

January 6, 2004

Magalie Roman Salas, Secretary
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Conference on Supply Margin Assessment
Docket No. PL02-8-000
AEP Power Marketing, Inc., AEP Service
Corporation, CSW Power Marketing, Inc., CSW
Energy Services, Inc. And Central And South West
Service, Inc.
Docket Nos. ER96-2495-016, ER97-4143-004,
ER97-1238-011, ER98-2075-010, and
ER98-542-006 (Not Consolidated)
Entergy Services, Inc.
Docket No. ER91-569-018
Southern Company Energy Marketing, L.P.
Docket No. ER97-4166-010

Dear Secretary Salas:

Please find for e-filing, the Joint Consumer Advocates' Comments on Staff White Paper Relating to Supply Margin Assessment Screen in the above referenced proceeding.

Very truly yours,

- Filed electronically -

Denise C. Goulet
Senior Assistant Consumer Advocate

Enclosure

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Conference on Supply Margin Assessment	:	Docket No. PL02-8-000
AEP Power Marketing, Inc., AEP Service Corporation, CSW Power Marketing, Inc., CSW Energy Services, Inc., and Central and South West Services, Inc.	:	Docket Nos. ER96-2495-016, ER97-4143-004 ER97-1238-011 ER98-2075-010 And ER98-542-006 (Not Consolidated)
Entergy Services, Inc.	:	Docket No. ER91-569-018
Southern Company Energy Marketing L.P.	:	Docket No. ER97-4166-010

JOINT CONSUMER ADVOCATES' COMMENTS
ON STAFF WHITE PAPER RELATING TO
SUPPLY MARGIN ASSESSMENT SCREEN

Pursuant to the Commission's Notice of Technical Conference on Supply Margin Assessment Screen and Alternatives issued December 19, 2003, the Pennsylvania Office of Consumer Advocate ("Pa. OCA"), the Maryland Office of People's Counsel ("MPC"), the Ohio Office of Consumers Counsel ("OCC"), and the Office of People's Counsel for the District of Columbia ("DC OPC") (hereinafter Joint Consumer Advocates) hereby submit comments supporting certain modifications to the Supply Margin Assessment ("SMA") screen. Joint Consumer Advocates urge the Commission to adopt Staff's proposed modified version of the SMA screen known as the Capacity Surplus Index ("CSI"); to adopt an additional modification that would factor in the nature of the mix of

generation plants owned by the Applicants and where those plants serve load on the demand curve; and to apply this screen to all entities seeking market based rate authority, or renewal of market based rate authority, regardless of whether such entities participate in bilateral contracts, spot energy transactions, or in Independent System Operator (“ISO”) markets or Regional Transmission Organization (“RTO”) markets served by a Commission approved market monitor.

Joint Consumer Advocates are offices empowered by law to represent consumers of utility services in their respective jurisdictions. All of the states and the District of Columbia represented by Joint Consumer Advocates herein have restructured the manner in which electricity is bought and sold in their states, allowing consumers to choose their provider of electric supply. Consumers in these jurisdictions are dependent upon the existence of workably competitive wholesale electricity markets. Joint Consumer Advocates have actively participated in PJM's stakeholder advisory committees, and in the development and revision of PJM's major markets. Consequently, Joint Consumer Advocates have significant experience and interest in the development of screens to assess and mitigate market power which informs these comments.

A. Background

The Commission in November, 2001, adopted a new method for assessing the potential for a generation entity to exert generation market power in *AEP Power Marketing, Inc. et al.*, Docket No. ER96-2495-015, *Entergy Services, Inc.*, Docket No. ER91-569-009, and *Southern Company Energy Marketing, L.P.* Docket No. ER97-4166-008, 97 FERC ¶61,219 (November 20, 2001). Those proceedings involved applications by AEP, Entergy and Southern Companies for market based rate authority in their

respective territories. In assessing whether to grant market based rate authority to an applicant, the Commission had traditionally used the Appendix A screen from the Merger Policy Statement. That screen represents a “hub and spoke” analysis that focuses on HHI concentration indices often used by the Department of Justice to assess market power issues in anti-trust investigations. In ruling on AEP’s, Entergy’s and Southern’s applications, however, the Commission in the November 20 orders determined that the “hub and spoke” analysis was inadequate to assess the full range of potential market power issues where a utility’s generation was pivotal to meeting peak demand in the relevant market and / or where transmission constraints may provide greater opportunities for the exercise of market power. Consequently, the Commission adopted a new methodology labeled the SMA screen analysis in order to assess not only HHI concentration factors, but to also consider transmission constraints and the relative importance of the applicant’s generation for meeting peak demand in the relevant market.

The Commission held a Technical Conference in October, 2002 to further consider stakeholder comments relating to the development of the SMA screen. Many commenters expressed concern that the SMA included capacity used to serve firm obligations, or to serve native load and associated operating reserves, even though states may regulate the price of that service. Others expressed concern that factoring in Total Transmission Capability (“TTC”) may overstate the size of the geographic market to the Applicant’s advantage. Joint Consumer Advocates filed comments in that phase of this docket urging the Commission to extend the use of the SMA screen to market based rate authority applications involving entities operating in RTOs or ISOs since generation

market power has been exercised in those regions despite the existence of market monitors and market power mitigation tools, citing California and PJM as examples.

On December 19, 2003, the Commission issued this Notice of Technical Conference indicating its intent to hold a second round of technical conferences in this docket to consider several alternatives to the SMA proposed in a Staff White Paper. Staff proposed three alternative methods to the SMA screen: the Capacity Surplus Index, the Limited Competing Supplier Screen and the Wholesale Market Share screen. Joint Consumer Advocates submit these comments supporting the Capacity Surplus Index screen with certain modifications discussed in Section C below.

B. Description of SMA and Alternative Proposals

1. SMA Screen

The SMA screen is intended to determine whether an Applicant's generation holdings relative to the overall size of the market is such that it raises market power concerns, that is, whether the Applicant's generation is pivotal in the market. If some portion of the Applicant's capacity is required to meet the peak demand, then it is deemed pivotal. An Applicant that controls more capacity than the surplus above peak demand will fail the screen and be subject to mitigation. Affiliated generation is included with Applicant's capacity in the analysis. For the purpose of the screen, the total capacity in the market region includes the generation that can be imported from neighboring regions limited by the TTC of the ties. All sales into an ISO or RTO with Commission approved market monitoring are exempt from the SMA.

2. Alternative Screens

The alternatives that Staff proposes have several features in common. First, each modifies the SMA definition of capacity by excluding planned outages and reliability council determined or state determined reserve requirements, such as operating reserve requirements, from the screen. Second, all three continue to include an adjustment to reflect the availability of capacity imports limited by tie line TTC. Third, each is applied to monthly data, operates as a monthly analysis and mitigates on a seasonal basis. In contrast, the SMA is applied to annual peak data, operates as an annual analysis and mitigates on an annual basis.

The Commission seeks comment on whether the TTC values used for purposes of the screen should be modified to recognize factors such as historical firm transactions, losses, and transmission reserve margins; whether transmission capacity should be included in the analysis for TOs that have not transferred control of their transmission systems to calculate the critical transmission-related detail; and whether generation capacity values should reflect restrictions due to transmission and other operating constraints. The Commission also seeks comment on whether it should use monthly or annual peak data, and whether the Commission's current regulations require the filing of all needed monthly data, or whether new regulations are required. The Commission also inquires in to whether Staff's proposed definitions of Data are correct.

a. Capacity Surplus Index Screen

The Capacity Surplus Index ("CSI") screen would eliminate the Applicant's supply from screen analysis and focus instead on whether there is sufficient competing supply in the control area to meet the peak. The screen would start with an analysis of

the Control Area Competing Supply, i.e. all non-applicant Installed Capacity (including planned outages, plus imports that are lesser of TTC or Uncommitted Capacity) and compare that with the Control Area Peak Demand (including operating reserves).

If the Control Area Competitive Supply is greater than the Control Area Peak Demand, the Applicant would pass the CSI screen. The Staff would also run the analysis for interconnected markets as well as the immediate Control Area market. The Staff would apply the screen on a monthly basis using monthly data and mitigate only in seasons where the screen is failed for one or more months. The SMA, on the other hand, would require mitigation all year if the Applicant failed the screen.

b. Limited Competing Supplier Screen

The Limited Competing Supplier Screen compares the Applicant's installed and uncommitted capacity with the total installed and uncommitted capacity available in the control area market plus uncommitted capacity available from neighboring markets. The screen divides the Applicant's Committed Capacity (installed capacity) by the total installed capacity of all suppliers in Control Area plus imports (TTC). Then, the screen divides the Applicant's Uncommitted Capacity (installed capacity less planned outages, native load, Long Term firm sales and operating reserves) by the Uncommitted Capacity of all suppliers in the Control Area. As with the CSI screen, the Staff would apply the screen on a monthly basis using monthly data and mitigate only in seasons where the screen is failed for one or more months.

If the Applicant's market share is less than 20%, the Applicant passes the screen. If the Applicant's market share is greater than 35%, the Applicant fails the screen and mitigation is required. If the Applicant's market share is between 20% and 35%, Staff

would propose to consider other factors such as transmission constraints. The Commission seeks inquiry into what other factors should be considered for cases that fall between the 20% and 35% thresholds.

c. Wholesale Market Share Screen

The Staff's proposed Wholesale Market Share screen recognizes the concern expressed by some stakeholders that an Applicant may not be able to exert market power over native load due to state regulation over rates. This screen considers the market share of only the uncommitted capacity of the Applicant.

The screen would divide Applicant's Uncommitted Capacity by total market Uncommitted Capacity in the control area market. Staff proposes to use the same 20% and 35% threshold tests for pass / fail decisions. The intent is to capture the size of supply and demand of the entire market, then remove the supply serving retail demand and retail demand itself from the total, along with related operating reserves. As with the CSI and Limited Competing Supplier screens, the Staff would apply the screen on a monthly basis using monthly data and mitigate only in seasons where the screen is failed for one or more months.

The Commission seeks comment on the ability of Applicant and vertically integrated utilities to segregate wholesale opportunity sales from retail sales and the reasonableness of such an approach.

C. Recommendations and Modifications

In this docket the Commission seeks to adopt a relatively straightforward test to determine if an Applicant for market based rate authority has generation market power. Joint Consumer Advocates submit that, while the alternatives proposed in the Staff White

Paper are all improvements over the SMA and the hub and spoke method, like the SMA, they are still one-dimensional screens for market power. All fail to include analysis of one key factor, i.e. which of the Applicant's units pose the greatest potential for market dominance due to the portion of the supply curve these units may control.

1. Analysis of the Type of Capacity and the Portion of the Demand Curve Controlled by that Capacity is a Critical Factor That Must Be Considered.

Joint Consumer Advocates observe that the SMA screen and each of the proposed alternative screens treat all capacity held by the Applicant and in the market as homogeneous. This simplification ignores the fact that type of capacity, duty cycle, and the portion of the demand served by said capacity, are often key factors in determining whether an Applicant has market power and the incentive to exercise that power. All of the proposed screens count the MWs and thus would reveal whether or not an Applicant controls sufficient supply to make such a strategy possible. However, the ability to exert market power is not limited to the size of the supply portfolio an Applicant controls. Some Applicants may pass these screens, yet still have the potential to exert market power because the portfolio or mix of capacity owned by those Applicants provides unique incentives for economic withholding.

For example, if an Applicant's capacity is all base load, the screens as currently proposed are likely sufficient. However, if the Applicant controls most or all of the peaking resources in its market area, and has only one or two base load plants, it may pass a screen but be in a position to raise prices profitably over small numbers of hours during the year and in certain locations. An Applicant who controls baseload resources and exercises market power via physical or economic withholding reduces the overall

supply in the market and increases market prices as well as revenues received by the remaining plants. An Applicant that controls most or all of the peaking resources in its market area effectively has the ability, absent mitigation, to set the price at peak. If the Applicant also controls a baseload or intermediate resource, raising the offer price of the peaking resources could significantly increase the profits to the Applicant's portfolio. In total, such an Applicant may not control sufficient capacity to trigger the SMA screen or one of the proposed alternative screens; nevertheless, it would be in a position to profit from strategic bidding. The three alternatives, CSI, Limited Competing Supplier Screen and Wholesale Market Share, while providing a more sophisticated analysis than the SMA from the perspective of outages, operating reserves and native load factors, all fail to take any account of the types of facilities controlled and whether the Applicant has market power because it dominates portions of the supply curve.

2. The CSI Screen, If Modified, Provides The Best Analysis of Market Power Potential.

The CSI screen approach appears to be the most straightforward of the four approaches discussed because it provides an answer to the central question: "Is the Applicant's generation needed to serve the peak?" However, as noted above, the CSI screen as proposed fails to consider the nature of the mix of units owned by the Applicant. Understanding the Applicants supply mix and its interplay with the demand curve will provide the Commission additional critical information in determining the Applicant's ability to exercise generation market power. The Commission should thus modify the CSI screen to incorporate such an analysis.

The Commission should further modify the CSI screen to focus on the details of supply arrangements in order to ensure that this calculation is accurate. An affiliated

generator may satisfy the native load or Provider of Last Resort (“POLR”) requirements of its affiliated utility using a number of sources. These may include using full-requirements contracts with other generators. So, the native load is, in fact, served partly by the affiliated generation and partly by energy from another generator. This can allow the generating affiliate to hold back some of its generation for participation in the market. This means that the determination of the affiliate’s generation in the market cannot be assumed to be equal to the load. Instead, the specific contractual and physical arrangements for supply to the native load must be understood. Consequently, Joint Consumer Advocates recommend that the Commission adopt the CSI Screen, modified to include: (1) analysis of the Applicant’s supply portfolio and what portion of the supply curve that those units are likely to dominate and (2) analysis of the supply arrangements for native load or POLR obligations in the case of affiliated generation.

3. Neither the Wholesale Market Share Screen Nor the Limited Competing Supplier Screen Adequately Assess Market Power Potential.

The Wholesale Market Share screen would allow removal of native load generation from the analysis. While such an approach may address concerns for applicants serving in states which have not accepted retail competition, it would not adequately address market power issues in retail choice states. AEP is a prime example of the problem inherent in this approach. AEP is not likely to pass the SMA screen. Exclusion of native load generation from the analysis may result in AEP’s market share more evenly matching competing suppliers in its markets. However, removing native load from the analysis may be inappropriate for a company like AEP. AEP serves a diverse population, operating both in states that have retail choice and those that do not. Consequently, an assertion that the Applicant cannot exert market power over native load

due to state regulation of rates may not be accurate and the screen would inappropriately exclude native load in choice states.

The Limited Competing Supplier Screen suffers from a similar defect. Application of the Limited Competing Supplier Screen and the Wholesale Market Share screen would require the Commission to assess what fraction of the Applicant's generation is dedicated at any given time (1) to supply native load, (2) to supply under bilateral contracts, and (3) to supply offers into the wholesale market. These three categories may not sum precisely because the Applicant's generation obligations to native load and bilateral contract obligations may not be met 100% by the Applicant's own generation and will likely be confounded by economy purchases and sales. Thus, application of the Limited Competing Supplier screen or the Wholesale Market Share screen to determine uncommitted capacity may be either data intensive or require many simplifying assumptions.

Finally, both the Limited Competing Supplier screen and the Wholesale Market Share screen depend upon the establishment of reasonable threshold market share levels. The Commission Staff proposes to set these threshold levels in a range from 20% on the acceptable side to 35% on the unacceptable side. There is no evidence submitted to support this range as opposed to some other range. Joint Consumer Advocates submit that the process of establishing an appropriate and non-arbitrary range may be administratively burdensome and subject to lengthy legal challenges.

D. Mitigation Recommendations

The Commission Staff proposes to continue to use a must offer requirement to protect against physical withholding and the split the savings approach to pricing units

that require mitigation for economic withholding. The split the saving approach would require a price for the Applicant's generation that would split the savings halfway between the seller's average incremental costs and the cost avoided by the buyer through purchasing from the seller.

Many have objected to mitigation of spot market energy sales at all; others have objected to the split the savings pricing approach; still others have objected to requirements to post incremental and decremental cost data. Staff's proposed alternatives include cost based rates and use of a single market clearing price.

Joint Consumer Advocates submit that, given the data intensiveness of the split the savings approach, that it is probably best to use this method only in regions with a functional RTO or ISO that has the infrastructure to collect the need data. Absent the data management infrastructure of an independent third party such as an RTO or ISO, the Commission would likely have to oversee the administration of this approach. Joint Consumer Advocates recommend that the use of a cost based rate as a ceiling rate for capacity and energy would be an administratively simpler and consistent approach to mitigating market power in regions without a Commission approved RTO or ISO.

E. Application to Bilateral Contract Transactions and Market Transactions in ISOs and RTOs.

The Commission continues to seek inquiry into whether it should extend the SMA screen, or any modified version thereof adopted in this proceeding, to applicants for market based rate authority operating in RTO or ISO regions. Joint Consumer Advocates submitted comments in an earlier phase of this proceeding urging the Commission to use the screen for all transactions, regardless of whether these transactions occur in RTO or ISO regions, or whether the transactions are bilateral or spot energy market transactions.

Recent experiences with the exercise of market power in California illustrates that the existence of the California ISO and an active market monitor in that region, did not prevent significant abuses from occurring. We also direct the Commission's attention to events that occurred during the first quarter of 2001 in PJM's capacity markets. Despite the fact that PJM operates one of the most liquid and competitive markets in the nation and despite the fact that PJM has an active market monitor that detected gaming of market rules in its capacity market within days of its occurrence, it took over three months to remedy the design flaw that allowed such gaming. This excessive period resulted in that generator recovering revenues in excess of otherwise competitive market prices. Having an extra tool through the SMA screen, or any modified version thereof, to review the potential for the exercise of market power may assist market monitors by providing an extra level of analysis.

Joint Consumer Advocates submit that conditions within markets can change rapidly so as to decrease the competitiveness of markets. The RTO and its market monitor may not be able to respond with sufficient speed to always prevent harm to consumers and to competition at the wholesale and consequently, at the retail level, that can occur from the exercise of market power. The Federal Power Act, 16 U.S.C. § 824 *et seq.*, imposes on this Commission the obligation to ensure that wholesale electric prices remain just and reasonable and provides the Commission the tools to remedy unjust and unreasonable prices when market power is exerted. The Commission must be vigilant in using these tools and should not limit the arena within which it will apply these tools.

While the Commission did not require the SMA analysis for those entities that were operating in an approved RTO, Joint Consumer Advocates submit that the

Commission should not let the fact that an entity operates in a region served by an ISO or RTO prevent the application of the SMA screen to the proposed application. First, as the Commission noted in *AEP Power Marketing*, given the "significant structural changes and corporate realignments" in the industry, the Commission's hub and spoke analysis is inadequate to fully capture all market power potential in relevant markets, particularly where an entity's and its affiliates' capacity holdings may be pivotal to supplying demand for capacity within the ISO or RTO capacity market. *AEP, supra*, Slip Op. at 7. Second, there is the potential for the exercise of market power even in a well-operated RTO/ISO with an active market monitor. Third, these markets are still not mature. They have been in operation, at most, for only a few years. Changes to rules and procedures are frequent and often of substantial impact. Nor is it certain that any rule change will permanently and fully resolve the capacity market problems that were identified at that time. Fourth, while the mitigation measures proposed herein may not be necessary in an RTO or ISO region due to the existence of the RTO's or ISO's own mitigation rules, the screen would provide a heads up to the RTO or ISO market monitor on potential load pockets and which transactions require greater scrutiny. Any screens passed would not mean that continued surveillance by market monitors is unnecessary because of the potential for rapid changes in market conditions as discussed above, however, any screens failed could provide early, critical information to market monitors that better enable them to timely address market power concerns in their regions.

The Commission should carefully consider the potential for any marketer or owner of generation and its affiliates to exercise market power in any market. As such, the Commission should direct power marketers and generation owners seeking market

based rate authority from the Commission to undertake a market power analysis of its activities and the activities of its affiliates in all markets, as well as an SMA or CSI analysis before the Commission issues a decision in such proceedings. The Commission must have all information available related to the proposed application, including information related to the applicant's capacity holdings vis-à-vis the total capacity available in the market it serves.

RTOs provide important structural remedies to mitigate the potential for the exercise of market power. The existence of RTO market monitors assists in the detection of the exercise of market power or in the identification of market design flaws that provide the opportunity for the exercise of market power. However, at this time, these tools alone are insufficient to adequately protect consumers as demonstrated both in PJM and in California. The Commission should employ the full range of remedies for all regions in the nation, including the remedies adopted in Docket No. EL01-118 relating to termination or limitation of market based rate authority, even where ISOs or RTOs and regional market monitors are in place.

The Commission should also extend the application of the final rule adopted in this docket to bilateral contract transactions. The Commission Staff in the White Paper notes that the Commission is considering not including bilateral transactions within the scope of the rule based on the presumption that mitigation in spot markets may sufficiently curb the potential to exert market power. Joint Consumer Advocates question this presumption. The Staff's logic presumes that forward market power will be mitigated because buyers will know that they can fall back on a mitigated spot market if bilateral prices are unreasonable. However, consistent with its obligation to ensure just

and reasonable rates under the FPA, absent the determination of competitive conditions, the Commission should require all sales, whether spot or forward to be subject to cost based price mitigation.

The Commission should take note that the PJM market monitor scrutinizes both bilateral transactions and spot market transactions to determine whether entities are exerting market power. The Commission itself has recognized the importance of providing RTO or ISO market monitors with access to bilateral contract data in order to ensure that all transactions are reviewed. In PJM, and in most RTO or ISO markets, bilateral contracts comprise the bulk of the transactions that occur. Spot energy markets account for only a small minority of the trades occurring in these regions. The potential to exercise market power may be even greater for bilateral transactions considering the share they have of total transactions. The Commission should ensure that all consumers, not just those served through spot energy sales, are protected from the potential for the exercise of market power.

F. Conclusion

Joint Consumer Advocates recommend that the Commission adopt the CSI screen in lieu of the SMA screen to assess generation market power potential of applicants for market based rate authority. The CSI screen better analyzes whether the Applicant's generation is pivotal to supplying load than do the other methods discussed and proposed. However, whichever method the Commission selects should be modified to incorporate analysis of the nature of the mix of the Applicant's generating units and the portion of the supply curve controlled by those units. The Commission should also incorporate an analysis of the supply arrangements for native load or POLR obligations in the case of affiliated generation. Such additional requirements would fine tune the Commission's proposed screens to focus on the critical issue of which units are at greatest risk of exerting market dominance. This fine tuning of the Commission's proposal would minimize the need to mitigate to those units that pose the greatest risk while maximizing consumer protection from such market dominance. The Commission should also limit use of the split the savings approach to mitigating market power to RTO and ISO regions and adopt a cost based rates approach to mitigation in non RTO and non-ISO regions due to the more complex data requirements and the more complex application of the split the savings approach in such regions.

Finally, the Commission should expand the application of the screen to RTO and ISO regions as well as to bilateral contract transactions. Bilateral transactions comprise the bulk of all market transactions and are scrutinized by RTO and ISO market monitors. There is no justification for excluding such transactions from the application of the screen adopted in this docket. Additionally, the existence of an RTO or ISO market and a

Commission approved market monitor does not in and of itself protect against the exertion of market power. Running the screen for Applicants for market based rates in RTO and ISO regions would provide early warning of potential areas of concern for market monitors. However, the Commission should clarify that the RTO or ISO mitigation procedures will apply in lieu of those adopted in this docket for non-RTO or non-ISO regions. Only by ensuring that all consumers across the nation are protected from a generator's ability to exert market power will the Commission both fulfill its consumer protection responsibilities under the Federal Power Act while at the same time promoting greater confidence in the competitiveness of wholesale power markets.

Respectfully submitted,

Filed Electronically

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