



**American  
Public Power  
Association**

Ph: 202.467.2900  
Fax: 202.467.2910  
www.APPAnet.org

1875 Connecticut Avenue, NW  
Suite 1200  
Washington, DC 20009-5715

**Statement**  
**of the**  
**AMERICAN PUBLIC POWER ASSOCIATION**  
**before the**  
**PENNSYLVANIA PUBLIC UTILITY COMMISSION’S**  
***En Banc* Second Public Hearing on**  
**“Current and Future Wholesale Electricity Markets”**

**November 6, 2008**

**Harrisburg, Pennsylvania**

The American Public Power Association (APPA) appreciates the opportunity to provide the following testimony for the Pennsylvania Public Utility Commission's (PA PUC) second *en banc* public hearing regarding "Current and Future Wholesale Electricity Markets." I am Susan Kelly, APPA's Vice President of Policy Analysis and General Counsel.

APPA is the national service organization representing the interests of the more than 1,000 not-for-profit, publicly owned electric utilities throughout the United States that collectively serve more than 45 million consumers. Public power systems provide over 15 percent of all kilowatt-hour (kWh) sales to ultimate customers, and provide service in every state except Hawaii. Thirty-five municipally owned systems in Pennsylvania serve 83,000 customers. APPA member utilities are owned by the communities they serve, operate on a not-for-profit basis, and have retained the legal obligation to provide retail electric service to their customers. Since they are owned by the customers they serve and have no outside shareholders, all costs are passed through directly to the customer.

Public power systems own approximately 10 percent of the nation's electric generating capacity, but purchase nearly 70 percent of the power used to serve their ultimate consumers from the wholesale market. Public power systems therefore have an abiding interest in well-functioning wholesale power-supply markets. Their goal is to provide the retail customers they serve with reliable electric power and energy at the lowest reasonable cost, consistent with good environmental stewardship. Rising prices and other problems with the centralized wholesale markets administered by Regional Transmission Organizations (RTOs), however, have made meeting these goals difficult for many net-buyer public power systems located in RTO regions.

These public power systems have experienced first hand the difficulties of obtaining reasonably priced and reliable wholesale power supplies. For example, wholesale power costs for the municipal utilities in New Jersey doubled between 1992 and 2007—and then doubled again in 2008.<sup>1</sup> Public power systems in Maine have witnessed significant increases as well, including one which experienced a tripling of its power costs within a two-year period.<sup>2</sup> Other public power systems are taking "offensive" action to reduce their reliance on wholesale power markets. American Municipal Power-Ohio, the joint action agency providing wholesale power supplies to 122 public power systems in Ohio and five other states (including 26 public power systems in Pennsylvania), has embarked upon a program to build and own new generation, including both coal-fired generation and run-of-the-river hydro. It is also implementing a demand response program with its member utilities. The purpose of these measures is to insulate its member public power systems and their retail customers from the volatile wholesale electric market to the

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<sup>1</sup> Written Comments of James A. Jablonski, Executive Director, Public Power Association of New Jersey, before the New Jersey Assembly Telecommunications and Utilities Committee (February 25, 2008).

<sup>2</sup> "Executives describe real-world problems with RTOs," *Public Power Daily* (February 29, 2008), available at <http://www.appanet.org/newsletters/ppdailyarchivedetail.cfm?ItemNumber=21282>.

maximum extent possible, by reducing AMP-Ohio's overall dependency on wholesale market purchases of electricity to meet demand.<sup>3</sup>

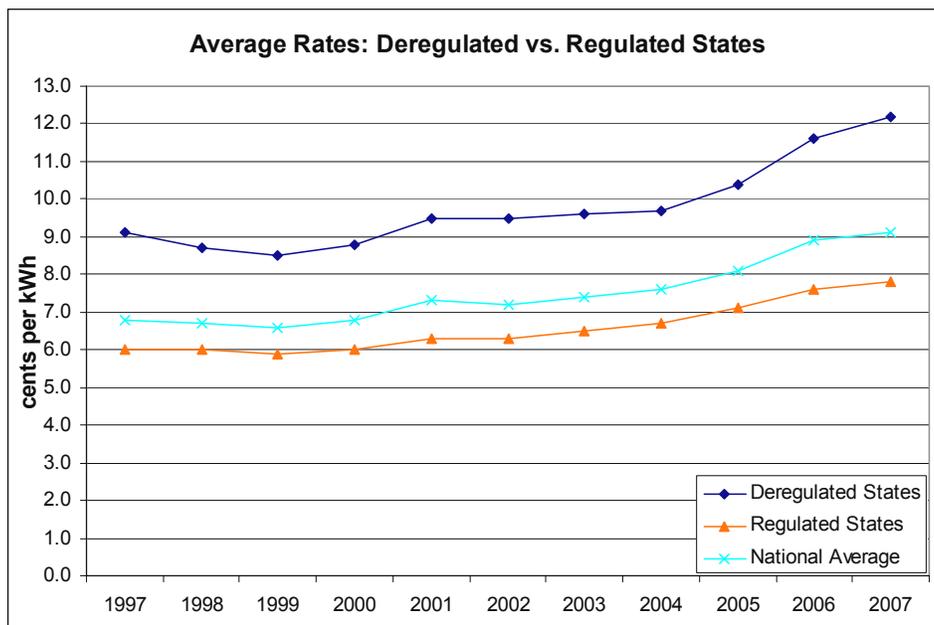
Initially, rate caps negotiated as part of the transition to retail access in states such as Pennsylvania largely sheltered retail customers of investor-owned utilities (IOUs) from price volatility in RTO-run centralized wholesale markets. But as you know better than I do, those rate caps have already expired in a number of other states, and will soon be expiring for most Pennsylvanians. When that happens, the retail customers served by Pennsylvania's larger utilities will be in much the same situation as our members in RTO regions—they will be directly exposed to the price volatility in RTO-run centralized markets, and the parallel bilateral contract markets that key off of the prices set in those RTO-run markets.

Because many states that implemented retail access programs required their IOUs to divest their generation facilities, these facilities are now generally owned by third-party companies (often unregulated affiliates of those same IOUs). These companies can charge "market-based rates" for their power in wholesale markets under authority granted to them by the Federal Energy Regulatory Commission (FERC). Most residential and small commercial consumers in these states are still purchasing retail electric service from their traditional utilities under "default" or "provider of last resort" service, meaning that these utilities must continue to provide power, but must now procure needed supplies on the wholesale market. When retail rate caps expire, these retail customers will find themselves exposed to the full brunt of higher wholesale power prices.

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<sup>3</sup> *Id.*

One of the simplest measures of the success of restructured retail and wholesale market structures is whether, as originally claimed, “deregulation” has reduced prices for consumers. While it is true that electricity and other energy prices are rising across the country, retail electric rates are higher in states with deregulated markets, and the rate disparity between rates in traditional regulated states and deregulated states is increasing.



Source: APPA Ten Year Comparison.<sup>4</sup>

Deregulated states shown in this comparison are those that have implemented retail choice, no longer have retail price caps and are located in RTO regions. Prices in deregulated states are 56 percent greater than those in the remainder of the country.

Supporters of restructuring often point out that the percentage increase in regulated and deregulated areas is the same. However, most deregulated states started with higher prices, so a percentage-increase comparison is misleading. In actual dollar terms, the increase in deregulated states is significantly greater than the increase in other states. Between 1997 and 2007, there was a 3.1 cent per kilowatt-hour increase in retail rates in deregulated states, compared to a 1.8 cent per kilowatt-hour retail rate increase in regulated states. Even where fuel costs are accounted for, the gap continues to widen.

APPA urges state decision makers, including the PA PUC Commissioners, to review closely the impact of restructured wholesale electricity markets on the retail customers in their states, and to take steps to effect necessary changes in those markets through action

<sup>4</sup> American Public Power Association, *Retail Electric Rates In Deregulated and Regulated States: A Ten Year Comparison* (March 2008), available at <http://www.appanet.org/files/PDFs/10year.pdf> (“Ten Year Comparison”), at 3.

at the federal level. APPA believes that changes in federal policies dealing with RTO-run centralized power markets are necessary if state regulators are to protect their retail customers (and public power systems are to best serve their own retail customers). Next I explain how APPA came to this conclusion.

## **APPA's Electric Market Reform Initiative**

In response to the growing problems APPA members were experiencing obtaining power supplies in RTO regions with centralized power supply markets, APPA launched the Electric Market Reform Initiative (EMRI) in March 2006. During the initial phase of EMRI, APPA commissioned a series of studies investigating various features of restructured wholesale markets. I discuss a few of these studies in my testimony, but all of them are available on APPA's website.<sup>5</sup> Based on the results of these studies, APPA concluded that RTO-run centralized wholesale markets had substantial problems, and were not yielding "just and reasonable rates," as the Federal Power Act (FPA)<sup>6</sup> requires. APPA therefore embarked on the second phase of EMRI—an advocacy effort to communicate the problems with these markets and the need for changes to key federal and state decision makers and the public, and the development of potential reforms to these markets that might make them more customer-friendly.

I need to emphasize here that APPA's concerns are not with RTOs themselves. Properly structured, RTOs can provide numerous benefits to both wholesale and retail customers. They provide independent and nondiscriminatory transmission service under open access transmission tariffs (OATTs), charge regional, non-pancaked transmission rates, and lead regional collaborative transmission planning processes. In fact, APPA supported the formation of Independent System Operators (ISOs) such as the PJM Interconnection, L.L.C., and the Midwest Independent System Operator (MISO) for just these reasons.

Unfortunately, over time FERC's policy emphasis turned from ISO provision of nondiscriminatory transmission service to having "RTOs" operate centralized power supply, ancillary service, and locational capacity markets. This shift towards ever more complex market operations has increasingly overshadowed the more basic and beneficial RTO transmission-related functions. A large portion of RTO resources is now dedicated to the operation and oversight of short-term spot markets for the purchase and sale of electricity, as well as ancillary service and capacity markets. As APPA's EMRI studies showed, several characteristics of these markets are especially problematic.

**Single-Clearing Price Auction.** An RTO takes all offers by generators and other market participants to sell electricity in the RTO's day-ahead and real-time markets for a particular upcoming time interval in ascending price order, stopping with the last offer needed to meet the estimated power demand during that interval. Given that virtually all market participants hold market-based rate authority granted by FERC, their offers need not

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<sup>5</sup> [www.APPAnet.org/emri.cfm](http://www.APPAnet.org/emri.cfm)

<sup>6</sup> FPA Sections 205 and 206, 16 U.S.C. §§ 824d, 824e.

reflect their actual cost of producing power during that hour; the only limits on their offers are set by RTO market rules and the RTO market monitor. All sellers whose offers are accepted in that time interval are paid the price set by the last accepted offer (the offer that “clears the market”), regardless of price level of their own offers. As a result, lower-cost resources are often paid prices far in excess of their submitted offers to sell power, as well as their own marginal cost of production in that time interval. This design is intended to send “price signals” to generators as to the value of their power to customers, and thus to induce new generator entry if prices are high enough.

The actual efficacy of these price signals, however, is questionable. A study that APPA commissioned by Synapse Energy Economics as part of its EMRI effort analyzed offer data from generators in both PJM and ISO New England. Synapse found that offers from the same generating unit fluctuated by over \$100 per megawatt-hour within one month. Generating units, however, typically have only minimal day-to-day changes in their production costs. The authors concluded that “[t]he evidence that this difference and other features like it represent market power . . . is compelling.”<sup>7</sup>

**Locational Marginal Pricing.** RTOs set wholesale day-ahead and real-time power prices that reflect the difference in power supply offers made in different locations within the transmission grid when there is “transmission congestion” at certain points on the grid. (In effect, transmission congestion causes the overall RTO grid to “separate” into a series of power supply “submarkets;” hence, this phenomenon is called “price separation.”) Like the single price auction design feature, locational marginal pricing was intended to send a high enough price signal to incent the construction of new generation and transmission in the more congested areas. The Synapse study I just discussed, however, found that there is no evidence that this has actually occurred.<sup>8</sup>

**Financial Player Participation.** Hedge funds, investment banks and other financial entities have been participating in RTO markets (both the power supply markets and the market for Financial Transmission Rights (FTRs)) through the auctions that the RTOs hold periodically to set power prices and allocate FTRs. These entities often do not participate in these auctions to purchase power or to hedge a transmission or power supply transaction. Rather, they participate in the hopes of extracting dollars from these complex markets. The oft-cited rationale for allowing such activities is that these

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<sup>7</sup> Ezra Hausman, *et al.*, Synapse Energy Economics, Inc., *LMP Electricity Markets: Market Operations, Market Power, and Value for Consumers* (2007), available at <http://appanet.org/files/PDFs/SynapseLMPElectricityMarkets013107.pdf>, at 79. See also 86 (“the potential for market power appears to be both present and significant”) and 64 (“The summary HHI and Lerner Index metrics in Table 4.1 through Table 4.3 indicate that in PJM, the results of the spot energy market performance deviate from competitive levels, and that both PJM and in parts of the MISO region, concentration indicators show the potential for exercise of market power.”).

<sup>8</sup> *Id.* at ix, x (“There is simply no evidence that the price signaling associated with LMP has been an effective spur to investment in generation, transmission or demand response initiatives, and some evidence to the contrary.”), and at 17–34.

financial players “add liquidity” to the RTO markets. APPA, however, is concerned that the profits these players are making from RTO markets come from the pockets of retail consumers, in the form of higher power supply prices and transmission service charges.

Worse yet, consumers can end up footing the bill for such financial players when they make the wrong bets. The most spectacular example of this is the January 2008 complaint that PJM filed against the so-called “Tower Companies,” an affiliated group of trading companies with offices in New York City. In December 2007, two Tower Company-affiliated hedge funds defaulted on payments to PJM, after they suffered financial losses associated with FTRs that they had purchased for speculative purposes.<sup>9</sup> PJM estimated that the total defaults for these two funds from their November 2007 invoices through to May 2008 would be close to \$85 million.<sup>10</sup> PJM subsequently filed a complaint against the Tower Companies, including one of the two defaulting hedge funds, Power Edge, LLC. PJM has alleged that the Tower Companies manipulated PJM’s FTR and day-ahead energy markets, and is seeking restitution and other remedies. (APPA filed a motion to intervene in this case, expressing its support for PJM’s actions.) On April 30, 2008, the FERC issued an order holding PJM’s complaint in abeyance pending the outcome of its own Office of Enforcement (OE) staff’s investigation into this matter.<sup>11</sup> As of this writing, FERC has taken no other public action in the case. Unless the Tower Companies are required to disgorge monies to remedy the defaults, it appears that other PJM customers may have to cover the FTR revenue shortfalls. In APPA’s view, this would be a grossly unjust result. Retail consumers in PJM, including those in Pennsylvania, should not have to backstop the losses of hedge funds speculating in PJM’s markets.

**Locational Capacity Markets.** The failure of the basic RTO market design to produce needed new entry and infrastructure investments has not led the RTOs or FERC to question the wisdom of the basic market design, but rather to layer on new markets. A number of RTOs have created locational capacity markets in which generators bid to receive additional payments, in exchange for agreeing to make their generation facilities available to supply power to the RTO in future periods. PJM’s new locational capacity market, the Reliability Pricing Model (RPM), has produced dramatically escalating capacity prices. As part of its EMRI effort, APPA commissioned a study of PJM’s implementation of RPM, which James Wilson of LECG, LLC, conducted.<sup>12</sup> APPA supported this study because its members in the PJM footprint had expressed their deep concerns to APPA about the steep cost increases they were incurring as PJM implemented

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<sup>9</sup> PJM News Release, “PJM Completes Analysis of Recent Market Payment Default” (December 26, 2007), available at <http://www.pjm.com/contributions/news-releases/2007/20071226-credit-default-news-release.pdf>.

<sup>10</sup> *Id.*

<sup>11</sup> *PJM Interconnection, L.L.C. v. Accord Energy, LLC, et al.*, 123 FERC ¶ 61,103 (2008), available at [http://elibrary.ferc.gov:0/idmws/file\\_list.asp?document\\_id=13606168](http://elibrary.ferc.gov:0/idmws/file_list.asp?document_id=13606168).

<sup>12</sup> James Wilson, LECG, LLC, *Raising the Stakes on Capacity Incentives: PJM’s Reliability Pricing Model (RPM)*, Report prepared for the American Public Power Association (March 14, 2008), available at <http://appanet.org/files/PDFs/RPMreport2008.pdf>.

its RPM. I don't need to tell you about the adverse financial impact RPM has had on PJM customers; the PA PUC is one of the complainants that joined in the complaint against PJM regarding the outcomes of the first four RPM transitional auctions.<sup>13</sup> APPA moved to intervene in support of that complaint, and has joined in the recent application for rehearing of the FERC order dismissing that complaint. Suffice it to say here that the implementation of RPM is having substantial adverse financial impacts on retail customers in PJM, as well APPA members located there.

## **Lack of Data Transparency**

APPA has long been disturbed by the difficulties of analyzing price formation in RTO markets. Reams of information are made available on RTO websites and in State of the Market Reports, but highly relevant data necessary to analyze fully the operation of those markets is kept confidential, or only released after a substantial time delay. At the request of APPA, William Dunn, a consultant with Sunset Point LLC, analyzed available RTO electricity market data.<sup>14</sup> He found that RTOs publish a large volume of data on market operations, but currently keep the most crucial information—generator offer data—confidential, only releasing it in masked form after a delay of several months. Moreover, RTO websites are each organized differently, which makes comparing data access, or in some cases even finding data, a challenge. Mr. Dunn recommended that generator offer data in RTO markets be made publicly available on the next day with the specific generation owners identified, as is done in the markets in England, Wales and Australia.

The failure to disclose full market data in a timely fashion so that all interested parties (including state PUCs, state attorneys general, and customer representatives) can examine exactly what is happening makes it much more difficult for them to detect potential market manipulation. The full brunt of the task of policing RTO markets thus falls initially on the RTO market monitors and ultimately on FERC, as they are the only entities with access to this confidential information. One recent example of the drawbacks to this approach is the settlement between Edison Mission, a generator in PJM, and the FERC's OE staff. On May 19, 2008, the FERC issued an order in which it approved a "Stipulation and Agreement" (Agreement) between the OE staff and Edison Mission, purporting to resolve "a matter in which Edison Mission engaged in conduct that misled Commission staff (staff) prior to, and during, an investigation of Edison Mission's bidding behavior in

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<sup>13</sup> *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, Docket No. EL08-67-000, Complaint of the RPM Buyers (filed May 30, 2008), available at [http://elibrary.ferc.gov:0/idmws/file\\_list.asp?document\\_id=13616296](http://elibrary.ferc.gov:0/idmws/file_list.asp?document_id=13616296). The Commission dismissed the complaint in an order issued on September 19, 2008. *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,276 (2008), available at [http://elibrary.ferc.gov:0/idmws/file\\_list.asp?document\\_id=13648809](http://elibrary.ferc.gov:0/idmws/file_list.asp?document_id=13648809).

<sup>14</sup> William H. Dunn, Jr., Sunset Point, LLC, *Data Required for Market Oversight*, Concept Paper prepared for the American Public Power Association (December 8, 2007), available at <http://www.appanet.org/files/PDFs/dunn2007.pdf>.

PJM Interconnection, LLC (PJM).”<sup>15</sup> The Agreement required Edison Mission to pay \$9,000,000, consisting of a \$7,000,000 civil penalty and institution of a comprehensive compliance plan estimated to cost at least \$2,000,000.

Among the matters resolved by the Agreement was Edison Mission’s practice of offering a substantial portion of its generation into PJM’s day-ahead market at a price between \$900 and \$999 MWh, just under the PJM Tariff’s offer cap of \$1,000 MWh. (The settlement called this practice the “High Offer Strategy.”) This behavior was observed by the PJM Market Monitor, and reported to OE Staff. The Agreement stated that the Market Monitor had told OE staff the high offers “had the effect of keeping the units out of the [day-ahead] market.”<sup>16</sup> According to the Agreement, Edison Mission engaged in this High Offer Strategy from 2004 until April 2006, when Edison Mission voluntarily stopped it, committing not to resume it in the future.<sup>17</sup> The \$7,000,000 penalty, however, was not levied on Edison Mission for engaging in the High Offer Strategy, but for its failure to be candid with OE staff regarding its use of that strategy. The Agreement contained no disgorgement of proceeds to PJM customers, and no ruling stating whether Edison Mission’s use of the High Offer Strategy violated the PJM Tariff. To the contrary, the FERC stated in its May 19 Order that “[n]o findings with respect to Edison Mission’s use of the high offer strategy are made in the Agreement.”<sup>18</sup>

Neither PJM’s customers nor the state PUCs in the PJM footprint had any notice that this investigation was even going on, much less that it was being settled, until the FERC issued its May 19 Order. A large group of PJM customers, state commissions, and other interested parties calling themselves the “Joint Intervenors” (including both the PA PUC and APPA) therefore tried to intervene in the docket and seek clarification of the intent of the Agreement. The FERC on October 7, 2008, flatly denied their request.<sup>19</sup> Its exact reasoning is worth quoting here:

... [W]e find that [the various intervenors] have failed to demonstrate the extraordinary circumstances that might warrant intervention in this enforcement matter. The fact that the investigation in this case centered on behavior in the PJM markets does not mean that every participant (or every representative of a participant) in PJM should be permitted to intervene. Interventions will very seldom be granted in proceedings originating under Part 1b. Accordingly, the motions to intervene are denied.<sup>[20]</sup>

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<sup>15</sup> *In re Edison Mission*, 123 FERC ¶ 61,170 (2008) (May 19 Order) at P 1, available at [http://elibrary.ferc.gov:0/idmws/file\\_list.asp?document\\_id=13612131](http://elibrary.ferc.gov:0/idmws/file_list.asp?document_id=13612131). The Agreement between Edison Mission and OE staff is attached to the May 19 Order.

<sup>16</sup> Agreement at P 17.

<sup>17</sup> *Id.* at P 2.

<sup>18</sup> May 19 Order at P 9.

<sup>19</sup> *In re Edison Mission*, 125 FERC ¶ 61,020 (2008) (October 7 Order), available at [http://elibrary.ferc.gov:0/idmws/file\\_list.asp?document\\_id=13653010](http://elibrary.ferc.gov:0/idmws/file_list.asp?document_id=13653010).

<sup>20</sup> *Id.* at P 42.

The FERC, however, also made clear the broad scope of the Agreement, and its resulting view that PJM customers and state PUCs could not pursue Edison Mission for its use of the “High Offer Strategy” in any other forum:

. . . [P]aragraph 32 of the Agreement provides only that *the Commission* is barred from holding Edison Mission liable in any proceeding for the subject matter of the investigation. It does not purport to bar actions beyond the Commission’s jurisdiction. However, the Commission’s jurisdiction is very broad, and, in particular, the Commission possesses exclusive jurisdiction to enforce tariffs filed with us as part of the comprehensive regime for federal energy regulation of sales of electric energy at wholesale by public utilities.<sup>[21]</sup>

APPA finds this state of affairs extremely troubling. Only the RTO’s market monitoring unit and the FERC’s staff currently have access to the confidential data needed to examine which generators are submitting what bids, and whether their bids have any relation to their costs, or are instead the product of market power, or even an attempt to manipulate the market. Yet the FERC has taken the position that only in the most extraordinary of circumstances will it allow third parties, including customer representatives and state PUCs, even to intervene to comment on a settlement already negotiated by FERC’s OE Staff, which has the effect of curtailing customers’ and state PUCs’ legal rights. Finally, it claims that it has exclusive jurisdiction over prices produced in RTO wholesale markets, and asserts that no remedies are available to customers or their representatives in other forums.

Supporters of the current market structure, including unregulated generators and their affiliates, characterize RTO-run power supply markets as “competitive.” They strenuously charge that critics of RTO markets are opposed to “competition.” But APPA makes no apology for its EMRI effort, or for its advocacy effort to spotlight problems with RTO-run centralized wholesale power markets. These are highly complex, bureaucratic, centrally administered markets subject only to the lightest-handed regulation, with little true data transparency. Contrary to claims advanced when FERC approved these markets, retail consumers have suffered from the removal of regulatory protections. To quote the popular bumper sticker, “[i]f you are not appalled, you haven’t been paying attention.”

## **FERC’s Responsibilities and Actions**

As should be clear by now, the FERC is responsible for oversight of RTO-run centralized wholesale electricity markets. Its core responsibility under the FPA is to “guard the consumer from exploitation by non-competitive electric power companies.”<sup>22</sup> Its primary (but not its only) statutory tools to protect consumers are FPA Sections 205 and 206. These sections require FERC-regulated “public utilities” to charge rates that are “just and

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<sup>21</sup> *Id.* at P 37 (emphasis in the original).

<sup>22</sup> *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975), *aff’d*, 425 U.S. 662 (1976).

reasonable.” FERC’s use of markets and competitive forces to ensure just and reasonable rates, while not prohibited by the FPA as a *method*, is in APPA’s view not working to achieve the required result.

Acknowledging the growing frustration of many with the RTO-run wholesale markets, FERC held a series of technical conferences regarding the operation of those markets in early 2007, in Docket No. AD07-7-000. It then issued in June 2007 an “Advance Notice of Proposed Rulemaking” (ANOPR) in Docket Nos. AD07-7-000 and RM07-19-000.<sup>23</sup> The ANOPR specifically sought public comment on potential reforms to improve operations in RTO-run centralized wholesale power markets. The FERC subsequently issued a full “Notice of Proposed Rulemaking” (NOPR) in these dockets on February 22, 2008.<sup>24</sup>

APPA had hoped that FERC would use these dockets as a vehicle to undertake a comprehensive review of RTO-run centralized markets. Numerous consumer-side interests urged the FERC at various times during this rulemaking to undertake a thorough review of these markets, and the justness and reasonableness of the prices they produce. APPA for its part submitted hundreds of pages of EMRI studies, and extensive comments on both the ANOPR (including sworn affidavits) and the NOPR, setting out its concerns and the EMRI study findings.

In the end, however, FERC decided not to undertake any systematic review of RTO prices, or the actual benefits those markets in fact provide consumers. Instead, it issued a Final Rule (Order No. 719) in these dockets on October 17, 2008,<sup>25</sup> in which it ordered RTOs to make compliance filings to institute changes in four discrete areas: (1) demand response; (2) long-term power contracting; (3) market monitoring policies; and (4) RTO responsiveness to customers and other stakeholders. It dismissed the broader concerns of load-side interests, including APPA, in one sentence: “As discussed in the NOPR, many of the broader issues commenters raise herein regarding the structure and functionality of organized markets are beyond the scope of this proceeding and would require further development to be ripe for inclusion in a rulemaking.”<sup>26</sup>

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<sup>23</sup> *Wholesale Competition in Regions with Organized Electric Markets*, FERC Stats. and Regs. ¶ 32,617 (2007).

<sup>24</sup> FERC Stats and Regs. ¶ 32,628 (2008).

<sup>25</sup> 73 Fed. Reg. 64,100 (October 28, 2008).

<sup>26</sup> Order No. 719 at P 308; *see also id.* at P 573.

I should note that FERC took this narrow approach to dealing with RTO markets in Order No. 719 even though the United States Government Accountability Office (GAO) had issued a report only weeks before calling into question FERC's position that RTO markets benefit consumers.<sup>27</sup> The GAO found that FERC had conducted no empirical analysis to support its position:

FERC officials also believe that RTOs have resulted in net benefits to the economy, such as new efficiencies in operating the regional transmission grid; however, FERC has not conducted an empirical analysis of whether RTOs achieved the benefits expected of them or developed a comprehensive set of publicly available, standardized measures to help evaluate such performance. GAO's Standards for Internal Control identify the value to organizations of comparing actual performance to planned or expected results; however, according to FERC, neither an empirical analysis nor performance measures are necessary parts of FERC oversight of RTOs and both would be methodologically challenging to develop.<sup>[28]</sup>

APPA's own view is that in failing to undertake in the rulemaking proceeding a comprehensive review of RTO-run centralized wholesale power markets, and the prices those markets produce, FERC in Order No. 719 failed to carry out its statutory responsibilities to protect consumers.

### **APPA's Proposal for Reform**

APPA used the lessons learned from the EMRI studies to develop a proposal to reform RTO-run centralized markets, which it released in a February 2007 white paper entitled "Consumers in Peril."<sup>29</sup> Simply put, APPA proposed to streamline RTO operations by maintaining those functions that RTOs are performing well, but eliminating or substantially scaling back the role of RTO-run centralized markets. These reforms would allow RTOs to focus their resources on their beneficial core functions: ensuring that all buyers and sellers have open access to the transmission system, simplifying regional transmission rate structures, and supervising regional transmission system operations.

To reduce the pervasive price-setting role of RTO-run day-ahead and real-time markets, APPA suggests that the majority of wholesale electricity transactions should take place under longer-term bilateral contracts entered into directly by Load-Serving Entities (LSEs), such as Pennsylvania's larger utilities, and generators. LSEs would be required to contract for such capacity under resource adequacy requirements, with substantial state

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<sup>27</sup> Government Accountability Office, Report to the Committee on Homeland Security and Governmental Affairs, U.S. Senate, *Electricity Restructuring—FERC Could Take Additional Steps to Analyze Regional Transmission Organizations' Benefits and Performance*, Report No. GAO-08-987 (September 2008), available at <http://www.gao.gov/new.items/d08987.pdf>.

<sup>28</sup> *Id.* at 7–8 (footnote omitted).

<sup>29</sup> <http://appanet.org/files/PDFs/ConsumersinPeril%2Epdf>

input into the power supply portfolio each state-regulated LSE develops. Future resource adequacy (long-term capacity) would be assured through such contracts, instead of through an RTO-run capacity market. RTOs would operate an “optimization market” to allow LSEs to purchase or sell short-term needed or excess electricity and ancillary services, and to allow generators to sell excess energy not already committed under bilateral contracts.

Finally, APPA proposes much greater data transparency, including public access to generator offer data on a next-day basis, with identification of specific generators, as well as generator cost and operating data.

APPA’s proposal is not the only market reform option to have been proposed. Both the American Forest and Paper Association and the Portland Cement Association submitted formal proposals to FERC in Docket Nos. AD07-7-000 and RM07-17-000. (I understand that the PJM Industrial Customer Coalition supports the Portland Cement Association’s proposal.) There are also academics right here in Pennsylvania who have offered their ideas for RTO market reforms.<sup>30</sup> APPA claims no monopoly on ideas for RTO market reforms; to the contrary, I hope more reform proposals will emerge.

## **Recommendations for the Pennsylvania Public Utility Commission**

The interests of state PUCs in retail-access states within RTOs closely resemble those of APPA members. Both are striving to provide their citizens with reasonably priced and reliable electricity service, while moving forward to address environmental concerns. Both public power systems and the states are finding the current structure of RTO-run centralized wholesale electricity markets an impediment to meeting these important goals.

There are several affirmative steps that Pennsylvania and the PA PUC, as well as other similarly situated states, can take. First, restructured states can reduce their purchases from the spot markets through the imposition of requirements on their utility LSEs for longer-term contract portfolios and/or utility construction of new power plants. Second, they can implement new or enhanced energy-efficiency requirements and demand-response programs. Such state-initiated measures would limit the amount of power purchases Pennsylvania’s utilities need to make in the RTO-run markets, thus deemphasizing the role of those markets in price formation over the long run. I understand that some of these steps are now possible since Pennsylvania House Bill 2200 was signed into law (although I hasten to add I am no expert on the new law).

APPA also urges the PA PUC to take an even more active role in communicating its concerns about problems in RTO-run centralized wholesale markets directly to FERC and to Pennsylvania’s Congressional delegation. While the passage of House Bill 2200 was an important first step, improvements in utility procurement processes at the state level

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<sup>30</sup> See, e.g., Lester Lave, Jay Apt and Seth Blumsack, “Deregulation/Restructuring, Where Should We Go From Here?,” Carnegie Mellon Electricity Industry Center Working Paper CEIC-07-07, available at <http://wpweb2.tepper.cmu.edu/ceic/papers/ceic-07-07.asp>.

will not by themselves overcome the need for fundamental reforms to RTO-run wholesale markets. With a new administration, there will be new opportunities to advocate for meaningful reforms. It is important for FERC to “feel the pain” of Pennsylvania’s retail electric consumers, and to take strong action to ensure the wholesale power supply rates they pay are just and reasonable, as the FPA requires.

The PA PUC should also continue its current advocacy activities in RTO stakeholder processes, although I realize that this takes substantial staff time and resources. In particular, the FERC in Order No. 719 did give RTO stakeholders an opportunity to argue for more transparency in RTO data release practices.<sup>31</sup>

## **Conclusion**

Thank you again for inviting me to appear before you today. I look forward to answering your questions.

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<sup>31</sup> Order No. 719 at PP 421–424.