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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket No.
MARKET-BASED RATES FOR : RM04-7-000
PUBLIC UTILITIES :
- - - - -x

Commission Meeting Room
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C.

Wednesday, June 9, 2004

The above-entitled matter came on for technical
conference, pursuant to notice, at 9:32 a.m., Steve Rodgers,
presiding.

APPEARANCES:
DAVID DeRAMUS, Partner, Bates White
MARK HEGEDUS, of counsel, Spiegel & McDiarmid, on
behalf of American Public Power Association

1 APPEARANCES CONTINUED:

2 PAUL BONAVIDA, President of Commercial Enterprises
3 for Xcel Energy

4 ROBERT WEISHAAR, Partner, McNeese, Wallace &
5 Nurick, on behalf of industrial customers

6 MATHEW MOREY, Senior Consultant, Laurits R.
7 Christensen Associates, on behalf of National
8 Rural Electric Cooperative Association

9 MICHAEL WROBLEWSKI, FTC

10 JULIE SIMON, Vice President of Policy, Electric
11 Power Supply Association

12 FRED BRYANT, General Counsel for Florida
13 Municipal Power Agency, on behalf of
14 Transmission Access Policy Study (TAPS) Group

15 GERALD NORLANDER, Chairman of the Electricity
16 Committee of the National Association of State
17 Utility Consumer Advocates

18 DIANA MOSS, Vice President and Senior Research
19 Fellow, American Antitrust Institute

20 JAMES BUSHNELL, Univ. of California Energy
21 Institute

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P R O C E E D I N G S

(9:32 a.m.)

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3 MR. RODGERS: Good morning. If we could. My
4 name is Steve Rodgers. I am the director of FERC's OMTR
5 Division South. And to provide some background information
6 on the purpose of today's conference, let me state that for
7 many years the Commission has conducted a four-part test to
8 determine whether an applicant should be granted market-
9 based rate authority.

10 Those four parts are whether the applicant has
11 generation market power; whether it has transmission market
12 power; whether the applicant can erect barriers to entry;
13 and whether there are concerns involving the applicant that
14 relate to affiliate abuse and reciprocal dealings.

15 Today's conference is a first-step in a
16 rulemaking proceeding the Commission has initiated with
17 respect to the adequacy of the current four-part test and
18 whether and how it should be modified to assure that
19 electric market-based rates are just and reasonable under
20 that Federal Power Act.

21 The purpose of today's conference is to frame the
22 issues that will comprise the rulemaking proceeding,
23 including the discussion of how all four parts of the
24 current test interrelate with each other as well as what
25 other factors the Commission should consider in granting

1 market-based rate authorizations.

2 Specifically this generic proceeding will
3 address, but not be limited to, whether the Commission
4 should retain or modify its existing four-prong test;
5 whether the interim generation market power screens that the
6 Commission recently adopted should be retained over the long
7 term; whether the Commission should adopt different
8 approaches to affiliate transactions than it currently does;
9 and whether there should be new Commission regulations
10 promulgated expressly for electric market-based rate
11 filings.

12 The Commission intends the scope of this
13 rulemaking proceeding to be broad and to include market-
14 based rate authorizations associated with ancillary
15 services.

16 The conference today will be transcribed and
17 those transcripts will be placed in the public record ten
18 days after the Commission receives the transcripts.

19 We have a distinguished group of panelists that
20 are joining us today to give us their views on these
21 important matters. They represent a wide array of diverse
22 viewpoints in the industry. And each panelist has been
23 asked to give a five to seven minute presentation that will
24 be followed up with a question and answer dialogue.

25 So that there may be a fuller discussion of the

1 issues, during the Q&A session panelists are invited to
2 comment on the remarks of other panelists. At the
3 conclusion of each of today's panels, there will be an open
4 microphone session where members of the audience will be
5 given an opportunity to ask questions of the panelists or to
6 make remarks.

7 David DeRamus who is a partner with the economic
8 consulting firm of Bates White and he was recommended to
9 FERC to participate on today's panel by EPSA, the Electric
10 Power Supply Association. So welcome Dr. DeRamus.

11 MR. DeRAMUS: Thank you very much.

12 Well, most of my prepared comments are directed
13 to the issue of vertical market power and fire market power.

14 Is that better?

15 While most of my prepared comments are directed
16 at the issue of vertical market power, including buyer
17 market power, I would like to begin with some general
18 observations about the Commission's current proposed screens
19 and analytical procedures for granting market-based rate
20 authority.

21 I would like to note at the outset that I support
22 the Commission's approach of using quantitative screens as
23 indicative of whether there is a need for more detailed
24 market power analysis rather than as a definitive litmus
25 test for the presence or absence of market power. Given the

1 concern that any metric is likely to result in some false
2 positives, i.e., incorrectly indicating the ability to
3 exercise substantive market power, making such screens
4 indicative rather than definitive should substantially
5 reduce the cost associated with false positives.

6 However, this also leads me to conclude that such
7 an indicative approach justifies a greater focus in the
8 instant proceeding on the potential for false negatives.

9 I also think it is appropriate to use more than
10 one indicative screen since some metrics may be useful for
11 identifying one specific manifestation of market power. But
12 the exercise of market power extends to a broader range of
13 behavior than a single screen is likely to be able to
14 identify.

15 For example, while a pivotal supplier screen may
16 be useful in identifying participants with the incentives to
17 withhold capacity under certain market conditions, capacity
18 withholding is only one way in which a participant may
19 exercise market power, and other screens may be needed in
20 order to identify participants with other forms of market
21 power.

22 In addition, the ability of market participants
23 to exercise different forms of market power depends
24 considerably on the specific institution and regulatory
25 characteristics of a market. As a consequence, it is

1 important that the screens and the other prongs of the
2 analysis account for different market characteristics, e.g.,
3 markets with and without RTOs, with and without structured
4 auction markets, with and without competitive procurement,
5 with and without retailed choice, et cetera.

6 Ultimately all four prongs of the Commission's
7 test for market-based rate authority addressed the same
8 broader question of whether a market is workably competitive
9 and whether a specific participant is able to engage in
10 anti-competitive behavior.

11 At the heart of the Commission's first prong is
12 the concern over capacity withholding and its potential
13 impact on prices which ultimately reflects the exercise of
14 horizontal market power.

15 However, as the other prongs of the Commission's
16 test demonstrate, a participant may also be able to exercise
17 vertical market power, particularly through market
18 foreclosure. And it is my opinion that vertical market
19 foreclosure can have even greater anti-competitive effects
20 than the exercise of horizontal market power.

21 Market foreclosure and especially vertical market
22 foreclosure has long been recognized by economists in the
23 courts as anti-competitive. There are several different
24 ways in which market participant may be able engage in
25 vertical market foreclosure.

1 In electricity markets, utility may have both
2 upstream vertical market power through its monopoly control
3 over the transmission network and other critical inputs as
4 well as downstream vertical market power through its
5 monopoly retail franchise in its local service territory as
6 illustrated in figure 1 of the attachments.

7 In certain markets, particularly those
8 characterized by the absence of an RTO in the absence of
9 some form of competitive procurement the monopoly retail
10 franchise allows a vertically integrated utility to exercise
11 monopsony power or buyer market power with respect to
12 wholesale generation.

13 Furthermore, if the utility also has a large
14 amount of generation, you will have increased incentives to
15 use as monopsony power in order to foreclose other
16 generators from the wholesale market.

17 As a general matter, the greater utility share of
18 both generation and load within a given market, the greater
19 its ability and incentive to use this monopsony power in
20 order to foreclose competing generators from the market.

21 Formerly economists often described the exercise
22 of monopsony as involving a firm's decision to reduce the
23 quantity of its purchased inputs. However, a firm may
24 exercise buyer market power in other ways as well.

25 In some electricity markets a utility may

1 exercise buyer market power by simply refusing to purchase
2 competing generation substituting its own higher-cost
3 generation for a competing generator's lower-cost
4 alternative as illustrated in Figure 2 of the attachment.

5 As a result the utility still serves the same
6 amount of load except at a higher cost. Profiting from the
7 continued inclusion of its generation in the rate base. The
8 extent of the resulting economic dispatch can provide a good
9 indication as to whether a utility is exercising monopsony
10 power in order to foreclose the market.

11 If the vertically integrated utility comprises a
12 large share of load within the relevant market, the
13 utility's monopsony power can also effectively foreclose
14 competing generators from the remainder of the active
15 wholesale market.

16 If this portion of the wholesale market is
17 relatively small, competing suppliers will often face
18 operational constraints such as minimum load requirements
19 for the generators. And, thus, they will not be able to
20 provide the vertically integrated utility with any pricing
21 discipline with respect to these customers.

22 The ability to foreclose competitors from this
23 remaining portion of the wholesale market I further
24 increased if the vertically integrated utility also
25 continues to exercise control over transmission.

1 The end result is thus not only uneconomic
2 dispatch with respect to generation serving the utility
3 service territory, an outcome that is clearly detrimental to
4 both efficiency and consumer welfare, but also a serious and
5 self-reinforcing impediment to the development of
6 competition throughout the relevant market.

7 I should also note that I am by no means the
8 first to identify the use of buyer market power as a way of
9 foreclosing competition and extending monopoly power from
10 one market into another. The landmark AT&T antitrust case,
11 to name just one example, the U.S. DOJ argued that AT&T used
12 its monopsony power over telecommunications equipment
13 purchases as a way of foreclosing competition and extending
14 as regulated monopoly power into a vertically related
15 market.

16 I believe the AT&T example is particularly
17 appropriate since it demonstrates that the incentive for a
18 regulated utility to monopolize a competitive market is
19 often derived from cost of service regulation itself.

20 Since the utility is precluded from earning
21 monopoly profits in its regulated markets, it has an
22 incentive to foreclose the competitive market to
23 competition, both in an attempt to earn monopoly profits in
24 that market and in order to maximize the size of its rate
25 base used to serve the regulated market.

1 It's important to consider the implications of
2 the foregoing for the proposed quantitative screens. If the
3 quantitative screens are solely intended to identify
4 incentives to engage in withholding the exclusion of the
5 capacity used to serve a utility's native load obligation
6 may have merit in certain markets. However, the overarching
7 concerns should be to identify market participants with the
8 broader capability to control prices and exclude
9 competition.

10 Therefore, I think at least one metric should be
11 designed to help address such broader concerns, and this is
12 consistent with identifying whether a particularly applicant
13 is dominant in his relevant market.

14 Furthermore, it is my view that a market share or
15 market concentration metric should not be adjusted to
16 exclude the capacity used to serve a utility's native load
17 obligation whether in whole or in part.

18 Not only would excluding such a native load
19 obligation fail to identify some firms that are clearly
20 dominant in their respective markets, but it also would fail
21 to identify firms that are able to exercise vertical market
22 power.

23 After all, a small amount of uncommitted capacity
24 and a small remaining active wholesale market may actually
25 result from successful vertical market foreclosure rather

1 than indicating the absence of market power.

2 I also think that the proposal to adjust both
3 proposed screens to exclude native load in whole or in part
4 is inconsistent with the way in which competitive analysis
5 screens are generally applied in Section 203 proceedings in
6 which one screen includes native load and another does not.

7 In the event that the Commission decides to
8 exclude native load in whole or in part from both of its
9 indicative screens, it is important to require at least some
10 market participants to demonstrate that they have neither
11 the ability nor the incentive to use monopsony power in
12 order to foreclose competing generators from the market.
13 Such evidence could include the existence of an all-
14 inclusive economic dispatch protocol, a competitive
15 nondiscriminatory procurement process or quantitative
16 evidence that the utility purchases power from competing
17 generators whenever it is cheaper than its own generation.

18 The Commission could also make use of other
19 metrics of buyer market power including buyer market shares,
20 a buyer HHI, or other more sophisticated screens that take
21 into account demand and supply conditions.

22 Finally, I would like to leave the Commission and
23 staff with the following thoughts. The incentives of market
24 participants to exercise horizontal market power are
25 greatest during periods of extremely tight supplies. And

1 such incentives can be muted to some considerable extent
2 through appropriate market rules and institutions. In the
3 absence of barriers to entry, horizontal market power can
4 also be somewhat self correcting. After all, high prices
5 provide strong incentives for increased investment which in
6 turn not only helps dampen future price increases, but also
7 reduces the incentives to engage in withholding.

8 By contrast, the incentives to exercise vertical
9 market power whether through transmission, monopsony power,
10 affiliate transactions, or other barriers to entry are
11 affected to a large extent only by changes in the regulatory
12 and market structure, not by changes in supply and demand
13 conditions. Simply monitoring participant behavior for the
14 exercise of vertical market power to the extent such
15 behavior can be detected, also does nothing to correct the
16 underlying incentives.

17 Furthermore, vertical market foreclosure is not
18 self-correcting. Even over the long-term the exercise of
19 vertical market power discourages new entry, reduces
20 incentives for investment, reduces efficiency, increases
21 costs and ultimately thwarts the goals of creating and
22 sustaining competitive markets.

23 Thus, it is my conclusion that a clear focus on
24 assessing and fully mitigating vertical market power however
25 it is exercised is of utmost importance in market-based rate

1 proceedings.

2 Thank you.

3 MR. RODGERS: Thank you, Mr. DeRamus, appreciate
4 that.

5 Questions from our staff?

6 MR. PERLMAN: I guess I have one just quick
7 question regarding your concept of buyer market power.
8 Since our market-based rates regulation really is directed
9 towards sellers and the ability of sellers to charge market-
10 based rates as opposed to some other scheme, how would you
11 suggest that we incorporate the concept of buyer market
12 power and the analysis that we undertake to regulate the
13 sales that we do regulate under the Federal Power Act?

14 MR. DeRAMUS: Well, obviously any market is
15 comprised of both buyers and sellers. I think ultimately in
16 a market-based rate proceeding, the issue is whether a
17 particularly entity has the authority to engage in wholesale
18 transactions at market-based rates. I think it is -- as I
19 mentioned in my remarks, I think it is certainly possible to
20 look at the underlying structural characteristics of the
21 market and determine whether any individual participant, as
22 a seller, ultimately is able to also exercise some form of
23 market power foreclosing competition through its activities
24 as a buyer.

25 I guess I don't know if I'm answering your

1 question, but I --

2 MR. PERLMAN: Well, would we somehow and in a
3 mitigation of approach or something create some conditions
4 associated with buyer activity that would then permit
5 market-based rates to be authorized or something like that?
6 We would expand the scope, I would think, in some ways of
7 our analysis which takes into account the totality of the
8 market as you have said. So then should we take into
9 account the totality of the market in looking at how we
10 would go from the conclusion that there was buyer market
11 power to a conclusion with respect to market-based rates or
12 mitigation?

13 MR. DeRAMUS: Particularly when you talk about
14 mitigation, I think that's an important place, maybe, for me
15 to begin. I do believe that competitive markets are
16 assisted by expanding the scope of those markets and that
17 particularly buyer market power can be mitigated to some
18 great extent by requiring some type of economic dispatch
19 protocols, some type of competitive procurement process more
20 generally, I guess.

21 Certainly as you move more to an RTO framework, a
22 lot of these concerns become more muted. I think they may
23 arise in certain contexts, but those are highly specific.
24 So I see it very consistent with the overall objectives of
25 the Commission to promote mechanisms or institutions such as

1 RTOs.

2 MR. PEDERSON: Along those same lines, again, on
3 the buyer market power and monopsony market power, currently
4 our evaluation is done on an applicant-by-applicant basis.
5 And I'm wondering what your opinion is of whether that is
6 sufficient in approach or whether it would be more
7 appropriate to look at our market evaluations on a regional
8 basis. And my emphasis is primarily outside of RTOs.

9 MR. DeRAMUS: Certainly. I think that's a very
10 good question. Economists typically look at a market as a
11 whole and certainly there is the potential for market
12 participants to engage in behavior -- individual behavior
13 that ultimately leads to outcomes that may be undesirable
14 from a policy perspective. One can think of coordinated
15 actions even if that coordination is not in some explicit
16 form of coordination.

17 So that said, in the beginning of my remarks I
18 mentioned that the goal of a market-based rate proceeding
19 should be determined whether a market as a whole is workably
20 competitive. That said, ultimately the focus does come down
21 to specific applicants. And I certainly wouldn't want a
22 fringe market participant -- those whom I consider to be
23 almost invariably pro-competitive to be somehow subject to
24 the exclusion or some form of mitigation or something that
25 would delay its participation in the market. The quicker

1 you get participants into a market, the sooner you get the
2 benefits of competition.

3 So have would be my only concern with a broader
4 conditioning, some kind of market-based rate authority on
5 looking at all the applicants together at one time.

6 And I also think that the Commission has the
7 ability to impose applicant-specific mitigation and the
8 problems are with individual applicant and not with the
9 market as a whole. So, to some extent I come down on both
10 sides of the issue. Yes, it's important to look at the
11 market as a whole, but I don't think that that importance
12 outweighs the practical considerations of doing the analysis
13 on an applicant-by-applicant basis.

14 MR. PEDERSON: I guess what I'm trying to get
15 through in my mind is, if we're going to look at the market
16 as a whole, how are we going to do that of we're just
17 looking at one applicant at a time?

18 Doesn't it -- if we're going to look at the
19 market, doesn't it necessitate that we also look at the
20 other sellers and buyers, all of the buyers and sellers in
21 that market?

22 MR. DeRAMUS: Absolutely. Yes, I would agree
23 that in -- when you're doing -- looking at any of the
24 industry applicants' position, you need to be looking at all
25 -- the incentives of all the other applicants at the same

1 time.

2 MR. RODGERS: Mr. DeRamus, if I understand your
3 statement correctly, it's your view that the Commission
4 cannot meaningfully get the best picture of the market power
5 situation by focusing on generation market power without
6 looking at transmission or by focusing on transmission
7 without looking at generation that the Commission needs to
8 take a more holistic approach, is that what I'm hearing?
9 Or --

10 MR. DeRAMUS: Yes, it is. And I think it's
11 somewhat artificial to call generation market power just
12 that, generation market power. The issue is ultimately,
13 what is the ability of market participants within a relevant
14 market to control prices and foreclose competition. And
15 ultimately that is -- the industry is not just about -- the
16 market is not just about that -- the actual production of
17 generation, it's also about its distribution and sale.

18 MR. RODGERS: Okay -- market power in traditional
19 markets than what it has in more organized markets such as
20 what we have in Isis and RTOs. And if you believe that,
21 could you explain why?

22 MR. DeRAMUS: As I mentioned at one point in my
23 remarks, I thought that it was important to take into
24 account the different institutional and market
25 characteristics of different markets. I certainly am more

1 concerned about vertical market foreclosure, the more you
2 have the absence of structures like an RTO, and a fully
3 functioning RTO with well-structured markets. And I think
4 it's also important in defining the appropriate screens to
5 be used that those screens account for potential differences
6 in how they're applied.

7 For example, when you are excluding a utility's
8 need of load obligation, that might make sense and then RTO
9 framework. But in a more traditional rate-regulated market
10 without -- that does not have an RTO where the utility
11 controls the transmission network and is the dominant
12 provider in generation, I do think that those -- that
13 excluding native load can lead to misleading conclusions
14 about market power.

15 MR. RODGERS: And following up on your native
16 load thoughts, is it your view that the Commission should
17 have multiple screens in that it would be okay to allow some
18 type of native load to deduction for one screen, but there
19 should not be a native load deduction for another screen.

20 MR. DeRAMUS: Generally I see that as a
21 reasonable compromise. Obviously my priors are that the
22 analysis should be focused to the specific markets in
23 regulatory institutions that are applicable in each given
24 market. And, therefore, you can have a whole different set
25 of screens for one market and different set of screens for

1 another market, and those most appropriately would address
2 then the specific forms market power that can be exercised
3 in those different markets.

4 As you go to a one-size fits all approach, and
5 this is where I realized that there was a need for some
6 regulatory certainty and just procedurally you have to
7 administer some rules that provide participants with some
8 clarity.

9 If you are going to go to that one-size-fits-all
10 approach, then you need enough screens out there that are
11 able to capture the different forms of market power that are
12 exercised by a wide variety of different participants in
13 different markets.

14 So the question is simply, where are you going to
15 account for these -- for this variety of market and
16 regulatory institutions? Are you going to account for it
17 directly in the analysis, or are you going to account for it
18 in defining the types of screens, the individual screens?

19 MR. GALLICK: I'd like to just follow-up on your
20 distinction between vertical market power and vertical
21 foreclosure. Would you agree that you might be able to tell
22 the story about generation market power perhaps with a
23 blocking strategy in transmission, and yet you still may not
24 be able to have -- you may not have the ability to exercise
25 market power in transmission. So I'm getting confused

1 between some of these terms.

2 It would seem to me that developing a theory of
3 market power would have to take into account the possibility
4 of entry. So you could have a blocking strategy on the
5 entry side, but that blocking strategy wouldn't -- if it was
6 vertically exercised, it wouldn't necessarily mean you would
7 have the ability to exercise market power vertically. So I
8 was reading into your distinction between vertical market
9 power and vertical foreclosure that the foreclosure might
10 pick up the blocking idea and, for example, if transmission
11 rates were regulated, you might not be able to exercise
12 market power vertically. Yet you need that piece to keep
13 prices high on the generation side without entry.

14 MR. DeRAMUS: I think sometimes -- I realize that
15 at times it is very helpful to have analytical clarity in
16 terms of which different concepts apply to which different
17 types of behavior. But I would like to maybe kind of go
18 back to my first point is that market power is this broader
19 concept about the ability to control prices and foreclosure
20 competition. To the extent that we are talking about
21 vertical market foreclosure, you can think of it happening
22 gradually overtime, or you can think of it happening in the
23 limit where somebody is completely foreclosed from that
24 market.

25 For example, one antitrust concept that is often

1 batted around is raising rival's cost. Is raising rival's
2 cost a vertical market foreclosure strategy? In the limit
3 it is. To the extent that your competitors -- that
4 competing generators are unable to compete, provide service
5 on the same terms with other market participants they're
6 going to find themselves foreclosed from any sales
7 opportunities. And it's a question simply of a matter of
8 degree.

9 So I guess I don't know if that's a satisfactory
10 answer, but ultimately it is one of those things where I do
11 agree that vertical market foreclosure ultimately is what I
12 think happens in the limit.

13 The exercise of vertical market power as an
14 ongoing matter is something that can raise rival's costs or
15 simply cause one particular market participant to be
16 disadvantaged.

17 I should also say that overall my primary concern
18 is with those forms of vertical market power that are
19 exercised as a result of some kind of regulatory environment
20 or a monopoly franchise that is granted by a regulatory
21 authority.

22 MR. PERLMAN: Could I ask you a follow-up?
23 Because I heard you say something before that I just want to
24 make sure that I understand what you mean when you talk
25 about vertical market foreclosure and the subtraction for

1 native load. Are you saying that the existence of state
2 franchised utilities with no retail competition and
3 therefore on peak, the majority of their generation is
4 serving their native load with residual, very small
5 wholesale market? Is that fact pattern sort of indicative
6 where you would conclude that there is vertical market
7 foreclosure, and the predominant reason for that is the
8 existence of the state franchised, no retail competition
9 environment; is that your perspective that you are conveying
10 to us today?

11 MR. DeRAMUS: No, and that's why I may have cut
12 short the portion where I wanted to talk about some of the
13 indicative screens for vertical market foreclosure and
14 monopsony power. What I would be concerned about is if
15 there were competing generators in a given market that had
16 been unable to get access to that market.

17 In particular, what one can look at, capacity
18 factors, for example, for a utility and look to see whether
19 those capacity factors are consistent with what would occur
20 under economic dispatch, i.e., do you observe very highly
21 efficient entities that are of that otherwise one would
22 think would have access to the grid that are somehow not
23 making sales on a consistent basis day in and day out. That
24 to me is an issue of concern.

25 I know this bleeds into the issue that I think

1 we're going to be talking about tomorrow in terms of
2 distressed merchant acquisitions. But when you see a change
3 in behavior, in contracting behavior where all of a sudden
4 that plant becomes part of base load capacity, when
5 previously it had been part of merchant capacity that had
6 been unable to access that market, that to me is a strong
7 indication of vertical market foreclosure.

8 MR. O'NEILL: Can I ask one question? Suppose we
9 -- excuse me -- suppose we buy all your arguments about
10 vertical market power, how do we remedy it?

11 MR. DeRAMUS: Again, I think one of the best
12 remedies is some type of competitive solicitation process.
13 And, particularly it is --

14 MR. O'NEILL: For the existing generation?

15 MR. DeRAMUS: Yes, if you have a vertically
16 integrated utility that comes to you and says, we want
17 market-based rate authority, you look at what's going on in
18 the market and you observe -- and if you observe that there
19 are competing generators with efficient plants that are
20 somehow not being able to access that market in posing a
21 condition that there is some type of competitive procurement
22 process, something that results in what would approximate
23 more economic dispatch is a remedy that I think could
24 address the ability to exercise --

25 MR. O'NEILL: In the short term how would you do

1 that? I mean, I can understand long-term for new
2 investment, but how do you do that in the short term?

3 MR. DeRAMUS: Well, one example that I looked at
4 recently was Entergy's procurement process. I mean, their
5 transition from over whatever time period from serving all
6 of their load through their own generation to a process
7 where they are procuring at least some portion of it,
8 competitively -- and it's not a requirement that they
9 purchase from competitors, they're only doing so when it is
10 a lower-cost alternative than their own generation. That is
11 not something that I would consider to be a particularly
12 long-term solution. Those are protocols that can be
13 implemented reasonably. So obviously it would need to
14 depend on the market characteristics, different markets may
15 have -- may allow that with greater speed than others.

16 MR. BARDEE: When you say, "comparing a lower-
17 cost alternative" could you be more precise about what the
18 comparison is? Are we talking about the Lee's variable
19 running costs compared to the bids from others?

20 MR. DeRAMUS: I think when it comes to the
21 specifics of how a competitive procurement process is
22 implemented, there are some thorny issues to ensure that
23 there is effectively a true competitive auction.

24 Generally, in looking for uneconomic dispatch, I
25 think comparing their variable costs, their incremental

1 costs, is something that is one way to do it. But
2 ultimately I would envision a bid-base market in which
3 whatever -- whoever is the lower-cost bidder is the one that
4 gets the contract.

5 MR. BARDEE: So you can set it up so that even
6 the LSE has to bid into some forum?

7 MR. DeRAMUS: Absolutely. And the trick is to
8 make sure that the -- that the protocols are set up so that
9 the bids are what they would submit if they were truly
10 operating at arm's-length.

11 MR. BARDEE: In terms of the measuring buyer
12 market power that you mentioned earlier, you referred to
13 buyer market shares and buyer HHIs. And the idea of
14 measuring monopsony power has come up occasionally in our
15 cases in the past, but never in much detail. When we apply
16 the same kinds of thresholds for measuring buyer market
17 power that we do for seller, for example, in a market share,
18 would we be looking at a 20 percent benchmark?

19 MR. DeRAMUS: I think that is a bit of a
20 difficult issue simply because you don't have -- ideally an
21 economist would be able to look to different characteristics
22 of different markets and observe what level of concentration
23 are correlated with increased exercise of monopsony power or
24 some kind of downside scenario. Ultimately, I think that's
25 why you do need to look at the evidence as a whole. I don't

1 have a whole lot of confidence in any individual screen to
2 give you a definitive answer in that way. I do think it's a
3 start. But ultimately, that's why I mentioned before that
4 you need to look for broader evidence of foreclosure, i.e.,
5 looking to see if there are more efficient generators that
6 are somehow foreclosed that have not been generating overly
7 high capacity factors for a utility's peak load, peak units
8 that otherwise wouldn't be warranted looking at the
9 comparison of other available generation.

10 MR. RODGERS: We'll take one more question from
11 Dave and then we'll move on to the next panel.

12 MR. PERLMAN: Just on this competitive
13 procurement idea, on the long-term front, I understand your
14 short-term. One thing that's a concern to us is that if you
15 had a long-term procurement, let's say a 20-year contract
16 for the output of a unit by the LSE, wouldn't that, in fact,
17 just transfer the market power rights back to the LSE by
18 purchasing the ability to dispatch and control that unit for
19 20 years? So how have you -- by having such procurement
20 with the ability to dispatch and have that unit in effect
21 become by contract the unit of the LSE's, how do you remedy
22 any kind of market power concern in such an approach?

23 MR. DeRAMUS: It's an interesting question. I
24 think it really helps to focus on why it's important to
25 distinguish between horizontal issues and vertical issues.

1 When you're talking about an LSE who controls
2 through contract the generation capacity of some other
3 market participant, their exercise to use that capacity
4 going forward for some anticompetitive purpose is really --
5 would only be really to drive up prices through some kind of
6 withholding type strategy.

7 I don't think -- it doesn't really get to a
8 vertical market power issue in terms of a foreclosure
9 strategy. The utility doesn't somehow get addition profits
10 from generating out of that third-party facility. Or, I
11 should say, up front, ex-ante when they're negotiating that
12 contract, that's a third-party contract that there are other
13 competitors out there bidding for, and therefore the result
14 is something that I would see as a market -- sort of a
15 market rate, even if it's over a longer time period.

16 MR. RODGERS: Thank you very much, Mr. DeRamus.
17 I really appreciate very much your thoughts here today. And
18 why don't we move on. Next up is Mark Hegedus of Spiegel
19 and McDiarmid and who is appearing today on behalf of the
20 American Public Power Association. Welcome.

21 MR. HEGEDUS: Thank you very much. My name is
22 Mark Hegedus. And the American Public Power Association
23 appreciates the Commission's invitation to appear at today's
24 technical conference. APPA is the national service
25 organization representing the interests of not-for-profit,

1 publicly-owned electric utilities throughout the United
2 States.

3 More than 2,000 public power systems provide over
4 15 percent of all kilowatt-hour sales to ultimate customers
5 in the United States. Nearly 1,900 of these systems are
6 cities and municipal governments that currently own and
7 control the day-to-day operation of their electric utility
8 systems. They purchased nearly 70 percent of the power used
9 to served their ultimate customers. Public power systems
10 own about 8 percent of the nation's high-voltage
11 transmission lines, although many of thee lines are
12 configured to deliver energy to our load centers. On
13 balance, public power systems buy much more energy and
14 transmission than they sell to third parties.

15 APPA members view the Commission's market power
16 program from their perspective as load-serving entities who
17 focus on securing reliable, economic and long-term power
18 supply to serve their retail customers. In recent comments
19 submitted to the Commission, APPA has emphasized LSE-
20 focused, "back-to-basics" policies that promote robust
21 transmission, ensure long-term transmission rights necessary
22 to preserve the economics of prior generation investments
23 and to facilitate new investment, allow network resources to
24 be delivered to network loads without crushing congestion
25 charges, remedy structural market power, and work with state

1 and regional authorities to ensure resource adequacy and
2 prevent free-riding. We have stressed the need for the
3 Commission to take market-specific facts into account and
4 not to impose a one-size-fits-all market design. Though
5 some may deride the APPA view as old-fashioned, the fact is:
6 "back-to-basics" works.

7 One of the most important basics is remedying
8 structural market power. However, instead of fixing it, the
9 Commission has dumped the problem into the laps of market
10 monitors, where they exist. Elsewhere, little has been
11 done. At the same time the Commission fears that overly
12 aggressive market monitoring could interfere with efficient
13 market outcomes, and it allows or requires market monitors
14 to apply lax standards for market intervention. Consumers
15 are doubly exposed to harm -- once by the unsolved
16 structural market power and again by relaxed mitigation
17 measures that allow dominant sellers to exercise that market
18 power successfully. While market mitigation and behavior
19 rules are necessary, they are not sufficient to protect
20 consumers.

21 The Commission's recent policymaking focus on
22 organized spot market rules ignores the structural market
23 power problem. It treats the symptoms of structurally
24 uncompetitive markets without curing the underlying ailment.
25 The Commission's orders have either turned a deaf ear to

1 APPA's calls for the Commission deal with structural market
2 power problems or have stated that now is not the time or
3 place. APPA believes that the commission must deal with
4 structural market power in addition to and not in lieu of
5 its actions, such as articulating market behavior rules. We
6 wonder, though, if and when the Commission will ever get
7 around to it. The Commission should finally do so as part
8 of this proceeding.

9 The Commission has correctly recognized that
10 market-based rate sales are a privilege, not a right. As
11 such, the Commission clearly has the authority to condition
12 such sales on the seller taking steps to structurally
13 mitigate its market power. As the antitrust agencies
14 consistently tell the Commission, it is better to eliminate
15 the ability and incentive to exercise market power rather
16 than constantly having to police it. Thus, when a seller
17 seeking authorization or reauthorization from the Commission
18 to sell at market-based rates is found to be dominant, the
19 Commission should require it to take structural steps to
20 remedy the market power. These can include sales that put
21 control of generation into the hands of competing suppliers
22 and transmission measures, whether set-asides or
23 construction, that allow customer to access more sellers.

24 The Commission needs to address transmission
25 adequacy and recognize its role in robust competition. In

1 the name of efficient transmission upgrades, we face a risk
2 that the system will remain under-built. If consumers and
3 load pockets or a party seeking transmission service are
4 stuck paying all the costs of an upgrade, the upgrade may
5 reflect only what they can afford, not what the system
6 needs. It would indeed be ironic if a policy intended to
7 result in broad regional markets instead produced narrow
8 markets with only backyard generation. Without broadly
9 supported, adequate transmission, efficient investments in
10 base load generation are threatened. Peakers alone will not
11 make markets competitive.

12 The Commission must remedy data and information
13 imbalances in which dominant sellers have a lot of market
14 information while consumers, some sellers and the Commission
15 itself do not. Intervenors and the Commission will be
16 handicapped in performing virtually any market power
17 analysis if data needed to run the analysis is not
18 available. A regional approach to assessing market power
19 which is suggested in the conference's agenda is a helpful
20 step that should be pursued. A similar measure is
21 consolidating the reviews of affiliated sellers. Beyond
22 these more procedural steps, the Commission needs to update
23 its data and information infrastructure. It should
24 condition market rate authorizations with a requirement that
25 sellers regularly report to the Commission the data to need

1 market-based rate analysis. Transmission providers required
2 to have open access tariffs on file should similarly
3 regularly report that data needed to perform the
4 simultaneous transfer capability analysis. Both sets of
5 data must be made available to intervenors.

6 The Commission needs to improve data transparency
7 to facilitate transactions. Delaying release of information
8 such as bid-offer data by three or six months disadvantages
9 consumers and benefits dominant sellers.

10 The commission needs to incorporate a supply
11 curve analysis into its assessment of generation market
12 power. The shape and composition of a market supply curve
13 and a seller's position on it, reveals useful information
14 regarding a seller's ability and incentive to exercise
15 market power. It was a basic component of electricity
16 market analysis when I worked in the Antitrust Division and
17 it should be part of this Commission's approach.

18 The conference agenda correctly questions whether
19 the Order 999 tariff eliminates the exercise of transmission
20 market power. It does not. The tariff does not ensure
21 independence of operation of an integrated seller's
22 transmission grid, including to prevent the seller from
23 favoring its own use of the grid over uses by third parties.
24 This risk is sufficiently great that the Commission should
25 deny market-based rate authorization to a seller who has not

1 mitigated its transmission market power.

2 The Commission must also take account of attempts
3 by vertically integrated investor-owned systems to tie sales
4 of their generation to take-over of municipal systems. APPA
5 members have seen a decline in the number of response to
6 wholesale power supply RFPs by vertically integrated
7 utilities. At the same time, the same IOUs who aren't
8 responding to RFPs do seem to have the power to sell when
9 they try to take over that municipal system.

10 Entry analysis must be expanded to include
11 consideration of all entry conditions, not just entry
12 barriers that the seller could erect. The seller's market
13 power is not affected solely by entry barriers over which it
14 has control.

15 Fundamentally the Commission's market-based rate
16 program should provide a means to consider and analyze any
17 relevant evidence that could affect the assessment of market
18 power. One of our guiding principles at the Antitrust
19 Division was that we took markets as we found them. That
20 meant that we needed to take account of facts on the ground
21 in a market and explain how the facts affected market power.
22 For example, we looked at market-specific facts when
23 defining geographic markets. We didn't ignore retail rate
24 regulation on a seller's incentives and ability to exercise
25 market power. However, we didn't assume that the existence

1 of retail rate regulation affected each seller in the same
2 way or to the same extent. In the name of standardization,
3 the Commission cannot cross over real market differences.
4 They need to make their way into the market analysis.

5 Thank you very much for the opportunity to speak
6 to you today and I look forward to your questions.

7 MR. RODGERS: Thank you, Mark. I appreciate
8 that.

9 You stated at one point that the Commission
10 should not provide market-based rate authorization for those
11 with transmission market power. How would you propose that
12 the Commission should measure that?

13 MR. HEGEDUS: Well, I am not sure that there is a
14 metric as such that measures transmission market power, but
15 I do think that the Commission needs to be looking more
16 closely at the means by which transmission providers have
17 failed to either provide the robust transmission system
18 that's necessary to support competitive wholesale markets or
19 to, for example, fulfill their obligations to plan for the
20 needs of network customers. As a result relegating some
21 load to load pockets and at the same time protecting the
22 transmission providers generation from competition.

23 So I think part of the process is actually being
24 open to examining facts that are brought forward to the
25 Commission by intervenors and understand how those facts

1 have affected the seller's market power.

2 MR. RODGERS: So the Commission should look at
3 evidence of failure to provide transmission access as
4 indicative of transmission market power and that we should
5 have some kind of test based on that.

6 MR. HEGEDUS: Well, again, I'm not sure. Tests -
7 - as I said, I'm not sure you can deem this part and put it
8 into a metric as such. But I think it's got to go into your
9 analysis of drawing a conclusion of whether or not
10 conferring market-based rates on this seller will produce
11 rates that are just and reasonable under the Federal Power
12 Act. It's part of a piece of evidence that leads to an
13 ultimate conclusion about the reasonableness of the market-
14 based rate authorization. If it's present that the market-
15 based rate applicant has been using its transmission market
16 power, has been dragging its feet, and responding to
17 interconnection requests, for example, then that has to be
18 taken into account as to whether or not market-based rates
19 should be conferred to that seller.

20 MR. RODGERS: Changing subjects a little bit, can
21 you explain to me why you think IOUs of late do not have an
22 incentive to sell or to bid during RFPs?

23 MR. HEGEDUS: I mean, I think one of the concerns
24 of APPA members is that at least in some parts of the
25 country, the IOUs remain interested in taking over municipal

1 load, and so are hanging on to that generation to do so.
2 To, you know, put competitive pressure on the municipal
3 competitors so that, you know, essentially withholding
4 generation from the market causing increases in prices for
5 that more long-term product and putting cost pressure on a
6 municipality that could actually lead to an attractiveness
7 of a buyout and approved by that municipalities customers.

8 MR. RODGERS: So it's your view that in some
9 parts of the country IOUs are engaging in a short-term
10 strategy of withholding bidding in RFPs to basically drive
11 municipal systems to have to join up with or sell their
12 systems to IOUs; is that correct, first of all? And,
13 secondly, what parts of the country are you seeing that
14 happen in?

15 MR. HEGEDUS: Well, I think that that will drive
16 some IOUs. I cannot say that it will drive all IOUs. But
17 you will hear later today from Fred Bryant speaking on
18 behalf of TAPS of that being a factor, apparently still done
19 in Florida.

20 Now, it may not be the sole driver in terms of an
21 effort to take over municipal systems. There could also be
22 efforts knowing that keeping the capacity off the market
23 puts competitive pressure -- has upward pricing pressure on
24 the market. A utility with a long-term view, you know, may
25 see that that's in its best interest to see those prices go

1 up and to see its competitors hurt in that market. So I'm
2 sure that the factors influencing that decision can be
3 varied.

4 MR. RODGERS: Okay.

5 MR. PERLMAN: I guess I have a couple of
6 questions. I would characterize your presentation as being
7 a very high-level presentation telling us a lot of the types
8 of issues you think we should take into account as we look
9 at market-based rates analysis going forward.

10 MR. HEGEDUS: That's right.

11 MR. PERLMAN: Sort of following along with what
12 Steve said before, we have to grapple with those issues and
13 try and find a way to operationalize them and actually make
14 them into a program that we can implement.

15 So I wonder if you could give us like two or
16 three examples of how we might operationalize the ideas that
17 you've talked about in making a program workable and
18 implementable by us when we have to deal with applications
19 for market-based rates.

20 MR. HEGEDUS: Let me take the example of supply
21 curve analysis. Actually coming up with a fairly simple
22 supply curve of a market is not terribly difficult. You can
23 do it using RDI data, for example. It gives you a picture
24 of what the generation in that market looks like, how it
25 stacks, where you might have a particular concentration of

1 ownership at some point in supply curve, perhaps in peaking
2 generation. It give you an idea of where you may have gaps,
3 where you have rather than a steady increase in the curve
4 you've got a gap between some intermediate generation and
5 some peaking generation.

6 A competitive effects story that says, okay, how
7 can that generator in that market owning these particular
8 units, how are they going to be able to use that generation
9 to affect price? Do they happen to own some generation that
10 is marginal more often than not? Do they also happen to own
11 some generation that is inframarginal? If they've got some
12 of that marginal generation, then withholding that
13 generation does not have a high cost relative to if the only
14 generation you have to uphold is low-cost inframarginal
15 generation. When you see that they have both kinds of
16 generation, you should look more closely as to whether or
17 not there is a greater incentive for that applicant to
18 withhold that generation.

19 So I would, you know, include as part of the
20 basic rate application a requirement of a submission of, you
21 know, some kind of RDI-based supply curve just so you have
22 that picture and then put on, for example, the market-based
23 rate sellers -- the applicant's filing requirement that they
24 address, given this supply curve, whether or not they have
25 incentive or ability to exercise market power. And

1 intervenors should be able to address the same thing.

2 MR. O'NEILL: Mark, in your supply curve, how are
3 you going to define the market and how would you deal with
4 transmission constraints?

5 MR. HEGEDUS: Well, I think, yeah, you can't do
6 it separate from the geographic market analysis. So, yes,
7 you have to go through the process of --

8 MR. O'NEILL: So you would first have to figure
9 out what the market is before you construct the supply
10 curve?

11 MR. HEGEDUS: Absolutely.

12 MR. O'NEILL: It changes day-to-day, week-to-
13 week, season-to-season, and then you would have to take into
14 account transmission constraints so the supply curve --

15 MR. HEGEDUS: It can change. It's hard. I mean,
16 I'm not saying that it's the simplest thing in the world.

17 MR. O'NEILL: Good. I wanted to make sure that
18 we agreed that it's not --

19 MR. HEGEDUS: But on the other hand, you know,
20 the Commission has embarked upon this agenda and it has an
21 obligation to ensure just and reasonable rates. It will --
22 it could take a beefing up of resources and time committed
23 to these kind of cases.

24 If I step back and think about it, for up until
25 this point the Commission spent a lot of time and money and

1 the parties spent a lot of time and money ensuring just and
2 reasonable rates under a cost-based regime. Why did we do
3 that? Lots of money was at stake. Billions of dollars.

4 The same thing is going on today. Lots of money
5 is at stake. Billions of dollars to be paid out by
6 consumers. There's no reason why the Commission shouldn't
7 be committing the same kind of resources looking at these
8 issues to ensure that just and reasonable rates will result
9 from market-based rate authorization.

10 MR. O'NEILL: Thank you.

11 MR. FRANKLIN: I've got a couple of questions and
12 I'm struggling a little bit on how to present the questions.
13 One has to do with, in general, with load pockets and
14 sometimes munies and cities and whatnot exist and they don't
15 have a lot of generation and they may exist in a load pocket
16 within a control area. And you had mentioned that a lot of
17 times munies may not have the money to upgrade transmission
18 which puts the control area in an awkward predicament of
19 getting rate increases to build -- expand their transmission
20 to serve a muni, per se. So the reason I bring this up is
21 most transmission was built for, you know, to bring in power
22 from nuclear plants and from coal plants. It was not
23 necessarily made to indefinitely deliver power long
24 distances. It wasn't originally set up that way. So
25 somebody is going to have to upgrade the transmission. And

1 typically that doesn't occur unless there's a little pain in
2 the short-run.

3 So my first question, and preface that is, first
4 of all, do you support, you know, mitigation of places where
5 there's true scarcity and load pockets? And the reason I
6 ask that is if you take away the incentive to build
7 transmission, then, you know, they probably won't get built
8 if you mitigate too much.

9 And then second of all, who is going to pay for
10 this transmission? You know, a lot of it can be, you know,
11 regulated over or spanned out over 30 years or whatever, but
12 it's going to be real difficult for anybody to build that
13 transmission that doesn't have a long-term commitment from
14 somebody to build it.

15 And if the munies or people are any entity load
16 entity within these pockets aren't willing to pay the full
17 cost of it, and they're going to be the main benefactors,
18 then who is going to pay for it?

19 MR. HEGEDUS: Well, I guess I disagree with the
20 assumption that the municipality would be the main
21 benefactor of the transmission upgrade.

22 Our view is that in fact a lot of the
23 transmission upgrades that are needed on the system today
24 will benefit all consumers by increasing that
25 competitiveness of the overall market. In addition there

1 are weaknesses in the transmission system that resulted from
2 failures of planning in the past, failures of coordinated
3 planning in the past.

4 And in order to remedy those, it does not make
5 sense to us nor do we seem -- nor do we believe that it's
6 fair that a municipality who happened to be stuck in that
7 load pocket should be stuck with all the costs of remedying
8 the mistakes of the past. Particularly when you consider
9 the fact that that municipality was probably paying a
10 rolled-in rate in the past that was supporting the building
11 up of a robust transmission grid on some other part of the
12 system. So they come back and say, well, it's unfair then
13 for those users who benefited from that municipality support
14 in the past now to support in part the transmission upgrade
15 that will benefit the municipality in part. I don't buy
16 that there's unfairness there.

17 In point of fact, with the way that the grid was
18 built and funded in the past, all users were supporting each
19 other.

20 So the municipality stuck in the load pocket
21 doesn't want to -- isn't saying that everyone else should
22 pay for an upgrade that's going to benefit them. Rather
23 what we are saying is that in fact the upgrade is one that
24 is going to benefit the system and should be rolled in, and
25 that's where your funding mechanism is going to come from,

1 from the network rate that's being paid by all users
2 connected to the grid.

3 MR. RODGERS: We'll take one more question before
4 we move on to the next panelist.

5 MR. GALLICK: I'd like to take you back to the
6 supply curve. I think what I heard you try to describe
7 would be a supply curve of current suppliers, if you will.
8 And that's okay. But what I was thinking of was how about a
9 supply curve that basically tried to track supplies
10 available to customers who are actually trying to move away
11 from a supplier that's raising price. It's a different
12 supply curve.

13 The initial supply group you're talking about
14 just was sort of a description of how an industry structure
15 kind of supply curve.

16 MR. HEGEDUS: Uh-huh.

17 MR. GALLICK: But a lot of those supplies would
18 not be -- if the concern is, price may go up, and if price
19 goes up, how do those consumers -- how do they avoid the
20 price increase? Well, they have to turn to alternative
21 sellers. But if the supply you were describing perhaps
22 included sellers that were already committed to their
23 buyers, so they're not really available, so you could come
24 up with another notion of a supply curve of who was
25 available out there that could come in at a little bit -- if

1 the price goes up a little bit, and that might give you an
2 idea of the ability of customers to switch. And if that
3 switching capability is significant, then you might conclude
4 that the ability to exercise market power might be less.

5 It's still tricky, because as Dick suggests, you
6 have to go through all those transmission constrained issues
7 and whatnot.

8 MR. HEGEDUS: Right.

9 MR. GALLICK: Is that part of your supply curve
10 notion?

11 MR. HEGEDUS: It certainly wasn't the notion I
12 specifically had in mind in bringing this approach up. But
13 on the other hand, and I think you raise a valid point in
14 terms of getting an idea of who the alternative suppliers
15 were.

16 It's interesting, one of the things when I did
17 investigations at Antitrust was that we would actually
18 interview people, market participants, and we'd ask them,
19 well, if the merging parties try to increase price, where
20 would you go? To whom would you turn? And what you are
21 talking about there is, you know, trying to find an answer
22 to that question. Where would you go, to whom would you
23 turn if you couldn't get -- or the supplies that the
24 dominant seller was trying to -- was putting into the market
25 were increased in price above a competitive level?

1 MR. RODGERS: Thank you very much, Mr. Hegedus.
2 We appreciate that.

3 Why don't we turn now to our next panelist who is
4 Paul Bonavia, President of Commercial Enterprises for Xcel
5 Energy and who is appearing today on behalf of the Edison
6 Electric Institute. Welcome.

7 MR. BONAVIA: Thank you.

8 As Steve said, I am Paul Bonavia. I am with Xcel
9 Energy. We are an investor-owned utility company with four
10 separate operating companies. We are in the MISO, we are in
11 the WECC, we are in the Southwest Power Pool. We see a
12 number of stages of evolution of the market orientation that
13 we're talking about today in that capacity.

14 I am here on behalf of the Edison Electric
15 Institute, a trade association of shareholder-owned
16 utilities and also its affiliate the Alliance of Energy
17 Suppliers which specifically represents unbundled, bundled
18 and independent power suppliers.

19 If you take the EEI membership together, we are
20 the largest segment of buyers out there in the market we're
21 talking about. We also represent the largest segment of
22 sellers. We have a very strong interest in both of those
23 capacities in promoting efficiency, efficient use of capital
24 and assuring fairness. We are also very concerned to assure
25 that any new regulations in the area preserve a wide variety

1 of business models since we represent a wide variety of
2 business models and we think that that is the right thing to
3 do to encourage the sort of innovation that will make a
4 market work.

5 Well, for more than a decade, the Commission has
6 encouraged the use of market-based rates. We've been
7 through a number of proceedings to get where we are today
8 which addressing the adequacy of the currently proposed
9 four-prong analysis deciding whether it ought to be
10 modified. So we would offer a few observations on that.

11 The first prong of the four is generation market
12 power, that's really probably the central point that we are
13 talking about today when the Commission began to move away
14 from the hub and spoke of approach we had concerns that the
15 substitutes did not adequately take into account the legal
16 commitment of the duty to serve, to supply native load. We
17 see in the current order a different approach that the
18 Commission has modified the interim generation market power
19 analysis. We're pleased. We think this is right. It does
20 explicitly account for native load commitments. However,
21 Edison Electric Institute has filed a request for rehearing
22 suggesting that the work is not done, that there are still
23 problems to be corrected and we would urge the Commission
24 not to implement this thing until we've got it right and
25 corrected some problems.

1 Here is what we think to be the issues to be
2 addressed. First, the pivotal supplier screen needs some
3 adjustments. Fundamentally it's on the right track, but
4 there are some specifics about the way it's applied and
5 we've laid those out in the motion for rehearing.

6 Secondly, the wholesale market screen is just a
7 different proposition altogether. It would seem to us that
8 it's simply fatally flawed. I look at how this thing is
9 going to apply in the real world and what I can tell you is,
10 vertically integrated companies where the states as a matter
11 of their public policy, discretion, and jurisdiction have
12 adopted that system are just not going to pass it. You are
13 going to go straight to mitigation. Maybe that's a
14 consequence intended by some, but I don't really think so.
15 I don't really think you want to make it easier automatic to
16 get to cost-based ratemaking and abandon the notion that we
17 can do workable markets. It's not a reliable indicator. It
18 takes into account capacity. It doesn't look at supply and
19 demand conditions at any given point in time. Maybe a given
20 -- might in off-peak seasons be a lot more capacity than
21 there is unserved demand in that market. It's not going to
22 affect prices. So I think what you're going to get is an
23 unreliable output.

24 Third the economic capacity screen of the
25 delivered price test should not be used. It doesn't adjust

1 for committed capacity. You're adding an extra requirement
2 here that really doesn't get you any closer to the right
3 outcome. It's inconsistent with the approach taken on the
4 pivotal supplier screen.

5 And, finally, we believe the Commission should
6 reinstate the RTO/ISO exemption. If those organizations
7 mean anything, if they're really effective, let's give them
8 a chance to work. So we recommend the Commission proceed
9 with a corrected version of the pivotal supply screen.
10 There are different modifications that can be made. We also
11 believe that the Commission has done the right thing and
12 ought to stick with the approach of allowing applicants who
13 fail to screen to demonstrate factually that they do not
14 have market power.

15 We also believe that the Commission needs to take
16 great care in fashioning mitigation measures. And I will
17 say as a matter of my personal view here that probably the
18 most puzzling and troublesome part of the currently proposed
19 interim test is the idea that for long-term transactions,
20 where we find a seller who has flunked the screen, what we
21 do is go back to good old embedded cost-based ratemaking.
22 Let's have cost-based ratemaking. That strikes me as
23 destroying the village in order to save it. We like the
24 competitive system so much that when we find a problem we're
25 going to abandon the competitive system and return to cost

1 of service ratemaking. That does not strike me as
2 practical. It strikes me as an overreaction. I think there
3 are a lot better ways to do it as a default screen.

4 The second prong of the test is transmission
5 market power. The question came up earlier, should a seller
6 who hasn't mitigated be given market-based rates? Well,
7 what does it mean to mitigate? We have Order 888 and open
8 access, we have Order 889, we have order 2000, and the
9 impetus toured RTOs. We have order 2003 now, large
10 generator interconnections. We have the standards of
11 conduct in Order 2004. We have pricing policies that
12 encourage the construction of transmission. There are any
13 number of policy initiatives that the Commission has come
14 forward with already which taken together ought to
15 constitute, if obeyed, if followed, if complied with, ought
16 to constitute the mitigation we're talking about. If they
17 don't then parties have the opportunity to challenge the
18 compliance in fact-specific proceedings. And it is going to
19 be a fact-specific determination whether a given participant
20 in a given instance has violated those provisions and
21 thereby abused its transmission ownership. Let's have the
22 fact-specific proceedings go forward if need be. But I
23 think we've got enough clear policy direction on this point.

24 The third prong of the test, can an applicant
25 erect barriers to entry? I've been in the independent power

1 business as well as the utility business. I've seen what
2 happened in the market in the late '90s and the early part
3 of this century. I think if we look at the real world, we
4 will see that there were not barriers to entry, else we
5 would not have the significant overcapacity that we see in a
6 number of regions. It just didn't happen that way.

7 Frankly, investors would have lost a lot less
8 money if there were greater barriers to entry. They rushed
9 in and built plants that weren't worth what they cost.

10 So we think the Commission has rightly focused on
11 the ability of an applicant to erect barriers, but we just
12 don't see the evidence that we are talking about a huge
13 problem and most importantly the Commission has given
14 parties the opportunity to challenge an applicant and say,
15 you're erecting barriers to entry. If you are out trying to
16 squeeze a municipality to make it sell out, that
17 municipality has the opportunity to come in and put on some
18 evidence of this. Otherwise, I think we have the risk of
19 unduly layering the market with a lot of regulations to
20 solve a problem that no one has demonstrated, at least to
21 me, satisfactorily really exists.

22 We also think the Commission in looking at this
23 entry barrier problem has to be practical and look at the
24 real world which is that the states have significant
25 jurisdiction over a lot of these decisions. The states are

1 diligent, every bit as diligent as this Commission or other
2 policymaking bodies in enforcing their responsibilities and
3 then carrying them out. And that has to be given
4 substantial deference in the world.

5 Fourth prong is affiliate abuse and reciprocal
6 dealing. I know there's a whole panel on that and so I
7 would say briefly that there is a test to determine or to
8 give an applicant an opportunity to prove that it is not
9 improperly engaging in that kind of affiliate abuse. That
10 is the Edgar test. It lays out the process to be used. I
11 think it provides a workable framework, let's let it work.

12 Again, this is an area where, when we look at
13 purchasing power where the Commission is simply bound to
14 give deference to state decisions about procurement. And we
15 think that's consistent with the reservation to the states
16 and power that's part of the Federal Power Act. It's
17 consistent with the provisions of PUCA, specifically Section
18 32K. I also think it's good policy. It is how progress
19 will be made for the type of efficient markets that this
20 Commission would like to promote.

21 And so with that I suspect I've used up my time
22 and more. I thank you so much for the opportunity to be
23 part of this.

24 MR. RODGERS: Thank you, Mr. Bonavia.

25 I have just one or two questions. You stated

1 that the Commission does in -- I think if I heard you
2 correctly, should continue to look at evidence of barriers
3 to entry in assessing whether market-based rate applications
4 should be granted and that intervenors now have an
5 opportunity to raise those concerns under our current
6 process.

7 Mr. Hegedus before you said that FERC should look
8 at evidence of denial of transmission access in granting
9 market-based rate authorization. Is that something that you
10 think the Commission should be looking at; and if not, why
11 not?

12 MR. BONAVIDA: I do think that the Commission --
13 that it's perfectly proper for the Commission to consider
14 whether an applicant for market-based rate authority has
15 violated the Commission's rules. We have open access rules.
16 We have standards of conduct. We have a number of
17 provisions currently on the books that preclude certain
18 abusive behavior. If an applicant has violated those, just
19 like violating any other rule, it seems perfectly
20 appropriate to consider that. But that's a very fact-
21 specific thing.

22 I mean, whether a given applicant in the
23 administration of its tariff has committed violations is
24 going to be highly fact-specific. And I think trying to
25 cast a very broad rule-based net that says, well, okay,

1 we've got all these rules, but, you know, frankly we don't
2 know what to do with them. There's an implicit assumption
3 that the Commission is not competent to enforce its own
4 rules in saying, it's just so risky, let's just do away with
5 their market-based rate authority and then we don't have to
6 mess around with all of these messy and complicated
7 hearings. And I think that's just wrong. I think the
8 Commission is perfectly capable of addressing those matters
9 on a case-by-case basis. If somebody think there's been an
10 abuse, let them prove it.

11 MR. RODGERS: There was discussion by the two
12 previously panelists about the Commission needing to take a
13 more holistic approach in looking at the different aspects
14 of the four-part screen that we have now, and in particular
15 integrating generation and transmission review. Is that a
16 viewpoint that you agree with or, if not, why not?

17 MR. BONAVIDA: I'm not entirely sure what
18 "holistic" means, but, yeah. I mean, fundamentally I do
19 agree with that. I have the dubious role of being the only
20 one on this panel that actually transacts in the markets
21 that we're talking about. I'm not an advisor. I'm not a
22 consultant. I actually do these deals and either get paid
23 or not, based on my success. And when you proliferate a lot
24 of separate tests, it makes the real business of transacting
25 difficult. So a holistic approach, I have to say, is highly

1 appealing where you start to look at this thing as a
2 coherent whole.

3 And I will say that the Commission's -- the use
4 of real-time import capability, let's call it, simultaneous
5 import capability is a nice example of beginning to
6 integrate and holistically look at the transmission market
7 power issue, the generation market power issue together.

8 I will also say that as the world moves toward
9 effective RTOs that giving the RTO a lead role, if not the
10 outright exemption which I think would be the right thing,
11 but giving that RTO the lead role, knowing how RTOs work,
12 when you go to an RTO and you see what they do, they're
13 going to be administering. The market they administer, the
14 flow gate analysis, they do the transmission studies, that's
15 going to get you to a holistic approach. Because the RTOs,
16 that's their business.

17 MR. RODGERS: So you would suggest that the
18 Commission should be more concerned about market power
19 issues and perhaps have a more rigorous test in part of the
20 country where there are not organized markets?

21 MR. BONAVIDA: Yeah. I mean, I think as a summary
22 statement, that's right. I think defining a market for a
23 participant who is part of an RTO as the RTO at least
24 presumptively, subject to transmission constraint, fact-
25 specific analysis, is going to have the effect that you've

1 just described of focusing the hard word somewhere else. I
2 would guess that's how the screens will turn out.

3 MR. BARDEE: Mr. Bonavia, you had during your
4 earlier remarks also said that you in fact wanted us to
5 restore the exemption for RTOs from the analysis. And
6 earlier in our review of these issues, there were some who
7 claim that that exemption was in fact some sort of improper
8 effort by the Commission, ill-motivated effort to push
9 people or strong-arm them into RTOs. Do I take it then that
10 you disagree with that?

11 MR. BONAVIA: I don't think that anything in this
12 proceeding is an ill-motivated attempt by the Commission. I
13 think that the RTO exemption is a sensible outflow of the
14 Commission's policy encouraging RTOs.

15 I know I am told there are legal questions
16 concerning the delegation of authority. I am not actually -
17 - technically I am a lawyer. I don't practice law and I'm
18 nowhere near as smart as the real lawyers here, so I can't
19 comment on the legal issues. But from the point of view of
20 market participant, it strikes me that the centerpiece of
21 the movement to come to effective competition, to mitigating
22 market power, whether it's vertical or horizontal, the
23 centerpiece of that effort is the RTO. A lot of work has
24 gone into this. A lot of work has gone into market
25 monitoring, let's give that some credit and see how it

1 works. Remembering that someone challenging an application
2 can always come in and say, you know, that's not really
3 right. There are flow gates, there are transmission
4 problems, there's loop flow issues, there's load pockets, on
5 a fact-specific basis that RTO exemption can be challenged.
6 But the RTO is the centerpiece of the policy, let's give it
7 a shot to work where they're in effect.

8 MR. RODGERS: Dick, you had a question?

9 MR. O'NEILL: Paul, let me start with a point of
10 agreement. I think going to cost-based regulation as a form
11 of mitigation should be a last resort. There's other ways
12 to mitigate market power that I believe are far better. It
13 appeared you did a lot of work in studying the tests that
14 were in the last order, but you didn't mention anything
15 about the transmission assumptions. So I assume that you
16 feel quite comfortable with those assumptions. But Mark
17 just a little while earlier argued that you had to look at
18 the facts of the specific case.

19 Do you think our transmission assumptions square
20 up with the historical access that people have had to
21 transmission?

22 MR. BONAVIDA: I need to make sure I know what
23 exactly you mean by "transmission assumptions". Because my
24 answer might not really reflect your question.

25 MR. O'NEILL: Well, all of our tests have

1 implicit transmission assumptions of one nature or another.
2 And you apparently have studied them very carefully. I was
3 just wondering if you agree with the transmission
4 assumptions.

5 MR. BONAVIDA: I don't want to hold myself out as
6 an expert on that, but I will say, first of all, assuming
7 the transmission is the critical piece of defining the
8 market and that you do need to look not just at total
9 transmission capability, you know, that's posted on an oasis
10 out there, but you need to get down to the real-time sort of
11 analysis that's reflected in simultaneous import capability.
12 I think that's a very good assumption. That's sensible,
13 it's going to get you to something that's much more accurate
14 in defining the market and the role of participants in the
15 market.

16 I think the assumption -- open access does
17 mitigate vertical market power, is a very good assumption.
18 Else, why do we have all these rules if we don't really
19 think they're going to get us somewhere. I also think
20 giving people the opportunity to challenge that on a fact-
21 based specific case is inevitable. It's assumed --

22 MR. O'NEILL: So, if in fact the historical
23 access to transmission didn't sync up with the assumptions
24 in the test, we should modify the assumptions?

25 MR. BONAVIDA: I mean, again, forgive me if I

1 don't -- I want to give you a straight answer, it's just
2 that I'm not sure I really know what all of that historical
3 data is. But I would say yes to your point if the
4 historical information tells you a story that's inconsistent
5 with what's in the rule. That's troubling.

6 You know, one of the points that my EEI
7 colleagues there have made in this motion for rehearing is
8 you also do have to look out in the future a little bit took
9 where you know things, where new construction, new
10 capability comes on line, that's also got to be a factor.

11 MR. RODGERS: Jon.

12 MR. OGUR: You have agreed -- Dick and you have
13 agreed that that there are better alternatives than --

14 (Simultaneous conversation.)

15 MR. BONAVIDA: We frequently agree.

16 MR. OGUR: -- if someone flunks the test, I'm
17 just curious what examples you had of what you thought were
18 the better alternatives that we should perhaps consider?

19 MR. BONAVIDA: Very good question. And this is
20 going to be one where I think the structure or the interim
21 test is pretty sane in allowing people to propose mitigation
22 tailored to the facts. I suspect that a lot more creative
23 minds than mine will come up with some really good ideas.
24 There's got to be a way, I think, maybe it's some form of an
25 up-to rate. Maybe it's something more flexible than

1 imbedded cost ratemaking. Maybe it's some kind of
2 mitigation over the transmission system or creating a market
3 of some of the things that have been suggested. I'd say all
4 of those things are food for thought.

5 On this point about embedded cost ratemaking,
6 being the last resort. And consider the dynamics of that
7 and then I'll try and turn that into a better answer. Let's
8 say, and some of our members are in this position, some of
9 my own operating companies are, we are a vertically
10 integrated company. That means the states in question have
11 made that determination as a matter of their public policy
12 authority. That's what they want, so that's what we've got.
13 And I've advocated competition in a lot of those states,
14 frankly, and not successfully. I've been opposed by members
15 who are represented by other panels here and there. But,
16 okay, that's what you've got.

17 By definition, you are going to have a vertically
18 integrated utility that has a substantial part of the
19 capacity and that's just the way that regime works. You're
20 going to see that over and over again. And that means,
21 okay, if that utility flunks the screen, now we're into
22 mitigation. If you do a long-term transaction often it's
23 with a sophisticated party, parties who are represented by
24 people like you see at this table. They're able to make
25 choices in a market. If you say, well, in effect, we're

1 going to take this market, we're one of the large suppliers,
2 the utility, cannot sell at market-based rates, but is going
3 to have an offer out there, if at all, based on embedded
4 cost ratemaking. I really think you're casting a shadow
5 over -- you're creating a barrier, you're creating an entry
6 barrier to real competition in that region for a long time
7 to come.

8 As I said, I've been in the independent power
9 business. If I want to go build something, I probably don't
10 want to go build it in a region where the incumbent large
11 utility is offering average embedded costs for long-term
12 power sales. Pretty tough to compete with that. You all
13 know how that works, right? Average embedded costs is an
14 accounting concept. It's not about supply and demand. It's
15 not about clearing the market, it's not about price signals.
16 It's about what is the historical cost on the books of that
17 company.

18 If you have old units they're highly depreciated.
19 You have all of that old stuff on there that goes into the
20 calculation of average embedded cost. The fact is, if I'm a
21 competitor, I'm going to have a hard time competing with
22 that. And the very fact that that's the only price that
23 that incumbent large supplier is allowed to offer is going
24 to have an effect on the dynamics of supply/demand/price
25 competition. It's going to skew the market. It is going to

1 skew the market because you've got one big player who can
2 only offer pricing on that one basis. And, you know, the
3 states, you're not giving the states an incentive to move
4 toward competition because the ones who have a vertically
5 integrated regime, they work on embedded costs. That cost
6 of service ratemaking.

7 So I think you're going to balkanize the market
8 as a whole by creating these regions where competition is
9 not likely to flourish.

10 MR. RODGERS: If I understand you correctly, then
11 in regions of the country that are dominated by vertically
12 integrated utilities -- especially those with older units,
13 the average embedded cost rate is lower than the market-
14 based rate?

15 MR. BONAVIDA: Often it will be. Yes, sir. If
16 I've got a 70-year-old coal plant that's been depreciated
17 down, it's tough to compete with that capacity.

18 MR. RODGERS: And so by granting market-based
19 rate authority to entities -- to those entities. Those
20 vertically integrated utilities, we're allowing them to
21 charge what will almost certainly be higher than cost-based
22 rates?

23 MR. BONAVIDA: Might be higher, might be lower,
24 but it will give a price signal to stimulate investment and
25 that's why markets exist. It will allocate resources more

1 efficiently than using historical accounting as the pricing
2 concept.

3 Markets are about efficient allocation of
4 resources.

5 MR. RODGERS: One more question then we'll go on
6 to the next panelist.

7 MR. PERLMAN: I guess two questions real quick.
8 The first one is, we talked about the holistic approach and
9 you said that those things should be looked at. But we
10 heard from Mr. DeRamus earlier today that he was interested
11 in looking at monopsony power and vertical foreclosure and
12 things of that nature. Do you agree that in this holistic
13 analysis that would take into account all issues that those
14 would be things the Commission should look at?

15 MR. BONAVIDA: I agree that somebody should look
16 at that. And in the regions where a state has adopted a
17 procurement regime, either a competitive procurement process
18 or exercised its authority to have the last word on resource
19 decisions. And, by the way, that is the real world. When
20 we make a resource decision, whether it's purchasing from an
21 independent or a co-op or a municipal, or building ourself,
22 whatever it may be, we don't have the last word, the state
23 commission does. It has a state law in effect, it has a
24 process, it has a public policy agenda. And where all of
25 those things are present, I think to come in and conduct, at

1 least what I consider to be a somewhat arid economic
2 analysis of the market and layer that on top of the very
3 practical state resource planning decision that's already
4 taken place is going to create a lot of conflicting signals.
5 It's going to be very difficult to deal with. It's going to
6 raise costs and costs are a barrier to entry. It's going to
7 make this harder to do.

8 MR. PERLMAN: I interpret what you're saying as
9 if the state is doing those types of things, then we should
10 not look at monopsony power?

11 MR. BONAVIDA: The Commission ought to give
12 significant deference. It doesn't mean you don't -- that
13 it's not a subject that's relevant, it means that where a
14 state has undertaken that responsibility you should give
15 deference.

16 And let me tell you the difficulty from a
17 practical point of view of living with all this. Again, I
18 only have the benefit of knowing how we actually do things
19 out there. The difficulty is that states in their wisdom,
20 and they have authority to make policy in our federal
21 system. They often have agendas which are different from,
22 not perfectly congruent with the kind of analyses of
23 monopsony power that we're talking about here. States have
24 legislation that deals with renewables mandates, it deals
25 with economic development, it deals with tax base, it deals

1 with air quality. There are a whole load of public policy
2 issues, very legitimate ones that are part of that state
3 resource planning process.

4 MR. PERLMAN: I understand --

5 MR. BONAVIDA: Then to come back and say, well,
6 yeah, okay, but you've got monopsony power and I tried to
7 paraphrase something I heard before, the incentive to
8 monopolize in vertical markets is often derived from cost-
9 of-service regulation. I don't know if that's true or not.
10 But you're going to have to go to the state legislature and
11 explain to them that cost of service regulation is a bad
12 thing and persuade them to drop it. Or cost of service
13 regulation is what you will, in fact, really be dealing with
14 out there. And the states feel they're competent to
15 administer it.

16 MR. PERLMAN: The other question I have is -- I'm
17 clarifying. I wasn't trying to -- I was arguing about cost-
18 of-service at the wholesale level. I wasn't trying to --
19 have

20 MR. BONAVIDA: I was actually paraphrasing
21 somebody else --

22 MR. O'NEILL: In any state proceedings, that's
23 their choice. But I think at the wholesale level it's not a
24 good idea.

25 MR. BONAVIDA: And, again, how do you -- how do

1 you reconcile a mandate or a policy determination to promote
2 competition at the federal level with the agendas of a state
3 legislature which are equally legitimate. And it's
4 difficult. And the urging that I would give you is, the
5 states are there, they have their rules, that's how this
6 stuff really works, and it is an area where, for a lot of
7 good reasons, deference is the appropriate thing.

8 Among others, if the Commission finds itself at
9 odds, I mean, what happens if you do one of these monopsony
10 screens and say, well, okay, no, no, you can't build. This
11 utility can't build a power plant. Or this utility can't
12 buy from its neighboring co-op. We find that transaction
13 inappropriate. What happens if the state has already
14 approved it? Now what do we do? I mean, it is an area
15 where practicality suggests you've got to bring the states
16 along, have dialogue with them and work with them.

17 MR. PERLMAN: I think all he was saying was that
18 we take the facts on the ground, don't second-guess the
19 state policies, accept the state policies and look at the
20 outcomes that those state policies would have for an
21 analysis of market power recognizing their wisdom and giving
22 them deference, and then making appropriate judgment, taking
23 into account those facts and not ignoring them. And
24 whatever policies would stem from that at the federal level
25 would. But I don't think it's necessarily he's saying that

1 there's a conflict, it's just what do we do with it once we
2 get to that point?

3 MR. BONAVIDA: Well, if though we're looking --
4 and I'll tell you the part that's troubling to me about a
5 lot of this discussion, and it's mostly troubling because
6 I'm ignorant relative to the others on this group. I'm not
7 an economist, but so many of these screens, and so many of
8 the rationales are predicated on the potential for abusive
9 behavior or the incentive for abusive behavior. Not the
10 proof that it's happened, but, gee, look at the way this
11 works, they have an incentive to do it. And where you say,
12 okay, that's a perfectly good starting point to make policy,
13 let's look at the incentives and the potentials and you then
14 go on and say, cost-of-service ratemaking creates that
15 incentive. Cost-of-service ratemaking is not something that
16 a market participant gets to decide. It's decided by a
17 state. And if you're going to create an environment where
18 that market participant will have a very difficult time
19 passing one of these potential abuse-based screens because
20 the state has decreed a certain regime, it's you're going to
21 wind up with a lot fewer market-based rate participants
22 among the bigger players.

23 So please don't destroy the village in order to
24 save it.

25 MR. RODGERS: I had a follow-up question on that.

1 If I'm understanding you correctly, cost-based regulation is
2 sort of the way it out there in the real world for retail
3 rates that are set by state regulatory commissions and that
4 FERC should give recognition of that and deference to that
5 fact as we go about looking at market power.

6 But at the federal level in terms of looking at
7 wholesale sales, we should allow market-based rates and even
8 though those are higher than cost-based rates.

9 MR. BONAVIDA: Or lower.

10 MR. RODGERS: Right. But you said earlier --

11 MR. BONAVIDA: You defined the Mountain View case,
12 why was that case decided the way it was? It's because they
13 can be higher or lower.

14 MR. RODGERS: But you said earlier, if I
15 understood you correctly, that in parts of the country where
16 the sales are being made from older units that are pretty
17 much depreciated that the market-based rate would typically
18 be above the cost-based rate, you thought.

19 MR. BONAVIDA: It's tough to compete with and that
20 -- it's on that embedded cost rate becomes almost like a
21 standard offer that sits out there in the market. And it
22 will affect the pricing behavior of the other participants.
23 That's what I'm saying, you will skew the market with that.

24 MR. RODGERS: Well, I'm trying to understand why,
25 if the sales of power to retail customer and wholesale

1 customers are essentially made from the same fleet of units,
2 why it's appropriate and right that states can set a cost-
3 based retail rate, but it's not right that FERC would set a
4 cost-based wholesale rate.

5 MR. BONAVIDA: You know, the FERC is certainly
6 perfectly free to set a cost-based wholesale rate and it's
7 not me that decides that that's not the way to go. The
8 entire thrust of where the FERC has been going for the past
9 ten years is to try and encourage markets to develop on the
10 premise that that's a more efficient way to allocate
11 resources, stimulate innovation and all the other things
12 that we're all familiar with. And what I'm saying is, when
13 you run into difficulties in making this work, and the world
14 is a complicated place, there will be difficulties, there
15 will always be difficulties. If there are not, economists
16 and lawyers will find them. So there will always be
17 difficulties, if at the sign of the difficulty the default
18 remedy is to abandon the movement to market-based rates and
19 say, fine, we'll just have embedded cost based ratemaking.
20 That's our remedy. It just strikes me as completely
21 inconsistent with what this Commission is attempting to do.
22 It strikes me as an impractical remedy. Because it cuts
23 against the thrust that this Commission has defined.

24 MR. RODGERS: I understand your --

25 MR. BONAVIDA: And which I think is right. I

1 think the Commission is right. So, please be careful with
2 that kind of a remedy.

3 MR. RODGERS: Just one point of clarification, if
4 my reading of Commission orders is correct, we would only
5 propose that remedy which I understand you view as kind of
6 harsh in situations where the Commission has determined that
7 market power exists that otherwise is not mitigated.

8 MR. BONAVIA: Yes.

9 MR. RODGERS: I think Dave had one follow-up
10 question.

11 MR. PERLMAN: I have one follow-up question just
12 to understand your perspective on one issue. You had talked
13 about a lot of the rules like the behavior rules and the
14 transmission access. And what you said was, "those are good
15 rules, let's go with those rules. But what's important is
16 that there's an opportunity if someone has a specific
17 problem to come back, raise that problem, we'll get into the
18 facts, and we'll get to an outcome that's more
19 representative of the specific than the general if we have a
20 problem.

21 But you also criticize the interim screen with
22 respect to the market shares. And do you feel differently
23 about that one? Because that one is just indicative as
24 well, and if that is showing a false positive, there's an
25 ability to come in and address that issue with the specific

1 from the general and it seems like potentially you're making
2 it a different standard for use of that screen than the
3 other rule. So if you could clarify that.

4 MR. BONAVIDA: Fair point. Fair point there. You
5 do have to take into account that people are allowed to
6 address the specifics of the situation if they pass the
7 screen or fail the screen. Someone is allowed to come in
8 with specifics. So I think your point is well taken. I
9 guess though that what tips the market share screen off the
10 table in my mind is simply that it's just so inaccurate.
11 It's just going to give you so many false readings, there
12 are so many flaws in it that at some point the weight of all
13 of that makes it not useful. It's not going to promote the
14 objective that you're trying to accomplish. You know, the
15 pivotal supplier screen isn't perfect either, but I see the
16 balance tipping the other way. I think there's more value
17 there than in the accuracy.

18 So, yeah, I think your point is well taken. But
19 I do think there are so many problems with that market share
20 that it's just not going to help.

21 MR. RODGERS: Thank you very much, Mr. Bonavia
22 for coming today and for your comments.

23 We are going to turn next to Robert Waushara who
24 is with the firm of Mines, Wallace & Natick and who is
25 appearing today on behalf of industrial customers. And what

1 I'm going to do is immediately after you're done with your
2 presentation, Mr. Weishaar, we are going to go straight to
3 the presentations of Mr. Morey and Mr. Wroblewski and then
4 have a Q&A discussion for all three of you after that, just
5 for considerations of time on the Q&A part. So, I'll
6 introduce Mr. Morey and Mr. Wroblewski later, but for now I
7 give you Robert Weishaar.

8 Thank you.

9 MR. WEISHAAR: Thank you. Good morning,
10 Commissioners, Commission staff, fellow panelists. I am Bob
11 Weishaar, McNees, Wallace & Nurick. Our firm represents
12 several regional coalitions of industrial customers
13 throughout the eastern interconnection. We represent
14 industrial customers in regions where ISOs or RTOs exist and
15 in regions where they do not.

16 My comments today reflect the input of those
17 industrial customers.

18 We believe that any analysis of market-based rate
19 authority must begin with the principal that market-based
20 rate authority is a privilege, not a right. You heard this
21 from Mr. Hegedus. We did not collaborate in the preparation
22 of our comments.

23 The distinction is important. It means that
24 market-based rate authority need not be given unless it
25 ensures just and reasonable outcomes and that it can be

1 taken away. A long line of appellate precedent leaves no
2 doubt that the Commission remains under a statutory
3 obligation to ensure just and reasonable prices even in
4 competitive markets and prices are only just and reasonable
5 in a competitive context if market power is either non-
6 existent or has been sufficiently mitigated.

7 We believe that to facilitate administration of
8 this statutory responsibility criteria for market-based rate
9 authority should be set forth in Commission regulations
10 after a notice and comment rulemaking process and the
11 Commission should work through this process expeditiously.

12 It clearly and unequivocally bear the burden of
13 demonstrating that granting them market-based rate authority
14 would promote the Commission's statutory obligation of
15 ensuring just and reasonable prices.

16 Our comments today are organized into two main
17 areas consistent with the structures that we have seen in
18 the eastern interconnect. I will begin with those areas in
19 which ISO or RTOs do not exist.

20 In areas where an ISO or an RTO has not assumed
21 operational control of transmission facilities, the exercise
22 of vertical market power in our opinion remains the single
23 greatest obstacle to competitive market development.
24 Transmission remains a natural monopoly. Transmission
25 market power and I think there was a question in a

1 supplemental notice to this effect really is vertical market
2 power. And vertical market power is exercised or can be
3 exercised by transmission owners to favor their own
4 generation. That is the problem that needs to be addressed.

5 In our opinion the pro forma OATT provisions
6 promulgated under Order 888 did not and will not eliminate
7 the potential to exercise vertical market power. Vertical
8 market power can be exercised in real time decisions about
9 available transfer capability. Vertical market power can
10 influence generation interconnection decisions and the
11 Commission's recent Orders 2000 and 2003 -- 2003 and 2003-A
12 recognized that phenomena. We note that both orders were
13 issued well after the issuance of Order 888. And Order 2000
14 was deemed necessary because the protections Order 888 were
15 deemed a first-step in the process, and insufficient to cope
16 with evolving electric power markets.

17 Vertical market power can be addressed only by
18 divorcing monopoly control of transmission facilities from
19 control of generation. This can be accomplished through the
20 transfer of operational control to an approved ISO or RTO.
21 Or it can be accomplished at the transmission owner's choice
22 through outright divestiture of transmission facilities to a
23 non-market participant.

24 Unless and until vertical market power is
25 addressed, a vertically integrated utility should not be

1 granted market-based rate authority. And only after
2 resolution of vertical market power can the Commission
3 proceed to the next stage of the analysis, i.e., whether an
4 applicant has the ability to exercise horizontal or
5 generation market power.

6 Let's shift to regions with ISOs and RTOs. In
7 areas where a Commission approved ISO or RTO has assumed
8 operational control generation market power and even on
9 occasion some residual vertical market power remain ongoing
10 and serious concerns. There is ample evidence of market
11 power being exercised in immature and transitioning ISO or
12 RTO coordinated power markets, and historically,
13 particularly in markets associated with resource adequacy
14 products.

15 IAO and RTO coordinated markets are still very
16 much in transition. We see entire new markets being added
17 as in the case of the Midwest, new market products being
18 added elsewhere, the evolving ancillary services markets in
19 New England, for example, and incremental changes in market
20 rules on an almost constant basis. Even in PJM since the
21 inception of L&P-based markets we have seen more than 100
22 market rule changes and that is in a three- or four-year
23 period.

24 ISO and RTO coordinated markets are by no means
25 perfectly competitive markets. We also note that the last

1 bid-in market structures now in place in New England, New
2 York, and PJM and proposed for MISO are premised upon the
3 critical assumption that that bid-in reflects the true
4 marginal cost of the least-efficient unit that must be
5 dispatched to meet load. And that mechanism by focusing
6 singly on that last bid in has the ability to amplify any
7 exercises of generation market power.

8 For example, just one 30-megawatt peaking unit
9 exercising market power that sets the market clearing price
10 can produce unjust and unreasonable outcomes for tens of
11 thousands of megawatts of load in a single hour. We note
12 this to emphasize the point that a last bid-in clearing
13 mechanism heightens the importance of market-based rate
14 reviews.

15 We also note that ISO and RTO coordinated markets
16 having been approved by this Commission at least in part to
17 generate production cost efficiencies have actually resulted
18 in increases in retail customer costs. If the production
19 cost efficiencies are occurring what we are seeing at the
20 retail level is they are being absorbed by generators and
21 suppliers before reaching retail customer prices.

22 Over the past few years market mitigation rules
23 and market monitoring units and even Commission orders have
24 been focused inordinately on load pocket issues and we've
25 seen a preponderance of them coincidentally along the I-95

1 corridor in the eastern part of the United States. Likewise
2 the Commission's proposed screens for market-based rate
3 applications must not overlook load pocket issues. Defining
4 relevant markets based on ISO or RTO boundaries and then
5 placing the burden of load pocket issues on intervening
6 parties will not get the job done.

7 Each applicant must be required to demonstrate a
8 sufficient market area through its initial application.
9 Market-based rate authority should not be granted until the
10 Commission has established a sufficient evidentiary record
11 to conclude that an applicant cannot be a pivotal supplier
12 in any load pocket at any time. The Commission should not
13 throw away a vital first line of defense, i.e., the market-
14 based rate review process and rely solely on the second line
15 of defense; i.e., market mitigation rules or market
16 monitoring units in ISO or RTO regions.

17 We also have a few retail customer's specific
18 issues that we request the Commission keep in mind as it
19 moves forward in a rulemaking process.

20 First, the Commission should defer to any state
21 requirements that obligate utilities with provider of last
22 resort obligations to use previously rate-based generation
23 to provide default service.

24 Second, any new regulations or market-based rate
25 authority should continue to respect the PURPA and PUCA

1 constructs that exempt qualifying facilities from the
2 market-based rate review process.

3 Third, the Commission should consider allowing
4 non-generation owning retail customers in retail access
5 states to make sales for resale up to their peak loads
6 without triggering FERC supplier licenses, or a market-based
7 rate authority review requirement. We believe that this
8 change would facilitate retail customers' procurement of
9 blocks of power, promote longer-term contracting with
10 merchant generation, a desire we've heard on repeated
11 occasions, and help to reinvigorate what is increasingly a
12 lack of market liquidity.

13 Thank you again for the opportunity to present
14 the industrial customer perspective on this complex, yet
15 critical, market issue. I look forward to your questions.

16 MR. RODGERS: Thank you, Mr. Weishaar.

17 Why don't we go next to Matthew Morey, who is a
18 senior consultant with Laurits R. Christensen Associates,
19 and who is appearing today on behalf of the National Rural
20 Electric Cooperative Association. Welcome.

21 MR. MOREY: Good morning. Thank you for the
22 opportunity to participate in this conference and to speak
23 on behalf of the National Rural Electric Cooperative
24 Association.

25 NRECA's comments to the Commission in previous

1 docket represent interest in this rulemaking that fall on
2 both sides of this issue. Therefore NRECA must view the
3 issues raised in this rulemaking through an objective lens
4 focused by what I believe are sound economic principles that
5 achieve a balance of those diverse interests that NRECA
6 represents.

7 NRECA and I commend the Commission for the steps
8 it has taken thus far. The April order make, I believe,
9 some improvements to the prior SMA screening regime
10 including requiring utilities, at a minimum, to pass both
11 indicative screens, the use of simultaneous import
12 capability and eliminating the blanket exemption from
13 applicants who supply in RTO regions.

14 However, despite this progress the Commission, I
15 believe, must reach beyond the April 14th order, if it does
16 not, I think it's ability to identify market power and to
17 act to mitigate it will be impaired.

18 In the time remaining in my opening remarks I
19 will focus predominantly on the first prong of your four-
20 part, four-prong test which looks at generation market power
21 and talks specifically about some of the problems that I see
22 with the indicative screens and makes some recommendations
23 for improvements in those.

24 You will find that in making those
25 recommendations, you will find that I am agreeing with some

1 of our panelist here and disagreeing with others. I'll give
2 you about six or seven, maybe eight problems that I see very
3 quickly here. First the current default, and you've heard
4 this before, the current default relative to geographic
5 markets, I believe, are in error. The relevant geographic
6 markets are determined, as you probably already know, by the
7 grid topology. That is the physical constraints and the
8 operational limitations of the grid.

9 In addition, the entire RTO footprint should not
10 be used as the default relevant geographic market unless it
11 could be shown that there is no significant chronic
12 transmission constraints or load pockets. You can consider
13 Midwest ISO as an example of that.

14 Second, the two screens do not fully capture the
15 impact of market concentration that can create conditions
16 for parallel or collusive behavior. In other words, the two
17 screens really, by themselves, I don't believe, are
18 sufficient to do the job that you want this MBRA process to
19 do.

20 Three, the Commission should not assume that
21 generation market power by MBR applicants selling into RTO
22 regions will be sufficiently mitigated by the RTO's own
23 market mitigation regime. Rules -- I'm thinking of some
24 rules in particular. Rules that permit a 300 percent
25 increase in price relative to an historical reference price

1 create opportunities for market power to be exercised.

2 Number four, the deduction of capacity tied to
3 long-term firm requirements in non-requirement sales from
4 the wholesale market I believe is inconsistent with the
5 Commission's recognition of the need to examine market power
6 in longer-term markets. Long-term sales obligations may
7 affect market power incentives in short-term markets, but
8 they don't eliminate incentives in long-term markets.

9 Number five, defining the pivotal supplier screen
10 according to the prevailing month and the peak month misses
11 the majority of situations throughout the year in which a
12 dominant supplier could exercise market power. The ability
13 to exercise market power changes over time. And screens, I
14 believe, must recognize this dynamic nature.

15 Six, the Commission's order is unclear, at least
16 to me, about what adjustments should be made to simultaneous
17 import capability.

18 Number seven, the screening process, I believe,
19 is still somewhat burdensome for small applicants, even with
20 simplifying assumptions.

21 Number eight, the 21 days that are proposed for
22 non-applicants to prepare analyses provides, in my opinion,
23 insufficient time for many non-applicant, and without access
24 to requisite data, non-applicants, I believe, will find it
25 difficult, if not impossible, in that timeframe to prepare

1 their own analyses.

2 The rulemaking itself, I think, initiates a
3 longer-term fix to the shortcomings of the present and past
4 approaches. So what is it that needs to be done?

5 I submit that the Commission develop a more
6 comprehensive set of assessment tool. I recommend the
7 Commission study the preliminary blueprint for addressing
8 generation market power issues submitted in February that
9 was prepared for NRECA by my colleagues the Christensen
10 Associates.

11 It doesn't answer all the questions, but it does
12 establish a set of principles and an agenda that I think
13 could be laid out in this rulemaking for accomplishing what
14 the Commission seeks to do. So now here are some of my
15 suggestions for fixing some of the problems.

16 First of all fix the relevant -- the definition
17 of the relevant geographic markets. For the immediate
18 future I think you could define geographic markets for
19 energy and operating reserves -- I wouldn't leave operating
20 reserves out of this -- according to a widely perceived
21 transmission constraint defined boundaries. A lot of those
22 have already been established in many studies.

23 And then for the longer-term, initiate a process
24 for developing power engineering criteria for objectively
25 determining the boundaries of geographic markets.

1 I think it might be useful as well to specify
2 some standards and methods by which these geographic markets
3 are to be defined and leave applicants really a little
4 discretion on how to go about doing it. Lay out the rules
5 for how it should be done.

6 Second, I think you ought to incorporate a
7 measure of market concentration in the screening process. I
8 think you ought to augment the two screen with concentration
9 metrics such as the HHI. But at the same time reassess in
10 light of this addition what criteria would be used to
11 determine whether an applicant passes the screen, fails the
12 screens, or is subject to additional analysis or ultimately
13 mitigation.

14 To improve the screens through the introduction
15 of other types of concentration indices such as those
16 discussed in the blueprint, the incremental capacity HHI,
17 minimum number of pivotal supplier metric, and the pivotal
18 supplier HHI, all of which get at concentration in much more
19 subtle ways than the standard conventional total capacity
20 HHI.

21 Eliminate the RTO mitigation safe harbor. MBR
22 applicants supplying RTO markets with Commission-approved
23 monitoring protocols should not be automatically exempt from
24 mitigation without showing that the RTO's protocols are
25 sufficient to mitigate the market power.

1 Four, refine the definition of uncommitted
2 capacity. For example, I think it's only appropriate to
3 deduct capacity associated with firm, long-term commitments
4 where the seller has turned over dispatch rights to a buyer
5 where the capacity is covered by a tolling agreement which
6 controls output pricing decisions. I think this was
7 discussed earlier.

8 Number five, recognize the dynamics nature of the
9 power markets. The screen should examine market power, in
10 my opinion, for the on-peak and the off-peak seasons or
11 periods of the different seasons. The Staff Paper's
12 proposal, if you recall, proposed to conduct the pivotal
13 supplier analysis in each month. And I think this was more
14 appropriate and I think it ought to be adopted.

15 A monthly analysis is particularly important to
16 gauge the effect of outages. So the PSS, I believe should
17 be conducted on a monthly basis and reflect planned outages.

18 Clarify the adjustments to the simultaneous
19 import capability. Whatever is going to be included,
20 determine what would be deducted after an appropriate load
21 flow study has been conducted.

22 And I think you ought to provide a safe harbor
23 for small applicants, some of these applicants are not in a
24 position and don't have the data or the resources to fulfill
25 this requirement. I think there should be some kind of

1 limited review unless, of course, special circumstances
2 would prevail that require further analysis.

3 Number eight, provide access to the relevant
4 data. For non-applicants to intervene and participate in
5 this process, I think they should be given more time with
6 which to prepare their analyses. And in fairness to them, I
7 think that the clock really shouldn't start ticking until
8 all the data has been presented by the applicant in the
9 process.

10 There is one other question the Commission had
11 asked in the supplemental notice that I think may require
12 some response here immediately. You asked, what's the role
13 of the merchant transmission investment in mitigating market
14 power. I think you've really struck on probably the key --
15 the fundamental issue here which is the transmission
16 expansion policy. And I think that's absolutely pivotal.
17 The market power is a structural problem for the most part.
18 The solution as well, for the most part is structural and
19 transmission expansion policy is central to the long-run
20 policy on wholesale market power mitigation because it
21 really goes to the root of the problem, barriers to entry
22 and therefore barriers to competition.

23 While I believe there is a role for merchant
24 transmission in the expansion to grid in increasing
25 competitiveness of wholesale markets, I don't think that the

1 Commission can rely on independent market merchant projects
2 to solve the systemic market power problems in most parts of
3 the country. The market risk is too high in light of all
4 unique externality in market failure problems that are
5 associated with grid investment. However, as NRECA has
6 suggested, through a roll-in pricing policy, the Commission
7 could provide encouragement for third-party transmission
8 investment, especially in cases where incumbent utilities
9 declined to undertake an expansion project that has passed
10 the benefit-cost test in a regional planning process. The
11 greater certainty associated with that, I think, with regard
12 to cost recovery could attract the needed investment dollars
13 and benefit consumers within the regional footprint and in
14 the long-term mitigate market power structurally as opposed
15 to the kinds of behavioral remedies or other kind of
16 mitigation -- short-term mitigation proposals that we've
17 been discussing here today.

18 With that I conclude my opening remarks. I thank
19 you for the opportunity to participate on this panel and I
20 look forward to further discussion.

21 Thank you.

22 MR. RODGERS: Thank you, Mr. Morey.

23 Next we're going to go to Michael Wroblewski who
24 is Assistant General Counsel with the Federal Trade
25 Commission. Welcome.

1 MR. WROBLEWSKI: Thank you. Thank you for
2 inviting me to speak at today's conference. Before I begin,
3 I must give the standard disclaimer that the remarks I make
4 today are my own and do not necessarily represent the views
5 of the Federal Trade Commission or of any individual
6 Commissioner and I take full responsibility for all the
7 mistakes that I will make.

8 The purpose of this session is to address whether
9 there are potential new analytical methods for assessing
10 markets and market power in the context of whether
11 electricity suppliers should have the ability to offer
12 supply market-based rates.

13 As both FERC and the Antitrust Agencies have
14 observed repeatedly, competitive markets are attractive
15 because in such markets private profit incentives are
16 aligned with customer interests in lower prices, improved
17 services, and increased innovation. The point is, if FERC
18 gets market power assessments correct, then the job of
19 ensuring just and reasonable rates are made much easier.

20 Accurate market power assessments provide FERC
21 with information on which to base sound regulatory policies
22 to foster competition in wholesale electricity markets.

23 FERC's current four-prong analysis of market
24 power generally corresponds to the examination of market
25 power in the field of industrial organization economics.

1 There is no need to redo the four-prongs that examine
2 generation market power, transmission market power, the
3 ability of the applicant to create barriers to entry, and
4 affiliate abuse or reciprocal dealing.

5 What may need updating, however, are the screens
6 of the thresholds that correspond with each prong of the
7 analysis. In the last 15 years since FERC has adopted the
8 four-prong test, wholesale market operations have evolved
9 and FERC has gained significant experience in monitoring
10 these markets. To correspond to these changing
11 circumstances FERC has undertaken several regulatory
12 initiatives to ensure market power at any level.

13 Transmission and generation do not hinder operations with
14 the anticompetitive effect of reducing output or increasing
15 prices. These efforts include Orders 888, 889 and 2000 as
16 well as the advised merger policy statement, standard market
17 design proposals, interconnection standards, revised codes
18 of conduct, and the solicitation processes issues that are
19 being addressed here tomorrow.

20 Through the course of these initiatives FERC has
21 made progress in identifying best institutions or best
22 practices that relate to each of the four prongs. In
23 specifying criteria for granting market-based rates, FERC
24 may wish to capitalize on this progress by establishing
25 screens or benchmarks derived from its efforts to foster

1 competition in wholesale electricity markets. With this in
2 mind, FERC may wish to adopt various rebuttable screens with
3 respect to each of the four prongs.

4 Let me touch on the screens for generation market
5 power, transmission market power, and barriers to entry. My
6 colleague at the FTC, John Hilke, will discuss the fourth
7 prong, affiliate abuse and reciprocal dealing in his
8 comments tomorrow.

9 For the generation market prong, FERC has
10 recently adopted interim standards for assessing generation
11 market power. The revisions are aimed at determining more
12 accurately whether an applicant has horizontal market power
13 in generation services.

14 We note that FERC has adopted screens and not
15 only focused on unilateral exercises of market power, but
16 also the risk of coordinate interaction. This is a sound
17 addition to FERC's analysis. Although for assessing the
18 risk of coordinate interaction, it may be better to focus on
19 a concentration measure such as HHI rather than solely on a
20 market share test that does not reflect whether a market is
21 conducive to coordination.

22 We also commend FERC for limiting the use of its
23 market power screens to establish a rebuttable presumption
24 about generation market power. This approach provides
25 opportunities for firms that fail these screens to

1 demonstrate through more refined techniques that they do not
2 have generation market power or for intervenors to
3 demonstrate that a firm has generation market power even if
4 it has passed the screens.

5 Delineating relevant product and geographic
6 markets for several reasons. First the screens assess
7 market power based on annual, uncommitted peak demand or
8 seasonal uncommitted capacity. These limited delineations
9 of relevant product markets do not account for when and at
10 what price an applicant will deploy its capacity at and
11 under various conditions throughout the year. Thus, FERC's
12 assessment of market power doesn't accurately reflect the
13 range of products that suppliers sell.

14 Second, there does not appear to be any economic
15 basis for delineating geographic markets based on control
16 areas. Relevant geographic markets depend on a variety of
17 factors including the capabilities and variable costs of
18 available generating units, electricity demand, contractual
19 and legal obligations of generators that limit the amount of
20 energy that can be sold, transmission charges and
21 congestion, and practices regarding access to the
22 transmission system.

23 The upshot of both of these observations is that
24 each hour is potentially a separate market with a different
25 geographic market. From our experience, market definition,

1 both product and geographic is often the most important
2 issue in determining the outcome of many antitrust cases.

3 As the FTC has indicated on a number of
4 occasions, FERC may wish to develop in-house capabilities to
5 utilize computer simulation modeling in order to improve the
6 accuracy of delineating relevant product in geographic
7 markets. These models can be used in this context and in
8 other contexts such as the assessments of market power --
9 assessments of market power including merger analysis and
10 local market power remediation in RTOs.

11 The same analytical framework of defining
12 appropriate geographic and product markets should be used in
13 all three contexts.

14 Let me turn now to the transmission market power.
15 FERC may wish to consider applying a presumption that if an
16 applicant for market-based rates is not a member of an RTO
17 or an ISO, it is presumed to have transmission market power.
18 This standard is based on FERC's own findings in addressing
19 and remediating transmission market power.

20 In 1996 FERC relied on behavioral rules to
21 prevent discrimination in access to wholesale transmission
22 services. FERC found that these rules in Order 888 and 889
23 were insufficient to prevent exercises of transmission
24 market power. This finding led to the Order 2000, the RTO
25 order. The clear message of this policy evolution is that a

1 supplier that is not part of an approved RTO or ISO may very
2 well have transmission market power. A reasonable
3 rebuttable presumption would be that such a supplier should
4 not be granted market-based rates unless it is a member of
5 an approved RTO or ISO.

6 For the entry barriers prong, FERC may wish to
7 consider a rebuttable presumption that an applicant for
8 market-based rates must be in compliance with both the
9 interconnection rules and be a member of an RTO or ISO.
10 It's important to consider entry barriers in two contexts.
11 That is, entry into generation and entry via existing
12 transmission or efficient transmission enhancements. A
13 reasonable initial presumption would be that a supplier must
14 be in compliance with both FERC's recently adopted
15 interconnection rules and be a member of an approved RTO or
16 ISO.

17 For the affiliate abuse prong, the chief concerns
18 include discrimination, improper information sharing and
19 cross-subsidization or cost shifting that favors the
20 unregulated affiliate relative to its competitors. FERC may
21 wish to establish a presumption that compliance with the
22 code of conduct rules and the rules pending in the companion
23 docket governing the solicitation process as a benchmark for
24 this prong.

25 As I noted earlier, my colleague at the

1 Commission, John Hilke, will discuss these topics in his
2 remarks tomorrow.

3 In closing, with each of these presumptions an
4 applicant may be able to present evidence that it does not
5 engage in the prohibited behavior to override the
6 presumption. And, of course, the violations of any
7 underlying codes of conduct or rules may warrant FERC re-
8 examining whether an applicant will be able to retain any
9 previously granted market-based rate authority.

10 Thank you for allowing me to participate and I
11 would be happy to take any questions that you may have.

12 MR. RODGERS: Thank you, Mr. Wroblewski. I have
13 just a couple of questions for you, if I could.

14 If I understood you correctly, you said that if a
15 market-based applicant is not in a Commission-approved ISO
16 or RTO, then it would be reasonable for FERC to presume that
17 they have transmission market power; is that correct?

18 MR. WROBLEWSKI: That's correct.

19 MR. RODGERS: And that there should be no market-
20 based rates for those that are not in Commission-approved
21 ISOs or RTOs?

22 MR. WROBLEWSKI: I said it's a rebuttable
23 presumption.

24 MR. RODGERS: Okay.

25 MR. WROBLEWSKI: You can certainly allow, as you

1 have done in the generation market power screen, allow these
2 to be indicative screens. And if the applicant can present
3 evidence indicating that it does not have, in this case,
4 transmission market power with the ability to discriminate
5 against unaffiliated generation, then that may be
6 sufficient, but as an initial presumption.

7 MR. RODGERS: And also you said, if I heard you
8 correctly, that if an applicant is not in compliance with
9 FERC's interconnection rules, they should not be granted
10 market-based rates?

11 MR. WROBLEWSKI: Once again, it would be a
12 rebuttable presumption --

13 MR. RODGERS: Okay.

14 MR. WROBLEWSKI: -- such that the applicant would
15 be able to present evidence indicating why -- you know,
16 interconnection or -- because what we were doing is we were
17 saying, entry barriers. And to the extent that the
18 interconnection rules are a way to eliminate entry barriers
19 for new generation compliance with those would seem to be a
20 reasonable presumption that there is no entry barrier.

21 MR. RODGERS: Okay. So if the Commission is
22 finding evidence when a market-based rate applicant comes in
23 that there is discrimination or barriers to entry in
24 providing access to the transmission system, then that would
25 create a rebuttable presumption in your view, that market-

1 based rates should not be granted?

2 MR. WROBLEWSKI: That's correct.

3 MR. RODGERS: Is your conclusions in this regard
4 both as to the need to be in an RTO as well as the need to
5 have this interconnection exemption, is that based solely on
6 FERC orders, FERC conclusions over the last few years, or is
7 that based on FTC's independent analysis?

8 MR. WROBLEWSKI: It's based on FERC's own
9 findings, especially in Order 2000 about -- in terms of the
10 transmission market power, in terms of the reason for moving
11 to RTOs. I mean, I think it's stated pretty strongly in the
12 preamble to the final order that Orders 888 and 889 have not
13 eliminated the ability or the incentive to discriminate in
14 the offering of transmission services and plus, if you
15 coupled that with the difficulty in detecting transmission
16 discrimination that behavioral rules still -- that it
17 engenders that moving to a more structural solution which I
18 believe is what the FTC staff and the Commission has said, I
19 think, repeatedly since 19 -- since I think our first
20 comment on the NOPR for Order 888 in, you know, 1996. I
21 think we are going to stick with that story.

22 MR. RODGERS: And just one follow-up. Has the
23 FTC undertaken any studies of its own, done any analysis of
24 its own as to the need for entities to be in RTOs or ISOs to
25 eliminate market power?

1 MR. WROBLEWSKI: About three years ago Congress
2 asked the FTC to look at retail competition programs at the
3 state level and to examine those features of retail
4 competition programs that had benefited consumers and those
5 provisions that had not.

6 One of the things that we found, and I think we
7 devoted an entire chapter to it in this report which was
8 issued in September 2001, was the importance of making sure
9 that the wholesale market was competitive. And that this --
10 not that the success of a retail program was correlated, I
11 should say, with a competitive wholesale market.

12 MR. RODGERS: Okay. Thank you.

13 MR. BARDEE: Mr. Wroblewski, on the issue about
14 transmission market power, I am presuming that if you are
15 not in an RTO or ISO that you do have that market as a
16 rebuttable presumption? If we are to set up that kind of
17 presumption and have a case-by-case adjudication on that,
18 what kind of evidence would the applicant have to submit to
19 rebut the presumption?

20 MR. WROBLEWSKI: I think that the -- I'm not an
21 expert in this particular area, but I would think that if
22 there were -- if intervenors came in to indicate that they
23 had attempted to get transmission and had failed, that would
24 be the types of evidence that you would be looking for.

25 MR. BARDEE: If it were a question of intervenor

1 complaint either in the actual case in which we're to make
2 that determination, or in preceding cases in other dockets,
3 would there have to be some sort of Commission finding that
4 the transmission provider violated the tariff in some way?
5 That it had not fulfilled some tariff requirement or -- I
6 assume it couldn't just be enough that the transmission
7 provider said, you asked for it, we didn't have it, we
8 couldn't give it to you?

9 MR. WROBLEWSKI: Sure. I would think that there
10 would have to be a formal finding of a violation. Yes.

11 MR. PERLMAN: Can I follow-up on that? I mean --
12

13 MR. WROBLEWSKI: Certainly.

14 MR. PERLMAN: -- what I would foresee, given what
15 you've said, is like what Mike was mentioning is that if
16 there was a rebuttable presumption, the transmission
17 provider would just come forward and say, I've got a tariff,
18 I've got my vice president of transmission and his affidavit
19 is that I comply with the tariff. And then it seems like
20 you satisfied your rebuttable presumption, you've pushed the
21 burden on to someone else and then what happens after that?
22 Because it seems to me that in that case the real burden
23 given that sort of structure which I would anticipate would
24 be -- it's hard to prove a negative which is what you've
25 asked them to do, so they've got the tariff to use, is going

1 to be on the complainants to provide specifics and meet the
2 burden that Mr. Bonavia was talking about before about if
3 you have some kind of specific problem about tariff
4 compliance and real failure to provide transmission service,
5 come forward and provide it with some specificity. So are
6 you saying --

7 MR. WROBLEWSKI: I'm not sure which tariff you
8 are talking about --

9 MR. PERLMAN: The open access transmission --

10 MR. WROBLEWSKI: So you're talking an Order 888
11 tariff?

12 MR. PERLMAN: Yes.

13 MR. WROBLEWSKI: Okay. Not a tariff that would
14 be as a part of an RTO. Okay.

15 MR. PERLMAN: Correct.

16 MR. WROBLEWSKI: Okay.

17 MR. PERLMAN: So is that what you would see the
18 real burden is on the complainants to provide with
19 specificity a case that would carry a burden that the
20 Commission would, as Mike was asking you, make a finding on
21 the record that the transmission provider had violated the
22 tariff in order to satisfy the leg that you were talking
23 about? Because, again, it seems to me that rebutting the
24 presumption is a pretty simple process as we just talked
25 about.

1 MR. WROBLEWSKI: Let me give that one some
2 further thought and we can get back to you.

3 MR. GALLICK: I have a question on the
4 thresholds. I think we sort of touched on it earlier. It's
5 sort of a two-part question. In terms of the work that you
6 all do, in terms of interpreting the HHI thresholds, do you
7 use the same thresholds for market power -- seller market
8 power as you do buyer market power?

9 MR. WROBLEWSKI: I will check on this. I think
10 we do, but I would have to check.

11 The one thing I wanted to make sure, I'm not sure
12 if it got lost in the conversation this morning about what
13 monopsony power was. You know, monopsony power, you want to
14 make sure is -- it leads to a lower price that reduces --
15 that has the effect of reducing output. The fact that it's
16 just leading to a lower price is -- that's a good thing.
17 That's a good thing and very pro competitive. It's the fact
18 that it reduces the output that is then sold is where the
19 problem comes in. But I can double check that for you and I
20 can get back to you.

21 MR. GALLICK: Thanks. That sort of eliminates my
22 second question because I wanted to move it over into our
23 markets. But --

24 MR. WROBLEWSKI: Okay.

25 MR. GALLICK: -- thank you.

1 MR. FRANKLIN: I had one comment. Some of the
2 presenters have raised concerns about the lack of
3 consideration of load pockets and constraints associated
4 with load pockets. And I just wanted to point out that the
5 -- I believe the order has in it that a transmission
6 provider would have to include all of the internal monitored
7 lines that it used in a summer period as well as all the
8 contingencies. That would be monitored lines and
9 contingencies associated with load pockets within the
10 control area. So even though the -- you know, it segregates
11 areas off by control area, the internal constraints are
12 taken or we attempt to try to take into account the internal
13 constraints by telling them that if you've had any
14 generators that were limited, like if you had generator
15 operating limits of any internal generators, you've got to
16 incorporate that in and you've got to incorporate all the
17 internal constraints that you normally would when you
18 allotted transmission real-time in the summer period and in
19 recreating that benchmark to allot all the TRM and the CBM
20 and all of the firm, point-to-point transactions. So it's
21 an attempt to benchmark to say, how much is left over to
22 unaffiliated generation to get into this in-service load
23 area assuming that the transmission provider utilizes all
24 its capabilities both internally and around the perimeter.

25 So I just wanted to make sure people were aware

1 that we had that language in there. Although it's not -- it
2 doesn't segregate off into load pockets, per se, it does
3 have internal monitored lines and internal contingencies
4 required. Thank you.

5 MR. HEGEDUS: Could I just --

6 MR. RODGERS: Go ahead.

7 MR. HEGEDUS: -- respond to that very quickly?

8 MR. RODGERS: Yes.

9 MR. HEGEDUS: I think the concern arises though
10 very particularly with respect to the ISO and RTO markets
11 where the order also said that applicants would be allowed
12 to assume entire footprint of that market as the geographic
13 market. What you are pointing out, I think, is more clearly
14 connected to the non-ISO RTO markets. But I think in the
15 ISO/RTO context, I think that concern is that we wouldn't be
16 able to point to that kind of evidence to say that it should
17 be a smaller geographic market.

18 MR. WEISHAAR: And I would also like to note that
19 my comments about load pocket issues were specific to that
20 context. That the order seems to shift the burden on load
21 pocket issues from the applicant from market-based rate
22 authority to the intervening parties and that causes us some
23 trouble.

24 MR. RODGERS: Let me mention -- go back to
25 something Mr. DeRamus said at our first presentation this

1 morning where he was talking about the Commission's need to
2 be more focused on monopsony power issues and to take that
3 consciously into account as part of our review of who gets
4 market-based rate authority; is that correct, Mr. DeRamus?

5 MR. DeRAMUS: (Nods.)

6 MR. RODGERS: And if I could go back to you, Mr.
7 Wroblewski, to see if you could comment on whether you agree
8 that that should be an explicit part of FERC's analysis of
9 who gets market-based rates authority and if so, how we
10 should go about measuring that and any other comments you
11 would like to make on what Mr. DeRamus said earlier?

12 MR. WROBLEWSKI: You know, I would focus on the
13 task at hand in terms -- I think the four prongs that you've
14 developed are sufficient and I would focus on refining the
15 generation market power screen so that you can accurately
16 assess whether applicants have market power, and then if
17 they do and it's assessed appropriately so you know when
18 they can exercise it. And if you're only looking at market
19 power for say a peak period, that's all you're finding.
20 You're not finding what's happening on the rest part of the
21 supply curve.

22 I thought Mark did a nice job of explaining, you
23 know, if you just look at particular -- one particular
24 product, you know, peak power, that's all you're going to
25 find. And so you don't want to design remediation that may

1 have other effects other than just that peak power period.

2 And so before moving into, I guess the short
3 answer is, before moving into looking at monopsony power, I
4 would make sure that you got the generation market power
5 screen because that's difficult enough.

6 MR. RODGERS: So if I could rephrase what I
7 understand your view is, it might be worthwhile for the
8 Commission to look at monopsony power issues but that that
9 should not be the priority?

10 MR. WROBLEWSKI: Yes.

11 MR. RODGERS: Okay. I was following up on
12 something you just said as well as something that Mr. Morey
13 said earlier, each of you seemed to suggest the Commission
14 should be more aggressive in looking at more periods of
15 time, looking at different product markets, and basically
16 undertake a more robust analysis on the generation screen.
17 But at the -- time than the routine 21 days to come in with
18 comments, for a brand-new market-based rate application the
19 Commission only has 60 days to act under the statute. So
20 I'm trying to understand the need for a more purist approach
21 that is more robust which you have directed us to with
22 attention that creates with our requirement under the
23 statute to process the filing within 60 days.

24 So, for example, Mr. Morey, if I were to grant --
25 or the Commission were to grant intervenors 45 days

1 routinely to file comments on market-based rate
2 applications, effectively more than doubling the time that
3 you now have, that wouldn't leave the Commission any time to
4 undertake a review of what you filed with us and still get
5 an order out within 60 days.

6 MR. MOREY: Well, I agree with you that the task
7 that you have to perform and the time you have to perform it
8 in is going to create a challenge for trying to balance, in
9 terms of fairness, the interest of the applicant and the
10 interests of the intervenors. But I think the amount of
11 data that is necessary to conduct these screens and to
12 conduct a set of screens that really would be appropriate as
13 we've suggested and as Michael has suggested, I think simply
14 requires more time. Perhaps it isn't 60 days, perhaps it's
15 substantially less than that. But I think 21 days may be an
16 awfully short period of time for non-applicants or for
17 claimants to make a case in a many of these instances. Many
18 of them are going to be small, and disadvantaged to begin
19 with as a result of limited resources with which to work.
20 So, some consideration, I think, should be given to allowing
21 more time for non-applicants to participate in this process.

22 MR. RODGERS: Okay. Yes.

23 MR. HEGEDUS: I just wanted to note that with
24 respect to the vast majority of market-based rate authorized
25 sellers, they already have it. And so we're not talking

1 about initial applications. And so I think that the concern
2 you're raising applies to probably a relatively small number
3 of applicants and the majority of cases, including the cases
4 that are going to be ones where people are going to want and
5 need the additional time, the Commission is not going to be
6 restricted by the 60 days.

7 MR. RODGERS: Okay.

8 MR. Weishaar?

9 MR. WEISHAAR: I think a potential way out of
10 your conundrum is to require the applicants to submit the
11 robust analysis that several folks on this panel have
12 suggested. To the extent all of that analytical data is up
13 front and it covers the various contingencies and initial
14 application, you can give intervenors a little bit more
15 time, but it's a burden shifting issue. And if you shift
16 the burden to the applicant to demonstrate that market-based
17 rate authority is indeed just and reasonable, the Commission
18 should have ample time to determine whether rates need to go
19 into effect 60 days thereafter or whether they need to be
20 suspended for further investigation.

21 MR. RODGERS: Just to clarify, I think that at
22 present the Commission requires applications to have the
23 supporting data behind the information that they file. If
24 it doesn't have the requisite information in it, then the
25 Commission would be empowered to, and I know at certain

1 times does go out with a data request, efficiency letters to
2 get the required information in and that restarts the 60-day
3 clock. So I'm not sure if I'm understanding what more the
4 Commission can or should require applicants to provide up
5 front with their filings beyond what we're requiring now.

6 MR. WEISHAAR: Let me take the example that was
7 discussed earlier with respect to load pocket issues and
8 ISO/RTO contexts. The way the order is currently
9 structured, the applicant would not have the burden in
10 demonstrating that market-based rate authority is sufficient
11 to address load pocket issues in an ISO/RTO. That burden
12 now resides with intervening parties.

13 To the extent that burden shifts back to the
14 applicant, it reduces the amount of time that intervening
15 parties need to analyze that application and respond
16 accordingly.

17 MR. MOREY: Let me just add, I think that within
18 the context of the two indicative screens there are a number
19 of assumptions that are being made. This is one example of
20 those. I think there are others. We won't go into all the
21 details on those, but those become, in my opinion,
22 rebuttable presumptions. They're not being treated as such,
23 but I think because they should be it then becomes -- it's
24 incumbent on the intervenors to make the case that those
25 assumptions are not correct or are in error. And that,

1 again, places an additional burden, which I think consistent
2 with the Commission's requirement that all the data be filed
3 and all of the analyses be filed by the applicants so that
4 it will be available for review, I think that's important.
5 But then, again, there are a number of instances in which
6 that data may not be filed because there's an assumption or
7 presumption that's been made that permits you to get away
8 with submitting much less than you otherwise would.

9 MR. RODGERS: Let me go back to something Mr.
10 Weishaar said. If I understood you correctly, you said that
11 if an entity owns generation and transmission in the same
12 market, that by definition should be presumed to be vertical
13 market power. Is that what you --

14 MR. WEISHAAR: Perhaps I didn't speak clearly
15 enough. If an entity owns transmission and generation and
16 has operational control of both, I think there should be a
17 presumption of vertical market power which creates the
18 distinction between areas with ISOs or RTOs and those
19 without.

20 MR. RODGERS: And does it matter how much
21 generation or how much transmission that entity has in that
22 hypothetical market?

23 MR. WEISHAAR: I guess it could. We have not
24 analyzed where in that gray area you would draw the line and
25 we haven't really given that a lot of thought. But I

1 suspect that it could.

2 MR. PERLMAN: Can I ask you a follow-up on that?
3 I thought you said that if you were in that circumstance
4 that you would not be a candidate for market-based rates
5 rather than a presumption.

6 MR. WEISHAAR: Yes.

7 MR. PERLMAN: So your view is that if you're
8 outside an RTO and you're a vertically integrated utility,
9 at least for you -- I assume for your control area you would
10 not be able to charge market-based rates; is that what you
11 are saying?

12 MR. WEISHAAR: That's correct. We advocate more
13 of a bright-line test for this rather than the rebuttable
14 presumption approach that FTC would suggest. And we are
15 concerned that the exercise of vertical market power or
16 transmission market power is an issue that is very difficult
17 to detect. It could repeat itself and intervenors may not
18 be able to find concrete evidence. It goes back to your
19 issue of if a transmission customer is denied access, the
20 transmission customer must then bear the burden of looking
21 behind the veil to determine why it was denied transmission
22 access. Sometimes it may find the smoking gun. Sometimes
23 it may not.

24 And in these situations I think the cautious
25 approach or the more prudent approach is to require a

1 transfer of operational control of transmission facilities
2 as a condition to market-based rate authority.

3 MR. PERLMAN: Do you agree -- I guess you
4 disagree with Mr. Bonavia, his perspective on that. And
5 please correct me if I'm wrong, is that if you were to bar
6 such entities from having market-based rates or to use
7 mitigation or what have you, you would be impeding the
8 ability for further competitive market development to occur
9 because you would be, in effect, cementing cost based rates
10 around the country if the folks did not want to turn over
11 operational control?

12 MR. WEISHAAR: I think as long as you leave the
13 possibility of the exercise of vertical market power you're
14 impeding the development of competitive markets. I mean,
15 you've got to deal with vertical market power first,
16 horizontal market power second.

17 MR. RODGERS: Mr. Bonavia, did I sense that you
18 were interested in responding to that question?

19 MR. BONAVIA: Oh, just a couple of thoughts. If
20 even a small amount of generation and transmission ownership
21 can disqualify party or change the presumption there goes
22 your small applicant exemption of small applicant, because
23 then they're going to have to model load pockets too and you
24 have to be careful with that. Where there's a real problem
25 it's going to show up.

1 Load pockets are not that difficult to identify.
2 This is not one of the mysteries that are out there. It's a
3 relatively straightforward process and I dare say the
4 participants in a given geographic market know what the load
5 pockets are. So I would caution you, if you find merit in
6 the idea that smaller participants can have a more
7 simplified path be careful about this load pocket thing.

8 On this other question of if you're not in an
9 RTO, if you haven't transferred operation control of
10 transmission, fundamentally you're going to be precluded
11 from having market-based rates. Again, consider how that
12 process happens. How does operational control get
13 transferred? I have a company that's in the process of
14 doing that. We are at different phases at different
15 operating companies in different regions and there are some
16 very important constituents involved in that decision. On
17 state Commissions those transfers don't get made until the
18 states are on board.

19 And, you know, we are spending an absolute
20 fortune. I'm not talking about a few dollars, I'm talking
21 about tens of millions of dollars complying with and getting
22 ready to go live with MISO day two. Absorbing the costs in
23 the meantime, absorbing our O&M in the meantime that's a
24 very substantial commitment of shareholder money. We
25 measure it not in dollars, but in cents per share. And when

1 you have 400 million shares, you're talking tens and tens of
2 millions of dollars.

3 At the ame time we are devoting -- I mean, if you
4 looked at my budget and see how many people I've had to add
5 to my organization to do this, we're devoting a huge amount
6 of effort and expense to working with and trying to persuade
7 the states to go along with this, to see the benefit of it.
8 We do appreciate the help we've gotten from the Commission
9 in that respect. But until that happens, nothing happens.
10 So if you want to say until a state decides that this is
11 okay, there will be no market-based rate authority for the
12 market participant. Again, I think you're going to do more
13 damage than you really mean to do to competition.
14 Competition is about having players out there transacting
15 and sending price signals that allocate resources. If all
16 we care about is low and stable rates, let's go back to
17 cost-based ratemaking all the way across the board. Except
18 that we don't think that that's the right way to proceed.

19 So you've got to let some people get in there and
20 do some competing and move on with this thing or you're not
21 going to get the benefit that fundamentally is driving this.

22 MR. RODGERS: Let me now go to the audience and
23 see if there's any questions or comments that folks in the
24 audience would like to make.

25 Yes, please come forward to one of the

1 microphones. And please identify yourself and who you are
2 here with.

3 MR. KUMAR: My name is Jay Kumar. I am on behalf
4 of Beleria Municipal Electric Corporation which is an
5 association of nine municipal systems in Delaware.

6 There are two aspects -- there are quite a few I
7 could comment on, but I would like to comment on two issues
8 which came up this morning.

9 And that point was also brought out by Xcel
10 Energy. Buyer's market power, in my opinion there is no
11 such thing, especially in an industry which is highly
12 monopolized. I've been in this business since 1972 and I
13 have been representing quite a few customers buying
14 electricity and gas since 1972 in almost every part of the
15 country and I don't know of any single incident where buyer
16 had market power. And I challenge anyone who could give me
17 that incident, one single example of that.

18 The reason it's very simple, both generation and
19 transmission are highly monopolized, it's in the hand of a
20 few entities. Over the years we used to have a list of 100
21 large utilities in the electric light and power. That list
22 has shrunk to about 50 now and it's going to shrink further.

23 Second comment about transmission market power.
24 I'll give examples of how this is exercised. I'll start
25 with PJM. Yes, PJM ISO was established in 1998. I analyzed

1 one transmission owner's investment in transmission
2 facilities. The average investment in the transmission
3 facilities during the four year period after the
4 implementation of the ISO, decreased by over 14 percent.
5 And I have not analyzed the investment by other transmission
6 owners in detail, I looked at the letter and in most of the
7 cases, after the formation of the PJM ISO, the investment in
8 transmission has decreased with the multiple integrations,
9 especially in load pockets where my clients are located,
10 their power cost has more than doubled.

11 The other way the transmission power is exercised
12 is the control by transmission owners is even after the
13 formation of the ISO RTO transmission facilities has
14 diminished very little. For example, there was a question
15 about third-party transmission facilities investment, you
16 try one and you will see what kind of hurdle you've come up.

17 I give you example, generation interconnection.
18 First if you want interconnection you can do it yourself up
19 to the point where you connect with the utility. I can
20 build 20 miles in less than six months, but the last 100 fee
21 may take me more than one year because of various hurdles.

22 Then come that right-of-way. To get a right-of-
23 way, the easiest way is to share the right-of-way with the
24 investor-owned utility. Again, there are hurdles,
25 obstacles, and as you want to go for your own right-of-way,

1 it takes a long time.

2 Then if interconnection is to rebuild, it has to
3 rebuild mostly by the investor-owned utilities according to
4 their specifications, their plan, their design. Then they
5 charge me for all the costs. I can get it done much cheaper
6 than IOU can get it done. But I pay for that.

7 On top of that previously I used to be -- the
8 customers used to be required to pay income taxes because it
9 was considered as a contribution aid of construction.

10 MR. RODGERS: Mr. Kumar, please --

11 MR. KUMAR: -- generation interconnection is
12 concern finally with a lot of efforts by consumer groups.
13 The IRS has given the exemption, but still the rule is not
14 clear if it is transmission to transmission interconnection.

15 And then add insult to the injury, I pay for
16 everything income taxes, everything, and then the utility
17 has the ownership.

18 MR. RODGERS: Mr. Kumar, we have need to break
19 for lunch hear. Actually, I'm a little bit past --

20 MR. KUMAR: I'm almost done.

21 MR. RODGERS: -- time for that, so if you might
22 be able to --

23 MR. KUMAR: Just one minute longer, sir.

24 MR. RODGERS: Okay.

25 MR. KUMAR: They still control the maintenance

1 schedule duration, they can prolong it and please the LMP.
2 They still advise the RTO about TLR, when to declare it and
3 TLRs when they are declared, generally it result in --

4 Thank you.

5 MR. RODGERS: Thank you, Mr. Kumar.

6 Why don't we go ahead and break for lunch now and
7 we will reconvene at 1:30. Thank you.

8 (Whereupon at 12:15 p.m., the conference was
9 recessed to be reconvened this same day at 1:30 p.m.)

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1 A F T E R N O O N S E S S I O N

2 MR. RODGERS: Let's get started. We have a full
3 afternoon of panelists and I know there's been some rumors
4 of traffic problems that are going to be arriving on us
5 imminently so I want to try to keep us on schedule so that
6 we re not getting out late in any event.

7 So without further adieu why don't we go ahead
8 and introduce our first panelist for this afternoon who is
9 Julie Simon who is Vice President of Policy with the
10 Electric Power Supply Association. Welcome Julie.

11 MS. SIMON: I'm first?

12 MR. RODGERS: Yes.

13 MS. SIMON: Okay. Well, first of all I want to
14 thank you for including me. The Electric Power Supply
15 Association is a national trade association of competitive
16 power suppliers. We very much applaud the Commission for
17 initiating this new rulemaking. We've been very concerned
18 that the focus over the last several years has been solely
19 on replacing the hub and spoke test which only addresses one
20 prong of the four-part test with a more rigorous test for
21 generation market power. And we're concerned in the focus
22 exclusively on that aspect of the four prongs the Commission
23 may have lost sight of the importance of the other three
24 prongs of the Commission's test. So we very much welcome
25 the initiation of this rulemaking.

1 From our perspective vertical market power
2 remains the most significant impediment to the development
3 of robust wholesale markets nationwide and it's appropriate
4 for the Commission to refocus its attention on ensuring open
5 and non-discriminatory access to transmission service, a
6 goal set years ago in Order No. 888 and still not achieved
7 today, as the Commission has recognized in subsequent order
8 including Order No. 2000. Other speakers today have
9 included quotes and sites so I will streamline my remarks by
10 just referring to theirs.

11 Both the EPSC and the Commission have preferred
12 structural solutions which have largely come in the form of
13 RTOs and ISO to provide both transmission access and open
14 and transparent markets, but the current pace of RTO
15 developments in some regions or the country challenge us all
16 to be both vigilant and creative in finding solutions.

17 It's particularly outside of well-functioning RTO
18 markets that the Commission needs to refocus its efforts on
19 all four prongs of its tests for market-based rate
20 authority. We've been asked on this panel this afternoon to
21 focus on affiliate abuse and to a certain extent barriers to
22 entry and I think those have been largely under recognized
23 in the Commission's focus on both generation and
24 transmission market power. Both can have a huge impact on
25 the competitiveness of a market, they're interlinks to each

1 other and they're both integral in links to vertical market
2 power. This is particularly true in light of the
3 Commission's decision under its new interim generation
4 market power screen to create certain exemptions for native
5 load.

6 We think that that approach -- and I wasn't
7 planning today to spend a lot of time commenting on that.
8 We have sought rehearing of the April 14th order raising the
9 numerous concerns that we had about that particular
10 proposal. But to the extent that the native load exemption
11 is included, the opportunities for affiliate abuse and
12 barrier to entry are heightened from our perspective.

13 These are two areas of the Commission's test
14 where the industry needs more guidance. They have been part
15 of the Commission's four-prong test for many, many years,
16 but they have not been well-litigated or well-explained and
17 I don't think there is much guidance that the industry has
18 had from the Commission as to what it takes to satisfy these
19 two prongs of the Commission's test.

20 With respect to affiliate transactions, although
21 it was noted this morning that Edgar has been a part of the
22 Commission's policy for many years, we don't have a lot of
23 guidance on exactly what Edgar means or what standards are
24 needed to meet the Edgar test.

25 What are the elements of a well-designed bidding

1 program? How do we assure that all generators have access
2 to network resource designation, how do we ensure that all
3 generators are allowed to compete fairly to serve load. The
4 issue isn't simply the ability of companies to build power
5 plants, but also their ability to compete to serve
6 customers. I'm mindful of David Perlman's suggestions on
7 this on other occasions that we look at ways to
8 operationalize some of these theoretical discussions. TO
9 that end we have prepared and filed previously with the
10 Commission a guidebook to competitive procurement entitled,
11 "Getting the Best Deal for Electric Utility Customers". We
12 would suggest that this level of detail needs to be
13 articulated by the Commission with respect to competitive
14 bidding programs that would meet the Edgar test.

15 We think the Commission should clarify other
16 aspects of Edgar and I don't want to get too much into the
17 weeds, but certainly expressing a preference for well-
18 designed competitive bidding programs that largely meet the
19 standards that are articulated in this guidebook.

20 With respect to barriers to entry, I want to hit
21 on two issues. One is that we need to be very careful about
22 the regulatory barriers. I know the Commission's test is
23 focused on the ability of the applicants to create barriers,
24 and I'll talk about that in a second. But we need to not
25 lose sight of the fact in this entire rulemaking process

1 that market-based rate authority provides opportunities for
2 market entry which in turn provided liquidity. Whatever
3 else we can say about the hub and spoke approach, it did
4 accomplish that goal. And I think as the Commission moves
5 forward it's important not to fully lose sight of that goal.

6 We also want to point out that we share some of
7 the concerns that were expressed by the gentleman from Xcel
8 earlier today about a default return to cost-based rates.
9 For the reasons that he articulated, there's a lot of
10 concern that cost-based rates can in fact be very disruptive
11 to nascent competitive markets. And therefore, we would
12 urge the Commission to focus on mitigating the types of
13 market power that it finds evidence in the applicant's that
14 come before it rather than simply reverting to cost-based
15 rates. Some of those mitigations may need to be more
16 structural. And, as I said earlier, more creative, for
17 example, in the form of office competitive bidding programs,
18 short-term resource procurements in the form of economic
19 dispatch that allow all types of generation to compete
20 equally to serve load.

21 We also want to suggest that under barriers to
22 entry that the Commission look at issues that perhaps
23 weren't on its radar screen when this test was first
24 articulated and particularly in the area of transmission
25 planning and expansion programs. Again, outside of

1 organized markets, irrevocable decisions can be made in
2 those processes about the type of resources that are going
3 to be able to access the market and those program therefore
4 must be done on a regional basis, they must be open to all
5 market participants, they have to be transparent, they can't
6 favor transmission over generation. Those are the types of
7 elements that we would urge the Commission to look at when
8 you reexamine the types of activities that can create true
9 barriers to entry.

10 Obviously the Order 2003 is an important step,
11 but it is prospective and we think the Commission needs to
12 look broader than just the rulemaking that's been adopted.
13 So I just wanted to give a real quick overview of some of
14 the key issues as we've identified them. We also have
15 produced a bare essentials for today's technical conference
16 that should be available and has also been filed in the
17 proceeding and we very much appreciate the opportunity to be
18 here and look forward to the discussion.

19 MR. RODGERS: Thank you, Julie. Could you
20 elaborate a little bit more on your statement about the
21 industry needing more guidance on affiliate abuse and
22 barriers to entry. What particularly or specifically would
23 you like the Commission to do to provide that guidance?

24 MS. SIMON: Sure. I think you have two different
25 opportunities before you right now. There are currently

1 several cases pending in which the standards under Edgar are
2 in dispute and are pending before a variety of
3 administrative law judges. I think those cases will give
4 the Commission an opportunity to provide some very concrete
5 guidance. And I think what's happening in the absence of
6 guidance is that you're getting conflicting approaches both
7 by your own staff and by administrative law judges how are
8 making decisions without a lot of Commission guidance.
9 That's certainly one way that these issues could get
10 clarified and resolved for the industry.

11 Alternatively because there are several cases
12 pending, the Commission could use the rulemaking process. I
13 want to sort of caveat both of those suggestions that we're
14 not looking at three- to five-year time frames to getting
15 the guidance that we need, but how ever the Commission
16 chooses to provide that guidance, I would suggest that it be
17 done as quickly as possible. And I honestly don't know
18 whether a rulemaking or the pending cases are better. But
19 there are a lot of open questions right now about what level
20 of procurement process is adequate to meet the Commission's
21 Edgar standards. Everything from how to evaluate apples to
22 oranges bids, that is cost-based bids versus life of unit
23 bids, how to handle unequal lives of the units, how to
24 handle transmission, incomparable transmission access, and
25 those are areas where the issues and frankly I think your

1 staff and your administrative law judges could benefit from
2 clearly policy direction from the Commission.

3 MR. PERLMAN: I guess I have a question. I
4 appreciate you are going to help operationalize this thing,
5 so that's great. But in your operationalization proposal,
6 you seem to be advocating, along the lines of Edgar and the
7 like, a long-term contract arrangement with a generator with
8 maybe a dominant vertically integrated utility that would
9 then, by contract have the rights to the output of that
10 generator and most likely the ability to dispatch it and
11 control its output for, in effect, the vertically integrated
12 utilities account. Won't that outcome create a market power
13 issue for the Commission when it looks at the vertical
14 integrated utilities market power screen and shouldn't we
15 count that contract and that generator as part of the
16 generation owned or controlled by the utility once the
17 procurement is over?

18 MS. SIMON: David, I'm glad you asked that
19 question really for two reasons. One is that I think it's
20 misleading if we only talk about resource procurement and
21 competitive solicitations in the context of the historical
22 20-year PPAs. I think that they are an ideal element of
23 many different aspects of utility procurement and are as
24 applicable to short-term transactions, the weekly
25 procurement was discussed today, but I think we need to get

1 a lot more creative outside the organized markets in finding
2 ways for all generators to be able to bid to serve load
3 whether it's for 20 years or for tomorrow. So I want to not
4 use the word "competitive solicitation" to lock in, in
5 people's minds a 20-year PPA. And so I appreciate that
6 question.

7 But with respect to a longer-term power purchase
8 agreement, we really -- I understand the question that
9 you're asking and we've given it a lot of thought.
10 Unfortunately I think the answer may still be, it depends.
11 If in fact the utility owns all the output of the project,
12 controls all of it, it may well be appropriate to count that
13 as part of the utility's generation dominance under any type
14 of a market power screen. If the new market entrant has the
15 ability to sell excess power from the plant, if there is
16 other entry in the market, if there's other ways to
17 challenge that market dominance, then even with part of a
18 project being under a long-term PPA, it may not have that
19 same term effect. I think the Commission needs to look at
20 that issue only from ownership issues frankly, but from
21 operational issues with some of the new market participants
22 that are not really owners and developers of plants, but
23 maybe short-term holders of those facilities if in facility
24 the concentration is being done through service companies.
25 There's a lot of issues there that I think you're absolutely

1 right and the Commission as part of a generation-dominant
2 screen probably does need to look at as well.

3 MR. PERLMAN: So just to be clear, are you saying
4 that from a competition standpoint and a market-based rates
5 perspective it would be better if that contract would have
6 maybe a block of power going to the utility but the
7 remainder and the ability to dispatch the unit residing with
8 the merchant owner of the unit and we should have -- you
9 know, give it a point for being pro-competitive if it has
10 that characteristic?

11 MS. SIMON: I think we have to be careful about
12 micromanaging the business relationships that our companies
13 want to engage in, in arm's-length transactions. And I
14 certainly wouldn't suggest to you that there be a standard
15 that as long as 20 percent of the power was reserved for the
16 market, I mean, that's okay, and 19 isn't. Because I do
17 think that, you know, these are sophisticated
18 counterparties, they're engaged in complex transactions with
19 a lot of money on the table and they need to be able to
20 arrange those business transactions in a way that best meet
21 their business needs. A long-term contract isn't
22 necessarily anticompetitive, but it could -- it could
23 increase generation dominance. And so I hate to not be as
24 helpful in terms of operationizing that issue with a check
25 the box which is the easiest way to operationalize any of

1 these things. But I do think you've raised an issue that
2 needs to be considered.

3 And I know I was talking to Diana earlier today.
4 I think the Commission needs to look at harmonizing some
5 aspects of these approaches because you don't want a
6 situation where a transaction passes through say a 205 or a
7 203 screen and then ends up disrupting a market-based rate
8 authority or vice versa. So that's why I think it's so
9 important that these two conferences are being held back to
10 back.

11 MR. RODGERS: Could I ask a follow-up question.
12 You stated earlier that vertical market power is in your
13 view the biggest impediment to the development of
14 competitive markets. What specifically do you think FERC
15 needs to do to come up with a screen or a test or a measure
16 of when there is vertical market power?

17 MS. SIMON: I think that's very difficult to do
18 because ultimately the solutions are going to be structural
19 rather than behavioral. I think the Commission has
20 recognized that. And I think that it's been well-
21 documented in a series of orders, starting with 888 through
22 2000 and heaven forbid the SMD NOPR, the types of problems
23 that are created under the current behavioral approaches.
24 So I think the Commission needs to be primarily focused on
25 promoting the structural solutions in the form of RTOs and

1 the types of mitigation that an RTO inherently creates in a
2 market place, both with respect to transmission access and
3 with respect to market creation.

4 I think the problem is going to be where the
5 Commission, for a variety of reasons has had its proposals
6 to do that stalled. And then that's where we need to look
7 at the types of programs that perhaps are interim or
8 transitional, but promote the type of structural solutions
9 that ultimately an RTO would get to.

10 And that's why this independent monitoring of
11 oasis, independence regional transmission operations -- I'm
12 sorry transmission planning processes that are overseen by
13 third parties, and I think the Commission needs to look more
14 towards how to remedy those problems than trying to figure
15 out when they do and don't exist. I think there's clearly a
16 presumption that as the FTC speaker on the earlier panel
17 said, when you're outside of an RTO the Commission has well
18 established that there are incentives and opportunities to
19 exclude other market participants from access to
20 transmission and access to customers. And the Commission
21 needs to proceed on that basis.

22 MR. PERLMAN: Are you saying that the Commission
23 should move ahead with these structural approaches you've
24 talked about with not waiting for an applicant to fail a
25 screen and that be a mitigation approach or just move ahead

1 in general with those types of approaches? I thought that
2 was what you just said.

3 MS. SIMON: We have suggested that in various
4 proceedings before the Commission that the Commission move
5 to examine the market power in those areas and implement the
6 type of remedies that we're suggesting. What I'm also
7 suggesting is in any type of rulemaking that goes forward
8 with respect to the four prongs of the market-based rate
9 authority that simply having an 888 tariff on file no longer
10 be a box that gets to be checked to eliminate any concerns
11 about transmission market power. And I'm suggesting that
12 that box needs to have some other information in it and
13 needs to focus more on the ability of transmission
14 providers, particularly outside of RTOs to exercise market
15 power through their generation and transmission ownership in
16 the form of foreclosing competition and excluding market
17 participants from access to transmission and to markets.

18 MR. PERLMAN: Could I follow-up on that because I
19 asked Mr. Wroblewski how we would deal with that if we had a
20 rebuttable presumption that an 888 tariff was inadequate,
21 what would happen then? I think what would happen is that
22 the applicant would say, I have an 888 tariff, here's my
23 vice president of transmission, here's an affidavit saying
24 that I have fulfilled the obligations of this tariff and
25 never violated it. And then they would probably meet their

1 requirement.

2 Is there something else that they should show, or
3 is there some other way that these issues could be on an
4 individual applicant basis vetted before the Commission and
5 we can make a judgment?

6 MS. SIMON: I agree with you about that being a
7 likely outcome in terms of the filings that you'd see. I
8 think what I would suggest instead is that the Commission
9 find that unless you're in an RTO market, that you have to
10 adopt certain structural remedies to address the resulting
11 market power concerns and perhaps have an opportunity for
12 people to show that as you have in other areas, that what
13 they are already doing are equal to or superior to that in
14 case they don't want to do what the requirements are. So I
15 do think you can give people a little bit of flexibility,
16 but it has to be on the equal-to or better-than side, not on
17 the rebuttable presumption side.

18 MR. PERLMAN: And just to be clear, that would be
19 a requirement that they would have to agree to in order to
20 get market-based rates; is that -- would that be the legal
21 basis for which we could obligate that?

22 MS. SIMON: I think that's the legal basis on
23 which you could obligate it. I do share the concerns
24 expressed earlier about the reversion to cost-of-service
25 rates. And I don't -- I'd hate to see the Commission set up

1 a paradigm where people chose to have to forego market-based
2 rate authority and go back to cost-based rates because it
3 actually gave them a competitive advantage in some of these
4 market places. In that case it may be that the Commission
5 needs to use other authority to remedy the resulting market
6 power.

7 MR. RODGERS: Thank you, Julie, very much.
8 Appreciate your remarks.

9 Why don't we move on to our next panelist, Fred
10 Bryant who is General Counsel for the Florida Municipal
11 Power Agency and who is speaking here today on behalf of the
12 Transmission Access Policy Study Group. Welcome.

13 MR. BRYANT: Thank you, Steve.

14 Commissioners, staff, I certainly appreciate the
15 opportunity for being invited to participate on behalf of
16 FMPA and Florida, the state of Florida and TAPS. Some might
17 say and have referred to me as the father of the Florida
18 Municipal Power Agency and certainly I had the distinct
19 pleasure some 30 years ago of going to each of our
20 individual 32 municipal electric utilities throughout the
21 state and setting forth to them a dream and a vision that
22 I'm thankful to say has come to fruition (sic). And I would
23 hope that you would not hold against the Florida Municipal
24 Power Agency it's lack of parentage.

25 But I am excited to be here today. I'm excited

1 to bring to you a story that's Florida-specific, maybe
2 perhaps applicable in other states, but to my entirety of 34
3 years of private practice and then recently as in-house
4 general counsel to Florida Municipal Power Agency has been
5 focused on Florida. So my comments will be focused on
6 Florida.

7 I bring you news from Florida on the progress of
8 the development of grid Florida. After nearly 30 years of
9 wrangling and fighting with Florida progress and Florida
10 power and light, in 2000, the year 2000, they filed along
11 with Tampa Electric Company with this Commission a proposal
12 for an RTO called "Grid Florida" which would eventually
13 eliminate the two biggest problems that we have with
14 transmission in Florida and that is pancake transmission
15 rates and the lack of credits for our own transmission
16 systems.

17 I fear though that I cannot survive another 34
18 years before that will finally happen in Florida. But I am
19 here to say that I'm going to give it a try.

20 I'm not an economist. I think you will figure
21 that out very quickly. I've not developed a market power
22 screen. I'm simply a Tallahassee lawyer. But I believe I
23 am an expert on market power based upon my experience of 34
24 years in dealing with Florida markets and the lack thereof.

25 To paraphrase Justice Potter Stewart's

1 pornography test, "I can't define market power, but I know
2 it when I see it and I have seen market power."

3 FMPA Is comprised of 29 members. We have
4 numerous projects and we provide numerous services to our
5 members. Our Cadillac project is what is called our all-
6 requirements project where we actually act as a real
7 utility, wholesale utility, 15 members, approximately 1500
8 megawatts of peak load. We currently have a need for
9 approximately 700 megawatts of new generation over the next
10 ten years for retirement of aging less-efficient generation
11 and to meet new local growth.

12 We have member cities scattered from Key West to
13 Jackson Beach and northeast Florida, Havana, the town of
14 Havana in northwest Florida, 15 miles from Georgia.

15 FMPA is a transmission-dependent utility. We
16 must utilize the transmission systems of Florida progress
17 and FPL to service our requirement cities from generation
18 resources scattered throughout the state. Most of these
19 resources that we own and have purchased have been planned
20 to minimize exposure to pancake transmission charges, not to
21 maximize the best places for generation to be located. Even
22 though FMPA's loads are mostly located on the FPL and
23 progress energy transmission system, FMPA has its own
24 dynamically scheduled control area.

25 We have no financial bias towards owning or

1 buying our power supply needs. Whatever is the cheapest and
2 best and most reliable for our consumers, that's what we
3 choose. In fact, we tend to rely on purchases for some 40
4 to 60 percent of our generation needs. And together with
5 similar electric cooperative we are essentially the
6 wholesale market in Florida. I have seen market power.

7 Florida market is the poster child for market
8 power. Florida is a peninsula and almost an island in terms
9 of import capacity from the north. And as you can well see,
10 there is no import capacity from the west, the east or the
11 south.

12 Only about 8 percent of Florida's peak load can
13 be imported and Florida progress in FPL own and use a
14 significant portion of the transmission capacity for long-
15 term from imports. No expansion is currently planned to the
16 500KV system connecting us to the real world. Voter
17 progress controls approximately 21 percent of Florida's
18 generation and capacity and FPL controls 49 percent for a
19 total of approximately 70 percent.

20 HHIs are in excess, clearly in excess of 2500.
21 Virtually no high voltage transmission lines have been built
22 in the last three year by FPL or progress energy and the
23 lines that have been built are generally for the purpose of
24 connecting their generators to their load.

25 New transmission lines are extremely difficult to

1 gain siting approval for in Florida. Almost any line of any
2 length will surely cross wetlands in the state of Florida.
3 And any significant transmission line will be difficult to
4 not only gain siting approval, but to gain citizen approval.

5 Even signing generation can be quite tricky in
6 Florida. We along with Jacksonville Electric Authority,
7 Seminole Electric Cooperative and Rita Creek are currently
8 in the advanced stages of evaluating the siting and building
9 of coal-fired capacity in Florida which we have not had a
10 new coal-fired plant built in Florida in ten years now. And
11 I will tell you that the likelihood of building a coal-fired
12 plant in Florida is going to be extremely difficult to
13 achieve.

14 FPL purports not to participate in the wholesale
15 market in Florida and does not respond to our RFPs for
16 wholesale power. However, FPL is plainly very much aware of
17 the impact of their actions on the Florida market.

18 FPL is actively pursuing buying out of municipal
19 systems as opposed to offering to sell power wholesale.
20 Witness the not too far away tragedy in Homestead when they
21 were devastated by a hurricane and the next day FPL showed
22 up at their doorstep not to offer them aid and assistance as
23 a sister utility, even though the Florida Municipal Electric
24 Association through their mutual aid agreement was sending
25 aid and assistance from the other municipal systems to

1 Florida power and light, they instead showed up to Homestead
2 store and offered to buy them out.

3 As recently as a few years ago Homestead put out
4 an RFP for additional power supply and instead of replying
5 to the RFP for power supply, FPL responded instead again
6 with an offer to buy out Homestead. And this has occurred
7 again just recently in the city of Vero Beach and other
8 cities that are members of FMPA.

9 FPL's partial requirements tariff is of little or
10 no value to FMPA because the severe restrictions placed upon
11 it on its use.

12 Yet, at its discretion FPL may make available its
13 generation including its Florida mandated, PSE mandated 20
14 percent reserve margin. To the extent FPL stays out of the
15 market ostensibly dedicating the generation to native load
16 they magnified Florida progresses market power.

17 Florida progress does offer better deals to the
18 wholesale cities it still serves or better deals in
19 soliciting the member cities that we serve. Yet at the same
20 time refuses to offer to us those same wholesale power
21 purchased fuels.

22 I know I cannot define it, but I have seen market
23 power in Florida.

24 This Commission's test for market power in my
25 opinion are not sufficient to capture and effectively

1 mitigate market power in Florida. If new interim screens
2 were applied on a control area basis, FPL and progress
3 energy, I am told would likely be denied NBR in its
4 respective control areas. But the mitigation may not
5 protect FMPPA at all since we are dynamically scheduled -- we
6 dynamically schedule our loads in the Florida progress and
7 FPL control area into our own control areas.

8 If the new screens were applied on a peninsula
9 Florida basis, although FPL would surely flunk, our back of
10 the envelope analysis suggests that Florida progress might
11 pass both screens even though it has never qualified for
12 MBRs within Peninsular Florida as reaffirmed by this
13 Commission's recent order.

14 Such a conclusion would make no sense as shown in
15 the paper that I have attached to my comments by Dr.
16 Lawrence Kirsch that we in Seminole recently submitted to
17 Florida Public Service Commission, great Florida workshop.
18 I believe something is very wrong with this picture. I have
19 seen market power in Florida.

20 This Commission's vertical power test assumes the
21 OATT tariff is enough. In consistent with the Commission
22 findings in order 2000 that the OATT tariff leaves open
23 opportunity for discrimination and inefficiency. In a
24 highly integrated grid like in Florida, absence of regional
25 planning and expansion leaves gaping holes where FMPPA's

1 access to transmission has been restricted by constraints on
2 systems other than the transmission provider.

3 FPL's repeated refused then and now to allow FMPA
4 to invest our money into their transmission system to help
5 them expand the transmission system in the state of Florida.

6 Interbarrier tests is inappropriately restricted
7 to barriers the applicant creates although I could certainly
8 make a case that Florida progress and FPL are insignificant
9 ways responsible for legal entry barriers in Florida, the
10 granting of the privilege of market-based rates should
11 depend upon evaluating the real world entry barriers
12 regardless of who created them. I have seen market power in
13 Florida.

14 Our enabling legislation includes a prohibition
15 on serving municipalities created after 1975. FPL and
16 progress energy demanded this prohibition in our legislation
17 on our ability to sell wholesale power, they publicly stated
18 that they did not want FMPA as a competitor. This means
19 that FMPA is removed as a competitor to serve Winter Park,
20 Florida's newest created municipal electric utility, created
21 this year.

22 This legislation also restricts -- our
23 legislation restricts FMPA's ability to construct generation
24 that we grow into by severely restricting our ability to
25 ability to sell surplus wholesale power, a five-year

1 restriction. You must be able to sell any excess within the
2 five-year period.

3 This limitation not only impedes our ability to
4 participate in that wholesale market, but limits our ability
5 to be the anchor tenant for merchant generation. Current
6 Florida law is vigorously enforced by Florida progress and
7 FPL to Florida Supreme Court and at the Florida Public
8 Service Commission effectively bars a siting of steam
9 generation in excess of 75 megawatts unless built on
10 electric utility with retail load in Florida. In other
11 words, effectively prohibits a merchant plant from building
12 generation in Florida unless that merchant plant has totally
13 contracted the capacity to allow that plant for the life of
14 that plant to an incumbent electric utility.

15 Can you imagine in the city of Tallahassee
16 passing an ordinance that says, before you can build a hotel
17 in the city of Tallahassee you must show that you have
18 contracts for every room for every night for the useful life
19 of that wholesale facility before you can get a building
20 permit. I have seen market power in the state of Florida.

21 Florida progress and FPL has successfully opposed
22 repeated attempts by Duke Power, Calpine, Reliant and other
23 major merchant builders to change the Florida Power Plant
24 Siting Act to allow merchant plant facilities to qualify for
25 a need determination.

1 It's not clear to me that this Commission will
2 consider entry barriers, vertical market power created by
3 the ability of FPL and Florida Progress the largest gas
4 purchasers in Florida to obtain preferential pipeline deals
5 and our life probably will get worse if FPL gets a lock on
6 LNG gas which now appears likely. I have seen market power
7 in the state of Florida.

8 In conclusion, I would -- I could relate to you
9 numerous other real life raw examples of the exercise of
10 market power by Florida Progress and FPL, but the message
11 that I wish to communicate to you is that while defined
12 tests can play a useful role in assessing market power, this
13 Commission must give equal consideration to the facts on the
14 ground. In Florida those facts demonstrate that FPL and
15 Florida Progress should not qualify for market-based rates.

16 Florida Progress and FPL have and will continue
17 to have market power in Florida. And if the Commission
18 screens don't show it, then those screens are defective.

19 I fear that I will continue to see market power
20 in Florida and it looks like pornography to me.

21 Thank you so very much for allowing me to be here
22 and participate today and I'll try to address any questions
23 that you might have.

24 MR. RODGERS: Thank you very much, Mr. Bryant,
25 for your comments. I had a couple of questions.

1 I'm wondering since FPNL and Progress don't have
2 market-based rates now in Peninsular Florida, in what
3 context would the Commission undertake a review of market
4 power for those utilities in that area?

5 MR. BRYANT: Well, I don't, if I understand your
6 question correctly, Steve, I think that certainly is an
7 appropriate task for the Commission to say that some
8 utilities based upon existing circumstances simply don't
9 have the -- aren't applicable to come to this Commission and
10 ask for market power.

11 But certainly if you look at Florida, this
12 Commission could very well say, based upon the transmission
13 situation in Florida and based upon the law of the state of
14 the Florida effectively barring merchant plant from being
15 built in Florida, how could either one of them ever pass any
16 screen tests? Therefore, why should they have the ability
17 to come as long as those -- to this Commission as long as
18 those circumstances are in existence.

19 MR. RODGERS: Well, if I take everything that you
20 represented at face value would you --

21 MR. BRYANT: That would be a big risk, but --
22 (Laughter.)

23 MR. RODGERS: Would the ultimate solution be to
24 just keep those utilities from every having market-based
25 rates as long as the circumstances there today exist; is

1 that all that is needed to remedy or is that as much as is
2 needed to remedy the problem that FERC can do?

3 MR. BRYANT: No, sir. I don't know if I'm
4 prepared to say that because that's what I would call the
5 "death penalty" perhaps. And certainly a very harsh
6 penalty. And perhaps the formation of a true independent,
7 truly inclusive RTO, or Grid Florida, or ISO, or whatever it
8 will be in Florida, that may well be sufficient mitigation
9 to allow market-based rates for those utilities. Maybe also
10 coupled with that that we also do have a vibrant wholesale
11 market recognized vibrant wholesale market in the state of
12 Florida which we do not now have. So certainly I think that
13 -- the pitch I'm trying to get is, look, you all need to
14 develop rules, you all need to develop tests, you all need
15 to develop screens, but you all need to look at what the
16 real world is that I live in every day on the ground, sure
17 enough circumstances and sometimes those sure enough real-
18 world circumstances is one of the most effective screens
19 there is.

20 MR. RODGERS: If there were a Grid Florida RTO of
21 the type that is now being fashioned, would there still be
22 vibrant wholesale markets in Florida as long as the Power
23 Plant Siting Act was in place and as long as jurisdictions
24 north of Florida have siting authority over the building of
25 additional transmission lines into Florida.

1 MR. BRYANT: I don't see how that could ever
2 happen. Progress, energy, and FPL certainly are not really
3 interested in selling wholesale power to FMPA. It's very
4 difficult for FMPA to buy the total capacity of a merchant
5 plant. Most merchant plants sell combined cycle, efficiency
6 is, you know, 400, 500 megawatts that they want to build.
7 We can't absorb -- we can't buy 4 or 500 megawatts at once.
8 So we don't have -- it's not like we have a service station
9 on every corner where we can shop for prices in Florida.

10 When we put out an RFP, and we will be putting
11 out an RFP very soon to evaluate our self-build option, w we
12 have to go through power plant siting at the PFC, I suspect
13 that the paucity of responses is going to be glaring.

14 MR. PERLMAN: I know that your Florida situation
15 is somewhat unique for the characteristics that you talked
16 about, but you're also speaking today on behalf of TAPS.

17 MR. BRYANT: Yes, sir.

18 MR. PERLMAN: Are you aware of any TAPS members
19 that have similar or market power problems maybe not of a
20 similar nature, but of a similar magnitude where the
21 entities that are selling them the power have market-based
22 rates or the utilities in their region have market-based
23 rates?

24 MR. BRYANT: Well, there's two parts to your
25 question. And I certainly am aware. We who are the

1 oppressed often commiserate together and in my 34 years
2 there's been a lot of commiseration. So I'm certainly aware
3 of in other states where that big gorilla normally gets what
4 he wants. As far as where there currently is also market-
5 based rates, I just have to tell you, I just don't know the
6 answer to that. I just have to get back to you on if
7 there's actually market-based rates in this that are still
8 occurring.

9 MR. RODGERS: I've heard before that the reason
10 that there's not more high voltage transmission built into
11 Florida from the North is because the price differential for
12 power generated in Florida is not so high that it justifies
13 importing power from north of Florida. Is that your
14 understanding about why there's not more transmission built
15 and have the recent increases in gas prices changed the
16 dynamics of that question?

17 MR. BRYANT: Well, Steve, I'm not sure where you
18 heard that rumor, because if that were the case, then when
19 FPL and Progress Energy built their 500KV's into Florida and
20 had accelerate depreciation on it for coal by wire then
21 somebody was telling the story wrong at the PSC. So I think
22 that the current 500kV lines that have been built certainly
23 were for economy purposes because coal by wire could beat
24 the prices of what we could generate in Florida which at
25 that time was predominantly gas-fired.

1 There was an attempt to -- by the PSC -- an
2 investigation by the PSC, now maybe 15 years ago, ten at
3 least, under the PSC's jurisdiction to find out and
4 investigate and order, if necessary, why a third 500kV line
5 was not being built. We participated in that proceeding and
6 we promoted the building of that line and offered that we
7 would pay our entry costs, our ownership costs as long as we
8 had an ownership interest in that line. That line was not
9 built for a host of reasons. One reason, I suspect, is
10 because Florida Progress did not want us to have an
11 ownership interest in that line.

12 MR. RODGERS: Let me ask one other question. If
13 as you say, coal generation is not going to be built in
14 Florida any time soon -- coal-fired generation --

15 MR. BRYANT: I don't think that was exactly my
16 words. I think it's going to be very difficult.

17 MR. RODGERS: Okay.

18 MR. BRYANT: Remember, I said, I don't want to
19 see this in the paper when I go home because we're spending
20 a lot of money on some very sophisticated studies right now
21 with a group of other utilities to see if we can build a
22 coal-fired plant. I certainly don't want to have to explain
23 away that headline if and when we go to a siting proceeding.

24 MR. RODGERS: We'll try to keep you out of the
25 headlines to the extent that's within our power.

1 MR. BRYANT: That's good.

2 (Laughter.)

3 MR. RODGERS: But given that there's difficulty -
4 -

5 MR. BRYANT: Yes, sir.

6 MR. RODGERS: -- great difficulty in siting coal-
7 fired generation in Florida at this time, what do you think
8 is the solution to getting lower power prices in Florida and
9 what can FERC do to help with that?

10 MR. BRYANT: Well, I think there are several
11 solutions. Certainly a lot of study and maybe even progress
12 is being made to utilize liquefied natural gas as an
13 alternative, gas powered source. I just don't want my
14 utility and other non-participants in that project to be
15 shut out effectively or economically from participating in
16 that project.

17 Probably would have little difficulty changing
18 the Power Plant Siting Act to allow merchant plant
19 generation with some reasonable restrictions on that
20 generation so long as FPL and Progress Energy withdrew its
21 opposition. I can tell you after 20 years of my first 20
22 years of actively lobbying at the legislature and now
23 unfortunately the last 15 years, periodically having a goal
24 towards the legislature that those two entities are very
25 powerful -- powerful at the Florida legislature. So if

1 their opposition were withdrawn, I suspect that Southern,
2 Calpine, Duke, and others would be able to get that
3 legislative passed. That would be a big help.

4 MR. RODGERS: Do you think that it's likely that
5 there will be a partial repeal of that act any time in the
6 near future?

7 MR. BRYANT: No, sir, I don't. Without a change
8 of heart from the opponents, I don't see that happening.
9 No, sir.

10 MR. RODGERS: Okay.

11 MR. BRYANT: If they've kept out -- it's amazing
12 how our guerillas have kept out the guerillas from the rest
13 of the country.

14 MR. RODGERS: All right. We'll close on that
15 note then, Mr. Bryant.

16 (Laughter.)

17 MR. RODGERS: Thank you very much for your
18 thoughts today.

19 Why don't we move on to our next panelist who is
20 Gerald Norlander who is Chairman of the Electricity
21 Committee of the National Association of State Utility
22 Consumer Advocates. Welcome.

23 MR. NORLANDER: Thank you for the opportunity to
24 be here today. The NASUCA is an association of 44 state
25 consumer advocates in 42 states and the District of

1 Columbia. And we also have some non-profit organizations
2 like my own public utility law project of New York that are
3 members of NASUCA.

4 NASUCA members obviously are from some states
5 that enact a legislation to restructure their electric
6 industries in reliance upon new market mechanisms such as
7 the ISOs and RTOs that have been approved by FERC.

8 Some state legislatures envision, for example,
9 total divestiture by the state's utilities of their in-state
10 generation functions while perhaps allowing them to form
11 holding companies and build power plants and engage in
12 energy trading in adjacent control areas.

13 Other states allowed the utilities to form
14 affiliates within the state and to move the generating
15 plants into the affiliate hands.

16 Other NASUCA members obviously are from states
17 like Florida that chose not to restructure or other states
18 which may have pulled back in recent years from plans that
19 they did have at one time to restructure.

20 So with all this diversity, I think it is
21 nonetheless fair to say that all of NASUCA's members have a
22 deep concern that utility affiliate abuse be prevented and
23 that market power be identified and prevented up front if
24 possible and mitigated if it is -- and remedied if it is
25 exercised.

1 NASUCA has supported strengthening FERC's test
2 for market power for several years. In 2001, NASUCA
3 resolved that the hub and spoke analysis was not effective
4 in determining market power and urged FERC to expand the
5 market power analysis. And so we welcome the direction here
6 and the initiative to issue -- possibly issue regulations
7 and to clarify further the market power analysis.

8 NASUCA also urged FERC to assure just and
9 reasonable rates by ordering cost-based price regulation or
10 other appropriate means of mitigation in any wholesale
11 market where rates are not demonstrably and reliably just
12 and reasonable.

13 NASUCA has also raised questions whether the spot
14 market have allowed the collective exercise of market power
15 by parties who individually satisfied market share tests.
16 But nonetheless, they're able to engage in non-collusive
17 strategic bidding. And I believe some of the earlier panels
18 today have mentioned that and we have been concerned about
19 that as well.

20 NASUCA has opposed weakening or repeal of the
21 protections of the Public Utility Holding Company Act, and
22 we have addressed the details of affiliate abuse prevention
23 and market power issues in some of the recent cases.

24 I think that -- I was struck yesterday as it came
25 down -- a crossword puzzle and one of the answers was

1 "discontent is the first step in the progress of a man or a
2 nation" and I think that you've done a good job of creating
3 preconditions for great advancement.

4 The new test that you are suggesting and that
5 have been suggested as the ones before them are
6 controversial and they're probably not perfect. And that's
7 to be expected. We live in an imperfect world and we are
8 unlikely ever to encounter a perfectly competitive market,
9 or for that matter perfect regulation.

10 I would like to address a couple of broad points.
11 One, I think that with regard to a utility that might fail
12 the screen for market rates a denial of market-based rates
13 is not the death penalty. Some might consider it torture,
14 but it's perfectly legal.

15 The utility that doesn't have market-based rates
16 can still negotiate individual, bilateral, long-term
17 contracts or contracts of any duration, for that matter, for
18 the sale of electricity and file the contracts under Section
19 2.05 in the traditional manner, subject as always to
20 scrutiny for reasonableness. And there's nothing that
21 requires -- it's conceivable, I suppose, if someone with a
22 fleet of plants, some base load, some peakers might file
23 rates that aren't necessarily embedded for at least some of
24 the peak times and things like that. There might be some
25 contract or some uses that might envision marginal cost type

1 pricing as well. So I don't think it's necessary -- I don't
2 think we can assume that all cost-based rates are
3 necessarily embedded cost-based, but in all likelihood long-
4 term base load commitments would need to recover the equity
5 investment. But if the equity investment has been largely
6 depreciated, it might be fairly close to marginal.

7 Prior Commission orders have indicated an
8 expectation that in the normal course of events most bulk
9 power sales should and will be made under long-term
10 contracts and not in the day-ahead or real-time balancing
11 markets. So to the extent that a utility has not arranged
12 for the sale of its output in a long-term contract, nothing
13 really stops that utility from filing rates to sell the
14 difference to any buyer under Section 2.05. And so any
15 utility that's dissatisfied with the market rates or with
16 modified cost-based rates proposed by the Commission could
17 make a conventional rate filing. So some of the tests that,
18 for example, marginal costs plus 10 percent. If a utility
19 wanted to charge 8 percent or justify 12 percent, they could
20 -- above marginal costs they could, I'm sure, make a
21 conventional rate filing.

22 And I think it's the general -- certainly my
23 opinion that for consumers the downside risk of cost-based
24 rates will be less than the downside risk of market rates
25 that may be affected by affiliate abuse or the exercise of

1 market power.

2 I think events in recent years have illustrated
3 that it's better to prevent market power and affiliate abuse
4 in the first place than to try to devise remedies after the
5 fact.

6 The second overview I think I would try to bring
7 is of a procedural nature. I think that there is a question
8 -- certainly some of our members raised the question of
9 whether by passing a screen or the set of screens, does that
10 satisfy with nothing more the utility's obligation to file
11 just and reasonable rates? Can we assume if nobody opposes
12 it that the rates that fall out of that seller's sale would
13 be just and reasonable. And can it be said in a sort of
14 traditional presumption analysis that the presumed fact
15 logically or naturally flows from the given facts. Is it
16 more likely than not that a utility that passes the screens
17 does not have market power? And I don't think we know
18 because the tests haven't been tried. So it's very
19 important that there be a fair opportunity to rebut the
20 presumption.

21 And I think that where there's been some
22 discussion about the problems of timing and how do the
23 intervenors have -- you know, analyze this perhaps do some
24 of their own investigation, retain their experts, prepare a
25 filing in opposition and so forth, and I think the general,

1 you know, time frame between -- for the public to respond to
2 market-based rate applications has been in the neighborhood
3 of three weeks. And I think that more is required. And I
4 think the 60-day period is good. I agree with the
5 suggestion before that if there is a problem in a case that
6 there could be a suspension for further investigation if
7 there is a problem that comes up requiring litigation of
8 market-based rate application.

9 And with that I will conclude my remarks and take
10 any questions you may have.

11 MR. RODGERS: Thank you. Questions?

12 MR. GALLICK: I'd like to follow on your
13 statement if a utility fails the screen, the denial market-
14 based rates is not a death penalty, by that do you mean --
15 are you saying that because if an applicant fails the
16 screen, the applicant has a chance to come in with a full-
17 blown analysis or you could set for hearing they have the
18 opportunity to present their data and make their case and it
19 goes well beyond the screen? Is that sort of the basis of
20 what you're thinking?

21 MR. NORLANDER: Yes.

22 MR. GALLICK: Are you allowing for that?

23 MR. NORLANDER: I'm just saying that if the
24 Commission decides that some entities don't get market-based
25 rates for some reason or other, that's not the end of the

1 world for them. They have always had the right and still
2 have the right to file rates. I would assume that those who
3 have market-based rates today could tomorrow, if they
4 thought it was in their interests file a conventional rate
5 filing and it would -- and then it would go through the
6 normal process. It would take effect unless the Commission
7 took action or it was objecting to it and so forth.

8 MR. GALLICK: Okay. I just wanted to make sure
9 that -- I think I must have misheard you. So what you are
10 saying is if the Commission decides, for whatever reason,
11 market-based rates are not appropriate, then what you're
12 suggesting follows. I was hearing you to say that if you
13 fail the screen, that's the end of the story. You don't get
14 market-based rates, but it's not a death penalty.

15 MR. NORLANDER: No, there might be situations
16 where they would be conditioned. There might be certain
17 times of the day or certain seasons when someone might have
18 to file their marginal costs. I think the PJM required some
19 of filing of cost data and things like that to see whether,
20 you know, the market is competitive. And it might be that
21 someone is in a certain position on the supply curve that at
22 certain periods of time where there might be more
23 safeguards.

24 MR. PERLMAN: I have a question. I guess it's
25 directed toward the NASUCA as a class. Maybe you can speak

1 for them, maybe you can't. We have people come to visit us
2 from time to time and they're from different organizations.
3 Sometimes they are from equity investor analyst groups and
4 things like that. And everybody is interested in retail
5 customers and benefiting retail customers, but you actually
6 have a job so you can help us here. And sometimes people
7 say to us, we want the utility to have market power and to
8 exercise it so they can get excess profits -- that's my word
9 -- in the wholesale market and credit that back to the
10 retail rate payers in the state ratemaking process. How
11 does NASUCA feel about that argument?

12 MR. NORLANDER: Well, I think that it might be
13 state-specific. I think from my own experience we advocated
14 something like that. We advocated against divestiture, but
15 we said it was at a time when spot markets were very popular
16 in thought and the idea was the undivested generation would
17 have to be bid in into the "at marginal cost" and then the
18 intermarginal benefit would redound -- would come back for
19 ratemaking treatment by the regulator and obviously some
20 benefit to consumers.

21 And that's not an uncommon thing in the natural
22 gas cases where sometimes the -- although they're not
23 engaged in commodity sale, the transportation revenues and
24 so forth from some of the classes comes back and is shared
25 with rate payers. So it's not a foreign concept.

1 I think the idea that the utility be able to make
2 external sales and windfall profits from that is something
3 that's within the state jurisdiction to capture. And I
4 think some states probably do that, like to see their
5 utilities profiting from external sales perhaps and coal --
6 cheap coal plants selling into areas where the clearing
7 prices are set by gas. And so they are going to reap that
8 benefit in those states.

9 MR. BARDEE: Mr. Norlander, one of the factors we
10 looked at in our analysis for market power is affiliate
11 transaction is affiliate abuse and we have various ways in
12 which we've assessed and one of them is called the Edgar
13 test where we would accept evidence of comparable sales not
14 involving affiliates as criteria by which we would measure
15 the price of an affiliate sale. Does NASUCA have a position
16 on what kinds of ways we should be measuring affiliate sales
17 of power, whether we should allow them at all, or any other
18 criteria you would suggest for us to look at?

19 MR. NORLANDER: I don't think we have a position
20 on the specific question you've asked. My own assessment is
21 that most states that have allowed holding companies have
22 put in affiliate transaction rules that ostensibly, you
23 know, benefit the rate payer and they would be buying cheap
24 and selling high.

25 I'm somewhat skeptical that we're going to be

1 able to monitor that just in the general world of other
2 kinds of transactions, but with the energy transaction, I
3 think it's even more difficult because we don't have a
4 uniform product and there are so many variations and the
5 products may be very long-term so that, you know, if there's
6 a ten-year or 20-year contract, how do you measure it? And
7 I would suggest that more transparency is better so that
8 people would be able to see what contracts were let last
9 week, not three months ago. And so I have -- and I've also
10 written on the topic of the issue of filing rates and
11 contracts for public inspection and that's --

12 Perhaps to provide a better database for the
13 public and a data pool for people to analyze and compare and
14 perhaps eventually move toward more standard products.
15 Because in a competitive market you have to be able to have
16 substitution. If you don't, as I understand it, I'm not an
17 economist, but -- and if you can't compare the products and
18 you can't substitute, then you're going to have more
19 difficulties with market power and analyzing whether it's
20 really competitive.

21 MR. RODGERS: Thank you, Mr. Norlander.

22 Why don't we move on to our next panelist who is
23 Diana Moss, Vice President and Senior Research Fellow with
24 the American Antitrust Institute and I might also add that
25 many years ago she used to work for Dick O'Neill and us. So

1 therefore you have our sympathies here on Commission staff.
2 And I just want to comfort you by letting you know that Dick
3 O'Neill has mentioned many times since you left that
4 everything you know about economics you learned from him.

5 (Laughter.)

6 MR. RODGERS: So with that introduction, welcome.

7 MS. MOSS: Thanks, Steve. And now we know why
8 Dick just left the room.

9 (Laughter.)

10 MS. MOSS: So I've been fine tuning my
11 presentation over the course of the day. A lot has already
12 been said and I'm in real-time here trying to find ways
13 where I can be brief, but still add some perspective or
14 value to what's already been discussed.

15 First of all I would like to thank the staff and
16 the Commission for inviting me here today to share AAI's
17 views on competitive issues related to market-based rate
18 authorizations. For those of you not familiar with AAI, we
19 are a Washington, D.C.-based non-profit and we do education,
20 research, training, advocacy. Our mission is to increase
21 the role of competition, and ensure that competition works
22 in the interests of consumers and challenge abuses of
23 concentrated economic power in the world and American
24 economy.

25 We will soon make available on our web site a

1 recent study that I completed on vertical reintegration
2 integration in the electricity industry with emphasis on
3 lessons learned from the last merger wave and a lot of what
4 I'll say in the next few minutes harks back to the
5 Commission's experience with mergers and also the antitrust
6 experience with mergers as well.

7 The study looks into -- really looks to one of
8 the best sources of insight, I think, into how the
9 Commission should be identifying, analyzing and remedying
10 current competitive issues and problems, and that's the
11 experience both regulatory and antitrust in remedying and
12 evaluating the 70-odd mergers and acquisitions that we
13 looked at over the period 1995 through 2002.

14 The '90s were marked by a considerable amount of
15 MNA activity, entry and expansion by large independent
16 generators, intra-corporate reorganizations of regulated
17 generation into unregulated affiliates. In the current
18 transition that we find ourselves in, regardless of where it
19 leads, I think it's really imperative that the competitive
20 implications of transactions be appropriately identified and
21 analyzed and remedied to ensure that competition and
22 consumers are not harmed. Really, I think the most
23 compelling public policy rationale for taking a look at
24 these issues and we really commend the Commission for acting
25 in such a timely way is that we not reverse some of the

1 gains of industry restructuring to date.

2 This has been said already and I'll say it again,
3 the Commission has acknowledged openly that open-access is
4 not a panacea. It is not cured completely of the vertical
5 problem implicit in integrated ownership of transmission
6 generation and I would also throw in distribution. And,
7 moreover, a look back at the merger experience indicates
8 that entry into wholesale markets which is often held out as
9 a disciplining factor for potential anticompetitive conduct
10 or mergers, entry is not particularly easy in this business.
11 And I think we would all agree on that.

12 I really want to focus briefly on two issues.
13 The first, I think, is the need, and this may be backing up
14 some from what's already been said here today. But I think
15 the first is the need to accurately classify and identify
16 competitive issues raised by these transactions. I would
17 suggest that the Commission might want to consider
18 streamlining its current classification system of
19 competitive concerns to focus on two broad categories,
20 vertical and horizontal. And those two words have been said
21 many, many times. This approach would consolidate the
22 existing four-part test since generation market power,
23 transmission market power, barriers to entry, and affiliate
24 abuse are all subsumed under either a horizontal and/or a
25 vertical competitive issue. So some streamlining might be

1 useful.

2 Obviously power purchases between a regulated
3 utility and either an affiliated or unaffiliated unregulated
4 generator pose both horizontal and vertical issues. As you
5 all know horizontal issues relate to one level of
6 production. They typically, if there's a competitive
7 problem, typically harms consumers directly through higher
8 prices, for example, by withholding, a strategic
9 withholding.

10 Vertical issues, as you all know, involve more
11 than one level of production such as transmission or
12 increasingly generation inputs and in the upstream markets
13 and wholesale electricity output in the downstream market.

14 Big difference between vertical and horizontal,
15 that I think needs more attention in some cases is that
16 vertical issues involve not only harm to consumers, but harm
17 to competitors through the exercise of exclusionary market
18 power in many cases.

19 So the effects -- the adverse effect on consumers
20 comes indirectly through harm to competition.

21 I think it's important to identify the full range
22 of theories of competitive or consumer harm that could flow
23 from these transactions related to market-based straight
24 authorizations. And to the Commission's credit and the
25 staff's credit, you all have accurately identified a lot of

1 the vertical concerns such as chilling of entry incentives,
2 discouraging entry as a result of non-competitive input
3 procurements, generation purchases, but there are numerous
4 theories of competitive harm that could arise in the current
5 cases. And I think it's really worth taking a hard look at
6 all of those potential theories before going into what I
7 hope will not be a huge rash of transactions involving rate
8 consolidation. But I think it's very helpful to get your
9 arms around it beforehand.

10 And most theories include discrimination,
11 obviously, raising rivals' costs, David DeRamus mentioned
12 some of these earlier today, foreclosure, both input and
13 output foreclosure, anticompetitive information sharing, and
14 regulatory evasion. The last two, typically fall into the
15 category of affiliate abuse. Many of these concerns arose
16 in the merger transactions of the 1990's. So there is an
17 existing body of experience and analysis and remedies that
18 have addressed these issues. And I think it's really worth
19 taking a look back at what those problematic mergers were,
20 the theories of harm that were forwarded in those cases and
21 what remedies were crafted to address competitive concerns.

22 I would note in particular that the Commission is
23 very adept at dealing with input foreclosure. The problem
24 associated with monopoly ownership of a transmission network
25 and the leveraging of monopoly power into generation

1 markets. We saw those issues arise in the AEP CSW merger
2 and also in the Ohio Edison and Centerior mergers. So those
3 are well-vetted issues.

4 But I think the current crop of transactions also
5 raises what I'll call consumer, customer, or generation
6 foreclosure. And that involves rival generators being
7 foreclosed from access to utility buyers. In other words,
8 rival generators wanting to sell to utility buyers who are
9 then in turn going to turn around and sell the output in the
10 wholesale or retail markets and that might happen as a
11 result of an unlevelled process through which utilities
12 acquire generating inputs or generation inputs from
13 affiliated or unaffiliated generators.

14 I would also note the importance of identifying
15 regulatory evasion problems that result from a utility
16 artificially inflating input prices and passing them on to
17 consumers, the regulated consumer, and shifting profits from
18 the regulated to the unregulated affiliate. This is also a
19 concern that falls broadly in the category of affiliate
20 abuse.

21 Remedying evasion problems, again is another
22 example where this issue has been identified and remedied.
23 In the Koch/Entergy Joint Venture Agreement that the FTC
24 looked at several years ago, evasion was a concern and the
25 Commission put into place requirements and process through

1 which the input procurement process, in this case between
2 upstream gas inputs and downstream electricity would be open
3 and transparent. So, again, there's an experience out there
4 involving the identification of evasion and remedying of an
5 evasion problem.

6 I would also encourage the Commission not to rely
7 overly on a blanket assumption that retail regulation will
8 always constrain regulatory evasion problems. Regulation is
9 not perfect. If it were, then there would be no attempts at
10 evasion and there would be no enforcement actions associated
11 with remedying competitive concerns associated with evasion.

12 I would also mention, and I think I haven't seen
13 this happen, but I can see it perhaps coming down the pike
14 as states and utilities are increasingly pressured to deal
15 with reliability issues and obtain sources of supply to meet
16 demand requirements, the whole process of examining
17 contracts and procurement processes and cost allocation
18 issues is going to become increasingly hectic and chaotic.
19 And it would be very useful for the Commission to keep an
20 eye out and examine transactions very carefully in these
21 cases.

22 We would encourage the Commission to ensure
23 prevention of anti-competitive competitive information
24 sharing between affiliates through rigorous enforcement of
25 its transmission codes of conduct, another good step in the

1 direction of promoting competitive markets.

2 I think accurately classifying and identifying
3 competitive issues that arise is very important for a couple
4 of reasons. One is that analytical approaches for
5 evaluating horizontal issues is different than for
6 evaluating vertical issues.

7 Horizontal issues typically assess affects on
8 market structure resulting from a loss of a competitor and
9 increases in market concentration. Vertical issues, on the
10 other hand, assess structural market competitiveness in
11 terms of the level of concentration, not changes in
12 concentration. So those are very, very different analytical
13 approaches. Different metrics for looking at levels of
14 concern or screening or triggers for concern.

15 Remedies will vary also, for vertical and
16 horizontal competitive issues. Again, a look back at the
17 merger experience indicates that remedies for competitive
18 problems generally target ability and incentive which most
19 of you are familiar with. A good remedy for a horizontal
20 concern wouldn't necessarily target ability through bid
21 caps, but would reduce incentive by requiring divestiture to
22 increase the scope of the market and reduce concentration.

23 I think the same logic applies to vertical
24 problems. Divestiture reduces or eliminates incentive as it
25 did in the vertical Pacific Inova merger in California in

1 1997. At the same time remedies for vertical mergers can
2 also target ability. And depending on the vertical problem
3 there are many possibilities including relinquishment of
4 control over transmission to an appropriate RTO, or
5 transparent input procurement processes. So remedies for
6 vertical and horizontal can be very different and I think
7 it's important to identify them appropriately.

8 My second point and I will finish quickly is that
9 AAI would strongly encourage the Commission to reevaluate
10 its analytical approach to assessing competitive effects of
11 market-based transactions, market-based rate transactions.

12 The Commission employs widely, and if I were in a
13 bad mood, I would say, wildly different standards for
14 competitive analysis across sections 2.05 and 2.03. There's
15 an Appendix A analysis for 2.03, there's that pivotal
16 supplier analysis for 2.05. There's the seasonal market
17 share test for 2.05. There are a lot of different tests and
18 screens and triggers for assessing what are really -- what
19 is really a very consistent body of competitive issues
20 across all of these cases, mergers, power purchase
21 contracts, everything. So this really complicates the
22 process. And I would offer that in contrast antitrust
23 employs a much more consistent set of techniques and
24 methodologies to evaluate competitive concerns under
25 Sections 102 of the Sherman Act and Section 7 of the Clayton

1 Act.

2 The problem here is that an inconsistent
3 approach, getting different answers based on different
4 screens, potentially, potentially jeopardizes the
5 predictability of Commission decisions and actions and also
6 the credibility of the Commission's decisionmaking process.

7 In the alternative, (a) I would strongly
8 encourage the Commission to look into the usefulness of the
9 DOJ/FTC guidelines approach. There are many sets of
10 guidelines, horizontal merger, vertical merger guidelines,
11 there are even vertical restraints guidelines which
12 officially have been revoked, but nonetheless contain some
13 interesting -- some interesting information. This approach
14 looks at market assessment and evaluation. It looks at
15 entry -- ease of entry. It looks at countervailing
16 efficiencies. And we would also encourage the Commission to
17 look to strongly pursue what I'll call non-structural
18 approaches to evaluating markets.

19 Under a standard merger analysis, under the
20 guidelines it's a structural approach which looks at market
21 definition and market concentration and changes in market
22 concentration if there's a horizontal issue. But, as I'll
23 talk about tomorrow, and I won't say much about right now,
24 looking -- using structural market analyses for electricity
25 markets is fraught with many technical difficulties.

1 -- besides the need to look at or pursue the use
2 of simulation models to directly estimate price and output
3 effects directly resulting from these transactions.
4 Adopting a more consistent guidelines type approach will
5 ease controversy over issues such as market definition.
6 This is the control area versus load pocket versus regional
7 market analysis tension. It will introduce correct metrics
8 for assessing participation in the market, take care of time
9 differentiated products and defining product markets, and I
10 think all of this will ensue a higher level of integrity and
11 consistency in the Commission's analysis.

12 Again, thanks for the opportunity to offer
13 comments and I look forward to any questions.

14 MR. RODGERS: Thank you, Diana. I have a couple
15 of questions. Do you think the Commission, as some
16 panelists suggested this morning, needs to be looking at
17 monopsony power issues as part of its review of market-based
18 rate authorization?

19 MS. MOSS: I would -- yes, I guess I would add
20 that to the list. I've always been a little hesitant about
21 monopsony because it's -- and I think Mike Wroblewski
22 mentioned this, this morning. You have make sure that there
23 is an impact, a decrease in output in the wholesale market.
24 He mentioned, and there's no point in repeating what he
25 said, because I think it was really well-said, that

1 decreases in input prices are, you know, that can be okay.
2 That's okay.

3 If those decreases in input prices are followed
4 by a decrease in the use of inputs, which would decrease
5 output, then, yeah, you can have a welfare effect in -- if
6 you're talking about the electricity market, then, yeah, you
7 could have a welfare effect in the electricity market.

8 I think it's worth looking into those issues
9 though as we sort of morph into this new environment where
10 utility are perhaps dominant buyers in small transmission
11 constrained markets. So, yeah, I would agree that that's --
12 it may not be the highest priority, but should certainly be
13 on the list.

14 MR. RODGERS: Okay. Speaking of Mr. Wroblewski
15 of FTC, he mentioned this morning that if an entity is not
16 in an ISO or RTO, there should be a rebuttable presumption
17 that they have transmission market power; is that your view?

18 MS. MOSS: I don't know whether I would -- yes, I
19 guess I would agree with that. I would agree with that. I
20 would even go a step farther and say that I think without
21 well-structured RTOs, and I know the Commission has worked
22 very hard on this, particularly getting the governance right
23 so that these -- so that there isn't an undue amount of
24 influence of the governing or underlying stakeholder
25 utilities that you still need to worry about transmission

1 market power. And here I'm going to give the standard line,
2 that vertical separation is obviously going to cure the
3 problem whereas maintaining the linkage between generation
4 and transmission, but removing control addresses the problem
5 in part.

6 MR. RODGERS: One other follow-up question
7 relating to Mr. Wroblewski's discussion earlier or comment
8 earlier. He also said, if I understood him, that FERC
9 should also be doing a check on whether the market-based
10 rate applicant has been in compliance with the
11 interconnection rules and that that should be a condition of
12 receiving market-based rate authorization. Again, it would
13 be a rebuttable presumption that they should not give it if
14 they were not in compliance, if I understood them correctly.
15 What are your views on that?

16 MS. MOSS: Well, I think that's another broader
17 category of rigorously enforcing all of these really good
18 initiatives that are going to promote access to these
19 bottleneck networks. That means rigorously enforcing the
20 standards of conduct, rigorously enforcing the
21 interconnection standards. You know, if it's a checklist
22 approach, fine. But I think all of those things need to be
23 really stayed on top of when it comes to looking at, you
24 know, the competitive effects of these transactions.

25 MR. RODGERS: Just one other thing that occurred

1 to me. There was discussion earlier about the Commission
2 possibly having different tests or different standards in
3 measuring market power in organized RTO/ISO markets versus
4 those that are not. And some felt that there was a greater
5 risk of market power being exercised in the latter type of
6 market. Obviously others did not share that view. But
7 where are you on that issue?

8 MS. MOSS: About the ease with which market power
9 would be exercised and detected --

10 MR. RODGERS: Yes.

11 MS. MOSS: -- in RTO versus non-RTO markets?

12 MR. RODGERS: The ease with which it could be
13 manifested in the various markets?

14 MS. MOSS: In various markets. Well, I think
15 that's a really good question. I'm not sure I have a really
16 good answer for it. I think obviously in an RTO setting
17 there's a huge amount of resources invested in market
18 monitoring and oversight, that sort of thing, and I think
19 some of that is good. But I also think in highly structured
20 programmed markets where you have a lot of different types
21 of markets, particularly slurry services and different
22 dynamic type markets, real-time versus forward and all that
23 stuff, I think sometimes that can create opportunities for
24 gaming. And whether that gaming is market power or just
25 gaming is, you know, is a complex issue.

1 But I think you have to be alert to it in either
2 context and make sure that the right types of analysis are
3 being used to sort of assess the market competitiveness, the
4 type of conduct that is probable and whether it's going to
5 harm competition or consumers.

6 MR. HUNGER: Diana, this morning, or just a
7 minute ago you mentioned the APCSW merger as a case where
8 the Commission showed its adeptness at remedying vertical
9 market power problems. Could you talk a little bit about
10 how the Commission identified the problem in that case and
11 how that would apply to a market-based rate application?

12 MS. MOSS: Sure. I think that was really the
13 second vertical merger case. And if you look back at all
14 the merger cases they're all vertical. It's really
15 interesting. If you look at the gas and electric mergers
16 and the electric and electric mergers, they all raise
17 vertical market power issues. There are very few, if any
18 examples of horizontal concerns. So I think that tells you
19 something.

20 Obviously there has to be ability and incentive.
21 And a merger, in a merger context merger is not problematic
22 unless it creates or enhances one or the other.

23 In a non-merger context, which is what I think
24 you're asking about here, a power purchase agreement can
25 enhance incentive. Because if the utility is able to

1 control the resource, the contracted-for resource, if
2 they're able to dispatch the unit, otherwise sort of direct
3 where the output is going to go, then in effect the utility
4 now controls more generation than it did before the contract
5 was in effect. That, in my mind, and others may disagree,
6 basically equates to an increase in the amount of generation
7 that the utility controls. I would liken that to an
8 increase in incentive. Because if prices are going to -- if
9 prices do go up, then the utility stands to profit on
10 additional units of infomarginal generation that it has.

11 And so I think even though it's not a merger
12 between -- well, in the case of an affiliate transaction,
13 it's obviously not a merger or merger-like agreement but it
14 still has the same effect of enhancing incentive. And I
15 think the next logical step is, well, if that's a problem,
16 and obviously you want to look at levels of market
17 concentration, not changes in, but levels in market
18 concentration, then what's the right remedy for dealing with
19 those vertical issues. And I think I listed some of the
20 types of remedies that was address that.

21 MR. OGUR: Diana, in your discussion of
22 regulatory evasion, you talked about how we should avoid
23 assuming that state regulation will take care of all
24 problems. In the vertical merger guidelines which I know
25 you're familiar with, having written them, there's

1 essentially a two-part test the Commission uses looking at
2 authority and whether the state has actually requested FERC
3 attention or assistant. Would you go beyond that in these
4 cases, or would you recommend that FERC go beyond that now
5 and if so, how should FERC evaluate the ability of the
6 states and the willingness of the states to prevent
7 regulatory evasion?

8 MS. MOSS: Again, a good question and obviously
9 one that's potentially politically -- fraught with political
10 ramifications.

11 I guess my answer is, yeah, I would go. I would
12 go beyond that. And it's certainly no negative commentary
13 on the capability of state commissions, but, you know,
14 regulation is not perfect. I keep repeating that. I sound
15 like a broken record. It may approximate perfect outcomes
16 in certain states, but I think that state commissions lack
17 the resources. In many cases they lack the familiarity with
18 competitive issues and sort of maybe mainstream thinking
19 about competitive issues. And may be so pressured to do the
20 deals, to get the utilities in control of the resources they
21 need to meet demand requirements and increase reliability or
22 maintain reliability that a lot of regulatory procedures may
23 be expedited or streamlined to get these deals done without
24 adequate review of what the terms of the contracts are, or
25 what the terms of the procurement process are. So I guess

1 what I'm saying is I think, you know, maybe it's possible to
2 strike a balance, to really solicit from states a call for
3 help when they really feel like they need it, but also for
4 the Commission really to understand how these abuse
5 problems, regulatory evasion or information sharing affects
6 wholesale markets because a lot of these things do affect
7 wholesale markets, not just retail markets, and then really
8 to sort of maybe ride parallel and look into these issues
9 yourselves.

10 MR. PERLMAN: Can I take you back to your process
11 proposal because I liked it. And it was, in my words, the
12 way I would do it is to look at the -- define the market.
13 Is this where you're saying define the market and analyze
14 the market to see if there's market power present in that
15 market. So we would, rather than have applicants come in
16 periodically who may be in some part of one market or a
17 different market or around the country look at one
18 particular market, look at the horizontal and vertical
19 issues you talked about in that market, and then make a
20 judgment with respect to the market participants in that
21 market, whether they are appropriately granted market-based
22 rates for participation in that market. Is that -- would
23 that be a better way for us to consider these issues and to
24 move forward in a comprehensive way, as you suggested, to
25 look at how we would grant market-based rates in the future?

1 MS. MOSS: You know, I actually think you can go
2 at it from either direction. And this might be something to
3 really think about. One approach may be to take -- to use,
4 for example, a non-structural simulation approach, using
5 simulation models to look at likely price and output
6 outcomes under a certain set of assumptions in regional
7 markets. And that would be a good way of identifying
8 potentially problematic markets and looking at different
9 types of behavior, vertical versus horizontal behavior.
10 It's used a lot in terms of looking at unilateral effects.

11 But, you know, that has the benefit, I think, of
12 dispensing with a lot of -- a lot of very small filings.
13 But I think if you go at it from the other direction which
14 is to use a good guideline style approach in terms of
15 defining markets, if you want to go the structural route, or
16 even using simulation models to go the non-structural route,
17 if that analysis is done right, I think you're going to get
18 markets that are going to look like relevant markets should.
19 They're going to be the right scope, they're going to be
20 defined according to the right products, the right products,
21 i.e., time differentiated demand. If you do the right
22 structural or even non-structural analysis on a case-
23 specific basis for each applicant coming in, and I think if
24 you did this repeatedly over all the applicants in a
25 particular region, you might get fairly consistent results,

1 and results that might approximate sort of the regional
2 market approach that you were suggesting in your comment.

3 I don't know if I'm actually articulating that as
4 well as I should, but I think --

5 MR. PERLMAN: Is it possible to get inconsistent
6 results if you were to do that on an applicant-by-applicant
7 basis? You seem to say that you might get consistent
8 results.

9 MS. MOSS: I think --

10 MR. PERLMAN: If you're looking at different
11 activities in the same market --

12 MS. MOSS: Right.

13 MR. PERLMAN: -- shouldn't you get consistent
14 results?

15 MS. MOSS: I think you should. I think you
16 should. Yeah, for some reason I'm reluctant to commit here,
17 but I think you should.

18 I'll talk tomorrow about a whole other problem
19 I've identified and that is what I'm finding is a lot of
20 inconsistency in the use of structural market analysis from
21 data -- from using data taken from the merger filings in the
22 1990s, but that's another topic.

23 But, I guess I would agree.

24 MR. RODGERS: Could I ask a clarifying question
25 on the one hand you've recommended that -- excuse me -- on

1 the one hand you've recommended that FERC should seriously
2 consider using simulation models rather than using a
3 structural approach. But aren't the DOJ guidelines based on
4 a structural approach?

5 MS. MOSS: They are. But I would also say that
6 they are not -- they do not prohibit nonstructural
7 approaches. In fact, this is a very timely issue because
8 the agencies, various antitrust experts, economists and
9 lawyers and others are debating currently the merits of
10 using simulation models for evaluating unilateral effects of
11 various mergers. So its' a very timely debate and --

12 MR. RODGERS: When you say the "agencies" you
13 mean DOJ, FTC, --

14 MS. MOSS: Yes, the antitrust agencies, yes.

15 And there's a lot of controversy. Obviously you
16 have to build a model, you have to calibrate the model,
17 dealing with demand and elasticity is a problem especially
18 in electricity markets, but I think what we are finding is
19 based on the assessment that I did of using merger data, is
20 that there needs to be more consistency in results obtained
21 in markets, relevant markets or regional markets, however
22 you -- whatever you want to call them over time. But I
23 think the use of non-structural models could be very much a
24 part of a guideline style approach. Because structural
25 simulation models can be used to improve on various aspects

1 of the analysis.

2 MR. GALLICK: I have --

3 MR. RODGERS: Go ahead, Ed.

4 MR. GALLICK: Diana, I wanted to follow-up -- my
5 question may sort of actually be related to where we are
6 now. Originally I thought it may not have because I wanted
7 to talk a little bit more about sort of coming up with a
8 unified approach to this market-based competition analysis.
9 If you had your way, would you start -- where would you
10 start -- how would you start -- how would you hone in on the
11 best approach? Would you start with a section 2.05 type
12 approach, section 2.03, or would you come up with some
13 totally different way of doing it or some hybrid.

14 MS. MOSS: Well, if I had my way, queen for the
15 day, I would dispense with the different -- all the
16 different tests for section 2.03, merger filings versus the
17 section 2.05 stuff, the power purchase contracts. I would
18 sort of get rid of it in one fell swoop, and I would
19 implement instead -- and I realize this doesn't sound
20 terribly operational, but I would instead implement a
21 consistent uniform approach across all of these transactions
22 that raise very similar competitive issues, vertical and
23 horizontal competitive issues. And I would look to the
24 guidelines for guidance on approach and methodology. I
25 would look aggressively into the use of simulation models to

1 deal with what are very peculiar problems in defining
2 electricity markets, evaluating electricity markets rather.
3 So I would really overhaul. I would be in favor of
4 overhauling the whole approach.

5 You know, it could be that at the end of the day
6 in Appendix A analysis, a pivotal supplier analysis, and a
7 seasonal market share analysis will get you the same
8 results. But I think that's highly improbable. If I'm
9 finding inconsistency within one particular approach, then
10 you can imagine what kind of inconsistency might occur
11 across separate and different screening approaches or
12 different types of tests.

13 So it could be that at the end of the day
14 everything turns out to be the same, but it also could be
15 that it doesn't. And I think you run the risk of incurring
16 huge costs in terms of inconsistency and unpredictability by
17 having a bunch of different tests and screens.

18 MR. O'NEILL: David, could I just clarify. The
19 guidelines require constructive of a hypothetical
20 monopolist. And the last time I checked, I couldn't find
21 any publicly available constructions of they hypothetical
22 monopolist test. And at least Paul Jaskow told me a year or
23 two ago that he doesn't know anybody that's ever done one.
24 Now, the Justice Department claims, I think, that they've
25 done them, but they declared them to be secret.

1 (Laughter.)

2 MR. O'NEILL: Are you aware of any --

3 MS. MOSS: No. No. I'm not. In fact, all the
4 mergers -- you know, I've worked in antitrust for 16 years
5 now and I've never used or constructed or built a model
6 using a hypothetical monopolist test.

7 MR. O'NEILL: But that's what the guidelines ask
8 us to do.

9 MS. MOSS: Right. Okay. But let me -- good
10 question, let me clarify. When I say "guidelines" I don't
11 necessarily mean to the letter of the guidelines I mean the
12 general approach and methodologies. I don't -- you know,
13 I'm certainly not going to advocate --

14 MR. O'NEILL: I wanted to make sure --

15 MS. MOSS: Yes.

16 MR. O'NEILL: -- you weren't literal.

17 MS. MOSS: No, that's good.

18 MR. RODGERS: Cliff, last question for her.

19 MR. FRANKLIN: Okay. I kind of your thinking, I
20 like the idea of simulation, although it does require a lot
21 of work. The only thing I'd bring up, and there's a
22 question embedded in this as well, in the event that a model
23 was made, typically you have -- and we've actually ran into
24 this at the Commission, you've got a lot of different ideas,
25 you know, economists have their corno models, the

1 mathematicians have their historical trending models, then
2 the engineer has got their simulation models and sometimes
3 getting them all to coordinate, and then the assumptions are
4 critical in these models, have you ever known -- and the
5 question evolves into this.

6 Do you know of many states that have accepted the
7 output of these models? Because I would think it would be
8 easy, you know, with new combined cycles at a heat rate of
9 7200 and the steam turbines that were built in 1955 at 1400,
10 it's going to be twice as cheap to run a combined cycle.
11 Yet, I don't see a whole lot of movement of states, you
12 know, retiring old units and bringing in the new combined
13 cycles. I don't see it and it seems like these models are
14 not getting quite the acceptance that -- so, you know, I
15 understand your point about structural models are not as
16 good as simulation. What I question is whether the
17 simulation models are going to get the credibility and the
18 acceptance that you portray?

19 MS. MOSS: Yeah. That's a very good question and
20 I don't in any way mean to portray this as a downhill
21 battle. I think it's -- nor do I think it's an uphill
22 battle. I think -- first of all, I think either John Hilke
23 or Mike Wroblewski can respond better to what states have
24 accepted in their various restructuring initiatives.

25 I know that the FTC has been very involved in a

1 number of state issues. So I really can't speak to that.
2 But you have to start from somewhere. Yes, simulation
3 models are still -- I wouldn't exactly say they're in the
4 formative stages, but there's been a lot written on them.
5 There's an active debate going on right now amongst the
6 antitrust agencies and experts. But I think the most
7 compelling reason to move forward in that area is -- really
8 relates to what we've finding in terms of inconsistency in
9 what's been produced in merger filings.

10 And, again, I'll talk more about this tomorrow,
11 but part of the problem is that because of the Commission's
12 process in approving section 2.03 and 2.05 filings, the
13 burden is on the applicants to come in with a showing that
14 they don't possess market power, or their merger is not
15 anticompetitive. So what you get is a bunch of different
16 models coming in from different consulting firms, different
17 economic experts, all of which are different, potentially
18 use different data, and so of course you are going to get
19 potentially inconsistent results. One way to fix that
20 problem is to do it in-house, is for the Commission to
21 develop its own model, structural or simulation, and still
22 put the burden on applicants to provide information and
23 data, but, you know, do the analysis themselves using a
24 well-formulated vetted model, simulation or non-simulation
25 model. And that will improve consistency about 500 percent

1 as far as I can tell.

2 Or the Commission could parallel path what's
3 going on with what applicants are coming in with, sort of as
4 a check on what's going on. But, yes, I think a dialogue
5 and I know the dialogue is -- the dialogue has been started,
6 it's been out there for a while. It's just been sort of
7 simmering on the back burner and I would really advocate for
8 bringing it to the front burner and pushing harder on it.

9 MR. RODGERS: One more question from David.

10 MR. HUNGER: Diana, in your opening statement you
11 mentioned that you thought -- you said that entry isn't easy
12 and the Commission ought to pay attention to entry barriers.
13 Now, this morning Mr. Bonavia looked at it the other way.
14 He said, look at all the entry that we had in the late '90s
15 or early 2000s, isn't that evidence that entry is easy and
16 unless someone can show that there's a particular entry
17 barrier, we can assume that you don't have to worry so much
18 about entry barriers. Can you explain why you think entry
19 isn't so easy and the Commission ought to be concerned about
20 it?

21 MS. MOSS: You know, no sort of mysterious
22 insight there. If you look back at the merger experience
23 again, and if you look at what the antitrust agencies, for
24 example, have said in mergers like Dominion and Consolidated
25 Natural Gas where they required divestiture of distribution

1 affiliate to deal with vertical concern, if you look at what
2 the DOJ said in the Pacific Inova merger when they required
3 divestiture of San Diego's generation to deal with incentive
4 problems in a vertical merger, in every single one of those
5 consent agreements or complaints, the agencies mentioned
6 that entry is not easy.

7 In other words, entry cannot be expected to come
8 on line or generators cannot be expected to come on line
9 within a time period and of a size, for example, that will
10 address the competitive concerns in those markets. So I
11 realize there's attention here. Yes, there was lots of
12 entry in the 1990s, but that was entry taken outside the
13 context of a competitive concern where it has to come in
14 within a certain -- typically two-year timeframe to be able
15 to discipline potentially anticompetitive behavior. That's
16 what I think the Commission needs to be focusing on.

17 MR. HUNGER: Thanks.

18 MR. RODGERS: Thank you, Diana, appreciate that.

19 Why don't we turn our attention to our final
20 panelist of the day who is James Bushnell, the Research
21 Director of the University of California Energy Research
22 Institute. Welcome.

23 23

24 24

25 25

1 MR. BUSHNELL: Thank you, thanks for the
2 invitation to appear. As it turns out, I'm going to be
3 picking up the discussion right where we left off with the
4 last panelist.

5 I'd like to talk about the evaluation of
6 generation market power, and I think that is the central
7 aspect of this market-based rate approval process. To
8 summarize, I basically would like to argue that I think the
9 time has come to seriously consider a simulation approach,
10 although I'm not sure if I would call it nonstructural, but
11 a more sophisticated model that would be applied on an
12 integrated fashion over a full market, rather than a piece-
13 by-piece type of screen like has been applied.

14 I'd like to commend the Commission for
15 recognizing that there are inherent weaknesses in its
16 historic approach for trying to measure market power,
17 predict market power, and for trying to improve upon those
18 measures.

19 And I'd also like to commend the Commission for
20 taking steps to end the automatic exemption from these
21 market power screens for firms participation in ISO or RTO
22 markets. I think, by the far, the preferred way of dealing
23 with these kinds of issues is to try to address the
24 structural problems that hamper competition, rather than
25 through mitigation or, even worse, a refund process.

1 That said, I think it's important that the
2 Commission continue to work to improve on the types of
3 measures it's proposed to date. The kinds of screens
4 described in the April Order, reflect the efforts of the
5 Commission to try and incorporate a more sensible
6 representation of the types of things that go in oligopoly
7 competition in electricity markets, but despite taking some
8 steps in that direction, the actual implementation falls
9 short of being a reliable tool for anticipating market power
10 problems.

11 There are attempts to incorporate the influence
12 of retail load obligations into these screens, but the
13 specific proxies used for retail load obligations is pretty
14 ad hoc, and doesn't seem to necessarily represent the actual
15 wholesale market position of a firm very well, or you could
16 certainly construct circumstances where it wouldn't.

17 I think about this as, if there was a firm that
18 had excess generation, that would fail the screen, and
19 wanted to go out and sell its generation under a long-term
20 contract, it wouldn't improve its performance under that
21 screen, because the specific contract position isn't the way
22 you're using this ratio of peak to off-peak or peak to
23 average demand and those sorts of things.

24 I think also that the use of the off-peak share
25 measure, the market share measure to capture the off-peak

1 concern, runs into all the problems that we have with these
2 structural measures.

3 And, last, there is a focus on pivotal supply
4 measures, and I think it's a step in the right direction to
5 try and recognize the relationship of overall installed
6 capacity to demand, but it's also important to recognize
7 that we're talking about the most extreme form of market
8 power in this circumstance, a circumstance where one firm
9 has effective monopoly power over at least some segment of a
10 market.

11 There are certainly other kinds of market
12 circumstances that we should worry about. When I was
13 reading the Order and thinking about these market power
14 screens, it struck me that if we apply these screens to the
15 California market in the Spring of 2000, I suspect all the
16 merchant suppliers would have pretty easily passed the
17 screen, while the largest net short buyer, Pacific Gas and
18 Electric, might have had trouble passing it.

19 To me, that's a strong signal that these screens
20 aren't doing what we'd hoped they would do. California is
21 an example, and there are other markets, too, where there
22 are a group of suppliers that are able to raise prices above
23 competitive levels, even though one of them, individually,
24 may not necessarily be pivotal at any given point.

25 You can certainly have equilibria where a number

1 of oligopoly suppliers can create very uncompetitive
2 outcomes.

3 Now, it's common to dismiss California as an
4 outlier and an aberrant outcome, and to say that, you know,
5 no reasonable market power screen could have predicted
6 problems there, but that's really not the case. I've been
7 studying and working with the kinds of simulation models
8 that were just being talked about for over ten years now,
9 and I think most of the more sophisticated models would have
10 turned up potential trouble in the California market.

11 I wrote a paper in 1998 where we used a Cornell
12 model. It's a sort of relatively simple oligopoly concept
13 to simulate that market.

14 The calculations weren't particularly
15 complicated. We just looked at a lot different possible
16 load scenarios, plugged in actual generation costs and those
17 sorts of things, and the models, indeed, showed a potential
18 for the kinds of large margins and high prices that we
19 subsequently saw there.

20 I've been reluctant in the past to push the
21 adoption of these kinds of simulation models too hard in
22 these kinds of policy processes, in part, because there has
23 been relatively little applied experience with them, and
24 there hasn't been a lot of empirical testing of their
25 accuracy.

1 Back in '98 when we were looking at these results
2 and sort of indicating prices potentially in the thousands
3 of dollars, one of the things that struck us that there were
4 other markets like the UK that had much worse market
5 structures, but weren't producing outcomes as dire as those
6 predicted in this model we were running.

7 However, since then, I've been working a lot with
8 trying to apply these models to other markets and
9 effectively back-cast results, and I have been surprised at
10 how robust these kinds of models are in trying to replicate,
11 at least qualitatively, the kinds of competitive issues we
12 might see.

13 It's very important to control for the retail
14 load obligation, and once you have that in there, these
15 kinds of models are fairly robust, not just to California,
16 but to markets like PJM and New England.

17 It turns out that California isn't the only
18 market where firms were behaving -- where we saw results
19 consistent with these kinds of oligopoly models. It just
20 happened to be the only market where we had firms without
21 any kind of long-term contracts or retail load obligations
22 and also acting in ways consistent with these kinds of
23 models.

24 So, what I have taken from this work is that
25 oligopoly models are these kinds of simulation models that

1 can be a very useful tool, more useful than the different
2 kinds of screens we've been using to date, and that it is
3 very important to try to correctly account for the contract
4 positions of the retail load positions of the firms.

5 It's also worth noting that there has been a lot
6 of research and a lot of progress on trying to model the way
7 oligopoly outcomes interact with transmission constraints.
8 It's a very complicated problem, but there's been a lot of
9 progress, and we can think about things in a bit more
10 sophisticated way than just viewing a market as sort of
11 inside the constraint and thinking of transmission
12 constraints as only keeping competitive supply out.

13 Certainly, action affects the transmission
14 constraints within a market can have, and trying to build an
15 accurate picture of this kind of interaction really requires
16 an integrated model that represents the whole system and
17 captures some of the key transmission constraints.

18 And that's why I strongly support the notion of
19 applying these kinds of approaches to an integrated,
20 marketwide perspective, rather than firm-by-firm.

21 Among other things, the current approach thinks
22 about what a firm would do if it got market-based rate
23 authority. But it's also worth thinking about what happens
24 to other firms without market-based rate authority.

25 So, if a firm with market-based rate authority

1 tries to raise prices for a product, other firms may not
2 necessarily come in and supply that product, if they don't
3 have market-based rate authority, because they can't earn
4 the subsequent higher price that's happening.

5 So, the interaction of different firms that may
6 or may not have market-based rate authority, affects the
7 competitiveness of the market. There's been skepticism
8 about sort of how complicated these models are, and it's a
9 fair point, but it's also important to observe that there's
10 a continuum here.

11 You know, oligopoly models do not necessarily
12 mean incorporating all of the first-level electrical
13 engineering constraints. We could certainly think about
14 exactly how complicated we want these models to be.

15 The HHI is itself, essentially a very simple
16 oligopoly model based somewhat upon the Cornell equilibrium
17 concept, just one that ignores things like demand elasticity
18 and transmission constraints, things that we're worried
19 about in these kinds of applications.

20 We can make simplifying assumptions about the
21 functional forms of cost and demands that would essentially
22 make models like this solvable in a spreadsheet, or, in the
23 extreme, even in a single formula.

24 Now, you can argue that these kinds of
25 simplifying assumptions are pretty extreme, but they really

1 pale in comparison to the kind of assumptions that underlie
2 the applications of the two screens described in the April
3 Order.

4 So, I'll just close by saying that I think that
5 we need to continue a process of improving these screens.
6 There is a lot of knowledge out there about better ways of
7 trying to do these things.

8 The alternative tools may not be perfect and they
9 may not be as simple, but simplicity is not necessarily an
10 asset in a tool that doesn't really work very well or
11 doesn't turn up the kinds of indications of problems that
12 we're trying to reach.

13 MR. RODGERS: Thank you, Mr. Bushnell. I had
14 just a couple of questions based on several things you said
15 that sounded to me like you conceded that some of the models
16 you're talking about are complex. There's been little
17 empirical testing of them.

18 There's questions that many people raise about
19 their accuracy, and I happen to believe that they also would
20 require a lot of manpower to feed the models and keep them
21 up to date, and they would require a lot of data inputs to
22 keep them accurate, even to the extent they can be
23 accurate.

24 And so I'm wondering, you know, how feasible, as
25 a practical matter, it is for FERC to think about investing

1 all of those resources in something that would be so
2 burdensome to maintain?

3 MR. BUSHNELL: Well, I didn't want to leave ou
4 with that impression. I think, you know, a lot of this has
5 gone on in the context of really detailed merger cases where
6 some complex consulting analysis has been done, or in the
7 academic world where, you know, sort of pushing the envelope
8 of the technical considerations is expected.

9 I think we could certainly explore the efficacy
10 of relatively simple models here. I don't think there has
11 been a serious enough consideration of that, something in
12 between the more complicated models that have definitely
13 been most presented and talked about, and the other extreme,
14 which is some kind of concentration measure that maybe takes
15 a very simple approach to transmission congestion.

16 So I wouldn't concede that this necessarily has
17 to be an extremely computationally intensive process. I
18 think it would require more data than, say, a concentration
19 screen, but in a lot of senses, that's appropriate, because
20 these are data or aspects of the market that we'd want to be
21 considering in trying to figure out whether this is giving
22 us an answer that's useful.

23 MR. RODGERS: Are there somewhat developed, off-
24 the-shelf models that the Commission could adopt for
25 application to energy markets that would be appropriate for

1 measuring market power in the market-based rate context, or
2 is this something that, largely, the Commission would have
3 to invent on its own?

4 MR. BUSHNELL: You certainly wouldn't have to
5 invent it. I mean, you know, the Cornell models have been
6 around for a long, long time, and they have been used in
7 many other industries, too.

8 There are certainly aspects of implementing the
9 notion of an oligopoly model that you would probably want to
10 standardize in the context of a market-based rate process.
11 And as far as trying to simplify the computational time,
12 that's another argument for trying to do this in an
13 integrated fashion, so that you don't have a bunch of little
14 companies, each trying to do this kind of analysis.

15 But, no, I think there is a wealth of existing
16 models out there. I think you're probably going to have
17 more problem sorting through them, rather than having to try
18 and invent your own.

19 But I think it's time for a discussion like that.

20 MR. O'NEILL: I don't think it's the
21 computational issues that scare us; it's the data; it's
22 maintaining a database that has all of the current
23 information, and especially contractual information which
24 can change from day to day and week to week.

25 In order to keep the contractual information up

1 to date, that's where you have a lot of personnel and effort
2 that has to take place, and that's one of things we fear.

3 MR. BUSHNELL: I think that on the contract
4 front, you know, if we're talking about a market-based rate
5 approval for some duration of time, some several years at
6 least, contract commitments that at least span that
7 duration, would be the ones that would be relevant, not ones
8 that sort of are shorter-term arrangements that may be
9 changing very frequently within that timeframe.

10 And, again, I think it would be incumbent on the
11 applicant to try and demonstrate that, yeah, we really don't
12 have the freedom to withhold this generator. We have it
13 sold under an obligation to somebody else, and produce that
14 kind of data.

15 MR. O'NEILL: How many companies file for market-
16 based rates?

17 MR. RODGERS: In what time period?

18 MR. O'NEILL: A year.

19 MR. PEDERSON: We probably have over 1200
20 entities that have market-based rates right now. We've get
21 a number of them that come in every year, 200 or 300 new
22 applications.

23 MR. O'NEILL: The reason for the screens is to
24 essentially get rid of a lot of the 1200, way ahead of time.
25 Even when you get rid of 1200, you end up with enough that

1 can really burden, you know, a sophisticated analysis.

2 MR. BUSHNELL: Yes, and, you know, I think I'm
3 not sure how many this breaks down to. If we thought of a
4 relevant geographic market was and how many of the 1200 fit
5 within each of these relevant geographic markets, that cuts
6 down the numbers, certainly quite a bit.

7 And I think, you know, safe harbor notions for
8 firms that under some common sense measures, do not
9 plausibly have market power, is certainly also appropriate,
10 but I think there's enough evidence that the kinds of
11 analyses we've applied to the less obvious cases, has
12 created problems that we definitely want to think about
13 doing something more sophisticated.

14 MR. PEDERSON: What's been going through my mind
15 is listening to this conversation on the simulation models.
16 It seems to me that there's going to be a lot more data. We
17 can make simplifying assumptions.

18 The more assumptions you put there, certainly
19 that just begs for additional discussion over whether those
20 assumptions are correct or not. And I was wondering if you
21 could think about or discuss -- in the back of my mind as I
22 listened to this, I was thinking about regulatory barriers.

23 We have a lot of little folks out there. There
24 were some suggestions through previous proceedings about a
25 small generator exemption. You know, one of the concerns

1 there, as I think we have seen in other markets, is that it
2 doesn't matter how big you are, if you're at the right place
3 at the right time and you are the only one that can provide
4 the power, you could very easily have market power, and so
5 giving you just a flat-out exemption, may not be the best
6 way to go.

7 But as we talk about these simulation models and
8 the difficulties of getting them up to speed, running,
9 maintaining them, having the different applicants come in,
10 can you talk a little bit about whether that's the
11 regulatory side of that, whether there would be a regulatory
12 barrier to entry to new generators coming in.

13 MR. BUSHNELL: Well, there are a couple of
14 issues. One would be a firm that didn't exist in a market,
15 didn't participate in a given market, building a couple of
16 new generation plants.

17 And I think, you know, that's a circumstance
18 where, depending on the size of this market, it's not likely
19 to create market power concerns. If it's a situation where
20 you have an existing firm that may have already gotten
21 approval and is bringing in some new generation, then it's a
22 relatively straightforward extension of whatever analysis
23 you've done to alter that aspect of that participant's
24 market structure.

25 You know, the data requirements would be things

1 like relatively reasonable representations of production
2 costs, some demand profiles, and depending on how
3 sophisticated you want to get on transmission, you know,
4 maybe some simultaneous ratings of key interfaces.

5 These are the kinds of things we've been talking
6 about already, you know -- maybe not the whole supply curve,
7 but I think that most of the alternatives we've been hearing
8 to just a straight sort of capacity-based measure, involve a
9 lot of the similar aspects of the same data.

10 So I'm not sure this is a huge data requirement.
11 It depends on how far down this road you want to go.

12 MR. RODGERS: Go ahead, Diane.

13 MS. MOON: Just to chime in quickly here, I think
14 it's important to hear what you're saying, in context. The
15 Commission's current approach, either Appendix A or pivotal
16 supplier, when it's implemented, those are not data un-
17 intensive efforts.

18 In fact, they are hugely data intensive. You
19 need a lot of the same data that you would need for a
20 simulation model. Now, it's not at the exact -- they're not
21 exactly the same, but they are very data intensive.

22 In fact, if you look back at a lot of the
23 controversial merger cases, they were all about data and
24 assumptions -- transmission constraints, how to allocate
25 transmission capacity -- so you're going to deal with those

1 data and modeling issues in a structural approach and in a
2 simulation type approach, so that's one thing to consider.

3 So it's not like this big unknown that is going
4 to require hugely more amounts of data ad modeling effort.

5 But I think the second thing you have to think
6 about, again, as sort of a driving force here, is that what
7 you're getting, at least on the 2.03 side, from applicants,
8 is that everybody's got their own model, everybody's using
9 different data, potentially different data, different
10 assumptions, and you're getting a high degree of
11 inconsistency across applicant-filed analysis.

12 And, in my mind, what that really screams out
13 for, is the need for the Commission to bring it inhouse and
14 to develop a model here or vet a model here, and make it a
15 standard, or at least work it in parallel with what
16 applicants are bringing in on their own.

17 So I think there's some pretty important, not
18 only policy issues, but sort of implementation issues here
19 that don't necessarily make simulation models unattainable.

20 MR. PEDERSON: I guess, though, what's going
21 through my mind is that on the 2.05 side, would you agree
22 that whatever the Commission were ultimately to adopt, that
23 it would be important that not only that the Commission
24 could run these models and the particular applicant run this
25 model, but other market participants in the market could

1 also run the model so that they have a fair opportunity to
2 rebut any case that's presented? Would you agree with that?

3 MR. BUSHNELL: Would I say that would be a good
4 idea? Yeah. And I don't think it would be necessarily that
5 difficult.

6 There's a question of confidentiality of the data
7 used in the filing in the first place, which is an issue
8 that comes up in other sorts -- using other sorts of
9 measures also. But, again, depending on what kind of
10 standard, how far down the road of a complex model you want
11 to go, I don't think the computational problems are that
12 difficult. I solve my on a website.

13 MR. PERLMAN: Would you agree with Diane that we
14 would only use one model?

15 MR. BUSHNELL: I think there's a lot of merit to
16 that, at least as the rebuttable proposition.

17 MR. PERLMAN: I've been involved in a lot of
18 these in the past, and the thing is, as a humble lawyer, you
19 come in with your model, then the other people come in with
20 their model, and then the staff hires a consultant and they
21 have their model, and nobody can figure anything out.

22 All they know is that they've all got different
23 outcomes. One says 100 percent yes, 100 percent no, and one
24 says, well, I'm somewhere in the middle.

25 And then the Commission, the people who are not

1 aficionados of programming and modeling, can't really cope
2 with that. So it seems to me that if you're going to have a
3 battle of the modelers as part of this process, you're going
4 to end up losing focus from what you're really trying to do
5 and really make an unworkable process.

6 And you would have to have a single model -- in
7 my view, a single model that you had some real material
8 level of confidence in, and, as Jerry said, was generally
9 available to people and they could put in their own
10 assumptions. Maybe the assumptions could change the
11 outcomes, but the model itself could not really be tinkered
12 with for us to even consider doing something like this.

13 Is that -- do you agree with that?

14 MS. MOSS: I agree with that. And, again, I
15 would point to the merger experience. In the Pacificorp-
16 Peabody merger, which actually didn't happen because there
17 was another buyer, the FTC staff used a simulation model to
18 look at raising cost issues related to the consolidation of
19 Pacifcorp with a whole bunch of generation, coal-fired
20 generation, with a bunch of mines in Wyoming.

21 And so they did it inhouse. Well, they actually,
22 I think, farmed it out to, you know, to an outside
23 consultant, but they were the ones who said this is the
24 model we're going to use, this is the approach we're going
25 to take, and this is the way we're going to proceed with our

1 competitive analysis in this case.

2 There is a history here of not only simulation
3 models being used, but the agency who is adjudicating the
4 issue or taking the enforcement action, doing it inhouse.

5 MR. O'NEILL: Can we try to close the loop on the
6 2.05 process? Let's suppose we get the simulation model and
7 we're happy with the data, and we do what we want, who
8 fails? How do we determine who fails, and when they fail,
9 what do we do to mitigate?

10 MR. FRANKLIN: If I could, can I piggyback onto
11 your question? Mine relates right with yours, if that's
12 okay?

13 When do you determine scarcity as acceptable for
14 high prices? And this kind of piggybacks onto what he's
15 saying, as when do people fail?

16 For example, you know, if you look at California,
17 there's not high prices right now, and it might be, because,
18 you know, we intervened or because of cases in the past.
19 But they had low hydro that year and they had five percent
20 reserve margin in Southern California.

21 So, at what point do you say scarcity is okay,
22 and that people can make money off scarcity and at what
23 point do you say, well, no, this is not appropriate;
24 marginal cost is the only thing appropriate?

25 And I might just -- and then I've got one thing

1 to add on later, but go ahead.

2 MR. BUSHNELL: Let me take the second question
3 first: So, we need to make a distinction here between a
4 simulation model that's sort of forecasting potential
5 outcomes in the future, where we're plugging in different
6 scenarios.

7 MR. O'NEILL: In pockets where there's scarcity?

8 MR. BUSHNELL: Yes, and, you know, depending on
9 how sophisticated we want to get, we have transmission
10 constraints where we have potential -- well, we're
11 forecasting scarcity.

12 I mean, basically the models are looking at
13 margins, okay? And so a high-price that is being driven by
14 scarcity would not be a margin; it would be a high price.

15 Now, that's to make the distinction between
16 what's been called a competitive benchmarking model where
17 you're trying to do this kind of -- trying to come up with a
18 hypothetical competitive price and compare that, and that is
19 all about trying to sort out whether you really had scarcity
20 under some historic context or not.

21 But this is actually looking at different
22 scenarios, and, so, back to what Dick asked, which is the
23 really hard question, this would be a tool that gives us a
24 whole lot more detail than just do you pass a particular
25 kind of concentration screen or pivotal screen?

1 And it forces upon the policymaker, the choice of
2 declaring how much market power is too much, what kind of
3 margins are unacceptable, what kinds of scenarios do we
4 think are implausible, and, you know, that's a -- I'm not
5 going to give you numbers right now, but --

6 MR. O'NEILL: But later?

7 (Laughter.)

8 MR. BUSHNELL: Implicitly, when we say a 20-
9 percent market share is too much, we are making that
10 calculation somehow in a much more crude fashion. It just
11 doesn't translate directly to, you know, five-percent
12 margins are good; seven are bad, or something like that.

13 I think there would definitely be some major
14 disputes over exactly where to draw those thresholds, but I
15 don't think that's necessarily unproductive. I think, you
16 know, we've sort of been covering that up, to date, by just
17 taking a shortcut and using a simpler screen that abstracts
18 away from those kinds of results.

19 MR. O'NEILL: And then what do you do with the
20 failures?

21 MR. BUSHNELL: I am less of a fan of mitigation,
22 I guess, than you are, in the sense that I think we tend to
23 use mitigation as a crutch that we describe as an
24 alternative to cost-based regulation, when, in fact, it's an
25 alternative form of cost-based regulation where we say plug

1 your costs into a bid curve, and we'll clear the market at a
2 certain price, rather than we'll price your output at
3 average cost or something like that.

4 I think the way to view these kinds of -- the
5 whole market-based process, as has been said on the vertical
6 side and on the affiliate side, is that what you're really
7 trying to do is invent structural change, and so having some
8 kind of mitigation measure that's unpalatable is not all bad
9 in the sense that if there are ways to take structural
10 measures that allow you to pass that screen, like sign a
11 contract and virtually divest your generator for the
12 lifetime of this market-based rate approval, then I think
13 you have a much more viable chance of actually getting those
14 kinds of structural measures passed.

15 I mean, you're right; you're stuck with either
16 mitigation or regulation or something like that, but it's
17 worth saying that really the goal here is to try and
18 encourage people to try to pass.

19 MR. O'NEILL: Oh, yes, if they come in and
20 voluntarily offer us divestiture or long-term contracts that
21 mitigate their market power, I agree with you. The question
22 is, do we have the power to force that to happen?

23 MR. BUSHNELL: Well, you don't. Well, I mean,
24 I'm not a lawyer, but what I've heard from people who are,
25 is that it's difficult for you to do that, but what you can

1 do is say you don't get market-based rates.

2 MR. O'NEILL: And then what do we do? Now we
3 have to --

4 MR. BUSHNELL: Then you can do lots of different
5 things.

6 MR. O'NEILL: Now we have to mitigate. Cost-
7 based regulation, whether you like the term or not, is
8 mitigation of market power.

9 MR. BUSHNELL: Oh, yes, yes.

10 MR. O'NEILL: So you have to mitigate. So one of
11 your alternative is cost-based mitigation. What else do you
12 do?

13 MR. BUSHNELL: That is about the only thing you
14 can do, and the goal here is to avoid that outcome. I think
15 there are certain circumstances where there may not be a
16 structural solution that's really even practicable in severe
17 load pocket and we're stuck with mitigation in those
18 circumstances, and others where firms may just prefer cost-
19 based regulation for one reason or another, but that is that
20 is what the process gives us.

21 MR. RODGERS: If there are no other questions for
22 the panelists, let me thank all of you for your comments
23 today, and go to an open mike session. If there are folks
24 in the audience that would like to ask a question? Julie?

25 MS. SIMON: Can I just make a point?

1 MR. RODGERS: Yes.

2 MS. SIMON: I want to go back to this discussion
3 that we were having about a more regional approach. I don't
4 want to opine on the details of one model over another,
5 because I have no expertise in that area, although I will
6 agree with Diana that there is almost a Rube Goldberg
7 approach to modeling and assumptions and studies and so
8 forth that are contained in the April 14th Order.

9 From my industry's perspective, we're very
10 concerned about what's going to be required to make a
11 showing, to refute a showing, what happens if somebody wants
12 to attack your showing, and, you know, the prospect of death
13 by case-by-case litigation is clearly inherent in that April
14 14th Order.

15 So it's incredibly resource-intensive, and that's
16 very worrisome to people at this point, and so I want to go
17 back to David's suggestion about looking at these things
18 more regionally.

19 One of the big problems with the details in the
20 April 14th Order is that the details that you're asking for,
21 often aren't available, and if they are, there aren't common
22 assumptions about what it consists of.

23 So an ability to process that data on a regional
24 basis would be enormously valuable. If the simultaneous
25 import capability is five on one side and seven on the

1 other, what are people supposed to do about that? There's
2 no forum for resolving those kinds of issues, and people
3 might think it's actually four or eight, and there's no
4 basis for addressing that in the framework that you've
5 created here, other than through a case-by-case litigated
6 proceeding, which is just an enormous drain on resources,
7 both within the Agency, and certainly within our industry.

8 Getting back to David's request that we look at
9 operationalizing, one of the ideas that we've been talking
10 about and that we suggest that the Commission consider, is
11 the possibility of regional technical conferences, not
12 philosophical conferences like this one about sort of
13 different theoretical ways to approach this, but very
14 practical technical conferences to address the issues of
15 common development of data, confidentiality issues, what's
16 available, so that people can actually do apples-to-apples-
17 to-apples types of comparisons, which, frankly, are unlikely
18 under the April 14th Order, if it ends up getting
19 implemented in its current form.

20 So that's one of the things that we would urge
21 the Commission to seriously consider, both inside and
22 outside the organized markets, to get away from the control
23 areas and look more regionally at what's actually going on
24 in these various marketplaces that have an impact on their
25 structure and their functioning.

1 But I wanted to make one additional point, which
2 is a concern that by taking that approach, we not default to
3 penalizing everyone within a particular market, if there
4 are, in fact, structural problems.

5 Because there is a dominant transmission supplier
6 or dominant transmission owner in that market, doesn't mean
7 that nobody should be entitled to market-based rates, for
8 example, if the other suppliers are smaller and have less of
9 an impact. So I just want to be sure that when we go
10 through a regional process, we don't get to a check-the-box
11 yes or no for everybody that's participating in that
12 marketplace. I just want to be sure that that concept is
13 included in the record of this proceeding. It's going to
14 end up being a little bit more difficult than that.

15 MR. RODGERS: Okay, thank you.

16 MS. SIMON: Thank you.

17 MR. RODGERS: Yes, please identify yourself and
18 say who you're with.

19 MR. ESPOSITO: Hi, I'm Peter Esposito. I'm with
20 Crested Butte Catalysts, and I'll be speaking for Intergen
21 tomorrow. I have a comment and a couple of questions that
22 arose out of the discussion with Diane.

23 The comment is that building is easy, relatively
24 easy, but getting access to the market is what's tough. So
25 you can see a lot of plants get built, but they're not

1 really marketing their power running. That's the tough
2 part.

3 My two questions are: You know, you talked about
4 all of the various mitigations and remedies over the last x-
5 years in various merger cases and the like, and I'm
6 wondering if anybody had actually, after the fact, gone in
7 and checked to see if they worked.

8 The second question is, when you talk about
9 monopsony power, you're talking about output being reduced.

10 I'm wondering if you've gone in and considered it in the
11 context of someone who would just buy from their own
12 generators and those own generators might be running at the
13 14,000 heat rate, and prices might actually go up, without
14 an impact on output.

15 MS. MOSS: Okay, I'm going to have to get you to
16 ask the second one again, but on the first one, I think that
17 in cases where remedies have addressed -- have been
18 structural in nature, meaning a divestiture, for example, of
19 generation to reduce or eliminate incentives, or
20 divestiture, for example, of an upstream affiliate to
21 eliminate ability.

22 I think you're obviously going to have more
23 success in remedying those types of competitive problems
24 when you're dealing with a structural remedy. And that
25 includes things like transmission expansion, too, upgrades

1 to the system to expand the scope of the market, anything
2 that gets the market to get bigger and reduces
3 concentration, I think is a good structural remedy, or to
4 ease entry barriers.

5 I think that if you look back at potentially
6 problematic remedies, that the Commission had -- that were
7 no implemented or were implemented in a foot-dragging kind
8 of way, it would be useful to take a look back at AEPSW
9 where, you know, obviously, joining up with an RTO, you
10 know, was a very long and protracted process, certainly not
11 within what I think the Commission expected the timeframe
12 would or should be, you know, looking at the market.

13 One condition in that merger was doing periodic
14 quarterly market monitoring reports. You know, you have to
15 sort of question whether the -- I think that in that case,
16 the integrity of the market monitor and the reporting was
17 very high, but I think it's useful to do what you're saying,
18 sort of on a regular basis, to go back and sort of evaluate
19 the effectiveness of remedies.

20 But I think, at the risk of being too general, I
21 think that structural remedies are always going to be more
22 successful because they are cleaner and they are obviously
23 one-time remedies, as opposed to more conduct-based or
24 behavioral remedies which require ongoing oversight and
25 enforcement, and where there's potential room for gaming the

1 system.

2 So, I guess that would be my reaction to that.
3 I'm sorry, can you ask the second question again?

4 MR. ESPOSITO: Sure. Let me just follow up on
5 one point you made. There are probably instances where you
6 can build transmission where you talk about that in terms of
7 a structural remedy. The transmission gets built, and then
8 it's like, who has access to it at what price, and, you
9 know, which would create a whole other round of study to
10 figure out whether it worked or not.

11 The second question was, when you're talking --
12 you were asked to address monopsony power, and you addressed
13 it in terms of reducing output. Candidly, I'm a lawyer and
14 I don't really understand all the nuances of that.

15 But I can look at monopsony power in the sense of
16 a utility owning a bunch of old boilers built in the '50s,
17 run at 14,000 heat rates, with a half a dozen 7,000 heat
18 rate IPPs sitting idle in their service territory.

19 The end result of that, with a fuel adjustment
20 clause is the price to the consumer is going up, and I
21 wondered if you had thought about it in that context?

22 MS. MOSS: You know, I haven't, but I think it's
23 an interesting -- you know, it's an interesting question.
24 But looking at monopsony issues is going to be something new
25 for the Commission, and I would note that AAI's annual

1 conference coming up here in a couple of weeks, specifically
2 addresses buyer market power issues. It's all about
3 monopsony in various industries and in antitrust enforcement
4 and that sort of thing.

5 I think that when you look at monopsony in the
6 electric power industry, you have to, in approaching the
7 analytics, you have to really work with the uniqueness of
8 the markets, the peculiarities of operating generation under
9 a variety of constraints -- reliability constraints, various
10 must-run constraints.

11 But I think the general approach still holds,
12 that you have a potential competitive concern, a concern for
13 consumers being harmed, if output actually goes down in the
14 output market.

15 That's not always going to be the case, and
16 there's actually been a lot written on this, which might be
17 useful to sort of review in the process of gearing up to
18 deal with these issues. I know I'm not addressing the issue
19 head-on, but I think, like we have on the monopoly side, in
20 terms of evaluating market power issues vertically and
21 horizontally, all these peculiarities of the industry that
22 make electricity so unique and difficult to deal with, I
23 think those have to be considered equally on the monopsony
24 side.

25 MR. O'NEILL: I don't understand this as a

1 monopsony argument. I mean, a monopsonist faced with very
2 inefficient plants and very efficient plants, would probably
3 bargain hard and go with the efficient plants.

4 This is really a vertical issue, as far as I can
5 see. I don't see this as a -- the fact that inefficient
6 plants are running and the efficient plants aren't, is not a
7 monopsonist issue; it has to do with the fuel adjustment
8 clause and the vertical structure, but, as a monopsonist, I
9 can't see that.

10 MR. BUSHNELL: We've come across this in our
11 simulations of some of the markets, and, yeah, I don't know
12 what the right name of it is, but you're right in the sense
13 that the classic monopsony story here, which is that I buy
14 less to drive the price down, doesn't apply, because the
15 utilities can't control what their consumers consume, for
16 the most part.

17 Now, you can have a circumstance where a utility
18 overgenerates with generation that has a marginal cost well
19 above the price. And in that sense, that also, if they are
20 bidding it in at zero, for example, will drive the wholesale
21 market price down, and that could be worth their while, if
22 they're buying enough.

23 They're losing a little bit on the margin with
24 this generation that they are overgenerating with, but
25 they're driving down the market price for their purchase

1 quantity. And in our simulations of some of these markets,
2 we see that, yes, you actually get a Cornell price below the
3 competitive price, if you have -- you need sort of special
4 circumstances where there's a firm that has expensive
5 generation and a really big retail load obligation, much
6 bigger than their generation -- much bigger than whatever
7 they happen to be producing at that moment. But it
8 certainly could come up.

9 Now, it could also be addressed in the same kind
10 of simulation approach that's dealing with contracts in the
11 other direction, too, though, in the sense that if you know
12 what a retail load obligation is and you know roughly what
13 the generation portfolio is, by examining the same range of
14 portfolios, you get both of these effects, and sometimes
15 they can offset each other where you have the supplier
16 market power and the -- whatever you want to call it, sort
17 of pseudo-monopsony power kind of offsetting each other.

18 MR. RODGERS: Why don't we take one more question
19 from the audience?

20 MR. DeRAMUS: David DeRamus from Bates-White. I
21 just know that I was a panelist this morning, and it may be
22 out of order for me to get up and ask a question of this
23 panel, but I thought it might be helpful for me to jump in
24 on that question, since that's how I started my
25 presentation.

1 MR. RODGERS: Sure, go right ahead.

2 MR. DeRAMUS: Just to avoid confusion, when I
3 raised the issue of monopsony early on, my concern -- and
4 that's why I had my Figure 2, which I know probably a lot of
5 people never saw in the handout -- that my concern is not so
6 much about a monopsonist, per say.

7 My concern is the use of monopsony power as a way
8 to fuel a monopolization strategy over generation. That's
9 why I was trying to be very clear that my concern about
10 monopsony only arises when you have a load-serving entity
11 that has generation, and that's where, kind of getting to
12 Peter Esposito's point, where you have the incentives for
13 the load-serving entity to foreclose market access to
14 competing generators, to refuse to buy from them.

15 I don't know what else to call it if you don't
16 call it buyer market power or monopsony power. You know, I
17 use that as a shorthand, and so I kind of went back and
18 forth about calling it monopsony versus buyer market power,
19 because in monopsony, everybody thinks, automatically, oh,
20 that's a supply reduction and the only way you get an
21 increase in price, is if there is a supply reduction in the
22 output market.

23 I think that might come up in very specific
24 instances, and, for example, I know that in the Entergy
25 case, there has been some complaints, I think, by some of

1 the bidders that they are precluded from actually being a
2 competitive alternative over the long term, because they are
3 kind of forced to bid in prices that are below their long-
4 run average costs.

5 I may be completely butchering their position,
6 but I recall that coming up. That is, to me -- while that
7 may be a concern, and that might a concern that you can
8 show, the concern about using buyer market power to
9 foreclose competition is not one you can show, and if you're
10 concerned about transmission, you've got be concerned about
11 that kind of monopsony power, because at the end, it's
12 still all about market foreclosure to competitors.

13 MR. RODGERS: Okay, with that, I'm going to turn
14 to Chairman Wood, if he'd like to make any closing comments.

15 CHAIRMAN WOOD: My brain is bursting.

16 (Laughter.)

17 CHAIRMAN WOOD: Thank you all for all your
18 brightness today, both panels. I've appreciated the
19 structure. Staff spent a lot of time pre-scoping this to
20 try to get a diversity of opinion and a depth of opinion. I
21 appreciate that very much.

22 There are people that didn't get a chance to
23 participate as much as you all did, and we want to give, as
24 we have discussed, 21 days from today for people to file any
25 additional thoughts with us. Then we'll move forward into

1 crafting the full rulemaking on these issues to complete the
2 work that we began with the discussion of the interim
3 generation screen two and a half years ago.

4 So, better late than never, and, obviously, from
5 the points made today, better sooner. And we do want to get
6 a complete view of market-based rate authority in the
7 current environment, in a practical manner, but in a
8 comprehensive manner.

9 So, I want to thank the team on all sides of the
10 table, and the audience, and wish you all well in the next
11 days in navigating the town, and we'll see you soon.

12 MR. RODGERS: Thanks, appreciate it.

13 (Whereupon, at 4:00 p.m., the technical
14 conference was concluded.)

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