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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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DOCKETING DIVISION
Public Utilities Commission of Ohio

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

REPLY COMMENTS OF AMERICAN MUNICIPAL POWER, INC.

I. INTRODUCTION

On March 4 2009, the Public Utilities Commission of Ohio ("Commission") issued an Entry in the above-captioned proceeding ("March 4th Entry") that initiated the inquiry into the value of the continued participation in Regional Transmission Organizations ("RTOs"). In accordance with the March 4 Entry, American Municipal Power - Ohio, Inc. (now "American Municipal Power, Inc." or "AMP") filed Initial Comments in this proceeding on March 26, 2009. In its Initial Comments, AMP concluded that the problems in today's RTO markets stem primarily from Day 2 functions which are related to the complex energy markets (e.g., energy, capacity, and ancillary services) now administered by the RTOs.¹

AMP also noted that the structure of the Ohio RTO markets creates numerous seams issues associated with operating within, and between, both MISO and PJM. These problems include the operation of multiple sets of tariffs, different market scheduling

¹ AMP Initial Comments at 5.

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times, differing ancillary service rates and administrative fees, communication and coordination problems, inconsistent market rules, and market power mitigation.²

AMP recommended that the Commission consider the studies of the American Public Power Association's ("APPA") Electric Market Reform Initiative ("EMRI"). The EMRI studies found no reliable evidence that consumers are better off with RTO markets.³ Furthermore, RTO operation of these Day 2 markets has adversely impacted the availability and cost of power sold under bilateral contracts. Generation sellers have no incentive to offer power in bilateral transactions at reasonable prices because sellers can extract relatively high prices in the short-term Day 2 markets.⁴ Moreover, EMRI concluded that these Day 2 markets also resulted in very high administrative and software costs.⁵

In its initial comments, AMP concluded that current RTO markets in the Midwest are not meeting the needs of retail customers. To help meet the needs of retail customers, AMP supported the EMRI Roadmap to remedy the absence of meaningful competition and consumer protections under the current RTO market model.⁶

AMP now respectfully submits these Reply Comments to the Commission. In its Reply Comments, AMP addresses additional EMRI studies that further articulate the

² Id. at 7.

³ In particular, the EMRI studies found that 1) supplier offers are 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. Id.

⁴ Id. at 9.

⁵ Id. at 10.

⁶ Features of EMRI's Roadmap include: 1) the creation of an RTO-run, marginal-cost based "optimization" market (i.e., in place of the current RTO-run energy and ancillary services real-time and day-ahead markets); 2) bilateral contracts between suppliers and load-serving entities (LSEs); 3) the phasing out of locational capacity markets; 4) the implementation of resource adequacy standards for each RTO; and 5) RTOs would conduct least-cost generation dispatch based on actual operating costs.

problems of the RTO markets. AMP also offers replies to specific comments made by other parties in this proceeding.

II. REPLY COMMENTS

A. Additional EMRI Studies Should Be Considered.

Since AMP filed its Initial Comments, the EMRI released two additional studies that give insight into the competitiveness of RTO markets and the potential impact of a cap and trade system on wholesale electric markets.

In May 2009, EMRI issued a study entitled *The Deregulation Penalty: Losses for Consumers and Gains for Sellers* showing that the excess earnings of electric generation companies after market deregulation has not led to a reduction in the cost of electricity.⁷

The study concludes that:

Excess earnings by these companies indicate that the revenues from the sale of electricity greatly exceed the costs of producing electricity. Were these restructured markets truly competitive, as is claimed by their supporters, such high profits would bring additional entrants into the market and drive down the prices. Anomalous financial outcomes, such as those experienced by these companies year after year, would be unlikely to occur in efficient competitive markets. The profitability of these companies is therefore a direct indicator of higher costs for consumers.⁸

Moreover, the “earnings for these owners of generation remained high in 2008, despite the severe economic downturn.”⁹ For example, the 2008 adjusted return on equity (“ROE”) for Exelon Generation was approximately 38%. This figure should be compared to the 2008 adjusted ROE for a set of regulated utility companies which was

⁷ *The Deregulation Penalty* may be found in its entirety at the APPA EMRI website at: <http://www.appanet.org/files/PDFs/BodmerUpdatedFinancialAnalysis52009.pdf>.

⁸ *Deregulation Penalty* at 1.

⁹ *Id.* at 3.

approximately 9%.¹⁰ Other indicators that consumers are bearing unnecessarily high costs are:

- The difference in ROE earned by a set of core companies (i.e., formerly vertically integrated, state-regulated utilities whose generation was constructed under rate-of-return regulation and is now unregulated) relative to the ROE earned by regulated companies was \$4.9B in both 2007 and 2008 and \$20B in total from 2001 through 2008.
- In 2008 alone, the gross margin on electricity sales for the core company generating segment and the merchant companies (i.e., companies not initially formed as regulated utilities whose primary business is selling power in deregulated wholesale markets) increased by \$4.4B.
- The core and merchant companies have realized increases of more than \$6B in free cash flow since 2005.
- Shareholder earnings in the PJM companies were between \$33B and \$47B greater than investments in the S&P 500 over six and ten-year holding periods, and between \$19B and \$26B above regulated companies.
- The difference in market-to-book ratios for unregulated relative to regulated companies implies that shareholders expect a future revenue stream of \$47B from ownership of stock of these companies above that earned from regulated companies.¹¹

¹⁰ Id. at 7.

¹¹ Id. at 3-4.

In short, *The Deregulation Penalty* concludes the largest owners of unregulated generation in PJM have extracted large amounts of wealth from consumers under a market structure ostensibly intended to create competition to benefit consumers.¹² It is apparent from EMRI's analysis that the markets for wholesale electricity have a long way to go before they can be considered truly competitive.

In July 2009, EMRI issued another study entitled *Productive and Unproductive Costs of CO2 Cap-and-Trade* which models the impacts of a range of allowance schemes on consumer and generator welfare in regulated and unregulated electricity markets during the early years of federal cap-and-trade greenhouse gas regulation.¹³ The study finds certain costs are "productive costs" which help to achieve the goals of the cap-and-trade policy such as reducing carbon emissions and becoming less reliant on foreign sources of energy. Productive costs include investments in energy efficiency and renewables, switching to less carbon-intensive fuels and investments in low-carbon energy sources.¹⁴

Unproductive costs, however, are those that do little to further the goals of cap-and-trade, and instead only increase the cost of electricity. The study concludes that a cap-and-trade system initiated in RTO markets will produce unproductive costs. This is because the purchase of carbon credits will raise the cost of electricity for some generators, but not all. For example, nuclear power costs will not increase as a result of cap-and-trade, but coal power plant costs will. In a single clearing-price structure, the highest cost of electricity dictates the price of electricity consumers must pay. Therefore,

¹² Id. at 3.

¹³ *Productive and Unproductive Costs of CO2 Cap-and-Trade* may be found in its entirety at: <http://www.synapse-energy.com/downloads/cap-and-trade.pdf>

¹⁴ *Productive and Unproductive Costs of CO2 Cap-and-Trade* at 2.

as a result of cap-and-trade in a single clearing-price structure, all electric generators will be paid more for electricity, even though their costs may not have increased.¹⁵

Because of this perverse pricing structure, an increase in costs for certain generating plants (i.e., those on the margin) can lead to an increase in revenues for all generation owners, regardless of whether cap and trade has increased costs for all generators.¹⁶ The EMRI study concludes that in the PJM market, this margin effect will “help to translate a \$20/ton allowance price into new annual consumer costs of almost \$6.5B.”¹⁷ In essence, a cap-and-trade system will only exacerbate the already negative impacts of the single clearing-price structure of RTO markets.

AMP submits that these two additional studies are further evidence of the dysfunction in the RTO Day 2 markets.

B. FirstEnergy Does Not Accurately Represent the Benefit of RTOs.

In its Initial Comments, FirstEnergy referenced several studies that attempt to quantify the monetary benefit to customers as a result of RTO participation. However, the studies cited by FirstEnergy are methodologically flawed, and/or are derived from suspect sources.

For example, FirstEnergy cites a study by Cambridge Energy Research Associates (“CERA”) entitled *Beyond the Crossroads, The Future Direction of Power Industry Restructuring* (“CERA Study”) which attempted to calculate the net gains of deregulation.¹⁸ The CERA Study sought to utilize an econometric model that took electricity prices for the period of 1981 to 1997 for four regions to predict electric prices

¹⁵ Id. at 3

¹⁶ Id.

¹⁷ Id.

¹⁸ FirstEnergy Initial Comments at 7.

for the period 1998 to 2004. Based on this analysis, CERA concluded that net gains from deregulation in the U.S. for the period 1998 to 2004 were \$34B.

The CERA Study was critiqued in an EMRI study entitled *The Flaws in the Primary Methodologies Used to Assess Electric Restructuring* by John Kwoka ("Kwoka Study").¹⁹ The Kwoka Study notes that there were several flaws to the CERA approach to calculating estimated savings due to energy deregulation. For example, the Kwoka Study points out that the use of the year 1997 as the year of deregulation is inherently flawed. As the Kwoka Study notes, deregulation was a multi-staged process taking place at different dates and different times; therefore no one date can be identified as the date deregulation "began."²⁰ Further, the CERA Study uses 1990-1997 prices to predict what regulated prices from 1998-2004 would have been. The Kwoka Study points out that prices in the previous seven years are unlikely to be an accurate predictor of prices in the next seven years.²¹ In sum, the Kwoka Study demonstrated that the CERA Study uses an unreliable methodology to calculate the economic impact of deregulation to customers.²²

FirstEnergy further cites two studies published by PJM and MISO that attempt to calculate the cost savings that have resulted from customer participation in each of the respective RTOs' markets.²³ These studies are clearly unreliable. The RTOs themselves have a vested self-interest in touting the benefits they ostensibly provide. Both of these studies seemingly reflect a public relations effort rather than a serious, well-supported independent study. The MISO link provided by FirstEnergy takes one to a MISO website

¹⁹ The Kwoka Study can be found in its entirety at:
<http://www.appanet.org/files/PDFs/RestructuringStudyKwoka1.pdf>

²⁰ The Kwoka Study at 27.

²¹ Id. at 28.

²² The Kwoka Study ultimately pointed out six flaws in the model used in the CERA Study to predict the cost savings of deregulation. Id at 27-29

²³ FirstEnergy Initial Comments at 7.

where the benefits cited are listed but not supported. Likewise, the PJM link provided by FirstEnergy takes one to a two-page brochure where the benefits cited are listed but not supported. These studies cannot be seriously relied on for accurate conclusions on market deregulation.

The final “study” FirstEnergy cites is a “discussion draft” of a study that apparently is not yet complete.²⁴ In the draft, the authors only sought comments from a limited number of sources, none of which represents buyer interests in the RTO markets. One in fact, William Hogan, is a primary architect of RTO markets and has a vested interest in promoting them. Again, the draft of a study that FirstEnergy cites cannot be relied upon to demonstrate the “benefits” of RTO markets.

C. FirstEnergy Mischaracterizes the RPM’s Effect on AMPGS.

In its initial comments, FirstEnergy cites AMP’s AMPGS project as evidence that PJM’s 3-year forward auction process has attracted new investment in electric generation.

FirstEnergy states that:

PJM’s RPM program – which is based upon a 3-year forward auction process as opposed to bilateral contracts – has been successful in attracting new investment. Also, other entities in Ohio are planning to invest in base load facilities, such as AMP-Ohio’s AMPGS project for 960MW of baseload capacity, although notably, these new generating facilities are largely in PJM.²⁵

FirstEnergy’s characterization of the AMPGS project is ironic at best.

²⁴ FirstEnergy Initial Comments at 7-8.

²⁵ *Id.* at 17.

First, as noted earlier, AMP supports EMRI's contention that RTOs have failed to create an environment conducive to effective and efficient bilateral contracting.²⁶ AMP maintains that the absence of a vibrant bilateral contract environment limits the regional ability to build new baseload capacity, especially in those states with retail competition.

Next, FirstEnergy touts PJM's Reliability Pricing Model ("RPM") as being "successful in attracting new investment." However, AMP supports EMRI's rebuttal to PJM's RPM entitled *Raising the Stakes on Capacity Incentives: PJM's Reliability Pricing Model* by James F. Wilson.²⁷ This study concludes that the RPM produced excessive capacity prices and costs to consumers; allowed sellers to withhold capacity and increase prices; and failed to attract significant new capacity.

In particular, AMP is disturbed that its AMPGS project is portrayed as a positive result of the RPM. AMPGS is an explicit effort on AMP's part to limit its Member's exposure to the dysfunctional RTO markets. In short, AMPGS is a "negative" reaction to PJM's RPM and other adverse effects of dysfunctional wholesale RTO markets.

D. Miscellaneous Comments.

AMP is also concerned that a number of additional problematic areas are addressed by RTO supporters through mere platitudes. For example, FirstEnergy, AEP, and Duke-Ohio all support the relatively recent revisions that both PJM and MISO have made to their queue and interconnection policies.²⁸ However, all of these investor owned utilities fail to address the current state of the interconnection queues and the difficulties to achieve grid interconnection for a viable project in a timely manner. It is troubling for

²⁶ Please see "Bilateral Contracting in Deregulated Electricity Markets" by Ezra Hausman, Rick Hornby, and Allison Smith, Synapse Energy Economics which can be found at: <http://www.appanet.org/files/PDFs/EMRISynapseBilateralsReport2008.pdf>

²⁷ This study can be found at <http://www.appanet.org/files/PDFs/SummaryRPM2008.pdf>

²⁸ See FirstEnergy Initial Comments at 21; AEP Initial Comments at 25; Duke-Ohio Comments at 29.

AMP, as an entity trying to complete a fairly aggressive asset acquisition program, to see that after a decade of trying, the RTOs cannot get the grid interconnection process right.

Seams issues between MISO and PJM are another area of concern. None of the Ohio investor-owned utilities acknowledge the many seams issues that AMP experiences as a buyer in both MISO and PJM. AEP acknowledges that there are “times when the RTOs act unilaterally and create rules that are then in conflict with the neighboring RTO that shares the seam.”²⁹ However, no mention is made as to the difficulties these “conflicts” create for buyers, and their customers, or how such conflicts may be more readily resolved.

FirstEnergy supports initiatives, and claims progress, towards addressing seams issues. FirstEnergy does also correctly note that there are a number of significant seams issues (e.g., transmission constraints; loop flows; and variability in dispatch at the RTO seams) that still have not been resolved after a decade of trying.³⁰ However, no mention is made as to the difficulties these seams issues create for buyers, and their customers, or how they may be readily resolved.

Duke-Ohio fairs no better on this matter. In fact, Duke-Ohio maintains that “most of the major Midwest ISO’s seams issues have been resolved or ameliorated and those remaining issues are being addressed by the RTOs and their stakeholder groups.”³¹ Duke-Ohio contends that the one major area remaining is the “allocation of flowgate rights between the markets.”³² However, Duke-Ohio makes no mention as to the difficulties this

²⁹ AEP Initial Comments at 25.

³⁰ FirstEnergy Initial comments at 22.

³¹ Duke-Ohio Initial Comments at 30.

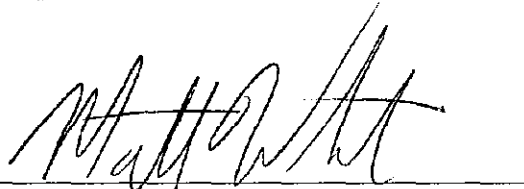
³² Id.

single seams issue creates for buyers, and their customers, or how it may be more readily resolved.

III. CONCLUSION

As noted in its Initial Comments, AMP remains very concerned about the current state of the RTO Day 2 markets. AMP continues to support the EMRI “Roadmap” to “remedy the absence of meaningful competition and consumer protections under the current RTO Day 2 market model.” This Commission should consider this “Roadmap” and the other EMRI studies (cited herein and on APPA’s EMRI website) as part of this proceeding. Further, AMP urges that the Commission consider its replies to a number of initial comments filed in this proceeding.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'John W. Bentine', is written over a horizontal line.

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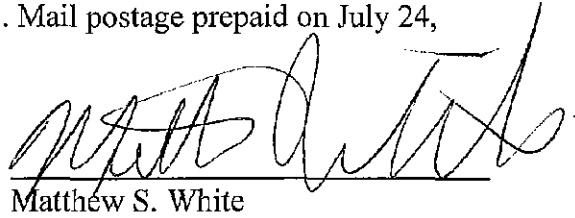
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading was served upon the following parties of record or as a courtesy, via U.S. Mail postage prepaid on July 24, 2009.

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