

## **EPSA Response to APPA's Day 1.5 Market Proposal<sup>1</sup>**

### ***APPA's Proposal is an Ill-Advised and Unnecessary Blanket Overhaul: Markets Need to be Refined, Not Radically Altered***

- Regional Transmission Organizations (RTOs) independently administer markets serving two-thirds of the country that provide efficiency, economic and reliability benefits for consumers, including better environmental performance and more renewable generation. These benefits stem from the independent and transparent nature of RTO wholesale markets, which coordinate the efficient, economic and reliable dispatch of electricity. By contrast, areas of the country without RTOs retain serious transmission and market access barriers.
- There is no claim and no evidence in the APPA white paper that the proposal it offers to rollback RTO functions would actually lower wholesale and retail electricity prices, much less do so consistent with maintaining the investments required to ensure reliability and improve the environment. Additionally, the time and cost required to undertake such a roll back is not supported by any evidence that doing so would bring benefits to consumers.
- There are several flaws with APPA's capacity market proposal. 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 as the 'forward' certainty of the market would be removed just as investors are relying on them. Further, these markets are the result of detailed and extensive settlements; the 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.
- Creating full disclosure for cost-based bids does not bring any helpful transparency, and in fact may reduce liquidity in the marketplace at the very time that more capital is needed to provide resource investments.

### ***The Current Basic Market Structures in RTOs Work and Provide Reliable Electricity Supplies and Opportunities for Demand Response***

- Today's capacity markets in PJM and ISO-NE were proposed as part of extensively negotiated settlements in 2005 and 2006 respectively because of dramatic capacity shortages predicted for 2008-2010 and beyond. Today, despite all the uncertainties related to increasing commodity costs, climate change legislation and unprecedented fuel cost volatility; sufficient capacity exists to reliably meet consumer needs in these regions.

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<sup>1</sup> The American Public Power Association proposal was detailed in the *Energy Law Journal*, Volume 29, No. 2, "Time For A Day 1.5 Market: A Proposal to Reform RTO-Run Centralized Wholesale Electricity Market" By Susan Kelly and Elise Caplan, Page 491 (Fall 2008).

- While not perfect, these capacity market constructs have largely met their intended purposes of ensuring adequate capacity. The forward capacity markets have considerably enhanced reliability for customers through additional electricity generation, the realization of demand response, and a continued trend in the reversal of planned retirement of older generating facilities.
- According to NERC's 2008 Long-Term Reliability Assessment issued in November 2008, every region of the country, including those served by RTOs with centralized wholesale markets, will need to make substantial investments to keep electricity supplies above the peak reserve margins set for reliability over the next decade.
- Competitive electricity suppliers are making plans for necessary investments, and moving forward with concrete implementation steps, in light of imminent need to enhance electricity infrastructure, largely based on the existence of these centralized wholesale markets. While targeted improvements to RTOs can and should be made, as the Federal Energy Regulatory Commission recently proposed, the APPA proposal to dismantle existing markets is neither constructive nor helpful to investment.
- In the same month that it issued a white paper called *Consumers in Peril* (February 2008) in which it called for RTOs to eliminate or scale back the centralized wholesale markets, APPA issued *APPA Report on New Generating Capacity: 2008 Update*. The APPA capacity report (pages 8-9) documents that the share of plants under construction has shifted towards competitive suppliers once again. It noted that in 2007 two-thirds of the plants under construction were by regulated utilities, but by 2008 "the share is distributed almost evenly between regulated and unregulated entities." Most importantly, this occurred because "the non-utility generator (NUG) capacity increased by more than 9,000 MWs between the 2007 and 2008 reports."

### ***APPA's Overview of Markets is Incomplete and One-Sided***

- The markets that RTOs currently run are highly regulated, administered by independent RTOs, monitored by independent market monitors, and overseen by federal regulators on a daily basis with input from state regulators. The energy and capacity markets are also highly mitigated. For example, every unit in PJM's capacity market has bid in at a mitigated price. The independent market monitors provide all data to federal regulators, who have repeatedly stated bi-partisan support for RTOs and competitive electricity markets based on their access to information and a full picture of the market operations of the RTOs.
- APPA concedes that buyers have contributed to the lack of long-term, bilateral contracts in recent years. "Regulatory uncertainty, lack of adequate long-term transmission planning, and lack of [long-term transmission rights]

have all impeded buyers' willingness to transact on a bilateral, long-term basis..." (Page 503). These market fundamentals, during a time of regulatory uncertainty and fuel volatility, have resulted in the disconnect between buyers and sellers of electricity over prices and risk allocations, which are the real reasons that long-term contracts have not been executed to the extent that APPA deems desirable.

- Despite greater cost pressures in a number of restructured states, rate increases in restructured and non-restructured states have tracked fairly closely since restructuring was implemented. This is consistent with independent analysis; 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 already the case in the mid-1990s, before these states were restructured—which helped cement support for restructuring efforts."<sup>2</sup>
- Although APPA criticizes the lack of generation development, a recent APPA report even concedes that "a number of real-world factors have impeded entry, with the result that entry has often been constrained and generation is not adequately competitive."<sup>3</sup> The report accurately highlights concerns of regulatory and environmental uncertainty and is critical of bid caps for mitigating "appropriately high prices." The report does, however, have a number of weaknesses including a failure to take into consideration the large investments competitive suppliers are making in new generation and largely relies on data that is already several years old, which exaggerate transmission problems while overplaying reserve margin concerns.

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<sup>2</sup> *Restructuring Revisited*, Johannes P. Pfeifenberger, Gregory N. Basheda and Adam C. Schumacher of the Brattle Group, Public Utilities Fortnightly (June 2007).

<sup>3</sup> *Barriers to New Competition in Electricity Generation*, John Kwoka, APPA (June 2008).