UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Conference on Competition in Wholesale Power Markets	Docket No. AD07-7-000

Prepared Remarks of
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ELCON appreciates the Commission's decision to hold this conference on the state of competition in wholesale power markets.

ELCON is perhaps the earliest national stakeholder group to advocate increased competition in the electric utility industry. Our members operate in competitive global markets and appreciate the efficiencies of open competition compared with poorly regulated centralized markets. However, after roughly a decade of experience with restructuring there are clear indications that the FERC-approved ISO and RTO markets are too costly, not truly competitive, and fail to deliver net consumer benefits.

Those defenders of the status quo who disagree with us bear the burden of showing real evidence that competitive power markets have arrived. We believe real competition would produce innovations, improved customer service, and the so-called "killer" products that everyone wants and that would have already been delivered in a truly competitive market. But the defenders of the status quo can't show us these because they simply aren't there. Real competition has not been realized. Restructuring has replaced the old state regulatory regime that had at least some end-user focus and rates based on average costs – with a costly ISO / RTO federal regulatory regime that has no end-user focus and rates based on the highest accepted bid (I emphasize bids, not costs).

Last December ELCON issued a white paper that reaffirmed our desire for real competition, but also stated in no uncertain terms that real competition simply hasn't happened and is not going to happen unless at least seven necessary and essential pre-conditions are actually implemented. FERC asked this panel to address expectations.

1. We expected a competitive market in which end-use consumers both compete head-to-head with generators to establish market-clearing prices and are paid compensation equivalent to those generators when load is reduced. Unfortunately this hasn't happen. The results have been simply a few utility-implemented demand-response "programs." It is important to emphasize that they are programs, not markets, because consumers interact with load-serving entities or the ISOs and RTOs, not generators. While these programs certainly have some value as damage control measures for operationally flexible customers against high clearing prices, they are not a long-term substitute for the levels of demand elasticity that are necessary for truly competitive markets.

2. We expected a competitive market to stimulate new investments. There is an enormous amount of capital seeking new investment, but investment in generation has all but ceased in the organized markets, and transmission investment is not far behind. Why? The Day Two markets are not real markets – they are regulation without a rate base. Efforts to patch this huge problem with artificial centralized capacity constructs are clear indications of market failures And perhaps worse, these constructs aren't trusted by either generator owners or Wall Street. This is no trivial problem because most of the benefits of restructuring were expected to result from new long-term investments. Instead, what we got was another form of regulation that pays billions of dollars to existing generators while incenting only minimal amounts of new gas-fired generation and raising reliability concerns.

3. We expected many new players to enter the competitive market, and some old, inefficient players to exit. This did happen on a limited basis early on, but unfortunately many of those that bailed out were the new players. The result is the old monopoly utilities with depreciated nuclear and coal assets earning very healthy profits, while marginal gas units are barely profitable, and significant barriers to entry remain for baseload and mid-merit units.

4. We envisioned a market in which both suppliers and consumers would hedge commodity price volatility with long-term bilateral contracts. The robust, liquid forward market created with those contracts would provide investors the same or better security as a traditional utility rate base. But it didn't happen. Instead, for all practical

purposes, consumers that need to hedge the commodity price risk simply can't do so. Their choice is simple. Take the unbundled spot price (the highest bid clearing the market) or take a contract based on estimates of these same spot price bundled with a huge risk premium. That is not a hedge – and it certainly is not the result of a competitive market. And to add insult, industrial consumers are finding that the benefits of self-generation, perhaps the most reliable hedge in the past, are being taken away through pre-mature repeal of PURPA.

5. We were early advocates of ISOs and the separation of operation from the ownership of transmission. We hoped that the congestion costs combined with the transparent, open-access operation of the grid by an impartial "air-traffic controller" would spur new investments. This didn't happen. First, the pricing mechanism, instead of providing investment signals, told those who own both generation and transmission where **NOT** to build while allowing them to continue to profit handsomely by protecting their inefficient investments. Second, the RTOs have not lived up to their promise as facilitators of regional planning and have failed to implement long-term planning that recognizes objectives such as fuel diversity, optimal generation and transmission investment, etc. Unfortunately, the problems are not self-correcting due to problems in governance. Conditions are getting worse, not better. We cannot just wait for good times to arrive.

6. We expected that industry restructuring would mitigate market power that was allowed, but hopefully addressed, under regulation. This might have been

accomplished if the five previous pre-conditions had actually been implemented. But this has not happened, and market power is now an even bigger problem as generators get bigger than before because the structural features that would have mitigated market power are not there. Market monitors cannot fill this void for a number of reasons both structural and legal.

7. Finally, and only after all the above conditions necessary for truly competitive markets have actually been implemented, we envisioned that wholesale price caps and bid mitigation measures could safely be relaxed If we eliminate scarcity pricing from the equation, we cannot have real competition.

The results of customer satisfaction surveys of large end-users by a nationally recognized research firm vividly show that the failure to achieve these expectations has significantly changed the way that industrial consumers view restructuring. Specifically, for the past nine years, the customer service scores in **regulated** states have been considerably higher than those in **restructured** states for every factor measured in those surveys. And worse, the gap is growing.

We are far from alone in our complaints. Many national, regional and state groups and entities have been expressing considerable opposition. Several states are seriously considering, if not already taking, actions to reverse restructuring. Residential consumers in many states are rebelling against significant price increases. And this rebellion is growing at a rapid pace – and in a way that often is not constructive.

Going forward, what is FERC to do? I offer four recommendations:

1. **FERC should acknowledge that the Day Two construct is not working for the benefit of end-use consumers as required by the Federal Power Act**. LMP is not robust enough to compensate for inadequate infrastructure and should never have been implemented without additional transmission and the elimination of major load pockets. LMP will not work unless enough infrastructure is in place to sufficiently mitigate the consequences of joint generation-transmission ownership of incumbent utility holding companies. Price signals are clearly not stimulating, and are probably discouraging, new infrastructure investment. Federal and state regulators do not share the same vision for the industry, which accounts for lack of demand response. And states and FERC are fighting over who determines resource adequacy rather than solving the problem.

2. **FERC should initiate an inquiry into whether today's RTO platform, with LMP, can be made a viable market model.** Are the necessary preconditions achievable and capable of delivering net benefits to end-use consumers? Can this platform address the problems such as infra-marginal revenues, barriers to entry for new baseload and mid-merit generation, siting problems for transmission, etc. The outcome of this inquiry should be a new road map for either reforming the RTO/LMP framework or considering a return to regulation.

3. **FERC should acknowledge the magnitude of this problem and recognize that simple technical fixes or additional regulatory intervention will not correct the**

inherent problems. FERC must be ready to substantially change the basic underlying structure and implement tariffs that provide consumers just and reasonable rates. Additional patches will not fix the problems.

4. **If conditions necessary to implement LMP cannot be achieved, the policy debate must shift to what form of regulation is appropriate for jurisdictional utilities: state, federal or a combination of the two.** If the Commission opts to "stay the course," the default option is continued consumer exploitation, no end-user focus and rates based on marginal bids further inflated by unmitigated congestion. Even worse, states will continue to rebel and take actions that at best will bring only minimal benefits. Such actions result in neither good public policy nor adequate consumer benefits. This is a major challenge.

Finally, recent judicial authority adds urgency to the Commission's analysis. We interpret the recent 9th Circuit decision in PUD of Snohomish v. FERC as extending way beyond the specific context of the western markets crisis of 2000-1. FERC must assure that markets remain competitive to support a market-based rate regime both under that decision and under the D.C. circuit precedent providing that market based rates are J&R if and only if there are competitive markets and an absence of market power.

I look forward to your questions and the discussion.