BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Investigation of Pennsylvania's	)	I-2011-2237952
Retail Electricity Market	)	

COMMENTS OF THE AMERICAN PUBLIC POWER ASSOCIATION

Introduction

The American Public Power Association (APPA) is submitting these comments in the docket that the Pennsylvania Public Utility Commission (PUC) initiated on April 28, 2011 to investigate Pennsylvania's retail electricity market.

Although the PUC in its April 28 Order poses a number of specific questions on the design of the retail electricity markets, APPA's comments address the fundamental issue raised in the PUC's first question: "What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?" Our response and the premise of these comments is that there cannot be true retail competition if there is not viable competition in the wholesale market – specifically the market operated by the PJM Interconnection. It is this wholesale market where all electric distribution companies (EDCs) and alternative suppliers must purchase power on behalf of their customers. A broken wholesale market will not support a healthy retail market.

Background

APPA is the national service organization representing the interests of not-for-profit, publicly owned electric utilities in the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour sales to ultimate customers and serve 45 million people, doing business in every state except Hawaii. Public power systems participate in wholesale power markets throughout the country and therefore have a keen interest in how well these markets work.

APPA utility members are not-for-profit load-serving entities (LSEs). Their primary goal is to provide customers in the communities they serve with reliable electric power and energy at the lowest reasonable cost, consistent with good environmental stewardship. This orientation aligns the interests of APPA-member electric utilities with the long-term interests of the residents and businesses in their communities.

APPA has a substantial number of members in the PJM service territory, including Pennsylvania, and has a direct interest in ensuring that the rates, terms, and conditions of service under PJM's tariffs are just and reasonable.

In response to growing problems that public power utilities were experiencing obtaining power supplies in RTO regions with centralized power supply markets, APPA launched its Electric Market Reform Initiative ("EMRI") in March 2006 to investigate restructured wholesale electricity markets and develop needed reforms to those markets.

Under this initiative, APPA commissioned a series of studies investigating the restructured RTO-run wholesale markets under federal jurisdiction.[1] 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)[2] requires. APPA therefore embarked on the development of potential reforms to these markets, an effort which culminated in the release of APPA's Competitive Market Plan in February 2009.[3]

The remainder of these comments summarizes these problems with the wholesale market and recommendations for steps that Pennsylvania and other retail access states in RTOs such as PJM can take to improve competition in the markets.

Primary Problems with Wholesale Electricity Markets

A fundamental reason for the restructuring of wholesale electricity markets was the expectation that the combination of open access transmission service and RTO-operated centralized wholesale markets would promote "competition." This increased competition in turn would spur efficiencies and innovation, ensure adequate supplies and, most importantly, lower rates for consumers. But the EMRI studies and the real-world experience of consumers shows that the opposite has occurred. These deregulated markets produce both higher prices and higher profits for suppliers than one would expect in a competitive market. Prices exceed those prevailing in the remaining regions that have not restructured and have retained cost-of-service regulation. The greatest beneficiaries of restructuring are not consumers, or the new, innovative companies that were promised to emerge under competition, but the owners of large fleets of previously regulated, largely depreciated generation units.

---

1 The results of these studies are available on the EMRI section of APPA's Web site at: www.APPAnet.org/emri.cfm

2 FPA Sections 205 and 206, 16 U.S.C. §§ 824d, 824e.

3 http://appanet.cms-plus.com/files/PDFs/EMRICompetitiveMarket.pdf

Wholesale energy prices fell in 2009, leading to false claims that the restructured markets were responsible for these decreases,[4] these price decreases were primarily a result of the recession-induced decreases in demand and fuel prices. In Pennsylvania, one of the primary reasons that alternative supplier rates are lower is simply that they purchased power later than the EDCs made their purchases, and made purchases at a time when electricity rates happened to be lower.[5] This timing difference is not a reflection of true competition, however.

There is no evidence that restructuring had any role in price decreases. In fact, retail electric rates in deregulated states within RTO regions have been 50 percent greater than regulated states in the past two years. [6] Moreover, prices have begun to rebound in RTO-run centralized energy markets and an increasing amount of revenue has been flowing through the capacity markets, especially PJM's Reliability Pricing Model (RPM).

These higher prices in RTO-run centralized energy and capacity markets have not translated into a more plentiful supply of power. Less than one percent of the capacity cleared in the RPM auctions has been net new generation.[7] The greater prices in the constrained regions have not led to higher levels of new generation construction or demand response in those zones.[8] The pending closure of some coal plants, especially in RTO regions, in response to EPA regulations is likely to constrain supply and result in the dispatch of more expensive power plants, increasing both energy and capacity prices. A number of financial analysts are projecting higher prices and

---

4 For example, the Electric Power Supply Association (EPSA), in a statement on the 2009 market monitor reports, asserted that: "The annual reports note that the organized wholesale markets are appropriately reflecting dramatically lower fuel prices with electricity prices dropping by roughly 50 percent from 2008 levels across the markets. The reports once again underscore the benefits to consumers of independent operation of the transmission system and markets that are quickly responsive to lower costs." *Organized Wholesale Markets Are Competitive and Delivering Benefits to Consumers*, EPSA PowerFact, August 25, 2010, http://www.epsa.org/forms/documents/DocumentFormPublic/view?id=16CC400000002.

5 *Who Chooses? The Market for Retail Electricity in PPL Territory*, Andrew N. Kleit and Anastasia V Shcherbakova, and Xu Chen, The Pennyslvania State University, Presented at the Penn State Electricity Markets Initiative 2011 Conference, Harrisburg, PA, April 12, 2011, p. 11. (*see* selected presentation slides attached as Appendix A).

6 *Retail Electric Rates in Deregulated and Regulated States: 2010 Update*, APPA, March 2011, http://www.publicpower.org/files/PDFs/RKWFinal2010.pdf

7 2014/15 RPM Base Residual Auction Results, PJM, May 2011. Table 6 shows the total new generation is 13,164.8 MW and the decrease in generation capacity is 8,894.8 MW, resulting in a net increase of 4,270 MW. This is equal to 0.4 percent of the total amount of generation cleared through all eight capacity auctions (1,058,133 MW) obtained by totaling the Generation Cleared in each auction in Table 5. http://www.pjm.com/markets-and-operations/rpm/~/media/markets-ops/rpm/rpm-auction-info/20110513-2014-15-base-residual-auction-report.ashx

8 *Direct Testimony of James F. Wilson in Support of First Brief of the Joint Filing Supporters*, Federal Energy Regulatory Commission, Docket ER10-787, July 1, 2010, Section V, http://www.wilsonenec.com/page1.php

profits for merchant generators who will have a financial incentive to keep the power supply constrained.[9]

A fundamental flaw in the current RTO markets is the near absence of long-term contracts. Such arrangements are a prerequisite for financing new generation. Along with comments submitted by Competitive Power Ventures (CPV) to the Maryland Public Service Commission, CPV attached several letters from financial institutions asserting that long-term contracts are critical for obtaining financing for new generation projects. For example, the Bank of Tokyo-Mitsubishi wrote that it "favor[s] the projects which operate in markets with transparent and stable regulatory regimes and projects which benefit from long-term fixed-price power purchase agreements with investment grade counterparties." [10] Similarly, UnionBank stated that "the prevailing market dynamic in PJM alone, without the ability to secure long-term off-take contracts, is not supportive of project-based financing…Moreover, given our extensive history as a market leader in the project finance sector within North America, we are confident that other lenders share our view on this matter."[11]

Because these contracts are a means for new generation to enter the market, and such entry is a fundamental requirement of successful competition, the absence of such contracts is a barrier to competition in the RTO markets. It is within this arena that states can take actions that will foster true competition, as described in the next section.

Recommendations for Pennsylvania

APPA recommended in its Competitive Market Plan that retail access states in RTO regions implement competitive power supply procurement processes to obtain a diversified resource portfolio for regulated LSEs serving loads in those regions, such as PJM. A significant portion of the power supplies would be procured under longer-term contracts of varied length and/or owned-generation arrangements. Demand response resources and energy efficiency investments would be fully considered in the development of such portfolios. Such a competitive procurement process would do a much better job of anchoring needed new generation and supply-side resources than the continuation of RPM auctions. Procurements would not

---

9 *See, e.g., Growth From Subtraction: Impact of EPA Rules on Power Markets,* Credit Suisse Equity Research, September 23, 2010, pp. 47-48, http://op.bna.com/env.nsf/id/jstn-8actja/$File/suisse.pdf; *The EPA's Utility Men - Anticarbon regulations and the corporate rent-seekers who love them*, the Wall Street Journal, December 23, 2010, http://online.wsj.com/article/SB10001424052748704694004576019730082447432.html.

10 Comments of CPV Maryland, LLC, *In the Matter of the Reliability Pricing Model And the 2013/2014 Delivery Base Year Residual Auction Results*, Maryland Public Service Commission, Administrative Docket PC22, October 1, 2010, Attachment B, http://webapp.psc.state.md.us/Intranet/AdminDocket/NewIndex3_VOpenFile.cfm?ServerFilePath=C%3A%5CAdminDocket%5CPublicConferences%5CPC22%5C35%2Epdf

11 Comments of CPV Maryland, LLC, Attachment D

necessarily have to be done state-by-state; multiple states could come together to sponsor a joint procurement, to increase interest by bidders and to diversify portfolio risk.

Since the release of the Competitive Market Plan, New Jersey and Maryland have initiated actions that closely track APPA's recommendations. Instead of welcoming the competition that these new resources would bring, however, incumbent generation owners sought to change the relevant PJM RPM rules to prevent the operation of these procurement processes. The Federal Energy Regulatory Commission's recent rulings on the Minimum Offer Price rule (MOPR), however, seem to ensure that states will not have the necessary tools at their disposal to assure reasonable rates for electric power supply to their own citizens.[12]

APPA hopes the PUC wishes to support more robust competition in regional wholesale electricity markets (thus providing a platform for increased retail competition in the future), and will take steps to promote a vibrant bilateral market that ensures a reliable supply of power in future years as recommended by APPA. A constrained regional power supply market dominated by a handful of incumbent generation owners will simply not provide sufficient competition in either regional wholesale or Pennsylvania retail markets.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

By /s/ Elise Caplan __________

Elise Caplan
EMRI Coordinator

American Public Power Association
1875 Connecticut Avenue, N.W., Suite 1200
Washington, D.C. 20009-5715

(202) 467-2947
Fax: (202) 467-2918
Email: ecaplan@appanet.org

---

[12] *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022 (April 12, 2011).

ATTACHMENT A

Who Chooses? The Market for Retail Electricity in PPL Territory

Andrew N. Kleit, Anastasia Shcherbakova, Xu Chen
The Pennsylvania State University
This research is sponsored by the Penn State Electricity Markets Initiative
All results preliminary

Electricity Restructuring and Retail

The heart of restructuring is that many electricity markets are naturally competitive.

Certainly this applies to the retailing of power. There is no shortage of firms that can supply power at retail.

Yet the retail market for electricity has been slow to develop.

A Broader View – Is the Pennsylvania Retail Scheme Sustainable?

Almost 2/3rds of PPL customers choose not to switch, even with a potential 10% savings.

Further, this savings was a result of falling prices during the PPL acquisition period.

Falling prices cannot be expected as a general proposition. What happens when the price differential is small (about 4% now in Allegheny-First Energy territory)? What happens when it is negative?

Other Potential Approaches

The Texas Approach – get rid of the price to beat (default service). Very effective in getting switching, but causes pain to customers who don't switch.

Municipal Aggregation – have local government act as an agent for its citizens, getting them the best deal possible. Very controversial right now at the PaPUC.