UNITED STATES OF AMERICA

BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

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

Tuesday, May 8, 2007

Written Statement of
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Good afternoon Mr. Chairman and members of the Commission. My name is Marc Gerken and I am President and CEO of American Municipal Power – Ohio, Inc. (AMP-Ohio). AMP-Ohio is a nonprofit corporation organized in 1971 which is composed of 120 Members in 5 states. In turn, these 120 Members represent nearly 516,000 customers whose peak load is approximately 3500 MW. AMP-Ohio owns and operates electric generating facilities; provides wholesale generation, transmission, and distribution services; and, coordinates, negotiates, and develops power supply options and interconnection agreements for its Members.

Introduction

AMP-Ohio wants to thank you for holding this series of conferences to examine the current state of competition in the wholesale electricity markets, and we appreciate the opportunity to testify before you today. Currently, AMP-Ohio purchases approximately 85% of its Members' generation needs in the organized Midwestern markets (i.e., MISO and PJM). AMP-Ohio generates the remaining approximately 15% of its Members' needs, and its generation must operate in these same Midwestern markets. Accordingly, AMP-Ohio remains very concerned about market structure, as well as market procedures and processes for both MISO and PJM. As noted in a multitude of prior submissions to this Commission, ***AMP-Ohio remains very concerned about the course of development in the organized wholesale markets in the Midwest. In short, customers of these markets continue to see their costs increase without realizing the entirety of the continually promised benefits of those same markets. As a result, I must regretfully conclude that current organized markets in the Midwest are <u>not</u> responsive to their ultimate customers.*** To put this conclusion another way, I would ask you to recall an analogy made by Chairman Wood during his tenure at the Commission. Specifically, Chairman Wood said that "public power is the canary in the mine" when it comes to the organized markets. In short, public power entities will be the first to judge whether these organized markets are working. Well, the canary is on life support!

Selected Background

Past criticisms of RTOs and ISOs have centered on their rapidly escalating administrative costs and the failures of those entities to deliver on the promised benefits of Day-Two markets. To address the former complaint, this Commission opened Docket No. RM04-12 to investigate RTO and ISO accounting and financial reporting practices.

AMP-Ohio endorsed the recommendations of the Transmission Access Policy Study Group (TAPS) in that proceeding. TAPS called on FERC to embark on a "pro-consumer track of cost containment and efficient operation…." Specifically, TAPS recommended that FERC: 1) revise the Uniform System of Accounts (<u>e.g</u>., to better capture RTO and ISO functions and associated costs); 2) modify RTO governance to provide for **hybrid** Boards (with a balanced stakeholder minority); 3) establish more robust Board elections (<u>e.g.</u>, multiple candidates for open Board positions, individual candidates subject to an "up" or "down" vote – no slate voting, elimination of the self-perpetuating Board model); 4) establish cost controls (<u>e.g</u>., benchmark RTO and ISO costs, biennial cost/benefit analyses by state, cost/benefit assessment of new initiatives, performance measures, and the stakeholder review of the RTO/ISO budget); and 5) tie

RTO/ISO management compensation to specific performance measures. In its final rule issued in Docket No. RM04-12, FERC chose to address only item #1 in the list above.

Pursuant to Section 1815 of the Energy Policy Act of 2005 (EPAct 2005), the Electric Energy Market Competition Task Force recently submitted its "Report to Congress on Competition in Wholesale and Retail Markets For Electric Energy." Generally, this report was descriptive in nature with few, if any, hard recommendations on how to cure the perceived problems in wholesale markets.

APPA commenced its Electric Market Reform Initiative (EMRI) to address wholesale market failures and other serious current challenges facing organized wholesale electricity markets. Some of these challenges include rapidly increasing wholesale prices, spiraling RTO and ISO administrative costs, the failure of higher prices (i.e., "market signals") to enhance generation and transmission adequacy, and the lack of long-term bilateral contracts at reasonable rates.

The results of the Phase I EMRI studies were released in February, 2007. These studies examined the factors behind the near-term wholesale price increases, the "winners" and "losers" in restructured markets, locational marginal pricing (LMP) and other facets of the current organized markets run by RTOs and ISOs. I heartily support the messages sent by the EMRI Phase I studies. The second phase of the EMRI process is to focus on recommendations on how to address the flaws present in the current organized markets. Phase II organizational meetings are now scheduled for May and June of 2007.

Joe Nipper, the Senior Vice President of the American Public Power Association, previously presented testimony in this proceeding relating to the problems inherent in today's bilateral markets. Specifically, Mr. Nipper mentioned: 1) continued transmission discrimination in certain areas of the bilateral markets and 2) the need to improve regional transmission planning and coordination. In addition, Mr. Nipper noted the growing concern of APPA relating to "adjacent RTO-run Day-Two markets." The problem is resulting in "an increasing number" of APPA members having difficulty in "securing long-term supply contracts at reasonable prices."

Discussion

Let us consider the first question asked of this panel: *"Are RTOs and ISOs…designed to address adequately the interests of their customers…?"* One needs to step back, however, and reassess two other fundamental questions before addressing the question just asked. First, one must identify the real customers of these regional entities. I maintain that the true customers of the RTOs and ISOs are the Load-Serving Entities (LSEs) represented by a variety of stakeholders. Let me be perfectly clear: the "customers" of the RTO/ISO are **not** the asset owners (i.e., the Transmission Owners, or TOs, and the Generation Owners, or GOs) **nor** are they the management of the RTOs and ISOs.

Second, one must also reaffirm what is the true goal of enabling wholesale competition. I would submit that the establishment of regional markets is a "means to an end" and not the end itself. Elaborate and complex structures that don't ultimately provide real benefits to customers are not what LSEs need. To truly serve customers, market structures must ensure that the ultimate customers pay "just and reasonable" rates for reliable service. In short, the goal of enabling competition is to achieve "just and reasonable" rates (as required in the Federal Power Act) for the true customers of the RTO and ISO.

I do not believe that the current organized markets have adequately served the interests of their true customers. New initiatives are continually promoted by MISO and PJM despite the almost unanimous opposition of stakeholders other than the TOs and GOs. With PJM, it was previously the Reliability Pricing Model (RPM) – a venture panned by a majority on several stakeholder votes. Customers are asked to pay mightily today under this venture with the dubious promise of potential future benefits. Now stakeholders are hearing of a new PJM initiative – the "SmartGrid" that promises to provide us with even higher current costs with more potential future benefits. With MISO, it's the new Ancillary Services Market (ASM) – another venture panned by a majority of stakeholders other than the TOs and GOs.

Despite rapid and consistent increases in prices, current organized markets and the "incentives" they provide to suppliers are not encouraging the necessary development of generation and transmission. Thus, needed infrastructure is not being built in a timely manner despite high LMPs and the continuance of a Uniform Clearing Price (UCP) mechanism. Moreover, the true customers of the RTOs and ISOs are not realizing the benefits cited to justify the establishment of the organized markets in the first place. For example, MISO continually overestimates the benefits from its initiatives while underestimating the costs associated with these same initiatives. In 2004, MISO originally promised $713 million in benefits from the establishment of its Day Two markets. According to the original ICF cost/benefits study (performed for MISO), the Day Two market has realized a first-year annualized benefit of only $70 million out of a potential benefit of $325 million for the period of June 2005 through March 2006. Originally, the Day Two implementation costs were forecast by MISO to be approximately $192 million. ICF noted that, to date, approximately $247 million has been spent to establish the MISO Day Two market.

In addition, the RTOs and ISOs fail to address specific customer service needs. For example, customer projects placed in the RTO/ISO interconnection queue are often stalled for appreciable amounts of time, and for no apparent reason. As a result, project timetables suffer and costs escalate. For example, AMP-Ohio is in the permitting stages on an approximately 1000 MW state of the art coal-fired baseload generating plant (i.e., AMPGS) to lessen its dependence on the organized markets in the Midwest. Accordingly, AMP-Ohio filed its interconnection application with PJM in January, 2006. PJM still has not completed the System Impact Study for this project. After a three-month delay in completing the Feasibility Study, the work on the System Impact Study has taken over nine months with a new projected completion date of May 31, 2007. I would submit this time period is too long. Delays in this project could cost our Members between $20-30M per month. Also, it should be noted that this project represents only one part of our strategic plan to lessen our dependence on the current organized markets. Overall, we project that AMP-Ohio will be investing approximately $4B in AMPGS and additional hydroelectric, wind and coal generation in the region.

What actions should the Commission take, within its jurisdiction, to address the issues? My initial reaction is that the organized markets in the Midwest are in such a sorry state that I don't know where to begin. In the Midwest, short-term organized markets are driving long-term bilateral prices, which shouldn't happen. As noted previously, public power entities are having increasing difficulty in acquiring long-term supplies at reasonable prices. As noted above, AMP-Ohio is building/purchasing significant new generation capacity in order to better meet our Members' needs (in a less costly manner), while lessening our dependence on the current organized markets. Still, I don't believe that we can totally give up on reforming the organized markets of the RTOs and ISOs, and we must start somewhere.

Accordingly, I would encourage this Commission to take action in three broad areas. First, FERC needs to address further RTO/ISO administrative costs through the implementation of the measures previously supported by TAPS in Docket No. ER04-12 (and endorsed by AMP-Ohio, a member of TAPS). Specifically, FERC should establish benchmark RTO and ISO costs, conduct biennial cost/benefit analyses by state, require a cost/benefit assessment of major new initiatives, and require stakeholder review of the RTO/ISO budget prior to its adoption.

Second, the governance of the RTOs and ISOs must be changed. Specifically, FERC should modify RTO governance to require **hybrid** Boards that include a balanced stakeholder minority (i.e., without current RTO/ISO management representation either). In addition, FERC should work to establish more robust Board elections (e.g., multiple candidates for open Board positions, individual candidates subject to an "up" or "down" vote – no slate voting, elimination of the self-perpetuating Board model). In addition, all stakeholders should receive more opportunities for direct communication with this hybrid

Board. Such measures should provide for a better focus on the true customers of the RTO and ISO, while ensuring better diversity in the decision-making process.

Third, FERC should **“GO SLOW”** on major new RTO/ISO initiatives. For example, MISO’s ASM (or any other major initiative) should not be allowed to proceed until the majority of the available potential benefits from the ISO’s Day Two market have been captured by customers – not asset owners. Likewise, PJM should not be allowed to proceed with “SmartGrid” (or any other major initiative) until customers have seen the majority of potential benefits that were to accrue from implementation of RPM. If the potential benefits from these last major initiatives are not realized, FERC must be prepared to step further back – perhaps even to limits on the use of the UCP, LMP, and the Day-Two market itself. I would also encourage the Commission to consider whatever recommendations are produced from the EMRI Phase II effort.

This concludes my prepared remarks, and I thank you again for the opportunity to appear before you today.