

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Wholesale Competition in Regions with
Organized Electric Markets

Docket Nos. RM07-19-000 & AD07-7-000

Comments of the
Electricity Consumers Resource Council (ELCON), American Chemistry
Council (ACC), American Iron and Steel Institute (AISI), Association of
Businesses Advocating Tariff Equity (ABATE), Council of Industrial Boiler
Owners (CIBO), and Wisconsin Industrial Energy Group

The Electricity Consumers Resource Council (ELCON), American Chemistry Council (ACC), American Iron and Steel Institute (AISI), Association of Businesses Advocating Tariff Equity (ABATE), Council of Industrial Boiler Owners (CIBO), and Wisconsin Industrial Energy Group (collectively Industrial Consumers) appreciate the opportunity to comment on the Commission's Notice of Proposed Rulemaking (NOPR) on wholesale competition in regions with organized electric markets. We highly commend FERC for recognizing the need for reforms to improve the operation of the organized markets. The Commission began this process in early 2007 with three public conferences and the issuance of its Advanced Notice of Proposed Rulemaking (ANORP) on June 22, 2007. The NOPR is a continuation of this process.

A. Executive Summary

The NOPR proposes a series of incremental changes to the organized markets that roughly follow three of the four target areas in the ANOPR: (1) demand response, (2) market monitoring, and (3) ISO/RTO accountability. But on important issues the NOPR backtracks and falls short of the bold initiative that the industry needs in these uncertain times. The NOPR's contemplated procedures would require the real outcome

of this process to await the actions of the FERC-jurisdictional ISOs and RTOs, and the results of six disparate compliance filings.

Demand Response

Industrial Consumers recommend that on demand response (DR), the final rule be changed to require each ISO and RTO to promptly implement a pro forma tariff that parallels the pro forma OATT. The pro forma DR tariff should be binding on each ISO or RTO and each of its market participants except upon a demonstration that an alternative proposal is consistent with or superior to satisfying the standards set in the pro forma DR tariff, and it should be adopted by each ISO or RTO within 30 days after issuance of the final rule. The need for DR has been studied enough and the Commission must now act to integrate proven best practices into the price setting mechanisms of the organized markets.

The issue of compensation should also be resolved sooner rather than, as the NOPR proposes, later. Potential providers of DR resource will not step forward if compensation is not provided and guaranteed on a comparable basis to that provided generators. Compensation should be source neutral and comparable to generator pricing. As ISOs and RTOs are reaching reserve margin limits and given the challenges in developing new generation and transmission projects where they are needed the most, DR can be a solution - especially in terms of shaving peak demands.

Industrial Consumers support opening the markets for ancillary services to DR resources on a "source neutral" basis, and the regulatory language should use those specific terms so its intent is clear. Industrial Consumers also support the NOPR's requirements to specify limits on the frequency and duration of DR services, to eliminate the deviation charge during emergency conditions, to permit aggregators of retail customers (ARCs) to bid DR resources on behalf of retail customers, and to assess the technical feasibility and value of DR by smaller loads.

Industrial Consumers are concerned that the scarcity pricing proposal is seriously premature given that the pre-conditions necessary to safeguard consumers are

absent. If the final rule retains this requirement, Industrial Consumers urge FERC to allow price levels to increase only in tandem with and proportional to the demonstration that certain benchmarks have been met including: (1) measured and verified amount of net incremental DR resources entering the markets, (2) net incremental reductions in congestion, whether via enhancement of generation and/or transmission resources, in the zones where scarcity pricing is implemented, (3) sustained increases in the volume of load hedged in long-term forward markets, and (4) the development of credible forward price curves that are regularly relied upon by market participants.

The NOPR directs FERC staff to host a technical conference on the proposals of the American Forest & Paper Association (AF&PA) and Portland Cement Association (PCA) on alternative market designs for long-term contracting and related issues. Industrial Consumers welcome this directive and strongly encourage the Commission to consider the merits of these and other alternative market designs.

Market-Monitoring Policies

The NOPR requires a series of changes to market monitoring policies that attempt to strengthen market monitoring units by safeguarding their independence and fostering useful and transparent market analysis. Industrial Consumers generally support the NOPR's market monitoring provisions, except that we continue to advocate the "hybrid" MMU structure to the exclusion of either a wholly internal or external structure. We believe that the hybrid structure provides one feature that neither the internal or external structure provides -- an internal market monitoring staff to conduct detailed day-to-day monitoring and data analysis working jointly with a part-time, external market monitoring unit that reports to the Board and whose members are not financially dependent on the ISO or RTO.

Responsiveness of ISOs and RTOs

The NOPR proposes to establish four new principles intended to ensure that an ISO or RTO is responsive to its customers by requiring each ISO and RTO to make a

compliance filing that details why the entity's existing practices comply with each principle or its plans to attain compliance. Industrial Consumers believe that the best long-term solution for increasing ISO or RTO accountability is to require a hybrid board consisting of a minority of stakeholder members evenly split between consumer and supplier interests.

B. Introduction

In their September 14, 2007 comments on the ANOPR in these dockets, ELCON, American Chemistry Council (ACC) and American Iron and Steel Institute (AISI) urged the Commission to use the proceeding to begin a process by which the current mix of regulation and competition in the organized markets is reconsidered to ensure that customers receive the benefits they deserve from restructured markets. We were genuinely encouraged by the ANOPR because it acknowledged several critically important areas for reform in the organized markets. These included: (1) an expanded role for demand response and the elimination of barriers to the integration of demand response in price formation, (2) the recognition that it is important that wholesale buyers and sellers have adequate opportunities to sell and buy power (and hedge spot price volatility) through long-term power contracts, (3) reforms to the market monitoring function of ISOs and RTOs to ensure independence, and (4) reforms to ISO/RTO governance to increase the responsiveness of ISOs and RTOs to stakeholders and customers. For many years, industrial consumers have identified a series of problems in the organized markets that needed to be fixed as essential pre-conditions to real wholesale competition.¹ The Day-Two market structure that mixes regulatory

¹ For example, in ELCON's March 12, 2007 Supplemental Comments in Docket No. AD07-7-000 ("Conference on Competition in Wholesale Power Markets"), the following necessary pre-conditions ("action items") for real competition were identified:

... (1) treat price-responsive load as a resource that is compensated on the same basis as generation and integrate demand response in the price-setting mechanisms, (2) eliminate centralized capacity markets and other regulatory fixes that are inhibiting new investment in the industry, (3) eliminate the rent-seeking ability of RMR generators with their threats to bring down the grid, (4) establish long-term forward contracting as the

mechanisms with bid-based auctions has not resulted in a true competitive market. This has been further compounded by growing hostility to consumer interests within ISO/RTO stakeholder processes and questions regarding the objectivity and independence of market monitoring units. The ANOPR seemed genuine in its response to at least some of these problems.

The NOPR is another matter. It not only backtracks from the ANOPR, but the Commission appears to have abrogated its own role in rulemaking and punted it to six ISO/RTO stakeholder processes. Instead of forthright and consistent directives, such as a pro forma tariff, to command the necessary market reforms, consumers must participate in separate and costly stakeholder processes at each ISO and RTO with the outcome being a series of six disparate compliance filings that are further adjudicated before the Commission. And without the assurance that any essential pre-conditions to competition are achieved, the NOPR directs each ISO and RTO to implement scarcity pricing. At a time of great uncertainty in our Nation's economy, and when energy prices are otherwise at historical high levels, we are distressed with a rulemaking that may only increase electricity prices and the profits of utility holding companies and those investing in utilities.

C. Comments on the NOPR

1. Demand Response

The NOPR preamble states that a "well-functioning competitive wholesale market should reflect current supply and demand conditions." Industrial Consumers had hoped that the NOPR would initiate the necessary reforms to accomplish this essential pre-condition to real wholesale competition. However, the NOPR misses the

dominant form of transaction between suppliers and loads or LSEs, (5) resolve the unintended consequence of locational pricing to discourage generation and transmission infrastructure investment, (6) resolve the market power of joint owners of generation and transmission, and (7) eliminate regulatory intervention in spot price formation once the other six pre-conditions have been successfully implemented. Suppl. Comments at 2.

mark, and only some, long-overdue, incremental steps are recommended instead of the necessary bold initiatives. The NOPR preamble admits as much by requiring that RTOs and ISOs “study whether further reforms are necessary to eliminate barriers to demand response in organized markets.” NOPR at ¶46.

The NOPR’s incremental reforms related to demand response are to obligate RTOs and ISOs to: (1) accept bids from demand response resources in its markets for certain ancillary services, comparable to any other resources; (2) eliminate, during a system emergency, a charge to a buyer in the energy market for taking less electric energy in the real-time market than purchased in the day-ahead market; (3) permit an aggregator of retail customers (ARC) to bid a demand response on behalf of retail customers directly into the RTO’s or ISO’s organized energy markets, unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate; and (4) modify their market rules to allow the market-clearing price to accurately reflect the value of energy during periods of operating reserve shortage.

Industrial Consumers are particularly disappointed that the NOPR fails to address two critically important issues: (1) the disposition of existing demand response “programs” unrelated to ancillary services; and (2) issues related to compensation except to the extent that it may be considered during a future technical conference. As a consequence, the NOPR falls short of the need to rationalize the role of all forms of demand response in price formation, which most end users consider an essential pre-condition for real wholesale competition in the organized markets, and fails to adequately promote the development of DR resources.

a. Need for Pro Forma Tariff to Implement the NOPR’s Demand Response Provisions

Industrial Consumers support the NOPR’s long-overdue requirement that each RTO or ISO accept bids from demand response resources on a basis comparable to

any other resources, for ancillary services (A/S) that are required in a competitive bidding process, if the demand response resources (1) are technically capable of providing the ancillary service and meet the necessary technical requirements, and (2) submit a bid under the generally-applicable bidding rules at or below the market clearing price, unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customers to participate. This proposal would apply to competitively-bid markets, if any, for energy imbalance, spinning reserves, supplemental reserves, reactive supply and voltage control, and regulation and frequency response as defined in the pro forma OATT, or in the markets of their functional equivalents in an RTO or ISO tariff. NOPR at ¶ 56.

Industrial Consumers are concerned, however, that piecemeal implementation by six RTO/ISO stakeholder processes may not produce the intended results absent strong leadership and more focused direction from the Commission. As the Commission is well aware, large industrial consumers typically have many facilities throughout the country and therefore often have major loads within the footprints of more than one ISO or RTO. It is a huge burden for demand response (DR) capable loads to respond to different rules and procedures, and potentially, different standards for comparability. This is especially critical given that improving RTO/ISO responsiveness to customers is also an unresolved objective of the NOPR. The Commission's recent order respecting ISO-NE's proposed changes to the market rules governing its day-ahead load response program (123 FERC ¶ 61,021, April 4, 2008) illustrates the complexities and burdens of addressing regionally-disparate demand response programs on a case-by-case basis.

The Commission's long-standing practice, extending back at least to Order No. 888 in 1996, has been to standardize rules and procedures for generators and other transmission users with the pro forma OATT and the standardized features of the Day-Two organized markets, as necessary to promote consistency and avoid undue discrimination. The Commission proposes to depart from that practice here, leaving

each ISO and RTO to revise their tariffs separately. Delay, inefficiency, and, likely, inconsistency will result. As specified elsewhere in these comments, the proposed reforms, while not sufficient, are necessary first steps to improve efficiency and reduce discrimination in the electricity markets, and they are needed promptly. Instead of the procedures set out in the NOPR, the Commission should specify pro forma tariff language to implement the findings of this rulemaking and require such tariff revisions to be adopted within 30 days of the final rule's effective date.

Order No. 888 is analogous to the present circumstances. There, the Commission established pro forma tariff language requiring open access to transmission because consistent action to "eliminate the remaining patchwork" of provisions was necessary to satisfy the "statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue discrimination." Thus, the Commission found that "[i]t is within our discretion to conclude that a generic rulemaking, not case-by-case adjudications, is the most efficient approach to take to resolve the industry-wide problem facing us."² The Commission adopted the same reasoning in Order No. 890, the most recent revisions to the pro forma open access transmission tariff, which throughout emphasized the need for greater uniformity to reduce the potential for undue discrimination.³

The Commission also has consistently recognized the desirability of assuring consistency between regions on key aspects of RTO implementation. The value of uniformity and consistency has been a constant theme in numerous recent Commission decisions. The line of decisions on reliability standards governing the bulk power

² *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities: Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

³ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31,241 (2007), *order on reh'g*, 121 FERC ¶ 61,297 (2007).

system is similar. In *Direct Energy Services, LLC, et al.*, 121 FERC ¶ 61,274 (2007), the Commission correctly observed that NERC must act consistently in its registration determinations or alternatively justify differential treatment. NERC's Rules of Practice and Procedures, as approved by the Commission, expressly impose on NERC the responsibility to ensure "that there is consistency, fairness of administration, and comparability of outcomes within each regional entity's certification and registration program among all of the programs (*Id.* Section 500, at 3.3). The key Commission orders on the underlying reliability standards, Order No. 693 and Order No. 672, are replete with references to the desirability for uniformity; Order No. 672, for example, stated that "uniformity of Reliability Standards should be goal and the practice, the rule rather than the exception."⁴

The Commission also recognizes that action on a generic rather than a case-by-case basis can be more efficient. Recently, in the context of its PURPA Section 210(m) rulemaking, the Commission found that acting generically "provides more effective notice to and opportunity for participation by all affected parties."⁵

It is an established tenet of administrative law that an agency may not depart from long-standing practice without reasoned explanation: "When an agency undertakes to change or depart from existing policies, it must set forth and articulate a reasoned explanation for its departure from prior norms." *Telecommunications Research and Action Center v. FCC*, 800 F.2d 1181, 1184 (D.C. Cir. 1986); *see also Midwestern Transp., Inc. v. ICC*, 635 F.2d 771, 777 (10th Cir. 1980) ("[A]n agency must apply criteria it has announced as controlling or otherwise satisfactorily explain the basis for its departure therefrom.").

⁴ *Rules Concerning Certification of the Electric Reliability Organization; Procedures for the Establishment, Approval and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204, at ¶ 292, *order on reh'g*, FERC Stats. & Regs. ¶ 31,212 (2006), *cited by Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242 (2007), *order on reh'g*, 120 FERC 61,053 ¶ (2007).

⁵ *New PURPA Section 210(m) Regulations Applicable to Small Power Production and Cogeneration Facilities*, Order No. 688, FERC Stats. & Regs. ¶ 31,233 (2006) at ¶ 4, *order on reh'g*, 119 FERC ¶ 61,305 (2007).

There is no rational basis to depart here from the Commission's prior practice. Just as Orders Nos. 888 and 890 were necessary to remedy discrimination and inefficiency in the markets, here, under the current tariffs and standard market design, generators have access, compensation and other advantages not available to providers of demand response. In both cases, the Commission has determined that its action is compelled by FPA Sections 205 and 206. NOPR at ¶ 282. In accordance with the long-standing practice, the discriminatory treatment here should be remedied promptly and consistently across the regions via a pro forma tariff.

The series of proceedings in each of the ISOs and RTOs contemplated by the NOPR would not be consistent with either the Commission's past practice or the dictates of the Federal Power Act. These proceedings before the RTOs and ISOs would be unduly prolonged, duplicative, and costly. They are likely to result in inconsistencies among regions that could be inefficient and potentially discriminatory, particularly for industrial consumers with facilities in various regions who could have to develop different mechanisms for demand response and other matters. Resolution, if achievable at all, could require not only the six month process specified in the NOPR but also a series of review and rehearing proceedings before the Commission for each RTO and ISO.

Moreover, RTO and ISO proceedings would occur under the purview of governance that, as recognized by the Commission in the NOPR, is flawed and requires reform. The governance reforms outlined in the NOPR apply to a broad range of issues including: "(1) inclusiveness; (2) fairness in balancing diverse interests; (3) representation of minority positions; and (4) ongoing responsiveness." NOPR at ¶¶ 245, 275, 279. The Commission observed that "[c]reating a mechanism and process to enable the board to be responsive to the needs of stakeholders is critical to an independent governance structure . . . is necessary for customers and other stakeholders to have confidence in the decisions that come out of RTO and ISO processes . . . [and] plays an important role in implementing the RTO and ISO policies and achieving its

objectives in a manner that customers and other stakeholders perceive to be fair, balanced, and effective.” NOPR at ¶ 274. In fact, Industrial Consumers submit that in view of the dominant influence of generation interests, there can be no assurance that the regions will faithfully adopt the principles enumerated in the Commission’s rulemaking. However, even the basic and essential governance reforms of the NOPR would not be in place during the pendency of the proceedings contemplated by the NOPR on demand response. Thus, there can be no assurance that the outcome of those proceedings would represent reasoned decisionmaking.

Having recognized the current, substantial flaws in RTO/ISO governance, the Commission cannot rely on those deficient processes to achieve critical reforms mandated by the non-discrimination requirements of the Federal Power Act. Instead, pro forma tariff language is essential to avoid undue influence of governance rife with conflicts of interest that would tend toward discouraging full, non-discriminatory acceptance of demand-response alternatives.

Industrial Consumers believe strongly that there is ample experience to date with demand response to go beyond the study phase and to begin the formal adoption of industry recognized best practices on a pro forma basis. In our comments on the ANOPR, Industrial Consumers referenced the ERCOT LaaR (“load acting as a resource”), which is widely viewed in the industry as one such best practice.⁶ Accordingly, the final rule should issue a pro forma DR tariff containing rules and procedures for:

- Economic DR Services (Day-Ahead and Real-Time)
- Ancillary Services (A/S)

⁶ On February 26, 2008, approximately 1,100-MWs of LaaR were successfully employed by ERCOT within a ten-minute window to avert a potentially serious reliability problem following an unexpected drop in wind energy production and the failure of certain generation resources to deliver their scheduled energy. For a detailed description of LaaR, see North American Electric Reliability Corporation, Data Collection for Demand-Side Management for Qualifying Its Influence on Reliability: Results and Recommendations, Prepared by the Demand-Side Management Task Force of the Resource Issues Subcommittee, November 2007.

- Other Reliability Reserves/Emergency Services (e.g., 1-2 hours)

Such pro forma rules and procedures would be binding on a RTO or ISO and each of its market participants except upon a demonstration that an alternative proposal is consistent with or superior to satisfying the standards set in the pro forma tariff and approved by consumer group members in the RTO or ISO's stakeholder process. The NOPR's encouragement that RTOs and ISOs cooperate and coordinate their efforts "in developing standard terms for demand response programs" (NOPR at ¶ 93) should be redirected to the specifications of the pro forma DR tariff. Given the ongoing efforts on DR measurement and verification by the North American Energy Standards Board (NAESB), it might also be prudent to engage NAESB with this effort.

b. Implementation of "Comparability"

To avoid misinterpretation by RTOs and ISOs, Industrial Consumers support clarification of the NOPR's language to the effect that DR bids in A/S markets be "comparable" to generator bids, i.e., DR bids must replicate the bid structures of generator resource bids. Further, the performance of a demand response resource should be comparable to that of a generator and comparable payment should be made for comparable generator performance. The NOPR currently states: "on a basis comparable to any other resources... ." "Any other resources" are exclusively generation resources. Clearly the Commission's intent is that RTOs and ISOs accept bids that are source neutral, and Industrial Consumers recommend that §35.28(g)(1)(i) of the NOPR be amended to read as follows:

Every Commission-approved ISO and RTO that operates organized markets based on competitive bidding for energy imbalance, spinning reserves, supplemental reserves, reactive power and voltage control, and regulation and frequency response ancillary services (or its functional equivalent in the Commission-approved ISO's or RTO's tariff) must accept bids from demand response resources in these markets for that product on a source neutral basis ~~comparable to any other resources~~, if the demand response resource meets the necessary technical requirements under the tariff and submits a bid under the Commission-approved ISO's or RTO's bidding rules at or below the market-

clearing price, unless the laws or regulations of the relevant retail regulatory authority do not permit a retail customer to participate.

The DR capabilities of many industrial loads can often provide grid operators with greater value compared to the typical generator. This value cannot be used in the A/S markets, and the improved market and operational efficiencies realized, if grid operators' expectations are limited to generation-like resources. An objective of the final rule should be to change these expectations.

c. Compensation for DR Resources

Industrial Consumers recommend that ISOs and RTOs should accept bids from demand response resources on a source neutral basis and, therefore, the payment structure should be comparable to the payment of a generator. It is only appropriate that if source neutral performance standards are applied then source neutral payments should also apply.

Industrial Consumers are concerned that expected progress in the development of DR resources will not materialize absent appropriate economic compensation, particularly in areas where demand response is not treated in a real-time manner (unlike that of LaaR in ERCOT). The NOPR does not address this problem except to perhaps defer it to a later time. This is unfortunate because potential providers of DR resources will not take seriously efforts by FERC and the ISOs and RTOs to promote demand response if there is no guarantee that they will be adequately compensated. Recent FERC orders suggest that the Commission is unwilling to authorize compensation for curtailed loads and instead expects loads to curtail power to aid system reliability without adequate compensation for the production or other losses suffered, which is the intended result of the so-called "gross load settlement method."⁷ Industrial Consumers believe that little or no progress on advancing the role

⁷ The gross load approach requires the provider of DR resources to pay for energy they did not consume – in essence, a wash trade.

of DR resources in the organized markets is achievable without fair resolution of compensation issues including recognition that loads incur substantial costs to curtail that may exceed the value of the LMP it may receive even absent the hypocrisy of the gross load settlement method. Moreover, the economic benefits to the market of shedding load are typically greater than those of generation ramping up (less congestion, no fuel consumption, no additional emissions, etc).

The related issue of customer baselines also is of critical importance and needs to be resolved on a consistent basis to promote development of DR resources. As Commissioner Wellinghoff recently observed in his separate opinion in the Commission's recent order respecting ISO-NE's proposed changes to the market rules governing its day-ahead load response program (123 FERC ¶ 61,021, April 4, 2008), "[a]ccurate representation of the customer's normal load is necessary to measure and verify that the load reductions indeed occur, so that demand response providers get paid for their service" Industrial Consumers agree that "[a] more precise tool is needed - a customer baseline methodology that accounts directly for seasonal shifts in customer load and for scheduled demand changes such as vacations, maintenance outage, and plant shutdowns" and that "a solution is needed sooner rather than later."

d. Minimum Threshold Size

The NOPR does not set a minimum threshold size for DR bids. Industrial Consumers recommended a 1-MW minimum in their ANOPR comments. The NOPR preamble appropriately suggests that smaller thresholds may be allowed if cost effective to both buyer and seller. Industrial Consumers agree, provided that the increased overhead costs of accommodating smaller transactions that could not otherwise be bundled by ARCs do not increase ISO/RTO uplift costs. Thus, Industrial Consumers support the requirement that RTOs and ISOs perform an assessment of the technical feasibility and value to the market of smaller loads providing some ancillary services. NOPR at ¶ 59.

e. Frequency and Duration of DR Service

The NOPR would also require RTOs and ISOs to allow DR resources to specify limits on the frequency and duration of their service in their bids to provide ancillary services, or their bids into the joint energy-ancillary services markets in the co-optimized RTO markets. NOPR at ¶ 62. These limits are intended to be comparable to the limits generators specify on price, quantity, start-up and no-load costs, and minimum downtime between starts. We strongly support this requirement and believe that it will be absolutely essential if there is any hope to increase the amount of DR resources in the organized markets. Whether these new parameters should be available for all bids and not just for DR resources should be governed by the principle of source neutrality that we introduced above. Industrial Consumers submit that the key objective for the final rule and other Commission initiatives should be to ensure that all viable resources can be offered into the market on a competitive basis in a way that maximizes their value to both the buyer and seller.

f. Deviation Charge

The NOPR proposes to require all RTO and ISO tariffs to be modified to eliminate any deviation charge to the buyer in the energy market for taking less electric energy in the real-time market during a real-time market period for which the RTO or ISO declares an operating reserve shortage or makes a generic request to reduce load to avoid an operating reserve shortage. NOPR at ¶ 72.

Industrial Consumers supported this proposal in our ANOPR comments and support its proposed adoption in the NOPR. We also supplemented our endorsement in the ANOPR comments with the recommendation that the Commission consider eliminating artificial charges in non-emergency conditions as well because demand response should ultimately be market driven and not used exclusively as a resource in reliability-related emergency conditions, thus giving generators a free hand to dominate the non-emergency energy markets. We are aware that a purpose of such deviation

charges was to mitigate the potential to game the day-ahead and real-time markets, but that problem exists because wholesale buyers cannot hedge the short term markets with bilateral contracts in a robust forward market.

g. Aggregation of Retail Customers

The NOPR proposes to require each RTO and ISO to amend its market rules as necessary to permit aggregators of retail customers (ARCs) to bid demand response on behalf of retail customers directly into the RTO or ISO's organized markets, unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate. NOPR at ¶ 86.

Industrial Consumers supported this proposal in our ANOPR comments and also support the NOPR's adoption of this provision. Industrial Consumers also support the criteria recommended in the NOPR preamble that ARCs and ARC bids meet the same requirements as eligible LSEs and large industrial customer demand response.

h. Potential Future Demand Response Reforms

The NOPR delays consideration of many of the issues raised in the ANOPR on demand response with the promise that "[t]he need for, and the focus on, demand response will continue." NOPR at ¶ 94. Given our concern that the scope of the NOPR is too timid to address the serious shortcomings in the organized markets, Industrial Consumers are left with no choice but to support the proposed staff technical conference to consider four issues related to demand response participation in organized markets. These issues are: (1) potential solutions to eliminate any potential barriers to comparable treatment of demand response; (2) potential solutions to eliminate any potential barriers to comparable treatment of demand response that have not previously been identified and what they are; (3) appropriate compensation for demand response; and (4) the need for and the ability to standardize terms, practices, rules and procedures associated with demand response, among other things. NOPR at ¶ 95. When considering these issues, Industrial Consumers recommend that special

attention be paid to ensure that demand response programs offered in the organized markets “do no harm” to interruptible programs.

i. Market Rules Governing Price Formation During Periods of Operating Reserve Shortage

The Commission states in the NOPR preamble:

We ... continue to believe that existing market rules appear to be unjust, unreasonable and unduly discriminatory or preferential during times of scarcity. In particular, they may not accurately reflect the true value of energy and, by failing to do so, may harm reliability, inhibit demand response, deter new entry of demand response and generation resources and thwart innovation. NOPR at ¶ 107.

As a result, the NOPR includes a requirement for scarcity pricing that intends to shift revenues collected by generators in the ISO or RTO’s capacity markets to the energy markets. The Commission proposes to require each organized market to make a compliance filing, within six months of the final rule in this proceeding, proposing any necessary reforms to ensure that “the market price for energy accurately reflects the value of such energy during periods of scarcity (i.e., an operating reserve shortage).” NOPR at ¶ 117. Because there are regional differences in market design, the NOPR does not mandate any one type of reform in this area. Rather, each region may propose one of the four approaches described in the ANOPR or it may propose a different approach. Alternatively, a region may demonstrate that its existing market rules already reflect the value of energy during periods of scarcity and therefore do not need to be reformed.

The four scarcity pricing approaches from the ANOPR are: (1) raise energy supply offer caps and demand cap bids; (2) increase bid caps for demand bids (i.e., customers’ offers to purchase a certain amount of energy at a given price); (3) establish an administratively-determined demand curve mechanism for operating reserves; and (4) set the market-clearing price for all supply and DR resources dispatched equal to the

payment made to participants in an emergency demand response program. The Commission has already approved mechanism #3 above for NYISO and ISO-NE.

In our comments on the ANOPR, Industrial Consumers rejected any such scarcity pricing requirement until the Commission addresses “the pre-conditions necessary to safeguard consumer interests.” Industrial Consumers ANOPR Comments at 21. The NOPR responds only partially to this request by providing a “phase-in” of the pricing mechanism and requiring (in the preamble not the actual proposed rule) that market power issues be adequately addressed before any scarcity pricing mechanism is adopted. NOPR at ¶ 116 and ¶ 128. This includes providing “adequate factual support” that demonstrates that the ISO or RTO’s proposal is adequately designed to protect consumers against the exercise of market power. NOPR at ¶ 118. This factual record will be used by the Commission to determine whether each ISO or RTO compliance filing (including any demonstration as to its existing market rules) would (quoting from the NOPR preamble):

- Improve reliability by reducing demand and increasing generation during periods of operating reserve shortage;
- Make it more worthwhile for customers to invest in demand response technologies;
- Encourage existing generation and demand resources needed during an operating reserve shortage to remain in business;
- Encourage entry of new generation and demand resources;
- Provide comparable treatment and compensation to demand resources during periods of operating reserve shortages; and
- Have provisions for mitigating market power and deterring gaming behavior, including, but not limited to, use of demand resources to discipline bidding behavior to competitive levels during periods of operating reserve shortages. NOPR at ¶ 119.

Industrial Consumers note that all six items address the adequacy of demand response in the energy markets or the ability or willingness of providers of demand response resources to enter those markets. Given that the NOPR explicitly defers to some future time the resolution of important issues related to demand response such as

compensation, it would seem that the Commission has the cart in front of the horse on the issue of scarcity pricing.

If the final rule retains the scarcity pricing requirement, notwithstanding the widespread opposition, Industrial Consumers recommend that a phase-in requirement of at least three to five years be included in the rule, together with the establishment of benchmarks (on a sliding scale basis) that measure the ability of specific market factors to protect consumers from the exercise of market power at the time of scarcity. Industrial Consumers strongly recommend that scarcity price levels only be allowed to increase in conjunction with and proportional to at least these four benchmarks:

- (i) Measured and verified amount of new net incremental DR resources entering the market,
- (ii) Net incremental reductions in congestion, whether via enhancement of generation and/or transmission resources, in the zones where scarcity pricing is implemented,
- (iii) Sustained increases in the volume of load hedged in long-term forward markets, and
- (iv) Development of credible forward price curves for power delivered at ISO/RTO hubs published in support of the third benchmark that are regularly relied upon by market participants.

In addition, forward capacity markets (e.g., RPM) should be suspended prior to the introduction of scarcity pricing to prevent generators from gaming multiple markets for the same revenues. The longer phase-in is consistent with the obvious need to further develop the energy markets with new infrastructure and forward contracting. If scarcity pricing is to be used, conditions of true competition must be demonstrated and everyone must agree that the conditions exist – not just those stakeholders who get economic benefits from the status quo. Scarcity pricing without competition is monopoly pricing in disguise.

2. Long-Term Power Contracting in Organized Markets

The NOPR proposes only two small steps on the important issue of forward market development. Although Industrial Consumers do not oppose these changes, much more is needed to promote long-term power contracting sufficient to reflect the investment cycle for new or expanded industrial production capacity.

First, the NOPR proposes that each Commission-approved ISO or RTO must provide a portion of its web site for market participants to post offers to buy or sell power on a long-term basis. The NOPR does not set by rule the specific type of bulletin board that each ISO or RTO must post. NOPR at ¶¶ 155-158. Industrial Consumers do not object to this requirement as long as it does not expand the scope of any ISO or RTO's market involvement or increase uplift costs. We echo the NOPR's finding that this scheme was offered by at least one RTO in the past and was abandoned because no one used it. In order to even begin to facilitate transacting bilateral contracts, any functionality should extend beyond simply buying and selling energy into the realm of buying and selling fully bundled products which include energy, capacity, transmission and ancillary services.

Second, the NOPR announces that the Commission has directed its staff to host a technical conference on the proposals of the American Forest & Paper Association (AF&PA) and Portland Cement Association (PCA) on alternative market designs for long-term contracting and related issues. NOPR at ¶ 161. Industrial Consumers welcome this directive and strongly encourage the Commission to consider the merits of these and other alternative market designs.

The NOPR preamble also adds: "The Commission will consider reasonable additional steps in response to comments on this NOPR, and continues to encourage ISOs and RTOs to work within their authorities with stakeholders to facilitate long-term power contracting." NOPR at ¶ 129. Industrial Consumers note that ELCON staff and

several industrials actively participated in the two-part PJM Long-Term Contracting Forum held in September 2007 and again in January 2008. The consensus among our groups is that there has been no real progress toward resolving these issues, and the NOPR proposals will do little more to stimulate long-term contracting in robust forward markets. At a minimum, Industrial Consumers urge FERC to define “long term” as being substantially more than one year and consistent with building cycles of new or expanded production capacity. Any entity making construction decisions regarding new facilities needs knowledge of prices going forward in order to make important investment decisions.

3. Market-Monitoring Policies

The NOPR includes a number of provisions on market-monitoring policies that attempt to strengthen market monitoring by safeguarding the independence of Market Monitoring Units (MMUs) and fostering useful and transparent market analysis. Industrial Consumers generally support all the provisions except as noted below.

The NOPR does not require any specific structure for the MMU that might help to safeguard the independence of MMUs. It can be internal or external to ISO/RTO staff, or a two-tiered hybrid of the two as recommended by Industrial Consumers in our ANOPR comments. The Commission continues to argue that “the nature of the MMU structure is not determinative of either independence or quality of performance,” and therefore an MMU can have an external, internal or hybrid structure. NOPR at ¶ 179. Industrial Consumers disagree to the extent that the hybrid structure may have at least one feature for ensuring independence that neither an external nor internal structure provides and that is, if the members of the top tier are otherwise fully employed and not dependent for their main salary or contract on services performed for the ISO or RTO, they are presumed independent. It has been our observation that the California ISO’s Market Surveillance Committee (the only such hybrid) has consistently exhibited greater candor and objectivity on controversial matters as evidence of this fact.

Regardless of the structure, the MMU must, however, not report to ISO/RTO management. The NOPR proposes that the MMU report to the ISO/RTO Board or a committee of the board in which ISO/RTO management has been removed. NOPR at ¶ 187. Industrial Consumers strongly advocated this requirement in its ANOPR comments and support the NOPR provision.

In the area of improving the market monitoring functions, the NOPR proposes that each RTO and ISO provide its MMU with access to market data, resources and personnel sufficient to carry out its duties. NOPR at ¶ 180. In addition, the NOPR proposes to require that the MMU's functions include: (1) identifying ineffective market rules and recommending proposed rules and tariff changes; (2) reviewing and reporting on the performance of the wholesale markets to the RTO or ISO, the Commission, and other interested entities; and (3) notifying appropriate Commission staff of instances in which a market participant's behavior requires investigation. NOPR at ¶ 198. The NOPR also proposes expanding the list of recipients to receive MMU recommendations regarding rule and tariff changes, and broadening the scope of behavior to be reported to the Commission.

The NOPR further proposes to remove the MMU from tariff administration, including price mitigation (NOPR at ¶ 210), require each RTO and ISO to include ethics standards for MMU employees in its tariff (NOPR at ¶ 213), and consolidate all its MMU provisions in one section of its tariff (NOPR at ¶ 217). The NOPR also proposes expanding the dissemination of MMU market information to a broader constituency, with reports made on a more frequent basis, and reducing the time period before energy market bid and offer data are released to the public. NOPR at ¶¶ 226-228. Industrial Consumers support each of these provisions of the NOPR.

The NOPR includes a requirement that each ISO or RTO release their offer and bid data within three months unless ISO or RTO obtains FERC approval for a different period. NOPR at ¶ 229. The current data blackout period is six months. Each ISO or RTO may mask the identity of market participants when releasing offer and bid data.

NOPR at ¶ 230. These provisions of the NOPR were suggested in the ANOPR, and Industrial Consumers advocated a shorter “within one month” data release policy. The Commission argues that a shorter period could create opportunities for market collusion. We support the NOPR requirement although we would rather have a shorter “within one month” policy.

4. Responsiveness of ISOs and RTOs to Stakeholders and Customers

The Commission proposes to establish new criteria intended to ensure that an ISO or RTO is responsive to its customers and stakeholders, and ultimately to the consumers who benefit from and pay for electricity services. NOPR at ¶ 275. These principles as stated in the NOPR are:

- (i) Inclusiveness. The practices and procedures must ensure that any customer or stakeholder affected by the operation of the Commission-approved ISO or RTO, or its representative, is permitted to communicate its views to the RTO or ISO board;
- (ii) Fairness in balancing diverse interests. The practices and procedures must ensure that the interests of customers or other stakeholders are equitably considered and that deliberation and consideration of Commission-approved ISO and RTO issues are not dominated by any single stakeholder category;
- (iii) Representation of minority positions. The practices and procedures must ensure that, in instances where stakeholders are not in total agreement on a particular issue, minority positions are communicated to the board of directors at the same time as majority positions; and
- (iv) Ongoing responsiveness. The practices and procedures must provide for stakeholder input into RTO or ISO decisions as well as mechanisms to provide feedback to stakeholders to ensure that information exchange and communication continue over time.

In each of these four areas, the NOPR would require RTOs and ISOs to consult with their stakeholders and make a compliance filing that details why the entity’s existing practices comply with the final rule in this proceeding, or the entity’s plans to attain compliance. Industrial Consumers are skeptical that the proposal is tenable. While these principles are certainly well-intended and incontrovertible, it would seem unimaginable that any ISO or RTO management or board would confess that they have ever done the contrary. We do not belittle the enormity of the problem. Large not-for-

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profit utilities have been created from scratch to manage and operate huge portfolios of assets that increasingly resemble the old vertically-integrated utilities.

The NOPR preamble is clear that the Commission favors two structural approaches (or “options for consideration”) to increase responsiveness: (1) establish board advisory committee, or (2) establish a hybrid board. NOPR at ¶ 277. The NOPR does not mandate that an ISO or RTO adopt either option but reserves to each ISO or RTO’s stakeholder process for development of its compliance plan. On the hybrid board proposal, the NOPR preamble did cite Industrial Consumers’ recommended ERCOT-like hybrid structure, in which the stakeholder members would be a minority of the total number of board members, and equally split between representatives of suppliers and consumers interests. Industrial Consumers continue to advocate the hybrid board approach as the best long-term solution for ensuring ISO/RTO accountability to stakeholders.

Respectfully submitted,

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April 21, 2008