

November 15, 2002

Office of the Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

RE: Docket No. RM01 -12-000

Attached, please find a comment on the Commission's proposed Standard Market Design. The comment was written by Seth Blumsack, Dmitri Perekhodtsev, and Lester B. Lave of the Carnegie Mellon Electricity Industry Center (CEIC) at Carnegie Mellon University, Pittsburgh, PA.

CEIC ([www.cmu.edu/electricity](http://www.cmu.edu/electricity)) is one of several Sloan Industry Centers. Established in 2001 with grants from both the Sloan Foundation and EPRI, the mission of CEIC is to work with companies, labor, regulators, the financial community, consumers, and technologists to make the electricity industry more competitive and its systems more reliable and secure, to create wealth, and to serve the public interest better by enhancing human resources, speeding organizational learning, improving its regulatory environment, and expediting new approaches to the generation, transmission, distribution, marketing, and use of electricity. CEIC's goals are to foster change in the industry, its regulation, and the way that industry stakeholders think about it by opening new business opportunities and bringing new insights to public policy. To accomplish this ambitious goal, the Center has embarked on a large program of interdisciplinary education and research, bringing together scholars from engineering, economics, public policy, and other areas.

The enclosed comment reflects the views of its authors, and is not necessarily intended to reflect the views of CEIC or its grantors. We hope the Commission will find our insights useful as it seeks to reform energy markets in the United States.

Seth Blumsack

Carnegie Mellon Electricity Industry Center

**UNITED STATES OF AMERICA**  
**BEFORE THE**  
**FEDERAL ENERGY REGULATORY COMMISSION**

Remedying Undue Discrimination )  
Through Open Access Transmission Service ) Docket No. RM01-12-000  
And Standard Electricity Market Design )

**INITIAL COMMENTS OF**  
**SETH BLUMSACK, LESTER B. LA VIE, AND DMITRI PEREKHODTSEV**  
**ON THE STANDARD MARKET DESIGN NOPR**  
**November 15, 2002**

**I. Introduction and Executive Summary**

This comment seeks to address two issues in the Commission's Standard Market Design Notice of Proposed Rulemaking (NOPR), specifically in the areas of market power mitigation and analysis of market structure in regional electricity markets.

The Commission has recommended that the market monitoring committee of each Independent Transmission Provider (ITP) conduct a competitiveness analysis of their the

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When this methodology of assessing market structure is applied to several existing power pools or ISOs, they appear to be far less competitive than conventional, market-share measures would indicate, implying that mitigation measures would need to be put in place more often than conventional wisdom might suggest.

The mitigation measures proposed by the Commission in the NOPR consist primarily of bid caps, mandatory offer requirements, an increased role for demand response, and resource adequacy requirements. The first two mitigation measures are inherently problematic, in that the combination of mandatory sell requirements combined with price caps may amount to a "taking," in which the federal government obliges a firm to sell a good at a fixed price, a price which may not represent fair compensation to the firm. Such a mandatory offer requirement can only be made



Market structure analyses in the electric power industry must be based on the relationship between a system's supply/demand balance (or equivalently, its excess





structure in electricity markets, we question whether the broad use of long-term contracts would result in customers seeing competitive prices. Why would a pivotal firm offer to sell along -



determining the capital costs of a generating unit, as well as its operations and maintenance costs. A major attraction of deregulation was being able to move away from a system in which generators first had to receive permission to build new capacity, and then prove their costs to regulators so that the proper price could be

Conversely, the pivotal firm analysis discussed in these comments suggests exactly the opposite. California's power crisis was first and foremost caused by a highly uncompetitive market structure, in which a small number of firms were given a large number of opportunities to set arbitrarily high market prices. The problems associated with an inherently uncompetitive market were simply magnified by the coincident drought and load growth. Simply tinkering with the design of the spot market (as the Commission's NOPR proposes to do) will not fix the market's structural flaws. The only way to create a competitive market for electricity is to greatly reduce the number of hours in which the market sports a pivotal oligopoly consisting of a small number of firms.

However, it is not clear that the approach taken by the Commission will be sufficient to yield a competitive market structure. The Commission has placed great emphasis on improving demand response in the face of restructuring. We agree that this is vital and has not been given sufficient attention in restructuring efforts to date. However, particularly in the face of a pivotal oligopoly whose capacity greatly exceeds spare capacity in the system, demand response can only go as far as to reduce the ability of the oligopoly to set prices; it cannot fully eliminate this ability. Similarly, we applaud the Commission's [()-2(a)4(W10(-120()-2(i)-2(en)-100(ol)3()-120(a)-2(ao)4(a)4(n)-2()-120(o)-2(ao)4(d)

generating capacity by at least 25% to protect itself against a pivotal duopoly being able to set the market price. BLP calculates that this could add around one cent per kWh to electricity costs in the state. Whether the benefits from deregulation would outweigh those costs remains to be seen, but the evidence thus far has not been encouraging.

## V. Appendix- SupportingGraphics

Figure1:PivotalFirmDurationCurveforCalifornia(June2000 –June2001)

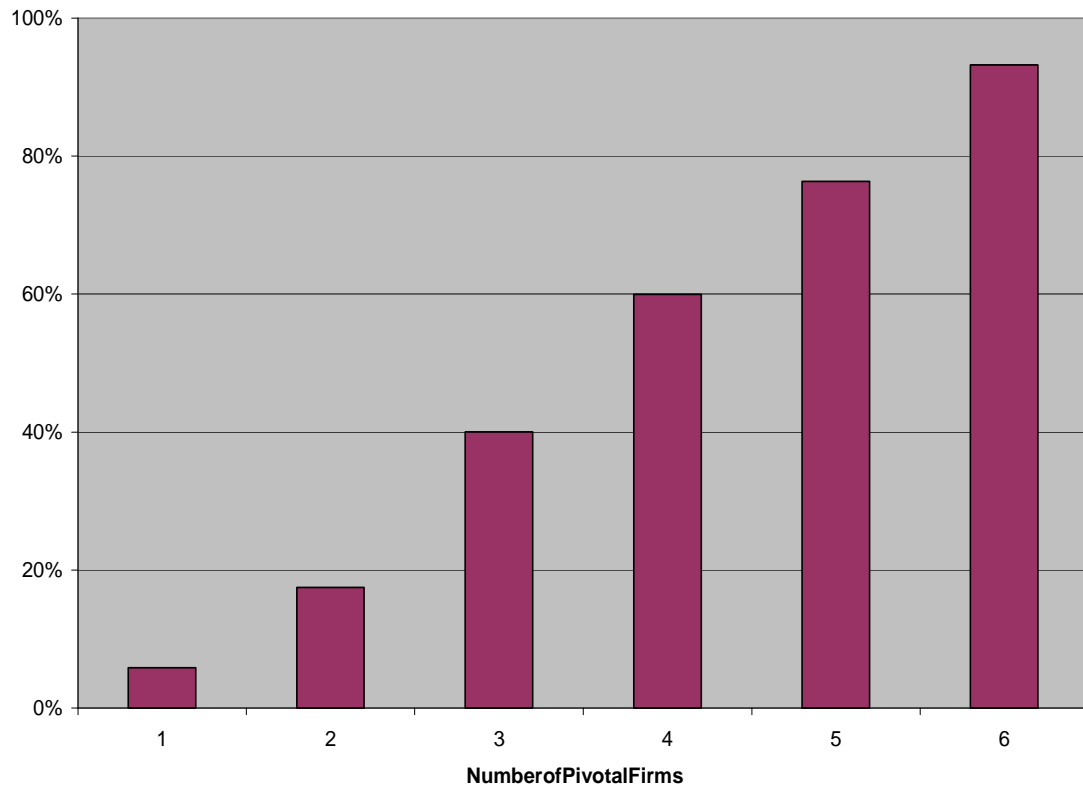


Figure 2: Pivotal Firm Duration Curve for PJM (June 2000 – June 2001)

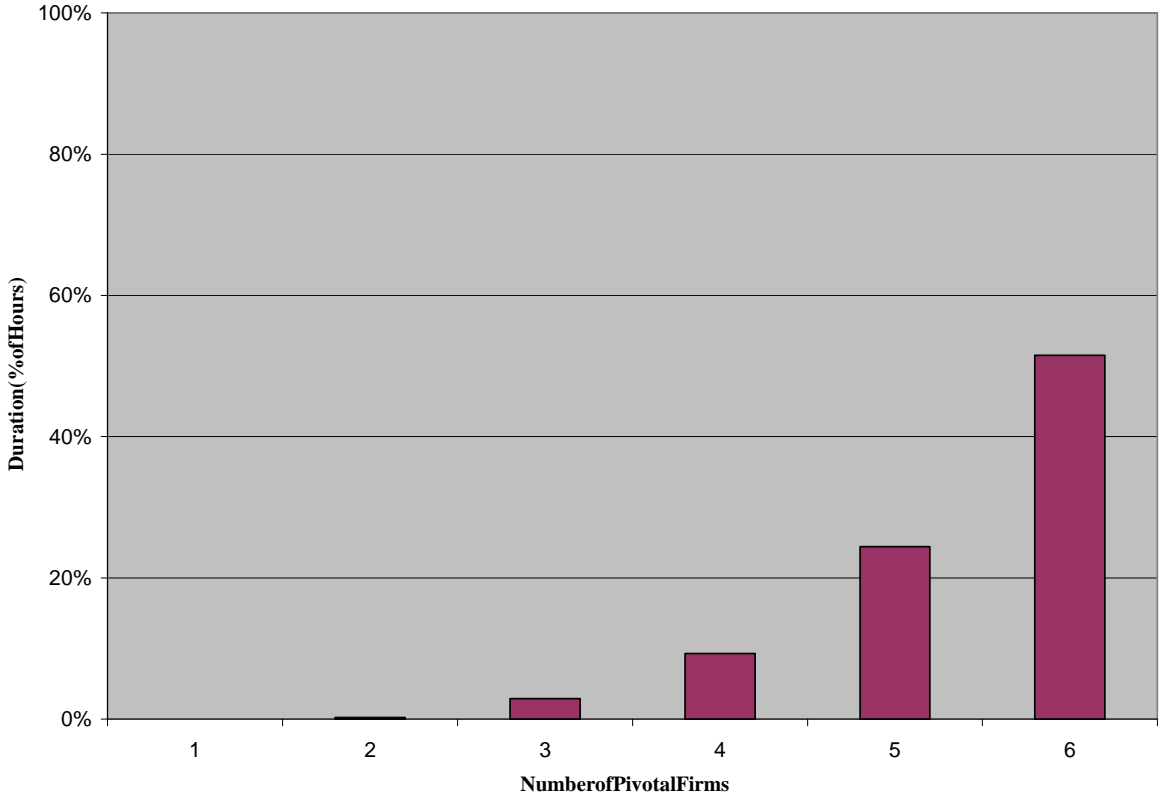


Figure 3: Pivotal Firm Duration Curve for New York (June 2000 – June 2001)

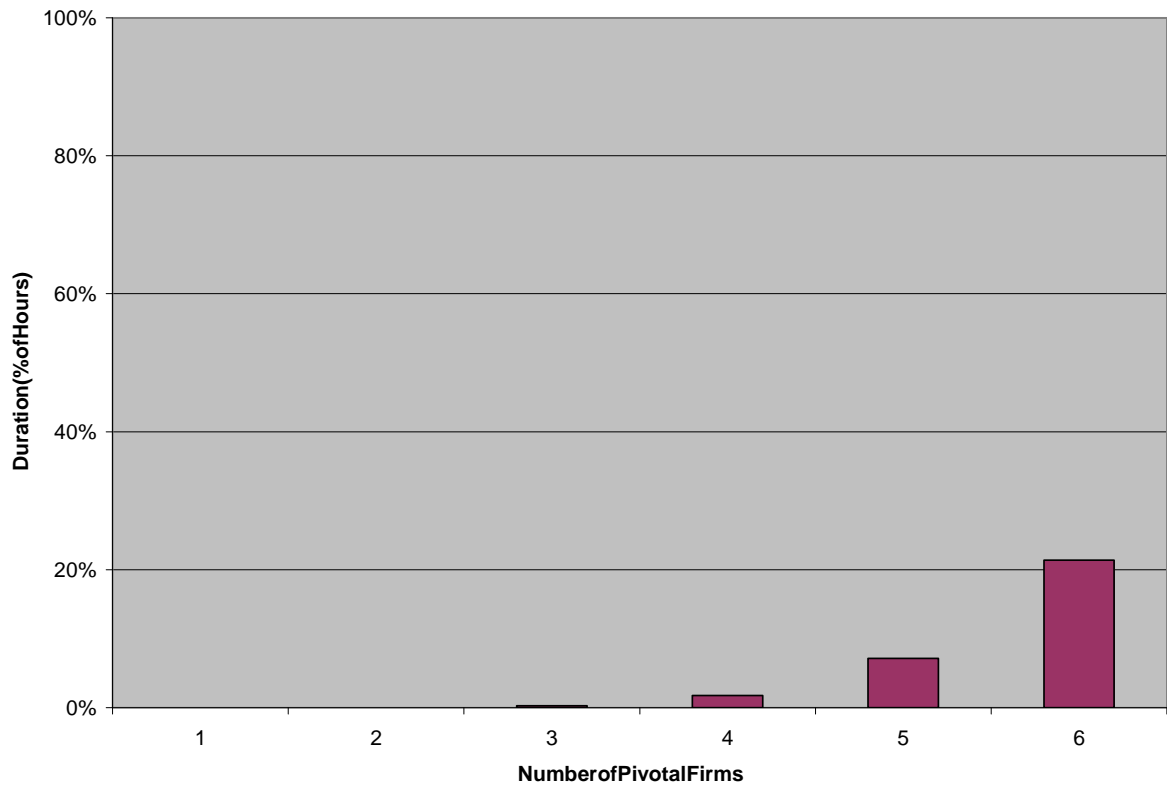


Figure 4. Normalized Prices in California and the Number of Pivotal Firms

