UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Refinements to Horizontal Market Power Analysis for Sellers in Certain Regional Transmission Organization and Independent System Operator Markets	Docket No. RM19-2-000

COMMENTS OF THE
ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON)

The Electricity Consumers Resource Council (ELCON) appreciates the opportunity to submit these comments on the notice of proposed rulemaking (NOPR) issued by the Commission on December 20, 2018 in the above-captioned docket.

Since 2007, the Commission has required sellers seeking to obtain or retain market based rate (MBR) authority to demonstrate that they lack horizontal market power by submitting two "indicative screens" – the pivotal supplier screen and wholesale market screen– for the Commission to review.[1] Passing both indicative screens establishes a rebuttable presumption that the applicant does not have horizontal market power. The NOPR proposes to relieve MBR sellers of the obligation to submit the indicative screens under two circumstances: 1) participation in RTO/ISOs using a capacity market (*i.e.*, ISO-NE, NYISO, PJM, and MISO) or 2) participation in RTO/ISOs without a capacity market if the sale is limited to energy and/or ancillary services only (*i.e.*, the indicative screens would still be required for authority to make capacity sales in those markets). This is predicated on the assumption that Commission-

[1] Currently, the indicative screens are required in an initial application for market-based rate authority, in a change in status filing, or in a triennial updated market power analysis filing.

approved RTO/ISO monitoring and mitigation, combined with remaining market-based rate reporting requirements, is adequate to address horizontal market power concerns.

ELCON is the national association representing large industrial consumers of electricity. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. ELCON members operate hundreds of major facilities and are consumers of electricity in the footprints of all organized markets and other regions throughout the United States. Reliable electricity supply at just and reasonable rates is essential to our members' operations. Accordingly, ELCON has a strong interest in ensuring that the Commission's tools for protecting against exercise of horizontal market power are effective and up-to-date.

I. INTRODUCTION

It is essential that the Commission not take any action that would dilute its analysis of horizontal market power issues. Such action would be inconsistent with the Commission's Federal Power Act obligations, would increase the risk of market concentrations harmful to consumers, and would threaten the proper functioning of the competitive markets. Consequently, before proceeding to a final rule, the Commission should analyze the issues carefully, and it should act with caution.

That said, ELCON believes that the indicative screens have limited value for efficiently identifying and mitigating potential horizontal market power and impose substantial burden on industry and Commission staff. Given the limited benefits of the indicative screens, there is some basis for the NOPR's objective of reducing burden on MBR sellers. However, many of the same reasons that make the indicative screens outdated also call into question the efficacy of the current RTO/ISO monitoring, reporting, and horizontal market power mitigation practices. As such, ELCON conditionally supports the NOPR, but only if the Commission (i) explicitly and fully retains its authorities under the Federal Power Act to take direct action to prevent any potential exercise of horizontal market power and (ii) simultaneously with any final rule in this proceeding, initiates a review of the effectiveness of market monitoring and mitigation practices.

II. COMMENTS OF ELCON

A. Shortcomings of the Two Indicative Screens

ELCON agrees with the NOPR that the indicative screens are not particularly useful tools to mitigate horizontal market power. The indicative screens provide limited value, while imposing a cost on consumers.

The value of the indicative screens is limited because they provide only a static "snapshot" of a seller's horizontal market power using historical data. This poorly reflects the dynamics of transmission constraints that make the exercise of horizontal market power often a very fleeting and location-specific opportunity. For example, the relevant geographic market often changes on a sub-hourly basis, and the ability to exercise horizontal market power is arising more frequently during off-peak periods as supply conditions become more volatile. The incremental effect of the indicative screens on horizontal market power mitigation is even further limited considering the more capable role of dynamic horizontal market power monitoring and mitigation measures.

The indicative screens add modest costs to sellers, which may place slight upward pressure on supply offers and, thereby, prices paid by consumers. ELCON notes that the burden of the indicative screen requirement likely exceeds the NOPR's estimate of $2.2 million once considering the full opportunity cost of industry and FERC staff resources. ELCON emphasizes that FERC staff resources would be better spent bolstering market monitoring and reporting services, including those evaluating exercises of horizontal market power and the efficacy of RTO/ISO horizontal market power mitigation practices.

B. Shortcomings of RTO/ISO Monitoring and Mitigation to Protect Against Exercise of Horizontal Market Power

Cutting back the use of the indicative screens will shift more focus to RTO/ISO monitoring and mitigation practices to protect against potential exercise of horizontal market power. Recent experience shows that merely because the Commission had deemed RTO/ISO monitoring and mitigation practices to be just and reasonable in the past does not establish that they currently are sufficient. To their credit, horizontal market power mitigation measures in the RTOs/ISOs use real-time data and are triggered by specific resource offers and dynamic market conditions, while sometimes tailored to the unique market design of each RTO/ISO. This is a superior framework compared to the static indicative screening tools, at least in energy and ancillary service markets, *if implemented adequately*. However, these mitigation measures have shown vulnerabilities that the NOPR's presumption of RTO/ISO monitoring and mitigation adequacy does not appreciate. As was emphasized by Potomac Economics, which provides market monitoring services for MISO, ERCOT, NYISO and ISO-NE and which, in the Commission's prior proceeding that addressed the indicative screens, agreed with the general principle of reducing unnecessary burdens on market-based rate sellers but cautioned that, "in some cases, participants selling into RTO markets may be exempt from certain market power mitigation measures or the mitigation measures may not be fully effective."[2]

[2] *See* Order No. 816 (October 16, 2015) at ¶26 (available at https://www.ferc.gov/whats-new/comm-meet/2015/101515/E-1.pdf).

1. Monitoring and Mitigation Challenges in the Energy Markets

In the energy markets aggregate market structures have generally been competitive and independent market monitors (IMMs) have generally found results to be competitive. However, local horizontal market power concerns arise from transmission congestion. The tools used to mitigate economic withholding during transmission congestion events are not infallible.

The effectiveness of one tool, the three pivotal suppliers (TPS) test used in CAISO and PJM, remains open to question. The PJM IMM has demonstrated how a supplier can avoid triggering the TPS and still exercise horizontal market power. In 2018, the PJM IMM noted that "the behavior of some participants both routinely and during periods of high demand represents economic withholding and the markups of those participants affected LMP."[3]

Deficiencies also exist in RTO/ISOs employing "conduct and impact" horizontal market power tests. In 2018, the internal market monitor for ISO-NE noted that its forward reserve market lacks any active horizontal market power mitigation, while the mitigation measures for the real-time market provide suppliers considerable ability to deviate from marginal cost offers before the rules would trigger and mitigate an offer.[4] In 2018, the NYISO IMM identified several shortcomings in NYISO horizontal market power mitigation rules, including the use of inflated fuel cost adjustments to inflate energy prices.[5]

Methodological advances in horizontal market power detection demonstrate a critical need to examine whether current RTO/ISO monitoring and mitigation practices continue to

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[3] Monitoring Analytics, LLC, Quarterly State of the Market Report for PJM: January through September 2018 at page 95 (available at . https://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2018/2018q3-som-pjm-sec3.pdf).

[4] ISO New England 2017 Annual Markets Report (May 17, 2018) at page 2 available at https://www.iso-ne.com/static-assets/documents/2018/05/2017-annual-markets-report.pdf).

[5] Potomac Economics, 2017 State of the Market Report for the New York ISO Markets (May 2018) at page V (available at https://www.potomaceconomics.com/wp-content/uploads/2018/06/NYISO-2017-SOM-Report-5-07-2018_final.pdf).

constitute best practices. A 2018 working paper developed by Matt Woerman takes a novel approach to examining exogenous variation in market size via transmission congestion due to ambient temperature shocks to isolate the casual effect of market size on horizontal market power conduct. Applied to ERCOT, the study finds that just a 10% decline in market size induces firms to more than double their markups.[6] The study finds $7 to $22 million of deadweight loss and over $2 billion in transfers from consumers to producers annually.[7] Although ERCOT is not FERC-jurisdictional, the study may imply external validity given the common nature of the "conduct and impact" tests used by the IMM of ERCOT and several FERC-jurisdictional RTOs/ISOs.

As noted in a recent paper issued by the UC-Davis Energy Economics Program, horizontal market power mitigation procedures limit offer prices but cannot compel generators to operate, which leaves the practices insufficient to eliminate horizontal market power.[8] Questions abound over the robustness of physical withholding verification practices. For instance, during severe cold weather events, misreporting of outage causes (*e.g.*, mechanical, fuel-related, otherwise) has been a consistent concern. False reporting is difficult to detect in some cases, including where IMMs could not confirm fuel gelling problems ex post or whether a natural gas-fired generator reporting an "unavailable fuel" outage would have been able to obtain pipeline service at a higher cost or with more physical restrictions despite substantial pipeline congestion.

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[6] Matt Woerman, Energy Institute at Haas, Market Size and Market Power: Evidence from the Texas Electricity Market (December 2018) (available at https://ei.haas.berkeley.edu/research/papers/WP298.pdf).

[7] *Id.*

[8] Bushnell, Flagg and Mansur, UC-Davis Energy Economics Program, Electricity Capacity Markets at a Crossroads (April 2017) at page 15.(available at http://deep.ucdavis.edu/uploads/5/6/8/7/56877229/deep_wp017.pdf).

2. Monitoring and Mitigation Challenges in the Capacity Markets

Aggregate capacity market structures across RTO/ISOs are sometimes competitive, but import-constrained capacity zones are chronically uncompetitive. Horizontal market power has been exercised in these areas both above and below offer cap levels. This reflects nuanced flaws in mitigation practices but also broad underlying constraints inherent to capacity horizontal market power detection and mitigation.

Capacity markets present a fundamental challenge to horizontal market power detection and mitigation, as they require administrative mimicking of market participants' long-term generator cost and revenue expectations. An information asymmetry exists between the IMM and the generator on the facility's capabilities and going-forward costs. Generators often hold a different view of market revenues than the IMM as well. Thus, a competitive reference level is much harder to gauge for long time horizons, such as three year forward capacity markets, than in the spot market. This is evidenced by the large volume of capacity offers from new entrants that come in at often a quarter or one-third of the administrative estimate of the net cost of new entry. Thus, not only are markups hard to detect and report, but mitigation efforts linked to reference levels are poor surrogates for competitive behavior.

Flaws with reference levels are moot where offer caps are too liberal. In a particularly egregious example, PJM's IMM recently filed a complaint noting that the excessive default capacity market seller offer cap "prevents effective mitigation of horizontal market power in the PJM Capacity Market. The lack of effective horizontal market power mitigation in the capacity market, where structural horizontal market power is endemic, is unjust and unreasonable."[9]

[9] Complaint of the Independent Market Monitor for PJM (filed February 19, 2019) at page 2 (available at http://www.monitoringanalytics.com/filings/2019/IMM_Complaint_Docket_No_EL19-XXX_20190221.pdf).

The PJM IMM found the results of PJM's latest Base Residual Auction (2021/2022 delivery year) to be not competitive as offers exceeded the competitive level.[10]

The introduction of capacity performance penalties created financial risk that exacerbates administrative error in mitigation processes. For example, PJM's introduction of Capacity Performance induced many anomalous "hockey stick" bids, where the vast majority of a facility or generator fleet's supply offered at a low price with the remainder offering very high. The horizontal market power review process struggles to determine whether this constitutes efficient risk management or withholding at the margin.

3. Monitoring and Mitigation Challenges Posed by Collusive Behavior

Current RTO/ISO practices aim to mitigate unilateral horizontal market power but do not clearly employ tools to comprehensively cover collusive behavior. Part of the intent of the wholesale market share screen is to detect a seller's ability to exercise horizontal market power in coordination with other sellers. As such, current RTO/ISO horizontal market power practices may not provide a complete substitute for the role the wholesale market screen intended to address. Only the TPS employs a structural test, which could be enhanced for broader multilateral horizontal market power, whereas the impact test could be applied simultaneously to all offers failing the conduct test.[11]

4. Monitoring and Mitigation Challenges Posed by RTO/ISO Governance Shortcomings

The outsized influence of parochial interests in RTO/ISO decision-making and attempts by RTOs/ISOs to restrict the role or statements of IMMs remain a fundamental threat to market

[10] Monitoring Analytics, LLC, *supra* note 2, at page 235 (available at https://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2018/2018q3-som-pjm-sec5.pdf).

[11] For further explanation, see The Brattle Group, Market Power Screens and Mitigation Options for AESO Energy and Ancillary Services Markets (January 26, 2018) at page 29 (available at http://files.brattle.com/files/13751_market_power_screens_and_mitigation_options_for_aeso_energy_and_ancillary_service_markets.pdf).

transparency, monitoring, and horizontal market power mitigation success. The Commission has demonstrated a pattern of being too deferential to RTO/ISO proposals,[12] which reflect the underlying power structure of the RTO/ISO stakeholder processes that favors incumbent suppliers and transmission owners. Deficiencies in current monitoring and mitigation rules can in part be explained by market participants voting on their own mitigation rules.

C. The Commission Should Retain Its Vigorous Oversight Of Potential Horizontal Market Power Issues

In the NOPR, the Commission states that "nothing in this proposal would prevent the Commission or others from initiating a proceeding under Federal Power Act section 206 if concerns are identified about a seller's horizontal market power or the ability of RTO/ISO market monitoring and mitigation to address any such horizontal market power."[13] Moreover, the Commission observes that it "would continue to reserve the right to require submission of complete horizontal market power analysis, including indicative screens, at any time."[14]

It is essential to ensuring just and reasonable rates and protecting consumers that these points be emphasized in a final rule and that the Commission, notwithstanding any procedural change, double down in its substantive efforts to protect against exercise of horizontal market power.

[12] R Street Policy Study No. 112, How the RTO Stakeholder Process Affects Market Efficiency (October 2017) at page 18 (available at http://2o9ub0417chl2lg6m43em6psi2i-wpengine.netdna-ssl.com/wp-content/uploads/2017/10/112.pdf).

[13] NOPR at ¶65.

[14] NOPR at ¶62.

III. ELCON RECOMMENDATIONS AND CONCLUSION

ELCON conditionally supports the NOPR, but only if the Commission simultaneously initiates a review of the effectiveness of market monitoring and mitigation practices that fully protect against the potential exercise of horizontal market power. Based on the information presented in these comments, ELCON does not believe that the evidence supports the NOPR's assumption that existing Commission-approved RTO/ISO monitoring and mitigation, combined with remaining market-based rate reporting requirements, currently are adequate to address horizontal market power concerns.

Ultimately it would be more productive if, instead of focusing on the indicative screens, Commission staff resources were redirected toward robust examination of dynamic horizontal market power, monitoring, and mitigation in the RTOs/ISOs. Since the implementation of Order No. 760, the Commission has greatly enhanced its human capital and computational ability for advanced data analytics, with a strong orientation towards horizontal market power analysis. These resources should be put to more productive use for internal and external consumption. In the spirit of "sunshine as the best disinfectant," the Commission should bolster RTO/ISO and Commission reporting to provide more transparency and analytic insights on the influence of horizontal market power in price formation. This includes more refined markup estimates and the aggregate and localized cost to load effects.

Accordingly, ELCON recommends that the Commission should modernize its approach to RTO/ISO market monitoring and mitigation, which includes moving beyond the archaic indicative screens rooted in 1990s-era thinking while moving toward more robust dynamic monitoring and mitigation. The Commission could initiate this process with a notice of inquiry and technical conference, before proceeding to the RTO/ISO specific determinations that would be necessary. To the limited extent that the indicative screens process for MBR authority serves as a backstop against faults with RTO/ISO monitoring and mitigation, the Commission also may consider a phase-out of indicative screen requirements as confirmation of a sufficient replacement regime emerges. ELCON recognizes that, in the NOPR, the Commission states that it "retains the right to consider whether to institute separate Federal Power Act section 206 proceedings that would be open to all interested entities to investigate whether the existing RTO/ISO mitigation continues to be just and reasonable and, if not, how such mitigation should be revised."[15] In these comments, ELCON has demonstrated that the potential for future action is insufficient, that in view of the current market conditions the Commission needs to take such action definitively and promptly, and that such a commitment to prompt action is an essential component of a final rule.

ELCON supports the NOPR's retention of indicative screen requirements on capacity in RTO/ISOs without an organized capacity market, as insufficient safeguards exist to protect against horizontal market power abuses. However, the Commission should not forego opportunities to improve screen parameters, such as refined geographic definitions and tight market conditions outside peak demand periods, to better mitigate horizontal market power. At the same time, additional process improvements that alleviate burdens on sellers and Commission staff without compromising effectiveness would be welcome.

Finally, in view of the fundamental need to protect against horizontal market power issues to ensure effective functioning of the competitive markets, the Commission should reiterate that it explicitly and fully retains its authorities under the Federal Power Act to take direct action to prevent any potential exercise of horizontal market power.

[15] NOPR at ¶70.

Respectfully Submitted:

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Dated: March 18, 2019

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of this proceeding.

Dated at Washington, D.C.: March 18. 2019

/s/ W. RICHARD BIDSTRUP
W. Richard Bidstrup