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April 3, 2001

Hon. Donald S. Clark
Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue, NW
Room H-159
Washington, DC 20580

Re: V0100003--Comments Regarding Retail Electricity Competition

Dear Mr. Clark:

The Transmission Access Policy Study Group ("TAPS") appreciates the opportunity to comment regarding retail electricity competition. TAPS is an informal association of municipal, cooperative and investor-owned utilities, and other supporters, in more than thirty-three states, promoting open and non-discriminatory transmission access.[1] Most TAPS members are entirely or predominantly transmission dependent. They have commented upon and been involved in nearly all aspects of electric industry restructuring activities both before the Federal Energy Regulatory Commission ("FERC") and in the legislative arena.[2]

While a number of TAPS members have been heavily involved in retail competition initiatives underway in their respective states, TAPS' focus is on the national level. For that reason, TAPS confines its comments to fundamental structural issues that cut across state borders:

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[1] TAPS is chaired by Roy Thilly, CEO of Wisconsin Public Power, Inc. Current members of the TAPS Executive Committee include, in addition to WPPI, representatives of: American Municipal Power-Ohio; Blue Ridge Power Agency; Clarksdale, Mississippi; ElectriCities of North Carolina, Inc.; Florida Municipal Power Agency; Geneva, Illinois; Illinois Municipal Electric Agency; Indiana Municipal Power Agency; Madison Gas & Electric Co.; Michigan Public Power Agency; Missouri River Energy Services; Municipal Energy Agency of Nebraska; Northern California Power Agency; Southern Minnesota Municipal Power Agency; and Vermont Public Power Supply Authority.

[2] Since 1989, when TAPS developed a formal position favoring fair transmission access through joint planning and use, TAPS has been actively involved in seeking fair and non-discriminatory transmission access for all users. *See Proposal of the Transmission Access Policy Study Group for Adoption and Implementation of a Fair Access Transmission Policy* in *The Transmission Task Force's Report to the Commission*, App. H, 253-267 (FERC, Oct. 1989). In the legislative process that led to the Energy Policy Act of 1992 (EPAct), TAPS continued to advocate strong transmission access provisions. TAPS has submitted comments in most of the FERC's rulemaking proceedings involving issues of transmission access or pricing.

- Truly independent and rationally-scoped regional transmission organizations are essential for competitive markets, both at wholesale and at retail.
- For electricity markets to work, FERC must have jurisdiction over both bundled and unbundled transmission service
- Transmission siting issues transcend state boundaries and cannot be rationally addressed on an individual state basis.
- Reserve sharing is critical to markets in which both large and small utilities can compete to provide reliable electric service at reasonable rates.

I. INDEPENDENT, RATIONALLY-SCOPED RTOS ARE ESSENTIAL TO COMPETITIVE MARKETS[3]

For competitive electricity markets to thrive, a structural solution is required: the grid must be regionalized, in a manner that eliminates any advantages in competitive markets arising from transmission ownership and control, by requiring transmission owners to place their transmission facilities under the plenary control of truly independent regional organizations (RTOs) that will provide all users access on an equal basis.[4]

The need for operational (if not corporate) unbundling has been recognized by FERC. In Order 2000[5], FERC found that RTOs are needed to remedy undue discrimination that continues even after Order 888, and to address the engineering and economic impediments which create obstacles to competitive electric markets and adversely affect reliability and operational efficiency. Building on experience of TAPS members and others, FERC "concluded that opportunities for undue discrimination continue to exist that may not be remedied adequately by functional unbundling," and that even the perception of undue discrimination can impede development of competitive markets. *Id.* at 824, 824-25.

> As we noted in the NOPR and Order No. 888, vertically integrated utilities have the incentive and the opportunity to favor their generation interests over those of their competitors. If a transmission provider's marketing interests have favorable access to transmission system information or receive more favorable treatment of their transmission requests, this obviously creates a disadvantage for market competitors.
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> While we have attempted to rely on functional unbundling to address our concerns about undue discrimination, there are indications that this is difficult for transmission providers to

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[3] *See* Market Structure Issue 1.

[4] If a for-profit transmission company (transco) qualifies as an RTO, (i) all load-serving entities should have the right to participate as passive owners based on load, if any passive ownership by market participants is permitted, and (ii) the transco should be subject to reasonable sunshine and open meeting requirements consistent with its monopoly, common-carrier status.

[5] *Regional Transmission Organizations,* Order No. 2000, 65 Fed. Reg. 810, 823-25 (Jan. 6, 2000), *order on reh'g,* Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), *appeal docketed sub nom. Pub. Util. Dist. 1 v. FERC,* No. 00-1174 (D.C. Cir. Apr. 24, 2000).

> implement and difficult for the market and the Commission to monitor and police.
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> . . .
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> The fact remains that claims of undue discrimination have not diminished, and there is no evidence that discrimination is becoming a non-issue.

Id. at 824. Order 2000 also found complaints before FERC are an inadequate remedy for undue discrimination. *Id.* at 824 & n.95. *See also id.* at 818 n.70, citing the NOPR ("the Commission's remedies for violations do not impose sufficient financial consequences on the transmission provider to act as a significant deterrent; and, in the fast-paced business of power marketing, there may be no adequate remedy for the lost short-term sales opportunities in after-the-fact enforcement. *See* FERC Stats. & Regs. ¶ 32,541 at 33,706"). Thus, FERC concluded (Order 2000 at 825):

> In summary, we affirm our conclusion in the NOPR that economic and engineering inefficiencies and the continuing opportunity for undue discrimination are impeding competitive markets. As noted below, we conclude that RTOs will remedy these impediments and that it is essential for the Commission to issue this Final Rule.

To achieve their pro-competitive purpose, RTOs must be truly independent of market participants, and have a broad regional scope designed to enhance competition and reliability, rather than to enhance the value of the generation owned by participating vertically-integrated transmission owners. As FERC has recognized, RTOs can facilitate competition by ending the current system of balkanized markets, where an additional "pancaked" rate (or toll) must be paid whenever a transaction crosses the boundaries from one transmission owner to the next. RTOs would permit competitors to sell their electricity goods throughout a broad regional market by payment of only a single "non-pancaked" charge. By expanding the market, RTOs can increase the number of buyers and sellers that can transact with each other, enhancing competition and reducing market power.

On the other hand, gerrymandered RTOs designed by vertically-integrated transmission owners to enhance their generation market power, by creating price or access barriers to competitors, are lethal to competition. For example, in recent comments to FERC regarding the settlement of Midwest ISO/Alliance RTO scope issues, a number of state commissions commented:[6]

> The single Super-Region rate is not available to transactions in which the generation source is located outside the combined MISO-Alliance region and the customer load is located inside the combined region. Therefore, a generator located outside the Super

[6] Initial Comments of the State of Michigan and the Michigan Public Service Commission, the Illinois Commerce Commission, the Public Utilities Commission of Ohio, the Indiana Utility Regulatory Commission, the Iowa Utilities Board, the Missouri Public Service Commission, the Public Service Commission of Wisconsin, the Pennsylvania Public Utility Commission, the Kentucky Public Service Commission and the Public Service Commission of West Virginia on the March 21, 2000 Settlement Agreement between the Alliance Companies, Midwest ISO, Inc. and Certain Transmission Owners in the Midwest ISO, dated March 30, 2001 under FERC Dockets numbered ER01-123-000 *et al.*, at 7.

> Region must pay a rate to the ISO in which it is located, a rate through the Midwest ISO and a third rate to the Alliance to move its generation across both RTOs.
>
> This exclusion protects the generation within the combined region from competition from generation outside the region. Most of that protected generation is owned by vertically integrated utilities who are parties to the settlement. This result is not easily reconcilable with the public interest generally or seamless wholesale competition specifically.

They note further in concluding remarks:[7]

> Running through these comments has been a common theme: the settlement can achieve its stated goals only through implementation that is conscientious, timely and consistent with Order No. 2000. The Commission must remember that the parties exercising significant influence over these proceedings were transmission owners who owned generation. There is no Alliance RTO; there are only "Alliance Companies," each of whom is a major owner of both generation and transmission. Thus, the positions taken by the "Alliance," unlike the MISO, have been the positions not of independent transmission owners but of generation-owning transmission owners. It has been, and will continue to be, difficult to achieve the "bedrock" goal of both Order Nos. 888 and 2000 – the unbundling of generation from transmission – on a voluntary basis where the parties exercising the most influence in proceedings continue to control both generation and transmission.

Unfortunately, FERC's decision to leave RTOs to voluntary action all but encourages vertically-integrated transmission owners to use RTO formation to enhance the value of their generation, at the expense of the competitive market. While Order 2000 recognizes FERC's authority to require RTOs in certain circumstances, the pro-competitive purposes of RTOs would be far better served if Congress clarified FERC's authority to require participation in rationally-scoped, truly independent RTOs to eliminate undue discrimination and as a standard conditions for approval of mergers and market-based rates.

RTOs must have sufficient authority over generation to ensure reliability, and the ability to plan and construct needed new transmission, subject to required siting approvals. All facilities that perform a transmission function, as determined by FERC, should be under RTO control. Subject to existing contracts, all transmission service should be unbundled and taken under the RTO tariff. In our view, regional transmission systems should be operated as a single system and priced on a cost-of-service basis without pancaking of transmission rates. TAPS opposes monetary incentives to join RTOs and efforts to recover from ratepayers premiums paid for monopoly transmission facilities. Instead, market-based pricing authority for generation should

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[7] *Id.* at 15-16.

be prohibited for any owner whose transmission is not in an RTO. FERC should be required to design transmission rates so that the RTO is rewarded for relieving constraints and minimizing curtailments, consistent with the just and reasonable standard, and penalized for failing to do so. Rather than providing incentive returns to existing owners to build improvements, RTOs should bid out transmission construction, including the return component, in order to put competitive pressure on the cost of new facilities.

II. FOR COMPETITIVE MARKETS TO WORK, FERC NEEDS TO HAVE JURISDICTION OVER ALL USES OF THE TRANSMISSION HIGHWAYS[8]

For electricity competition to be successful, FERC must have authority to establish one set of rules for the use and operation of the nation's interstate transmission system. The Eighth Circuit undermined FERC's ability to do so, by ruling that states can set their own rules for the transmission of "bundled" retail sales (traditional retail sales where the price for power is "bundled" with the price of transmission and distribution services) and favor these in-state users when there is insufficient transmission capacity. *Northern States Power v. FERC*, 176 F.3d. 1090 (8th Cir. 1999), *cert. denied*, 528 U.S. 1182 (2000). Under *NSP*, each state can set its own rules for transmission of bundled retail sales within that state, without regard to what other states do and without regard to FERC's rules, while FERC is limited to setting rules for wholesale and "unbundled" (choice) retail uses.[9] No regulatory body would have authority to ensure a coherent scheme for the use and allocation, among all users, of what is necessarily the single transmission network. The need for a single set of rules to govern the transmission highways is plain. Think what pandemonium would occur if the interstate highways posted two sets of speed limits, one for in-state trucks and the other for trucks going out of state. Imagine further that a state could establish a rule that if there was congestion, in-state trucks would be permitted to pass, while out-of-staters would have to wait until the traffic subsided. Interstate commerce would plainly be impaired.

The issue of FERC's current statutory authority over bundled and unbundled retail transmission is currently before the Supreme Court, on challenges to the D.C. Circuit's affirmance of FERC Order 888. *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667 (D.C. Cir. 2000), *cert. granted sub nom. New York v. FERC*, Nos. 00-568 and 00-809 (U.S. Feb. 26, 2001). The D.C. Circuit affirmed FERC's assertion of jurisdiction over unbundled retail transmission,[10] while deferring to FERC's characterization of bundled retail transmission as part of retail sales subject to state jurisdiction.

Regardless of how the Supreme Court ultimately interprets the 1935 Federal Power Act, if there is to be viable competition in electric markets, Congress needs to make clear that all uses of the transmission are governed by FERC. As we move toward competition on a state-by-state

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[8] *See* Market Structure Issue 5.

[9] If *NSP* is correct, FERC's authority over interstate transmission would be far more restricted than its otherwise parallel authority over natural gas transportation. *See FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (recognizing Federal Power Commission authority over all interstate gas transportation).

[10] "We are bound by the High Court's dictates to conclude that the FPA gives FERC the authority to regulate the transmissions at issue here, whether retail or wholesale. Even if the Court had not so spoken, however, ... we would be hard pressed to conclude that FERC's interpretation of § 201(c) as giving it jurisdiction over both wholesale and retail transmissions is unreasonable or impermissible." 225 F.3d at 694.

basis, FERC must be authorized to establish a single regimen that does not relegate use of the grid for wholesale transactions or retail choice programs to second class citizen status. All transmission service is ultimately provided to deliver electricity to end-use customers. Why should those served on a bundled take priority over those who are not? Is the price of exercising choice to be less reliable service? If so, we will never achieve effective competition; consumers will not switch suppliers if they cannot rely on obtaining power. The absence of a clear, unified set of rules would enable one state to cripple choice programs in a neighboring state, by according in-state bundled sales a higher priority than unbundled deliveries to its neighbors.

III. LEAVING SITING TO INDIVIDUAL STATES WILL NOT CREATE THE ROBUST TRANSMISSION SYSTEM NEEDED TO SUPPORT COMPETITIVE MARKETS[11]

Competitive electricity markets are necessarily predicated on the ability to obtain reliable sources of supply other than the surrounding vertically-integrated transmission owner. But the nation's transmission system was built primarily to serve load from the generating resources of the local utility, not for long distance transfers from remote sources. As wholesale transactions have increased, the grid has become more congested, with the result that transmission service is denied or curtailed (through "TLRs," Transmission Loading Relief, administered through NERC Security Coordinators to maintain system security, stability, and reliability) with increasing frequency.[12] On the wholesale side, TAPS members have seen the results of this situation in foreclosed,[13] cancelled, [14] or disrupted transactions,[15] and far fewer responses to RFPs.[16]

Notwithstanding the growing congestion, little transmission has been constructed in recent years. Part of the reason for absence of construction is the desire of vertically-integrated

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[11] *See* Market Structure Issue 6.

[12] *See, e.g.*, FERC Staff Report, Investigation of Bulk Power Markets – Midwest Region, issued November 1, 2000, at 2-17 to 2-22 (showing increasing TLRs despite milder temperatures last summer), *available at* http://www.ferc.fed.us/electric/bulkpower.htm.

[13] Attempts to import firm power into Wisconsin at this point are futile.

[14] For example, TAPS member Oklahoma Municipal Power Authority has been tried to purchase 15 MW from Duke Energy Trading and Marketing for the summer of 2000. Duke requested the transmission needed from Entergy on October 21, 1998. Entergy controls a significant portion of the transmission from the east serving the state of Oklahoma. Entergy is also a competitor of Duke. For a year, Entergy refused to provide the transmission and refused to explain why it cannot do so. For a year, the only answer Duke and OMPA could get is that the transmission of this small amount of power is "under study." Ultimately, by letter of November 9, 1999, Duke Energy was forced to cancel the sale for lack of transmission.

[15] For example, TAPS member WPPI has within the last week (and on the weekend) experienced curtailments of firm transmission service. Missouri Joint Municipal Electric Utility Commission and its members also experience curtailments of firm transmission service last summer and fall. During the summer of 1998, TAPS member Illinois Municipal Electric Agency (IMEA) had the choice of firming up its summer power supply in two ways: (1) a straight forward buy from Pennsylvania through AEP's transmission; or (2) a much more convoluted and costly buy from the Dakotas, with power routed through the Oklahoma Municipal Power Authority and then transmitted through two other utilities, Ameren and Illinois Power. IMEA was so concerned about AEP's tendency to claim transmission constraints that IMEA opted for the more complex and costly alternative buy.

[16] OMPA received only 7 responses (most of which were transmission contingent) to a 1999 RFP which it sent to 100 potential suppliers. In the fall of 1998, the Marshfield Electric & Water Department in Wisconsin received no responses to an RFP sent to 8 potential suppliers (3 utilities; 3 power marketers; and 2 independent power producers) seeking firm capacity and energy for 2004 and peaking capacity for 2001.

transmission owners to use their ownership of transmission and control of planning and construction to protect the value of their generation. Particularly given the relatively small portion of such an owner's assets represented by transmission investment, as compared with its generation investment, the owner has a powerful interest in not building the transmission that would permit more competitive suppliers to reach its customers.

Even where a transmission owner actively seeks to construct transmission, siting is a very difficult challenge. Siting transmission tends to be harder than siting generation because more landowners are necessarily affected. But transmission siting is greatly complicated by the fact that it is a state and local matter, sometimes involving more than one approval process even within a given state. Often an upgrade crosses state lines, with separate siting approval required by each state, which by law if not political pressure may be limited to narrowly considering the issue of how the upgrade benefits that state's citizens, without considering the value to the region. In other instances, due to the dynamic and highly integrated nature of the AC grid, action in neighboring states may well be needed to give full effect to a transmission upgrade undertaken by an adjoining state to alleviate a constraint. Thus, a state can spend hundreds of millions of dollars on transmission improvements, only to find that it cannot obtain the intended additional transmission capability because of a limiting element one or even two states away. Individual states simply are not in a position to "cure" their own transmission problems.

For example, one of the most transmission constrained portions of the country is the Eastern Wisconsin/Upper Michigan ("WUMS") area. Eastern Wisconsin has 11,700 MW of load and 1500-1600 MW of import capacity, almost all of which is controlled by the three major utilities in Eastern Wisconsin. These three utilities together control more than 90% of the generating capacity in this area. (Wisconsin Electric Power Company controls 54%; Alliant and Wisconsin Public Service each control about 20%.) Yet, efforts to relieve the constraints and to better support Wisconsin load require cooperation from neighboring states. For example, a Report of the Wisconsin Reliability Assessment Organization on Transmission System Reinforcement in Wisconsin, filed with the Public Service Commission of Wisconsin on June 14, 1999, identified upgrades required in Illinois, Iowa and Minnesota to make effective transmission improvements implemented in Wisconsin. Indeed, Illinois upgrades were a common element of all the alternatives considered.[17] Similarly, the limiting element on the MAPP-WUMS interface, which severely restricts imports into Wisconsin, has at times been in Nebraska, Minnesota or Illinois.

The need to obtain separate siting approvals in multiple states complicates and slows down, if not stymies, the construction of transmission necessary for a reliable and robust market. AEP has for more than ten years been trying to build a 132-mile 765-kV line from the Wyoming Station in West Virginia to the Cloverdale Station south of Roanoke Virginia. The West Virginia PSC approved its portion of the line May 1998. If approved by Virginia, the line could connect to a somewhat lower voltage line that we understand had been previously approved for construction by Virginia Power and would significantly increase the import export capacity into its service area. As of now, a Virginia State Corporation Commission hearing examiner has recommended construction of a 90-mile line (from Wyoming Station to Jacksons Ferry, VA), which would provide shorter-term relief from reliability problems on that portion of the AEP

[17] *See* Report of the Wisconsin Reliability Assessment Organization on Transmission System Reinforcement in Wisconsin (June 14, 1999), Attachment A1 (WIREs Phase II Study Report), Appendix C (especially Appendix C-4), *available at* http://www.powerupwisconsin.com/wrao.html.

system, but would not improve access to Virginia Power's service area, to which access is constrained. At the same time, growing generation needs in the Virginia Power area are being met largely by new generation constructed by Virginia Power. When retail choice commences in Virginia in 2002, choices will be severely limited by transmission constraints and the resulting market power of the incumbent investor-owned utilities.[18]

As recently reported,[19] the Connecticut Siting Council recently turned down a 24-mile 300-MW transmission line from Connecticut to New York, "saying it would provide a marginal benefit to Connecticut consumers and would harm the state's oyster beds." It was reported that "Consumer advocates who opposed the plan said the line would siphon power from Connecticut to Long Island, which faces transmission constraints and a shortage of generation." Nearly a year ago, FERC approved the request of TransEnergie U.S., Ltd. (a division of Canada's Hydro-Quebec) to sell electric transmission capacity on that planned cable in a decision FERC's press release hailed as "deliberate action to promote grid expansion."[20] While the line is not necessarily dead (TransEnergie may seek an alternative route or technology within fifteen days), the process illustrates the difficulties in getting multiple states to cooperate on transmission siting even where it is widely reported that a neighboring state could be subject to severe shortages.[21]

Efforts have been underway since 1996 to site a 38-mile 230-kV line from the Chicago substation in Lent Township in Chicago County, MN, to the Apple River substation in Lincoln Township in Polk County, WI (a line bisected by the boundary between Minnesota and Wisconsin). The primary need for the project is to serve local load located in northwestern Wisconsin. Although Wisconsin approved the line in June 1999, Minnesota did not act on the application. In light of opposition to the project in the Minnesota proceeding applicable to projects with voltages higher than 200 kV, the proposed line has been revised by the applicants to a 161-kV line, and approvals for the revised project are needed from the Public Service Commission of Wisconsin and local jurisdictions in Minnesota. Approval of the project from all the various authorities with jurisdiction is not assured.

As these examples demonstrate, individual state siting is not the answer to getting built the transmission needed to support a competitive supply of reliable electricity. Instead, there is a clear need for siting approval and federal eminent domain authority for transmission projects needed for regional reliability and vigorous competition. At least a regional, if not a federal, solution is required. Indeed, the dynamic nature of the integrated AC transmission grid makes an

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[18] More information on this 765-kV line can be found at www.aep.com/news/765. The press release associated with the SCC hearing examiner recommendations can be found at www.state.va.us/scc/new/aeprept.htm.

[19] Kristen McNamara, *Conn Agency Nixes Running Elec Power Line To Long Island,* Dow Jones Newswire, *available at* http://wsj.com (Mar. 29, 2001); Kristen McNamara, *DJ Ct. Agency Seen Rejecting Proposed Pwr Line To LI-Agency,* Dow Jones Newswire, *available at* http://wsj.com (Mar. 16, 2001).

[20] Press Release, FERC, Commission Facilitates Undersea Cable Linking New York and New England ISOs (May 31, 2000), available at http://www.ferc.fed.us/news1/pressreleases/prsrls1.htm. *See also TransEnergie U.S., Ltd.*, 91 F.E.R.C. ¶ 61,230 (2000).

[21] *See, e.g.,* Press Release, New York Independent System Operator, Expedited Power Plant Development & More Customer Choices Needed To Avoid California-Type Energy Crisis in NY, Says NYISO Report (Mar. 14, 2001), *available at* http://www.nyiso.com/topics/articles/index.html#news_releases; Press Release, New York Independent System Operator, New York Independent System Operator Finds that New York City Faces Electricity Shortage (Feb. 14, 2001), *available at* http://www.nyiso.com/topics/articles/index.html#news_releases.

even stronger case for federal siting of transmission lines, than interstate gas pipelines, which have long been sited by FERC.

IV. RESERVE SHARING IS CRITICAL TO COMPETITIVE ELECTRICITY MARKETS[22]

Market power can be of particular concern with regard to certain services, as FERC has recognized with regard to ancillary services. Core reserve sharing services, such as emergency service (which would come into play after expiration of the period covered by the operating reserves included as ancillary services), are similarly critical to the ability of all but the largest utilities to economically and reliably serve load. Many regions have a long history of reserve sharing that enhances both reliability and the ability of all players to participate in the competitive market. Indeed, the Southwest Power Pool's reserve sharing services were so valuable that even after Entergy quit SPP as a NERC reliability council to avoid participation in the non-firm and short term firm region-wide transmission rate, Entergy retained its SPP membership for the limited purpose of continuing to participate in SPP reserve sharing.

Very large utility systems have a significant advantage over smaller systems (or independent generators) with fewer units or even medium-sized competitors with regard to reliance on coordination services.[23] This advantage can be increased significantly by mergers, to the point that mega-utilities (formed by the stampede to consolidate that the industry has recently been witnessing) may be able to effectively provide these services internally. Mega-utilities may be tempted to withdraw from coordination arrangements because they see a competitive advantage in doing so, observing that even though such a withdrawal may increase their own costs, the withdrawal may well result in a proportionately higher increase in costs of other participants.

In principle, one might assume that the market would provide risk management tools to protect against the owner's risk of outage at a time at which the unit is needed. But those tools should look very much like the pre-existing reserve sharing arrangements and pools, and those pre-existing tools have worked well enough that the risk management products to supersede them have not yet been brought forward by the market. Especially during restructuring, an assumption that "the market will provide" is unwarranted, and plainly not the answer to planning for and efficiently sharing reserves, as recent experience demonstrates.

Installed capacity markets have not worked as well as had been hoped,[24] and California's elimination of reserve requirements is one of the sources of problems identified by FERC in its

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[22] *See* Market Structure Issue 7.

[23] To take advantage of economies of scale, smaller systems tend to have individual resources that represent greater proportions of their requirements than would a larger utility. Participation in a reserve sharing arrangement or a pool represents a sharing of both the risks and benefits of that choice, and thus the risks inherent in such choices are pooled as well. While a large utility can often use other resources on its own system to replace a unit that suffers an outage, a small utility with adequate reserves often must look to others during forced or scheduled outage of its units (*e.g.*, even 30% reserves would not insulate a small system from needing to call on reserve sharing from others if it loses a resource that serves 40% of its load). *Cf. Gainesville Utils. v. Florida Power Corp.*, 402 U.S. 515 (1971).

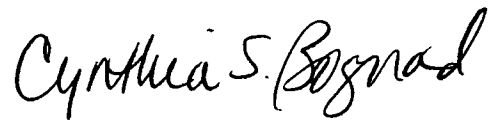
[24] *See* FERC Staff Report, Investigation of Bulk Power Markets – Northeast Region, issued November 1, 2000, at 1-81 to 1-83 (discussing problems with New England installed capacity market, and noting pending Department of Justice investigation of that market), *available at* http://www.ferc.fed.us/electric/bulkpower.htm.

proposed order addressing California's market collapse.[25] In a "Back to the Future" move, it has been reported that generators, faced with extremely high prices in the market, and penalties for not meeting their bids in real time, are retaining their own reserves on an individual "single largest risk" basis. FERC spent a great deal of time and effort getting rid of this inefficiency in the old regulated regime.[26] The resort to this inefficient and expensive practice in the new world signals that some form of reserve sharing is still required for efficient operation, just as it was for the older style markets, and just as participants in other markets require insurance or reinsurance in order to make those markets work. A market without a reserve sharing mechanism or insurance equivalent is, on its face, a market with barriers to entry when prices and penalties for nondelivery rise. In such a market, the higher reserve margins effectively required of smaller competitors (as compared with larger producers) competitively burdened their participation.

Thus, in order to move toward reliance on future competitive markets with many buyers and sellers, steps need to be taken to enable both big and small systems to compete by ensuring continued or expanded reserve sharing, or equivalent mechanisms, at least until it is clear that the market in fact has provided equivalent tools that are widely available.

Again, TAPS appreciates the opportunity to comment. Please contact us if we can provide additional information, or if you have any difficulty obtaining referenced materials.

Sincerely,



Robert C. McDiarmid
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[25] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange,* 93 F.E.R.C. ¶ 61,121, at 61,365 (2000).

[26] *See, e.g., Gainesville Utils. Dep't v. Florida Power Corp.*, 402 U.S. 515 (1971); *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156, 1172 (D.C. Cir. 1979), *aff'g, Mid-Continent Area Power Pool Agreement*, 58 F.P.C. 2622, 2635-36 (1977).