

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection, L.L.C.

*

Docket No. EL03-236-006

COMMENTS OF THE JOINT CONSUMER ADVOCATES

Pursuant to the Commission's Notice of March 17, 2005, the Maryland Office of People's Counsel ("MPC"), the Pennsylvania Office of Consumer Advocate ("Pa. OCA") and the D.C. Office of People's Counsel ("D.C. OPC") (collectively referred to as "Joint Consumer Advocates") hereby submit comments on PJM's March 4, 2005 filing in this docket.

I. Introduction

In its January 25, 2005, order in the above-captioned docket, the Commission directed PJM Interconnection, L.L.C. ("PJM") to make a filing providing further explanation of the three-pivotal supplier test used by PJM as a trigger to suspend offer capping in the energy market.¹ PJM made such a filing on March 4, 2005 and supported its filing with an attached Declaration of Joseph E. Bowring, the PJM Market Monitor. The Joint Consumer Advocates have previously intervened in this case.

II. Comments

In its March 4, 2005 filing and attached declaration, PJM provides support for the three-pivotal supplier test for exempting areas from bid capping. This is the same test

¹ PJM Interconnection, L.L.C., 110 FERC 61, 053 (2005).

that was part of PJM's compliance filing of July 21, 2004 in this case. The Joint Consumer Advocates filed a protest on August 6, 2004 in response to the July 21, 2004 compliance filing on the grounds that the proposed procedure for exempting areas from bid capping did not adequately protect consumers.

While the Joint Consumer Advocates do not believe that PJM's test provides the best protection for consumers, the Joint Consumer Advocates agree with PJM that any less restrictive test than the one proposed by PJM would leave customers with inadequate protection. Thus the Joint Consumer Advocates believe that the test proposed by PJM should be the minimum standard used. As the Joint Consumer Advocates maintain that the test supported by PJM's March 4, 2005 filing did not adequately protect customers, any less stringent test would certainly not be sufficient.

The relevant arguments from the Joint Consumer Advocates' August 6, 2004 protest in this docket remain applicable to PJM's March 4, 2005 filing and are incorporated herein by reference. Specifically, the automatic trigger mechanism utilized by PJM may require the suspension of offer capping in situations where a complete market power analysis, which includes a review of where units fall on the supply curve for the local market, reveals significant market power concerns. While the market monitor can perform a complete market power analysis for the area once the trigger is met, offer capping cannot be re-instituted without a Commission decision, and the remedies available to market participants that are harmed in the intervening time are limited.

In support of the July 21, 2004 compliance filing, the PJM Market Monitor, Dr. Bowring, provides a declaration that frankly states that “[t]here is no

perfect test, but the no-three pivotal suppliers test for local market power strikes a reasonable balance between the requirement to limit extreme structural market power and the goal of limiting intervention in markets where competitive forces are adequate.”²

There is no persuasive evidence, however, that the level at which there is reasonable assurance of a competitive outcome is not some higher threshold level, for example a no four pivotal suppliers test as opposed to the no three pivotal suppliers test.³ Dr. Bowring’s July 21 declaration discusses the predictions made by Cournot theory of how a small number of competitors can raise prices.⁴ The theory predicts that there will be significant mark-ups over marginal cost if there are three pivotal suppliers. The results are not comforting even if there are four pivotal suppliers as opposed to three. The calculation described in paragraph 17 of the July 21 declaration uses an HHI of 3333 for three equal suppliers.⁵ If there were four equal suppliers, the HHI would be 2500. Working through the same calculation as Dr. Bowring performs for an HHI of 2500, the result assuming elasticity of 50% is a mark-up of 100% above the competitive level.⁶ Even that

² Declaration of Joseph E. Bowring attached to PJM’s July 16, 2004 Compliance Filing, par. 8.

³ In fact, there is evidence that six suppliers is not sufficient. “Experimental economics laboratory simulations of various electricity auction models, with six generators having equal market shares and no transmission constraints (thus passing traditional screens for number of sellers and no single market share exceeding 20%), show that participants - following market rules - can drive single price auction market prices above cost by 50%, on average.” T.D. Mount, W.D. Schulze, R.J. Thomas, R.D. Zimmerman, *Testing the Performance of Uniform Price and Discriminative Auctions*, Cornell University Dept. of Applied Economics and Management and Dept. of Electrical and Computer Engineering, at 2 (Revised Draft 2, July 16, 2001) (<http://www.pserc.wisc.edu> under Document Index/2001 Publications, Item 2001 01-18).

⁴ Declaration of Joseph E. Bowring attached to PJM’s July 16, 2004 Compliance Filing, par. 16 -17.

⁵ The HHI would be higher for one large supplier and 2 small suppliers. PJM’s no-three pivotal suppliers test would not distinguish between the two situations.

⁶ $(P-MC)/P = 2500/10,000/0.5 = 0.5$. Therefore, $P = 2 * MC$ and the price mark-up is 100%. Under Dr. Bowring’s calculation, $(P-MC)/P = 0.67$, which means that $P = 3 * MC$ and the price mark-up is 200%.

calculation is very conservative. Dr. Bowring states that the actual demand elasticity of the PJM energy market is “much lower than 50 percent.”⁷

The Cournot theory predicts that there is an inverse relationship between the level of demand elasticity and price increases. In other words the “much lower” demand elasticity would result in much higher prices, whether there are three, four or more suppliers in the area. Using the actual low elasticity of the PJM energy market, the only real restriction on price increases in these scenarios is the global \$1,000/MWH bid cap for the energy market.

As can be seen, the no-three pivotal supplier test still may allow for a mark up in prices above competitive levels. The use of a trigger of no-three jointly pivotal suppliers may have been more appropriate under a construct in which a market power analysis is conducted before suspension of the mitigation measures. However, under a construct where suspension of mitigation is automatic, in order to protect customers, the trigger threshold should be more rigorous, but certainly no less restrictive than that proposed by PJM. A more appropriate test for lifting offer capping without a complete market power analysis would be a no-four pivotal supplier test. Using a no-four pivotal supplier test would increase the likelihood that market concentration would not exceed the indices of 2500 HHI and 25% market share.

III. Conclusion

For the foregoing reasons, the Joint Consumer Advocates respectfully request that the Commission find that a less restrictive test than the no-three pivotal supplier test

⁷ Declaration of Joseph E. Bowring attached to PJM’s July 16, 2004 Compliance Filing, par. 17.

would not adequately protect customers, as argued by PJM in its March 4, 2005 filing. Further, the Joint Consumer Advocates respectfully request that the Commission direct PJM to file modifications to its Operating Agreement to provide that a no-three pivotal supplier test shall trigger a requirement that the PJM MMU will perform an analysis in a defined period of time of the competitiveness of a local area. If the PJM MMU's findings are disputed, the matter would be promptly submitted to the Commission for resolution. In the alternative, if an automatic trigger for suspension of local market power mitigation is approved, the threshold for the automatic trigger should be a no-four pivotal supplier test.

Continued for signatures:

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 15th day of April, 2005, a copy of the forgoing Comments of the Joint Consumer Advocates was mailed first-class, postage-prepaid to each person designated on the official service list compiled by the Secretary in these proceedings.

William F. Fields
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April 15, 2005

Honorable Magalie Roman Salas
Office of the Secretary
Federal Energy Regulatory Commission
Dockets Room – Room 1A
888 First Street, N.E.
Washington, DC 20426

Re: Docket No. EL03-236-006

Dear Secretary Salas:

Attached are the Comments of the Joint Consumer Advocates for electronic filing in the above-referenced proceeding.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

William F. Fields
Assistant People's Counsel

WFF/mcm
Enclosures
cc: Service List