



Electric Power Supply Association  
*Advocating the power of competition*

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November 14, 2008

VIA FEDERAL EXPRESS

James McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
2<sup>nd</sup> Floor, 400 North Street  
Harrisburg, PA 17105-3265

Re: En Banc Hearings on Wholesale Electricity Markets  
Docket No. M-2008-2066901

Dear Secretary McNulty:

Enclosed for filing please find the original and ten (10) copies of the Electric Power Supply Association's Reply Comments following the November 6, 2008 hearing in the above-referenced matter.

If you have any questions regarding this filing, please contact me at your convenience at (202) 349-0153 or [ddolan@epsa.org](mailto:ddolan@epsa.org).

Sincerely,

A handwritten signature in black ink that reads "Daniel S.M. Dolan/st".

Daniel S.M. Dolan  
Vice President, Policy Research and Analysis

Enclosures

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COMMONWEALTH OF PENNSYLVANIA  
BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

*En Banc* Hearings On  
Wholesale Electricity Markets

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Docket No. M-2008-2066901

REPLY COMMENTS OF THE  
ELECTRIC POWER SUPPLY ASSOCIATION

I. INTRODUCTION

The Electric Power Supply Association (EPSA)<sup>1</sup> respectfully submits these reply comments in response to the Pennsylvania Public Utility Commission's (Commission) *en banc* hearing on current trends in the wholesale electricity markets held on November 6, 2008, in the above-captioned docket. This was the second in a series of three hearings on this topic following an initial hearing on October 23, 2008, and a third scheduled for December 18, 2008.

EPSA supports the Commission's efforts to understand the scope of issues currently facing the wholesale electric markets given the intertwined nature of wholesale and retail markets. This is particularly important in light of the challenges ahead in ensuring adequate investment in both existing and new infrastructure, as well as demand response and energy efficiency, so that reliable service remains available for all customers at a reasonable price reflective of economic realities.

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<sup>1</sup> EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

At the second hearing, the five Commissioners heard testimony primarily from representatives of industrial consumers and public power entities.<sup>2</sup> In light of certain testimony and discussion comparing industrial customer rates in a restructured state versus non-restructured state,<sup>3</sup> and given that retail rates largely reflect costs associated with fuel and wholesale power prices, EPSA offers additional general information on rates and investment in restructured versus non-restructured states to provide further perspective on these issues.

There was also discussion at the hearing regarding an alternative RTO pricing proposal that was filed at the Federal Energy Regulatory Commission (FERC) by a coalition led by the Portland Cement Association and considered at a May 2008 FERC technical conference on forward capacity markets in wholesale electric markets.<sup>4</sup> EPSA has previously analyzed the proposal, which is essentially a return to cost-of-service ratemaking, and provides comments for Commission consideration as it reviews this alternative.

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<sup>2</sup> See Pennsylvania PUC website for agenda and testimony from November 6, 2008 En Banc hearing on Wholesale Electricity Markets:  
[http://www.puc.state.pa.us/electric/electric\\_issues\\_wholesale\\_markets\\_enbanc\\_hearings.aspx](http://www.puc.state.pa.us/electric/electric_issues_wholesale_markets_enbanc_hearings.aspx)

<sup>3</sup> Statement of Robert A. Weishaar, Jr., on behalf of the PJM Industrial Customer Coalition for the Pennsylvania PUC *En Banc* Second Hearing on Wholesale Electricity Markets, p.2 (PJMICC Statement) and Testimony of John P. Hughes, Vice President – Technical Affairs, Electricity Consumers Resource Council (ELCON) for the *En Banc* Second Hearing on Wholesale Electricity Markets, p. 16

<sup>4</sup> PJMICC Statement, p. 5 (referencing Consumers' Supplemental Comments and Proposed Alternative Market Model, filed in FERC's Wholesale Competition in Regions with Organized Electric Markets proceeding, Docket Nos. RM07-19-000 and AD07-7-000, (January 19, 2008) and FERC Technical Conference on Forward Capacity Markets in New England and PJM, Docket Nos. AD08-4-000 and ER08-633-000, (May 7, 2008))

## II. COMMENTS

### A. Comparison of Rates in Restructured versus Non-restructured States

As a threshold matter, EPSA would note that any comparison of retail electric rates between states with different regulatory regimes is difficult because of the dramatically different fuel sources available or deemed desirable from region to region given that fuel costs are the primary driver of electric rates. In fact, a recent study by Bates White, LLC which highlights the benefits of competitive electricity markets for Pennsylvania consumers notes that:

While some states with traditional rate regulation, such as West Virginia, Kentucky and Tennessee, have lower electricity prices than in Pennsylvania, this is not the result of restructuring in Pennsylvania, but of the predominance of coal-fired generation in Appalachia and other macroeconomic factors. Moreover, the price difference has narrowed. Between 1998 and 2005, electric rates in the Appalachian states rose 13%, while rates in Pennsylvania rose only 5.6% over the same period. In New Jersey, where electric restructuring was also undertaken, and where retail rate caps expired in 2003, prices have also risen more slowly than in Appalachia, and more slowly than in traditionally-regulated southern states – Alabama, Georgia, Louisiana, Mississippi, and South Carolina – often viewed as “low-cost.”<sup>5</sup>

Not surprisingly, industrial and public power witnesses at the November 6 hearing conceded that rates in restructured and non-restructured states have largely increased at the same percentage rate in recent years. This is consistent with independent analysis and as one report found:

...the fact that rates in restructured states have increased approximately the same as rates in non-restructured states appears to be good news, considering the more pronounced increases in average fuel and labor costs. While it is correct that average rates in restructured states significantly are above the rates in non-restructured states, that was

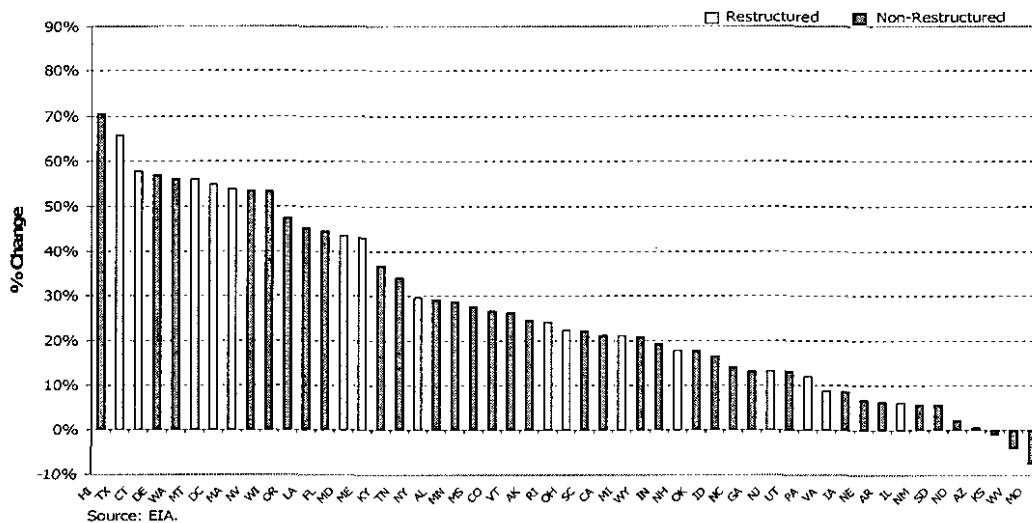
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<sup>5</sup> *The Pennsylvania Electricity Restructuring Act: Economic Benefits and Regional Comparison*, Collin Cain, M.Sc. and Jonathan Lesser, Ph.D. of Bates White, LLC, pg. EX-2 (February 2007)

already the case in the mid-1990s, before these states were restructured—which helped cement support for restructuring efforts.<sup>6</sup>

Despite greater cost pressures in a number of restructured states, rate increases in restructured and non-restructured states have matched fairly closely since restructuring was implemented:

**Percent Change in Average Electricity Prices  
Restructured and Non-Restructured States  
1995 - 2007**



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EPSA would also like to note that at the November 6 hearing, Mr. David Ciarlone, the Alcoa witness, cited a highly flawed study issued by the Carnegie Mellon Electricity Industry Center (CEIC),<sup>8</sup> which was intended to examine whether restructuring of the electricity industry has led to improved operating

<sup>6</sup> *Restructuring Revisited*, Johannes P. Pfeifenberger, Gregory N. Baseda and Adam C. Schumacher of the Brattle Group, Public Utilities Fortnightly (June 2007)

<sup>7</sup> Dr. Susan F. Tierney, *Decoding Developments in Today's Electric Industry – Ten Points in the Prism*, The Analysis Group, October 2007, p. 10.

<sup>8</sup> Testimony of David F. Ciarlone, Manager, Global Energy Services, Alcoa, Inc. *En Banc* hearing on Wholesale Electricity Markets, November 6, 2008, p. 5

efficiency of electric power generation, lowers costs and lower retail prices.<sup>9</sup> The study falls short of determining any of those answers because of deficiencies in the data used, inconsistencies in its analysis and disregard of inconvenient facts. A number of the study's flaws stem from using two different data sources to compare prices and costs despite the very different assumptions in the information that is used to quantify price data (Edison Electric Institute's Typical Bill & Average Rate voluntary survey) than in the information used for cost data (FERC Form 1).

In addition, it appears that the authors cherry pick results that support their conclusions and ignore data that does not support their conclusions. When their data yields inconvenient conclusions, it is glossed over. For example, their data found a decrease in the cost-price ratio of \$.0274/kWh in regions within an RTO and with retail competition; however, this finding is noted neither in the summary nor the abstract. The paper also neglects to mention that the PJM Independent Market Monitor does have proprietary cost information from generators to determine if a market is competitive. The PJM Independent Market Monitor reports continue to find that the PJM market is competitive. Note that no such analysis is conducted on utilities in non-organized markets with market-based rates. For these reasons, EPSA has serious concerns with relying on this flawed study for evaluations of the benefits of competition.<sup>10</sup>

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<sup>9</sup> "Electricity Prices and Costs Under Regulation and Restructuring," Jay Apt and Seth Blumsack, March 2008

<sup>10</sup> EPSA PowerFact: "Analysis of Flaws in Carnegie Mellon Report on Electricity Costs and Prices," March 10, 2008, [www.epsa.org](http://www.epsa.org)

On a final note, a report this year by the Economic Analysis Group within the U.S. Department of Justice's Antitrust Division argues that electricity restructuring is now producing tangible benefits for consumers where it has been fully implemented and says calls for "heavy-handed regulation" should be resisted. The report states "[t]he evidence simply does not support critics' claims that there have been dramatic price increases in restructured states relative to states that have maintained more traditional forms of regulation.....there is no clear pattern in the restructuring status of the states that have seen the greatest increases in retail prices since the mid-1990s." The report notes that among the 28 states in which some form of restructuring was implemented, 10 (plus the District of Columbia) experienced increases in average retail prices from 1995 to 2006 that outpaced the national average and 18 states had increases (or even decreases) below the national average. Among the non-restructured states, 11 had price increases above the national average and 11 had below average price increases.<sup>11</sup>

#### **B. Recent Rate Increases in Non-restructured States**

Significantly, recent activity clearly confirms that non-restructured states are not immune to major rate increases.<sup>12</sup> For example, Dominion Virginia Power received approval for an 18 percent rate increase earlier this year, while Dominion North Carolina Power customers are facing a 17.7 percent increase if

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<sup>11</sup> "Electricity Restructuring: What Has Worked, What Has Not, and What is Next," Economic Analysis Group Discussion Paper by Jeff Lien, US Department of Justice, Antitrust Division, pg. 2 (April 2008), <http://www.usdoj.gov/atr/public/eag/232692a.htm>

<sup>12</sup> For further information and examples of rate increases across the country, visit EPSA's website at: <http://www.epsa.org/industry/index.cfm?fa=rateHike>

approved starting in January 2009. Progress Energy Florida is predicting a 25 percent increase for monthly electricity bills in 2009, caused by rising fuel costs, investment in nuclear energy, and environmental compliance; Progress Energy is also pursuing a pending 11.5 percent rate increase in North Carolina. The Tennessee Valley Authority increased its monthly rates by 20 percent in October 2008, which is its biggest rate increase since 1974. This follows a 7 percent increase which went into effect in April.

As noted by Dr. Susan F. Tierney, “[a]s much as one would like to conclude otherwise, relatively high electricity prices are likely to be the “new normal” in the electric industry. This is our new reality – whether consumers are served in regions with vertically integrated electric utilities under cost-based regulation, or in ones relying substantially on markets. This reality stems from fundamental economic forces tied to global markets for fossil fuels and other products, and to the need to address other critical economic and social challenges such as continued demand for power, aging infrastructure and global warming.”<sup>13</sup>

In other words, a return to a cost-of-service regulated construct is not likely to result in a reduction in rates. Rather, in this time of rising costs and challenging economics, policymakers in restructured states need to continue to work toward market improvements that will provide the regulatory certainty necessary for investment in infrastructure in concert with other mechanisms,

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<sup>13</sup> Dr. Susan F. Tierney, *Decoding Developments in Today's Electric Industry – Ten Points in the Prism*, The Analysis Group, October 2007, p. 22.



such as demand response and energy efficiency, which will ensure continued consumer benefits over the long-term.

### **C. Investment In Restructured States**

A number of studies and reports, including by independent market monitors in RTO/ISO markets, demonstrate that many of the nation's power plants are operating more efficiently in a competitive market, reflecting an increase in output through productivity gains, better operating practices or through investments in existing facilities to enhance performance. Consumers in restructured states have benefited from these changes, since the vast majority of investment in existing (and new) generation since 1995 has been made by "non-utility entities, with investors bearing risks of cost overruns and surplus capacity."<sup>14</sup>

New data also confirms the benefits of competitive markets for investment in renewables, including wind development. A report issued earlier this year by the U.S. Department of Energy confirmed that RTO/ISO markets facilitate wind energy, and noted the broader benefits of these markets for ensuring a reliable and efficient generation portfolio to serve consumers.<sup>15</sup> This supports information from the ISO/RTO Council, reporting that organized markets host 73 percent of today's installed wind generation capacity, even though these markets

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<sup>14</sup> *Id.*, p. 15

<sup>15</sup> *20% Wind by 2030: Increasing Wind Energy's Contribution to U.S. Electricity Supply*, U.S. Department of Energy, May 2008

only include 44 percent of U.S. wind energy potential and 53 percent of U.S. electricity demand.<sup>16</sup>

As noted by Dr. Joe Bowring, the PJM Independent Market Monitor, at the October 23 Hearing, thanks to PJM's Reliability Pricing Model (RPM), more than 12,500 MW of increased capacity is available in the region, and "the data show that generation owners plan to spend \$5.1 billion on existing units through the 2011/2012 delivery year."<sup>17</sup> In addition, "The results of the first five RPM auctions, have delivered investments to supply 9,986 MW of new resources, including a base-load coal plant, over 800 MW of renewable resources, and over 2,000 MW of new Demand Response resources."<sup>18</sup> Competitive suppliers have and continue to robustly respond to the market to provide needed capacity to meet consumer demand.

#### **D. Portland Cement's Alternative Market Design Proposal Is A Direct Return To A Cost-Of-Service Regime**

In filed testimony and during the hearing, Bob Weishaar, on behalf of the PJM Industrial Customer Coalition (PJMICC), stated that PJMICC "joined with the Portland Cement Association and other industrial groups to file with FERC an Alternative Market Design Proposal (AMDP)."<sup>19</sup> To summarize, in submitting the proposal to FERC, the Portland Cement Association coalition (PCA) claimed the

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<sup>16</sup> *Increasing Renewable Resources: How ISOs and RTOs are Helping Meeting this Public Policy Objective*, ISO/RTO Council, October 16, 2007

<sup>17</sup> Analysis of APIR Investment and MW Added Under RPM: 2007-2011 RPM Auctions, Independent Market Monitor for PJM, September 2008

<sup>18</sup> Testimony of Andrew Ott, Senior Vice President of PJM Interconnection, Pennsylvania PUC En Banc Hearing on Wholesale Electricity Markets, October 23, 2008

<sup>19</sup> PJMICC statement, p. 5

alternative addresses their concerns that the RTO capacity markets are not effective, and that locational marginal pricing (LMP) and the single-clearing price auction as currently structured result in unjust and unreasonable prices. The AMPD is intended to better “correlate” capacity and energy to each other, rely on the use of long-term contracts for energy, and utilize a mix of cost-based and market-based prices to result in what they deem a more rational price. The proposal has two main components – a capacity payment, and a long-term contract for energy under which load pays the lesser of the spot clearing price or the marginal cost of a proxy unit. The proposal would use a given generator’s own marginal costs.

The AMPD supported by PJMICC and other PCA coalition members is essentially a direct attempt to go back to cost-of-service ratemaking. In this regulatory alternative, units bid into the capacity market via an as-bid auction and are then committed to the energy market under a long-term contract. When committed capacity is called, it receives an energy strike price which is based on the actual fuel and O&M costs associated with dispatch of that generator’s unit (i.e., cost-based). Only those units not receiving a capacity payment would collect LMP in a very limited balancing market (*Day Ahead and Real Time*). Based on the unit-specific capacity payment, this proposal represents a full retreat to cost-based ratemaking and would result in price discrimination between existing and new capacity.

While EPSA commends the PCA, PJMICC and other coalition members for developing a specific, substantive proposal for consideration, EPSA cannot

support the proposal on a number of fronts. First, forward capacity markets in RTOs such as PJM and ISO-NE were only fully implemented this year. While refinements should be (and are being) considered, to replace the current construct at this early stage would be counter-productive. Further, these markets are the result of detailed, negotiated settlements and the resulting regulatory and investment uncertainty that would result from such a retreat would threaten the ability to assure continued system reliability in PJM and other markets.

In addition, the faults and dangers of a pay-as-bid auction design over a uniform-clearing price auction have been articulated by a number of experts.<sup>20</sup>

As noted in particular by a blue-ribbon panel on the subject:

In sum, our response is that the expectation behind the proposal to shift from uniform to as-bid-pricing—that it would provide purchasers of electric power substantial relief from the soaring prices of electric power such as they have recently experienced—is simply mistaken. The immediate consequence of its introduction would be a radical change in bidding behavior that would:

- forestall those anticipated savings;
- introduce unmeasurable inefficiencies in the dispatch of power and impose new costs on generating companies, which would inevitably tend to increase rather than decrease average prices;
- tend to weaken the competition in generation that is the best safeguard against exertions of monopoly power such as may have contributed to the painfully elevated prices at times of peak demand; and
- impede—again to an unmeasurable extent—the expansion of capacity that, along with intensified demand-side response, is the only fundamental

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<sup>20</sup> *Electricity Restructuring: What Has Worked, What Has Not, and What is Next,* Economic Analysis Group Discussion Paper by Jeff Lien, US Department of Justice, Antitrust Division, pg. 2 (April 2008), <http://www.usdoj.gov/atr/public/eag/232692a.htm>; also see *The Most Effective Way*, Public Utilities Fortnightly, Thomas L. Welch (October 2006) *Uniform-Price Auctions in Electricity Markets*, Peter Cramton, Steven Stoft, (March 2006) [www.cramton.umd.edu/papers2000-2004/cramton-bidding-behavior-in-electricity-markets-hawaii.pdf](http://www.cramton.umd.edu/papers2000-2004/cramton-bidding-behavior-in-electricity-markets-hawaii.pdf)

remedy for the recent poor performance of electricity markets in California.<sup>21</sup>

### III. CONCLUSION

EPSA supports the Commission's efforts to understand the scope of issues currently facing the wholesale electric markets. EPSA encourages the Commission to consider modifications where and if necessary, to allow competitive markets to continue producing benefits for consumers in Pennsylvania, rather than a retreat to a rate-based construct that shifted more risks and costs on to captive ratepayers. We appreciate the opportunity to contribute to this dialogue and look forward to the next hearing on these critical issues.

Respectfully submitted,



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November 17, 2008

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<sup>21</sup> *Pricing in the California Power Exchange Electricity Market: Should California Switch from Uniform Pricing to Pay-as-Bid Pricing?*, Alfred E. Kahn, Peter C. Cramton, Robert H. Porter, Richard D. Tabors (January 2001)

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