



**Testimony of
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Generation Market Power Screens
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Introduction

Good morning. I am Louis R. Jahn, Director, Wholesale Market Policy, for the Edison Electric Institute. I am appearing before the Federal Energy Regulatory Commission ("Commission") today on behalf of the Edison Electric Institute, the association of the nation's shareholder-owned electric utilities, and its affiliated Alliance of Energy Suppliers, a division of the Institute that specifically represents power suppliers (together "EEI").

EEI's members include electricity generation, transmission, distribution, and service companies that operate in wholesale and retail markets throughout the country. They serve nearly 70 percent of the nation's ultimate electricity consumers, and represent the largest segment of buyers and sellers in wholesale markets subject to the Commission's jurisdiction.

Many of EEI's members have been granted approval by the Commission to sell wholesale power at market-based rates (MBR). Most also purchase power sold under

market-based rates as well. Thus, EEI's members have a significant interest in the development of competitive wholesale markets and in a market-based rate authorization process that protects against the abuse of generation market power while at the same time providing a fair, practical approach to authorizing use of market-based rates.

As the Commission seeks to finalize, within the context of the generic RM04-7 proceeding, its determination of the appropriate screen(s) to implement prospectively for assessing whether an MBR applicant possesses market power, EEI offers the following testimony.

The purpose of my testimony today is to present to the Commission a proposal for what Commissioner Kelliher has characterized as a "fourth generation market power screen", i.e., a market power screen that go beyond the indicative function of the interim Pivotal Supplier and Market Share Screens and provides the Commission with more accurate assessment as to whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the wholesale marketplace. This fourth generation market power screen, which EEI has termed a Historical Contestable Load Analysis, focuses on the determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives (contestable loads) in the relevant market and the competitive generation resources that were available to serve those loads. This analysis is intended to be filed at the time the MBR applicant makes its initial filing for market based rate authorization for review by the Commission for the purpose of determining whether the applicant does or does not possess market power. If the Commission determines that the analysis demonstrates an absence of market power, a rebuttable presumption would then be established that the applicant does not possess

market power and therefore there would be no need to initiate a Section 206 proceeding. A detailed explanation of that proposal is attached as Appendix A to my testimony.

The Historical Contestable Load Analysis proposed by EEI is also directly responsive to the Commission's April 2004 order that allows for MBR applicants failing either of the indicative screens to present additional evidence, such as historical sales data, to support whether the applicant does or does not possess market power. As such, EEI presents the Historical Contestable Load Analysis for consideration and adoption by the Commission for the purpose of providing structure, process and evaluation standards to this additional evidence opportunity that has been provide by the Commission to MBR applicants.

The Need for a Fourth Generation Market Power Screen

As has been explained by the Commission in several orders, both the Pivotal Supplier and Market Share Screens were primarily designed by the Commission to function as indicative screens, i.e., to identify those MBR applications that will require more detailed scrutiny by the Commission to determine whether the applicant does or does not possess market power.

As with any indicative screen, both the Pivotal Supplier and Market Share Screens have had to trade a certain degree of analytical accuracy for simplicity in preparation as well as a limitation on the scope of the data inputs required by the Commission. This analytical tradeoff process, however, has been particularly significant with regard to the Market Share Screen. For example, the Market Share Screen does not take into account the relative size of total market demand to total uncommitted generation capacity which is a major factor in assessing whether the applicant can exercise market

power. To illustrate, an applicant could have a market share of 50% (5,000 MW/10,000 MW) but not have the ability to exercise market power if the total market demand is only 2,000 MW.

Further, in the calculation of the Market Share Screen, seasonal estimates of uncommitted wholesale market generation capacity are developed through a process by which proxies for seasonal native load requirements (the lowest of the daily peaks within each season) are subtracted from each market participant's nameplate generation capacity. The use of this type of native load proxy in the Market Share Screen seriously understates the generation capacity actually required by the applicant to meet seasonal native load obligations and therein overstates the generation capacity available to the applicant for wholesale market sales.

The effect of incorporating these analytical tradeoffs in the Market Share Screen is to create the potential for the screen to generate a significant number of false positive results, i.e., to inaccurately attribute to an MBR applicant the ability to exercise market power. EEI would note that non-RTO utilities are currently experiencing a failure rate of approximately 70% for the Market Share Screen within their control areas in the MBR filings that have been made to date (August to December 2004). This contrasts to a failure rate of approximately 9% for the Pivotal Supplier Screen.

This result from the MBR filings that have been made to date indicates that there is a high probability of a false positive problem associated with the use of the Market Share Screen particularly in light of the results of the supplemental analyses that have been filed by some applicants failing the Market Share Screen that appear to demonstrate the competitiveness of the wholesale market within their control areas. EEI would

suggest therefore that the current structure of the Market Share Screen should be reexamined by the Commission to determine what modifications to this screen may be warranted.

While EEI believes that there is a need to address the potential false positive problem associated with the indicative Market Share Screen, EEI also believes that there is a greater need at this point to move forward with the development of the fourth generation of market power screens, i.e., market power screens that go beyond the simple indicative function of the Pivotal Supplier and Market Share Screens and provide the Commission with an assessment of whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the wholesale marketplace. From EEI's perspective, that process should focus on a determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives (contestable loads) and the competitive generation resources that were available to serve those loads. This is the conceptual premise for EEI's Historical Contestable Load Analysis proposal.

For applicants that have already filed for MBR authority and for which a Section 206 proceeding has already been initiated, the Commission should also adopt this proposal and allow for those applicants to file this analysis in the Section 206 evidentiary proceeding as a demonstration of the absence of market power.

Historical Contestable Load Analysis Preparation Guidelines

In structuring the proposed preparation guidelines for the Historical Contestable Load Analysis, EEI has taken the position that such guidelines should not be prescriptive

in nature, but rather set forth specific evidentiary thresholds that the MBR applicant would have to meet for the analysis to be deemed by the Commission as demonstrating that the applicant does not possess market power. As such the applicant would have the opportunity to develop specific methodologies to meet the evidentiary thresholds contained in the guidelines. As we gain more experience with the implementation of this screen, it may be possible for the Commission to adopt a more standardized approach to the preparation guidelines.

Let me comment briefly on the proposed guidelines. Guidelines Nos.1 to 3 requires the applicant to use the most recently available historical market data to identify the relevant market and products that will be used in the analysis. Note that the applicant is given the opportunity under the guidelines to define multiple product markets for use in the analysis, e.g., on-peak, off-peak, short-term, long-term, etc. Note further that while the applicant is required to file the analysis based on historical market information, the applicant is also provided with the opportunity to file a forward-looking analysis for review by the Commission. A forward-looking analysis would be particularly important if the applicant's asset position or market conditions are expected to change significantly in the future.

Guideline No. 4 requires that the applicant identify all loads within the relevant market that were actually subject to competition (contestable loads) by product for the historical test period. The applicant is further required to explain in detail the methodology used by the applicant to identify contestable loads. For example, the applicant might rely upon an analysis of the RFPs that were issued in the relevant market for an historical period to identify contestable loads. Alternatively, an applicant might

identify contestable loads through an analysis of the power supply portfolios of the wholesale customers within the relevant market. Finally, in regard to POLR obligations imposed by state regulatory commissions in retail access states, whether such loads should be deemed contestable would depend upon the nature of the POLR obligation imposed upon the utility as well as upon both the historical and expected switching levels.

Guidelines Nos. 5 to 7 require the applicant to identify potential competitive suppliers in the market, to identify the total uncommitted wholesale capacity that would have been available to compete for contestable loads and finally to determine what portion of that total uncommitted wholesale capacity could have been imported into the relevant market during the historical period. As with the process for the identification of contestable loads, the applicant has the opportunity to select the specific methodology to meet this evidentiary requirement. For example, an applicant might choose to develop an estimate of uncommitted wholesale capacity on an hourly basis through a load shape analysis that incorporates hourly data for native load obligations.

Guideline No. 8 requires the applicant to provide a demonstration that transmission constraints did not limit access by the contestable loads to competitive generation resources. This requirement could be addressed by the applicant, for example, by an analysis of transmission congestion data as might impact the ability of the contestable loads to access competitive generation suppliers.

Finally, Guidelines Nos. 9 to 10 establish the criteria for the applicant to pass the Historical Contestable Load Analysis. Under the proposed guidelines, if total competitive generation resources are at least twice the total contestable load, the

applicant will be deemed to have passed the analysis for the specified product and seasons. In addition, the applicant would have to demonstrate that the competitive generation resources were not unduly concentrated amongst the competitive suppliers.

Conclusion

EEI recognizes the need for the Commission to employ an indicative screening process to identify those MBR applications that will require more detailed analysis prior to granting MBR authorization to the applicant. For that role the Commission has chosen to employ the Pivotal Supplier and Market Share Screens.

With regard to those indicative screens, however, EEI is concerned that the Market Share Screen is currently generating a failure rate in the range of 70% for non-RTO utilities. This contrasts to the failure rate for the Pivotal Supplier Screen of approximately 9%.

This result from the MBR filings that have been made to date indicates that there is a high probability of a false positive problem associated with the application of the Market Share Screen particularly in light of the results of the supplemental analyses that have been filed by some applicants failing the Market Share Screen that appear to demonstrate the competitiveness of the wholesale market within their control areas. EEI would suggest therefore that the current structure of the Market Share Screen should be reexamined by the Commission to determine what modifications to this screen may be warranted.

Beyond the issue of determining the final structure of the indicative screens, EEI believes that there is also a need at this time to focus on the development of the fourth

generation of market power screens, i.e., market power screens that go beyond the indicative screen function of the Pivotal Supplier and Market Share Screens and provide the Commission with a more accurate assessment of whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the marketplace. From EEI's perspective, that process should focus on the determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives within the relevant market (contestable loads) and the competitive generation resources that were available to meet those loads. This is the conceptual premise for EEI's Historical Contestable Load Analysis.

On behalf of EEI, I wish to thank the Commission for providing us with the opportunity to explain our proposal to you today. I look forward answering any questions that you might have. Thank you.

Appendix A **Historical Contestable Load Analysis Proposal**

Introduction

In the April 2004 Order, the Commission stated that, for market-based ratemaking (MBR) applicants failing either the Pivotal Supplier or Market Share Screen, it will provide such applicants with the opportunity to present additional evidence such as historical sales data to support whether the applicant does or does not possess market power.

While the Commission has made available to the MBR applicant the opportunity to submit additional evidence, the Commission has not yet specified either the required structure of such evidence or the standard the applicant would have to meet with regard to such evidence to establish that the applicant does not possess market power.

To address this need, EEI presents to the Commission a proposal for a “fourth generation market power screen”, i.e., a market power screen that goes beyond the indicative function of the current interim Pivotal Supplier and Market Share Screens and provides the Commission with a more accurate assessment as to whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the wholesale marketplace.

This fourth generation market power screen, which EEI has termed a **Historical Contestable Load Analysis**, focuses on a determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives (contestable loads) and the competitive generation resources that were available to serve those loads in the relevant market.

This analysis is intended to be filed at the time the MBR applicant makes its initial filing for MBR authorization for review by the Commission for the purpose of determining whether the applicant does or does not possess market power. If the

Commission determines that the analysis demonstrates an absence of market power, a rebuttable presumption would then be established that the applicant does not possess market power and therefore there would be no need to initiate a Section 206 proceeding.

The Need for a Fourth Generation Market Power Screen

As has been explained by the Commission in several orders, both the Pivotal Supplier and Market Share Screens were primarily designed by the Commission to function as indicative screens, i.e., to identify those MBR applications that will require more detailed scrutiny by the Commission to determine whether the applicant does or does not possess market power.

As with any indicative screen, both the Pivotal Supplier and Market Share Screens have traded a certain degree of analytical accuracy for simplicity in preparation as well as a limitation on the scope of the data inputs that would be required by the Commission.

This analytical tradeoff process, however, has been particularly significant with regard to the Market Share Screen. For example, the Market Share Screen does not take into account the relative level of total market demand to total uncommitted generation capacity which is a major factor in determining whether the applicant can exercise market power. To illustrate, an MBR applicant could have a market share of 50% (5,000 MW/10,000 MW) but not have the ability to exercise market power if the total wholesale market demand is only 2,000 MW.

Further, in the calculation of the Market Share Screen, seasonal estimates of the uncommitted wholesale market generation capacity are developed through a process by which seasonal proxies for native load requirements (the lowest of the daily peaks within each season) are subtracted from each market participant's nameplate generation capacity. The use of this native load proxy in the Market Share Screen seriously understates the generation capacity actually required by the applicant to meet seasonal native load obligations and therein overstates the generation capacity available to the applicant for wholesale market sales.

The effect of incorporating these analytical tradeoffs in the Market Share Screen has been to create the potential for the screen to generate a significant number of false

positive results, i.e., to inaccurately attribute to an MBR applicant the ability to exercise market power. EEI would note that non-RTO utilities are currently experiencing a failure rate of approximately 70% for the Market Share Screen within their control areas in the MBR filings that have been made to date (August to December 2004). This contrasts to a failure rate of approximately 9% for the Pivotal Supplier Screen.

This result from the MBR filings that have been made to date indicates that there is a high probability that there is a false positive problem associated with the use of the Market Share Screen particularly in light of the results of the supplemental analyses that have been filed by some applicants failing the Market Share Screen that appear to demonstrate the competitiveness of the wholesale market within their control areas. EEI would suggest therefore that the current structure of the Market Share Screen should be reexamined by the Commission to determine what modifications to this screen may be warranted.

While EEI believes that there is a need to address the potential false positive problem associated with the indicative Market Share Screen, EEI also believes that there is a need at this point to move forward with the development of the fourth generation of market power screens, i.e., market power screens that go beyond the indicative function and provide the Commission with a more accurate assessment as to whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the marketplace. From EEI's perspective, that process should focus on the determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives (contestable loads) and the competitive generation resources that were available to serve those loads. This is the conceptual premise for EEI's Historical Contestable Load Analysis proposal.

Historical Contestable Load Analysis Preparation Guidelines

EEI proposes that the following guidelines be adopted by the Commission as a template for the purpose of providing guidance to applicants for use in the preparation of a Historical Contestable Load Analysis. These guidelines are not intended to be prescriptive in nature, but rather designed to set forth specific evidentiary thresholds the applicant would have to meet for the analysis to be deemed by the Commission to

demonstrate that the applicant does not possess market power. As such the applicant would have the opportunity to develop specific methodologies to meet the evidentiary thresholds contained in the guidelines. As we gain more experience with the implementation of this screen, it may be possible for the Commission to adopt a more standardized approach to the preparation guidelines.

1. The Historical Contestable Load Analysis shall be prepared using the most recently available historical data. While an applicant will be required to submit such an analysis based upon historical data, the applicant may also submit a prospective analysis for further consideration by the Commission. A forward-looking analysis would be particularly useful if the applicant's assets and/or market conditions are expected to change significantly in the future.
2. Identify the relevant geographic market(s). Provide the justification for the relevant geographic market(s) selected by the applicant.
3. Identify the relevant wholesale product(s) that the applicant will use in the preparation of the analysis (e.g., on-peak period, off-peak period, short-term, long-term, composite, etc.)
4. Identify all loads within the relevant market that were subject to competition (contestable loads) by product for the historical test period. Explain in detail the methodology used by the applicant to identify contestable loads.
5. Identify all potential competitive generation suppliers for the relevant geographic and product markets.
6. For the identified potential competitive suppliers, specify the total uncommitted wholesale capacity that would have been available to compete for loads seeking competitive suppliers during the historical test period. Describe the methodology utilized by the applicant in estimating the total uncommitted wholesale capacity.

7. Determine what portion of the total uncommitted wholesale capacity from competitive suppliers could have been imported into the relevant market during the historical test period. Describe the methodology used by the applicant in estimating total import capability.
8. Provide a demonstration that transmission constraints would not have limited access by the contestable loads to competitive generation resources during the historical test period.
9. Calculate the ratio of total competitive generation resources to total contestable load by product and season during the historical test period.
10. If the total competitive generation resources were at least twice the total contestable load, the applicant will be deemed to have passed the Historical Contestable Load Analysis for the specified product and seasons. In addition, the applicant should provide a demonstration that the competitive generation resources were not unduly concentrated amongst the competitive suppliers.

Conclusion

EEI recognizes the need for the Commission to employ an indicative screening process to identify those MBR applications that will require more detailed analysis prior to granting MBR authorization to the applicant. For that role the Commission has chosen to employ the Pivotal Supplier and Market Share Screens.

As with any indicative screen, both the Pivotal Supplier and Market Share Screens have traded a certain degree of analytical accuracy for simplicity in preparation as well as a limitation on the scope of the data inputs that would be required by the Commission. In particular, with regard to the Market Share Screen, these tradeoffs have been significant and relate to the failure of the screen to consider demand/supply relationships in the market as well as the underestimation of capacity requirements to meet native load obligations.

The effect of incorporating these analytical tradeoffs in the Market Share Screen has been to create the potential for the screen to generate a significant number of false positive results, i.e., to inaccurately attribute to an MBR applicant the ability to exercise market power. EEI would note that non-RTO utilities are currently experiencing a failure rate of approximately 70% for the Market Share Screen within their control areas in the MBR filings that have been made to date (August to December 2004). This contrasts to the failure rate of approximately 9% for the Pivotal Supplier Screen.

This result for the MBR filings that have been made to date indicates that there is a high probability of a false positive problem associated with the use of the Market Share Screen, particularly in light of the results of the supplemental analyses that have been filed by some applicants failing the Market Share Screen that appear to demonstrate the competitiveness of the wholesale market within their control areas. EEI would suggest therefore that the current structure of the Market Share Screen should be reexamined by the Commission to determine what modifications to this screen may be warranted.

While EEI believes that there is a need to address the potential false positive problem associated with the use of the indicative Market Share Screen, EEI also believes that there is a greater need at this point to move forward with the development of the fourth generation of market power screens, i.e., market power screens that go beyond the indicative function and provide the Commission with a more accurate assessment as to whether the applicant does or does not possess market power based upon an analysis of what is actually happening in the marketplace. From EEI's perspective, that process should focus on a determination of the relationship between the wholesale loads that were actually seeking competitive supply alternatives (contestable loads) and the competitive generation resources that were available to serve those loads. This is the conceptual premise for EEI's Historical Contestable Load Analysis proposal.