESTIGATION INTO THE VALUE OF CONTINUED PARTICIPATION IN REGIONAL
TRANSMISSION ORGANIZATIONS

PJM Interconnection, L.L.C. (PJM) respectfully submits the following Reply Comments in the Matter of the Commission's Inquiry into the Value of Continuing Participation in Regional Transmission Organizations. PJM is gratified that the Initial Comments submitted by many parties to this proceeding acknowledge the significant value provided by RTOs. PJM's Reply Comments address the arguments set forth by American Municipal Power-Ohio (AMP-OH), Citizen Power, and Industrial Energy Users-Ohio (IEU-OH) regarding Day 2 Market design, concerns expressed by Buckeye Power and other stakeholders regarding seams coordination between MISO and PJM, as well as the general matter of the impact of wholesale market prices on retail customer rates. PJM has already addressed most of the matters raised by other stakeholders in this proceeding in our Initial Comments.¹

¹ There are some exceptions that hardly merit a response, such as Citizen Power's misinformed and patently false claim at page 3 of its Initial Comments that PJM's operating budget is "covered by congestion charges and other fees."

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Day 2 Market Design

AMP-OH, Citizen Power, and IEU-OH urge the abandonment of Day 2 Markets in RTOs and call for the implementation of electricity market reform proposals set forth by the American Public Power Association (APPA).² But the APPA proposals are ill-advised. Apparently motivated by a desire that bilateral contracts be made available at lower prices, APPA's proposals would undermine two principal objectives of RTO market design: maintaining the reliability of the bulk power system and assuring open and non-discriminatory access to the transmission grid. PJM's Initial Comments in this proceeding establish the unequivocal linkage between PJM's FERC-endorsed market design and PJM's mission of reliable and non-discriminatory operation of the transmission grid. Here, PJM takes the opportunity to raise several problematic aspects of APPA's market proposals identified in a recent report issued by LECG (LECG Report), which PJM hereby incorporates in these Reply Comments.³

The APPA proposals endorsed by AMP-OH and IEU-OH seek to suppress spot prices, but in doing so would result in inadequate investment in resources required to be available during shortages. APPA's most recent iteration of its market reform proposal mandates that generators bid and receive individual short-run marginal costs of operation, *i.e.* receive compensation at less than their cost-of-service, and that they be prohibited from considering opportunity costs as a basis for dispatch and spot market participation. Furthermore, APPA's proposal to establish an "optimization market" would result in the inability of RTOs to determine which resources to dispatch for energy and which to hold as operating reserves. As the LECG Report clarifies, RTOs co-dispatch energy and operating reserve resources by setting clearing prices for

² *Competitive Market Plan*, American Public Power Association, February 2009, and *Consumers in Peril*, American Public Power Association, February 2009, are the two latest versions of APPA's market reform proposals.

³ *Electricity Market Reform: APPA's Journey Down the Wrong Path*, William W. Hogan and John Chandley, LECG, April 16, 2009, available at http://ksghome.harvard.edu/~WHogan/Chandley_Hogan_Compete_041609.pdf.

each service provided so that the RTO's total costs are minimized and value is maximized to each provider. As the LECG Report succinctly states, "[t]he APPA mistake is proposing to pay generators at cost to provide reserves, rather than a clearing price optimized between energy and operating reserves. This design error would distort incentives to follow dispatch instructions and encourage reserve shortages."⁴

Another serious flaw of APPA's most recent market reform design is its proposal to allocate Financial Transmission Rights (FTRs) only once annually, and to provide undue allocation preference to entities holding long-term bilateral contracts. APPA's proposal would not provide a means for RTOs to confirm the simultaneous feasibility of FTRs, thereby threatening system reliability and undermining open access to the bulk power system. As the LECG Report makes clear, the limited access to the spot market afforded by APPA's "optimization market" would ultimately lead to the resurrection of contract scheduling and associated requirements including replacement of FTRs with physical transmission rights to match bilateral contract schedules – increasing annual energy production costs in PJM by an estimated \$247 million.⁵

APPA's market reform proposals suffer from a variety of other flaws, a few of which include the inability to enforce mandatory long-term contracting, disregard of the cost of undoing utilities' divestiture of generation resources, and the burden that would be placed on RTOs' Independent Market Monitors charged with verifying generators' short-term marginal costs. As troubling, the market reform proposals endorsed by IEU-OH and AMP-OH are not only motivated by private interest – they are premised on the unfounded assertion that long-term contracts are unavailable in today's marketplace.⁶ Worse yet, these proposals

⁴*Id.*, p. 8.

⁵ See *id.*, Appendix E, pp.50-53.

⁶ See *PJM Initial Comments*, pp. 49-52. Long-term contracts of up to three years duration are readily available, and the primary factors precluding longer duration contracts appear to be regulatory uncertainty and concomitant differences of opinion between buyers and sellers about pricing.

reflect a basic misunderstanding of how today's RTO market design supports regional reliability and affords non-discriminatory access to the transmission grid. The Commission should reject their arguments.

Seams Management

Several stakeholders raised issues regarding the management of the seam separating PJM and MISO.⁷

But as PJM pointed out in its Initial Comments⁸, the PJM-MISO Joint Operating Agreement requires an ongoing analysis from a cost-benefit perspective of Joint and Common Market features having the potential to improve seams coordination. As well, PJM and MISO regularly coordinate to resolve seams issues raised by differences in their protocols that impact transmission system transactions.

A pertinent example of such coordination resulted in the recent plan for resolution of a PJM-MISO seams issue affecting Buckeye Power, one that presumably occasioned its filing of Initial Comments with the Ohio Commission alleging "burdensome and unnecessary inefficiencies resulting primarily from the lack of functional integration between the two RTOs."⁹ In that instance, the resolution reached promises to

⁷ The Ohio Consumers' Counsel and Buckeye Power each addressed seams management in their respective Initial Comments. Despite the insinuation by the Ohio Consumers' Counsel's consultant Synapse Energy Economics (Synapse) that Ohio's electric utility customers might be better served if all of Ohio's electric utilities were in the same RTO, Synapse noted that "Considerable effort has been expended [by PJM and MISO] to address energy market pricing issues, congestion management protocols (including a "redispatch" agreement), interregional power flow, FTR policies, transmission planning, and many other operational issues....While energy market pricing is not the only seam issue deserving of careful consideration, Synapse believes that it is a primary indicator of the extent of seam "smoothness" between the regions." *Ohio Consumers' Counsel Initial Comments, Exhibit 1*, p. 39. .

⁸ See *PJM Initial Comments*, pp. 65-66.

⁹ See *Buckeye Power Initial Comments*, p. 4. The issue arose because Buckeye Power has non-zonal load that is dynamically scheduled into PJM. From PJM's perspective the load was considered to be PJM load, and as a result PJM was charging Buckeye Power ancillary services for the load. MISO's perspective was that since the load resided within MISO, it was obliged to charge ancillary services for the load – Schedules 3 (regulation), 5 (spinning), and 6 (operating reserves). In effect, since MISO implemented its Ancillary Service Markets on January 6, 2009, Buckeye was being charged twice for ancillary services. In this instance, PJM, MISO and Buckeye Power reached a resolution to propose to FERC whereby in 2013, Buckeye load connected to MISO transmission owners will become MISO load subject to all MISO tariff requirements. In the interim Buckeye Power will continue to receive

completely address Buckeye's concerns. Both RTOs recognize and acknowledge that differences in business rules between PJM and MISO have sometimes resulted in unique cross-border service transactional issues, but each has worked diligently when those do arise to promptly address them as was the case for Buckeye Power. PJM remains focused on and dedicated to resolving customer concerns fairly and expeditiously.

The Impact of Wholesale Market Prices on Retail Rates

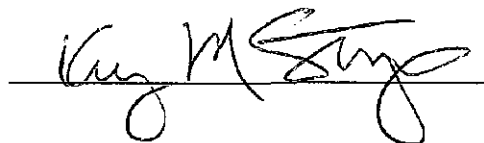
Initial Comments filed by several stakeholders, most vigorously by IEU-OH, submit that Ohio customers face unjust and unreasonable electricity service costs that stem from the wholesale prices determined in RTO Markets. To the contrary, PJM's Initial Comments in this proceeding establish that the prices clearing in its Markets are the lowest wholesale electricity prices feasible, consistent with reliable operations. As well, empirical evidence indicates that employing the prevailing RTO organized market design has resulted in substantially improved overall market efficiency, and that the efficiency gains far exceed implementation costs.¹⁰

ancillary services from PJM, and MISO will refund to Buckeye Power its charges for ancillary services back to January 6, 2009.

¹⁰ See *Market Organization and Efficiency in Electricity Markets*, Erin T. Mansur and Matthew W. White, Discussion Draft, June 30, 2009, available at <http://bpp.wharton.upenn.edu/mawwhite/papers/MarketOrg.pdf>. The Mansur/White paper concludes at page 37 with respect to the integration of nineteen Midwest-based firms including AEP's Ohio operating companies and Dayton Power and Light into PJM in October 2004, that "the organized market design identified new trading opportunities that were not realized by the bilateral trading system that preceded it. These findings are consistent with the theoretical concern that decentralized bilateral markets may have difficulty in achieving efficient allocation of the complementary services – viz., generation and transmission – required in these markets. Moreover, the magnitude of these gains calls into question the assertion that organized market designs are not worth their costs of implementation." On the basis of an econometric analysis, Mansur and White conclude that a 2.5-fold increase in quantities traded between regions subsequent to the October 2004 integration represents an incremental increase in total gains from trade of \$163 million per year.

There is no disputing the fact that wholesale market prices have an impact on retail rates. By the same token and in the final analysis, *retail* rates are established by *retail* regulatory authorities, subject to the body of *state* law authorizing the scope and substance of their actions. Congress and federal policymakers implementing the Federal Power Act have established the policy objective of the promotion of efficiency in wholesale electricity markets, consistent with the maintenance of reliable service at reasonable cost. PJM is proud of its accomplishments in that regard. At the same time, PJM stands by its commitment to work with state regulatory commissions on matters of mutual interest, including the establishment of price responsive demand. With due respect, PJM suggests that stakeholders – some of whom blatantly seek to serve their private interests by undermining the foundation of the nation's competitive wholesale electricity markets -- instead explore alternatives in the retail ratemaking arena for equitably allocating the benefits of increased efficiency in wholesale markets.

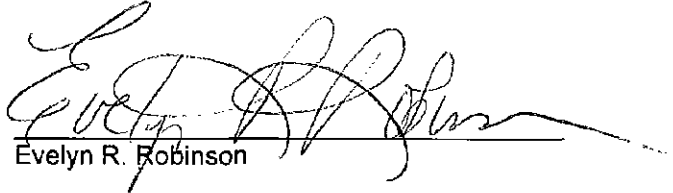
Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kerry M. Stroup", is written over a horizontal line.

Kerry M. Stroup
Manager, State Government Policy
PJM Interconnection, L.L.C.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Reply Comments of PJM Interconnection LLC has been served upon the following parties via regular U.S. Mail, postage prepaid, or also by electronic mail, this 24th day of July, 2009.


Evelyn R. Robinson

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