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ELECTRICITY LAW DEVELOPMENTS – March 3, 2008

Prepared for ELCON

This report summarizes recent developments in FERC proceedings in which ELCON has been active and other matters of interest to industrial consumers. Inside this issue:

- **FERC Issues NOPR on Reforms to the Organized Markets Docket Nos. (RM07-19, AD07-7) (p. 2)**
- **FERC Accepts MISO Ancillary Services Market Proposal (FERC Docket No. ER07-1372) (p. 6)**
- **New Harquahala Protests Registration in NERC Compliance Registry (FERC Docket No. RC08-4) (p. 8)**
- **WSPP's Ceiling Rates Found No Longer to be Just and Reasonable (FERC Docket Nos. EL07-69, ER91-195) (p.11)**
- **FERC Issues Final Cross-Subsidization Rules (FERC Docket Nos. RM07-15, RM07-21) (p. 12)**
- **ISO-NE Seeks FERC Approval to Raise Demand Response Price Floor (FERC Docket No. ER08-538) (p. 13)**
- **FERC Allows PJM ELRP "Subsidy" Program to Sunset (FERC Docket No. EL08-12) (p. 14)**
- **SPS and Others Request Rehearing of FERC Grant of PURPA Relief to SPP Utilities (FERC Docket No. QM07-5) (p. 19)**
- **Challenge to FERC's PURPA Sec. 210(m) Implementation Rules (U.S. Court of Appeals for the D.C. Circuit, Case No. 07-1328) (p. 21)**
- **Dismissal of Petition for Review of FERC's Order on MISO's Ancillary Services Market Proposal (U.S. Court of Appeals for the Seventh Circuit, Case No. 07-3592) (p. 21)**

New developments since the January 2008 issue of Electricity Law Developments are **in bold**.

I. FERC PROCEEDINGS

A. FERC NOPR on Reforms to the Organized Markets Docket Nos. RM07-19, AD07-7

On February 22, 2008, the Federal Energy Regulatory Commission (FERC) issued a notice of proposed rulemaking intended to improve the function of the wholesale organized (RTO and ISO) electricity markets. The proposed rule continues a proceeding that began in 2007 with two technical conferences and an advance notice of proposed rulemaking.

The proposed rule is relatively modest in scope, as FERC resisted proposals to expand the proceeding to a wider-ranging examination of wholesale market reforms. It has four major components: (1) demand response and market pricing during periods of reserve shortage; (2) long-term power contracting; (3) market-monitoring policies; and (4) responsiveness to stakeholders and customers. Most of the requirements would be implemented through revisions to the tariffs of RTOs and ISOs due six months after a final rule, and therefore would be the subject of a series of future proceedings.

Demand Response

The proposed reforms relating to demand response are particularly robust in establishing a principle of comparable treatment for demand response resources and other available resources and in requiring that, during periods of operating reserve shortage, pricing proposals must be supported by an adequate record showing protection against market power and gaming, including use of demand resources to discipline bidding behavior to competitive levels. Moreover, demand response issues are to be further explored in a technical conference to be held during the pendency of the rulemaking, and

the dialogue at the Commission meeting suggests that there continues to be debate about whether, and how to ensure that, demand response resources are granted appropriate incentives, taking into account other generation resources.

Specifically, the proposed rule would require RTOs and ISOs to:

- Accept bids from demand response resources in their markets for certain ancillary services comparable to other resources.
- During a system emergency, eliminate the deviation charge imposed on a buyer for taking less energy in the real-time market than it purchased in the day-ahead market.
- Permit an aggregator of retail customers to bid demand response on behalf of retail customers.
- Modify market rules to allow market-clearing prices, during a period of operating reserve shortage, to reach a level that rebalances supply and demand so as to maintain reliability while providing sufficient provisions for mitigating market power.

The latter provision to adopt a scarcity-pricing requirement is expected to be particularly controversial.

Long-Term Power Contracting

The proposed rule is relatively weak on long-term contracting, simply requiring RTOs and ISOs to dedicate a portion of their websites for market participants to post offers to buy or sell power on a long-term basis. The preamble states, however, that the Commission “will consider reasonable additional steps in response to comments on this NOPR, and continues to encourage RTOs and ISOs to work within their authorities with stakeholders to facilitate long-term power contracting.”

Improved Market Monitoring

The proposed rule contains a series of basic reforms, similar to those in the advance notice and to those already adopted by PJM relating to market monitoring. Specifically, the proposed rule would:

- **Require each RTO and ISO to provide its Market Monitoring Unit (MMU) with access to market data, resources and personnel necessary to carry out its duties.**
- **Require the MMU to report directly to the RTO or ISO board.**
- **Expand the list of recipients who would receive MMU recommendations regarding rule and tariff changes, and broaden the scope of behavior reported to FERC.**
- **Remove the MMU from tariff administration, including mitigation, and require each RTO and ISO to include in its tariff ethics standards for MMU employees.**
- **Expand dissemination of MMU market information to a broader constituency, with more frequent reports.**

Responsiveness to Customers and Stakeholders

The proposed rule would require RTOs and ISOs to adopt procedures to ensure inclusiveness, fairness in balancing diverse interests, representation of minority positions, and ongoing responsiveness, including permitting adoption of hybrid boards with stakeholder members. It is particularly useful that the proposed rule would direct RTOs and ISOs to “provide a forum for affected consumers to voice specific concerns (and to propose regional solutions).”

Further Proceedings

The proposal also sets forth the following additional steps:

- **RTOs and ISOs are to consult with their stakeholders and make compliance filings that detail their plans for compliance with tariff revisions due six months after the final rule.**
- **RTOs and ISOs are encouraged to study whether further reforms are necessary to eliminate barriers to demand response and ensure that demand response resources are treated on a comparable basis as other resources. The proposal also encourages RTOs and ISOs to provide a forum to consider any specific proposals from consumer organizations or other entities to strengthen competitive markets.**
- **A FERC technical conference will address proposals by the American Forest and Paper Association and Portland Cement Association *et al.* to modify the design of organized markets.**
- **As noted above, a separate technical conference, to be convened by FERC staff shortly after receiving comments on the proposed rule, will discuss barriers to demand response in organized markets, potential solutions to eliminate barriers to comparable treatment, appropriate compensation for demand response, and standardization of practices and procedures associated with demand response.**

Commissioner Wellinghoff issued a separate concurrence in which he expressed an interest in receiving comments addressing the NOPR's proposed rules governing price formation during infrequent periods of operating reserve shortage, including means to protect consumers against the exercise of market power. He also emphasized the need to develop an adequate factual record prior to approving pricing proposals and to demonstrate that provisions exist 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 shortage.

In a separate dissent, Commissioner Kelly noted partial disagreement with the approach the Commission is proposing in the NOPR with respect to scarcity pricing and market monitoring. She indicated that she did not think the Commission should mandate scarcity pricing -- all of the regions except SPP already have some kind of scarcity pricing

mechanism in place, and she stated that in her view, SPP should be allowed to implement its own mechanism when SPP believes it is appropriate to do so. She also stated that she does not think stakeholder participation in RTO/ISO boards is an effective solution to lack of responsiveness to stakeholder concerns. Instead, she suggested rewriting RTO/ISO mission statements to include responsiveness to stakeholders and consumers, to make it part of the very purpose of the RTO/ISO.

Comments on the proposed rule will be due 45 days after its publication in the *Federal Register*.

B. FERC Accepts MISO Ancillary Services Market Proposal (FERC Docket No. ER07-1372)

On February 25, 2008 FERC conditionally approved MISO's proposed implementation of a real-time and day-ahead ancillary services market (ASM), stating that the proposal incorporates and in some cases improves upon, design features that have worked successfully in other organized markets. MISO had initially submitted a plan to FERC for the ASM in February 2007, but in June, FERC sent the ISO back to the drawing board in part because the proposal lacked a market power study and provisions for market power mitigation measures. MISO submitted a revised proposal in September 2007.

Among the features of the ASM that FERC approved:

- The Midwest ISO will determine operating reserve requirements and procure operating reserves from all qualified resources, in place of the current system of local management and procurement of reserves by the 24 Balancing Authorities, thus creating a single market for ancillary services in both the real-time and day-ahead markets and allowing for price competition among various resources.
- The Midwest ISO proposes to transfer and consolidate Balancing Authority responsibility in the Midwest ISO so that it will become the North American

Electric Reliability Council-certified Balancing Authority for the entire Midwest ISO Balancing Authority Area. This will allow for the centralized management of ancillary services.

- **Greater participation by demand resources.**
- **Scarcity pricing through the use of demand curves as part of a simultaneous “co-optimization process” of energy and operating reserve market.**
- **Adoption of a comprehensive package of market mitigation measures, including conduct and impact tests (with reduced thresholds during a start-up period) and audits by the IMM to detect potential physical and economic withholding, to ensure that ASM rates are just and reasonable as the region moves from cost-based to market-based rates.**

With respect to the proposed implementation of a scarcity demand curve, FERC stated that existing market rules may appear to be unjust, unreasonable and unduly discriminatory or preferential during times of scarcity because prices may not accurately reflect the true value of energy. The lack of a proper price signal may in turn harm reliability, inhibit demand response, deter new entry, and thwart innovation. FERC noted that in the NOPR on organized markets (discussed above) one suggested method for remedying the problem is adoption of a demand curve for operating reserves such that when available generating capacity falls short of combined energy demand and operating reserve requirements, the market price for energy and operating reserves would increase to specified levels, typically above the market-wide seller offer cap. “While the proposed rule set forth in the Competition NOPR is subject to comment and has not taken effect, we note that the Midwest ISO’s proposed use of demand curves and scarcity pricing is consistent with that scarcity pricing method, and that the Midwest ISO has developed measures to monitor and mitigate market power that could artificially drive prices to scarcity levels.” With respect to cost allocations under scarcity pricing, FERC said:

[W]e are requiring the cost allocation for ancillary services to more closely reflect cost causation. Under the Midwest ISO scarcity pricing provisions, during reserve shortage periods prices will reflect scarcity, and therefore market participants will see better price signals for making longer-term decisions. Loads will pay the costs of scarcity in their zone regardless of whether they were the cause of the scarcity. Generally, these loads should be able to hedge most of these higher costs through contracts. However, we recognize that obtaining a perfect hedge of these scarcity costs could be difficult given the dynamic determination of reserve zones. We note that, as a practical matter, determining precise cost causation is difficult, especially in scarcity situations. Many factors can cause scarcity conditions (i.e., transmission outages), and scarcity situations are not necessarily caused by market participants with insufficient reserves. Given this imprecision and the need for the Midwest ISO to obtain reserves to reliably serve all customers, we find it reasonable to assign scarcity costs to the load zone that benefits from the reserves. While ideally the load that may be the cause of the scarcity should see the full scarcity price and thereby see the prices they caused to be incurred, we do not believe that the lack of a price signal makes the cost allocation unjust and unreasonable, for the reasons discussed. We encourage the Midwest ISO to discuss this issue further with stakeholders.

In a separate dissent, Commissioner Wellinghoff expressed concern that market power is greater in the ancillary services market than in the energy market. He stated: “Despite the importance of demand response to such a comprehensive approach, Midwest ISO’s filing contains no factual record assessing whether demand response can effectively participate in its markets under its proposed rules Without such a record indicating potential demand response to discipline bidding behavior, the reasonableness of Midwest ISO’s overall proposal, and particularly its plans to implement scarcity pricing, is called into question.”

C. New Harquahala Protests Registration in NERC Compliance Registry (FERC Docket No. RC08-4)

On February 4, 2008, generator New Harquahala appealed a NERC/WECC requirement that it be registered in the NERC Compliance Registry as a Transmission

Owner (TO) and a Transmission Operator (TOP) because of tie line or radial ownership. WECC argues that because the generator's interconnection to the grid is part of a larger transmission system that is important to bulk power reliability the generator should be registered as a TO or TOP. This proceeding involves registration of a facility that agrees it is subject to registration as a generator, but protests registration as a TO/TOP. New Harquahala argues that what is owned and operated is a minor piece of the transmission system that is not integrated with the grid and, in and of itself, bears no risk to reliability. Thus there is no reliability gap or material impact on interconnection; the facility should only be registered as a generator.

ELCON plans to intervene in this proceeding for two reasons. As a procedural matter, WECC's and NERC's rejection of New Harquahala's arguments represents another instance where these reliability organizations, while enjoying quasi-regulatory status, do not engage in reasoned decision-making and order registration without due consideration of the arguments against registration. This is a point that ELCON also raised in the Direct Energy Services docket (121 FERC ¶ 61,274 (2007)).¹

New Harquahala's Arguments Against Registration

Specifically, New Harquahala has argued:

NERC's denial of Harquahala's NERC Appeal is inconsistent with the plain language of the NERC Registry Criteria, which excludes from registration any entity that does not own or operate "an *integrated transmission element* associated with the BPS 100 kV and above, or such lower voltage as defined by the Regional Entity necessary to provide for the reliable operation of the interconnected transmission grid." Harquahala's tie-line is a sole use, radial line and, therefore, not an integrated transmission element. NERC's principal error is its rejection of the historical and common usage of the term

¹ Direct Energy Services, 121 FERC ¶ 61,274 (2007), did not involve generation registration but rather registration of retail marketers who were serving peak load in excess of 25MW as LSEs. FERC reversed NERC's registration of these entities since they did not meet the applicable criteria, i.e., they were not connected to the bulk power system (more than 100 KV).

“integrated,” which is used to describe transmission facilities that are looped with other facilities so as to provide a parallel path for power flows over an interconnected network of transmission facilities, and not to include sole use, radial lines such as the Interconnection Facilities. NERC, instead, without providing any notice to the Commission and the industry, asserts that it will deem “integrated” as synonymous with “connected;” that is, because the Interconnection Facilities connect the Generation Facility to Hassayampa, NERC concludes that they are integrated transmission elements under the Registry Criteria. The Commission must reject NERC’s *post hoc* reinterpretation of the commonly understood term “integrated” as applied to transmission facilities.

New Harquahala points out that under FERC precedent “there is an important distinction between ‘interconnection facilities’ and ‘network upgrades’ in that the former are sole use facilities (e.g., radial line that extends from the generating facility to the point of interconnection with the grid) that benefit only the interconnection customer, while the latter are part of the integrated grid and, therefore, benefit all users of the transmission system.” The TO/TOP requirements fall into two categories: (1) requirements that clearly are intended to apply to integrated facilities, as that term is commonly understood, and not to interconnection facilities; and (2) requirements that are duplicative of TO/TOP requirements and therefore already full captured with respect to such interconnection facilities. Included in the first category, for example, are requirements involving the direction of other entities during emergencies or to coordinate the activities of other entities; and standards that apply by their own terms only to significant transmission paths in WECC. Treating New Harquahala like a TO/TOP would require Harquahala to employ at least five NERC-certified transmission operators to monitor the operation of its generator tie-line, at an estimated cost to exceed \$1 million initially, with continuing costs for wages and training going forward.

Interventions are due on March 5.

D. WSPP's Ceiling Rates Found No Longer to be Just and Reasonable (FERC Docket Nos. EL07-69, ER91-195)

On February 21, 2007, FERC issued an order indicating that sellers in the Western System Power Pool (WSPP) may no longer use the WSPP demand charge ceiling rate in markets where they do not have market-based rate authority unless the rate may be justified on the basis of that seller's own fixed costs.

First approved in 1991, the WSPP agreement allows seller to charge wither an uncapped FERC-approved market-based rate or a price up to a cost-based ceiling rate that is calculated by adding the seller's forecast incremental costs to a demand charge based on the average fixed costs of a representative group of sellers. The representative sellers include approximately half of the WSPP sellers at the time the ceiling rate was conceived in 1989, but now the group represents only about 5% of all sellers. In June of 2007, FERC initiated an investigation into the reasonableness of continued use of the rates when it came to the Commission's attention that several sellers who had failed FERC's market power screens were still able, under the WSPP agreement, to charge a rate above their own cost-based rates. Given the changes in the market over the past several years, FERC found that it is: "unjust and unreasonable to allow a seller that has been found to have, or is presumed to have, market power to in essence side-step the Commission's market-based rate requirements and use the WSPP agreement demand charge to determine the price it can charge to buyers."

Sellers lacking market-based rate authorization who operate under the WSPP have 60 days to provide cost justification if they wish to continue to operate under the WSPP agreement; otherwise, they must file individual rate schedules.

**E. FERC Issues Final Cross-Subsidization Rules
(FERC Docket Nos. RM07-15, RM07-21)**

On February 21, 2008, FERC issued orders finalizing certain restrictions on affiliate transactions and adopting additional blanket authorizations under FPA Section 203.

With respect to affiliate transactions, FERC adopted restrictions applicable to transactions between franchised public utilities that have captive customers or that own or provide transmission facilities, and their market-regulated power sales affiliates or non-utility affiliates, including rules related to the applicable pricing standard for such transactions, rules addressing potential affiliate abuse, and rules related to non-power goods and services transactions between affiliates. The rules are not limited to cross-subsidization as a result of a merger, but apply to all franchised public utilities with captive customers or that own or provide transmission services over FERC-jurisdictional transmission facilities. FERC will continue to defer to state-imposed mechanisms to protect wholesale customers where such mechanisms exist and are adequate. However, where state commissions do not have the authority to impose necessary protections or if state protections are insufficient, FERC will fill the regulatory gap.

In the order on blanket authorization, FERC granted a series blanket authorizations under Section 203. Most significantly, as was proposed, the order pre-authorizes a public utility to dispose of less than 10 percent of its voting securities to a public utility holding company but only if, after the disposition, the holding company and any associate or affiliate companies, in the aggregate, will own less than 10 percent of that public utility. The order also adopts three additional blanket authorizations under section 203(a)(1) to parallel, for the most part, existing blanket authorizations granted to holding companies under section 203(a)(2). In addition, the order grants a blanket authorization

under section 203(a)(1) for the acquisition or disposition of a jurisdictional contract where neither the entity acquiring the contract nor the entity transferring the contract has captive customers or owns or provides transmission service over jurisdictional facilities, the contract does not convey control over the operation of a generation or transmission facility, the parties to the transaction are neither associate nor affiliate companies, and the acquirer is a public utility.

F. ISO-NE Seeks FERC Approval to Raise Demand Response Price Floor (FERC Docket No. ER08-538)

On February 5, 2008, ISO-NE submitted a proposal to FERC to allow changes to its day-ahead load response program. According to the grid operator, the existing price floor for offers to participate in the demand response program must be raised in order to prevent potential manipulation.

Under the new proposal, the floor would be indexed to a number that reflects fuel price levels. The current price floor is set at \$50 per MWh. The purpose of the floor was to prevent payment for load reductions when, for example, a facility was not planning to operate but might submit a bid for load reduction on that day in order to receive a payment. According to ISO-NE, fuel price increases in recent years, particularly since August 2007, have lead to what ISO-NE characterizes as “exaggerated” load reductions. Recently, the number of participants in the program has increased, but the average offer size has decreased. “[T]he vast majority of assets now participating in the [load response program] submit load interruption offers at the minimum level allowed by the program rules (100kW), even though such participants are capable of delivering substantially greater load interruptions in real-time.” ISO-NE has noted a trend for all load response

participants to offer to interrupt load at the \$50/MWh floor price at every eligible hour of every weekday.

The program was designed so that offers would clear when conditions were producing higher LMP levels and when the supply curve tends to have a steeper slope so that load reductions could significantly reduce market clearing prices. “At lower LMPs,” ISO-NE explained, “such as in the range of \$50/MWh in today’s market, the supply curve in both the day-ahead and real-time energy markets has a very modest slope, meaning that a program that induces demand response at such lower impacts would have a small impact on market clearing prices and potentially a negative effect on net societal benefits. Hence, even in the absence of strategic behavior, offers clearing at or near [the current floor price] result in a cost that other consumers bear but with little benefit to these consumers or to society as a whole.”

G. FERC Allows PJM ELRP “Subsidy” Program to Sunset (FERC Docket No. EL08-12)

In 2002, FERC approved PJM’s Economic Load Response Program (“ELRP”) on a temporary basis, and later allowed the program to become permanent. To encourage participation in the demand response program, under the ELRP, end-users were paid the real-time or day-ahead LMP for power usage they would curtail, less generation and transmission charges they would otherwise have incurred. However, if the market price for power exceeded \$75/MWh, participants were paid the full LMP, inclusive of generation and transmission charges.

On November 20, 2007, the PJMICC filed a complaint arguing that to allow PJM’s ELRP to expire as planned on December 31, 2007, would be unjust and unreasonable. Allowing the

program to sunset would have the result that “all economic demand responders will be denied the opportunity to receive just and reasonable compensation for the benefits they bring to PJM by providing load curtailment.” PJMICC argued that allowing the program to expire would be a violation of the FPA because the tariff provisions are necessary in some form to ensure at least minimal levels of demand elasticity in the market and thus, serve as one of several “checks” on the exercise of market power.

In a December 31, 2007 order, FERC declined to prevent the provisions from sunseting. Characterizing the payments as a “subsidy,” the majority explained that the payments were originally approved as an interim means to encourage participation in the new program in order to provide reimbursement for startup expenses. Now that the program has been in place for several years, it is not unreasonable “for the PJM stakeholders to conclude that customers interested in demand response have already had sufficient opportunity to recover start-up costs, so that a subsidy payment is no longer necessary to create an incentive to participate in the program.” FERC also said that lapse of the subsidy does not mean PJM customers lack incentive to reduce load in response to appropriate wholesale price signals. Customers paying retail rates below the applicable wholesale rate will be paid the difference between wholesale and retail rates. For wholesale customers, “because these customers are paying the applicable wholesale price, they already have an incentive to curtail load.”

Commissioner Kelly and Wellinghoff strenuously dissented, objecting to the majority’s use of the term “subsidy”. The expiring payments do not amount to a “subsidy” because, as PJM’s own market monitor has found, the costs of the demand response program are greatly outweighed by the benefits, thus no subsidy is borne by other customers. Additionally, since LMP reflects market value of a resource, payment of the full LMP to demand response providers

is comparable to LMP payments to generators. “By contrast, offsetting LMP by the demand response provider’s ‘avoided’ retail rate ignores the fact that the load-serving entity . . . is avoiding generation and transmission costs that it would have incurred to serve the customer providing the demand response. Because those costs are avoided by both seller and customer, there is no ‘subsidy’ to recover from other customers.” They stated that they agreed with PJMICC that “the rationale for the expiring payments is as valid today as it was when the Commission initially approved them.” They were also critical of the Commission’s failure to take the opportunity to use the proceeding to develop a more complete record on what compensation is appropriate for demand response providers in the PJM market, particularly in light of PJM’s own admission that “now might not be the proper time to eliminate the payments at issue.

On January 30, 2008, ELCON and PJMICC requested rehearing of the Commission’s order, arguing that the Commission erred by: (1) characterizing PJM ELRP incentive payments for load curtailment when the locational marginal price ("LMP") exceeds \$75 per MWh as "subsidies" and relying on that mischaracterization to allow the incentive payments to expire; (2) finding that insufficient evidence was presented to justify either a hearing or settlement judge process; and (3) not accepting PJMICC's Answer to other parties' Protests.

ELCON and PJMICC state that although the Commission labeled the incentive payments received by ELRP participants in exchange for their curtailments as "subsidies," the record is devoid of evidence supporting the Commission's characterization of these payments. To the contrary, the record includes evidence demonstrating that the payments at issue are not subsidies, because the system-wide benefits resulting from the load

curtailment during high-price periods outweigh the costs of the payments. Moreover, by characterizing the incentive payments as "subsidies" without a reasoned explanation, the Commission departs from its existing policy and precedent. The Commission erred by characterizing the incentive payments under the PJM ELRP as subsidies and relying on this mischaracterization to allow the incentive payments to expire.

With respect to the sufficiency of evidence to justify a settlement conference or hearing, ELCON and PJMICC point out that PJM and a number of other parties argued that the conditions giving rise to the need for incentive payments still exist and, absent an extension of the incentive program or the implementation of a reasonable alternative, the expiration of such incentives would have negative consequences for customers in the PJM region. Furthermore, in its Complaint, PJMICC argued that the Commission's initial approval of the incentive payment was intended to improve elasticity of demand by facilitating greater demand response, and the need to realize these objectives continues. PJM's own market monitor stated in the most recent State of the Market Report that PJM should evaluate "additional actions to increase demand-side responsiveness to price in both Energy and Capacity Markets" And PJM's Answer to PJMICC echoed PJMICC's position on this point, stating that now may not be the proper time to eliminate the incentive payments because the conditions that initially supported the need for these payments still exist and the market needs to mature further. PJM also cited a portion of the State of the Market Report observing that PJM's economic demand response market is not yet mature and that "targeted incentive payment structures could be considered. "At a minimum, the record in this proceeding raises issues of material fact as to . . . the immaturity of demand response in PJM's energy market, the need for the incentive

payments to ensure just and reasonable rates, and the appropriate compensation level for ELRP participants that cannot be resolved based on the record and are more appropriately addressed in the context of a hearing or settlement judge procedures.”

FERC has not yet ruled on the rehearing request.

H. Rehearing Requests of FERC’s Grants of PURPA Relief to SPP Utilities (FERC Docket No. QM07-5)

On January 22, 2008, FERC granted the requests of the Oklahoma Gas and Electric Company (OG&E) and two AEP subsidiaries (the Public Service Company of Oklahoma (PSO) and Southwestern Electric Power Company (SWEPCO)), for relief from mandatory PURPA obligations. The simultaneously-filed application of Xcel Energy Services Inc. on behalf of Southwestern Public Service Company was denied. 122 FERC ¶61,048. A divided Commission found that OG&E and the AEP subsidiaries met the statutory standard for prospective relief from the requirement to enter into new contracts with QFs with a net capacity in excess of 20 MW. Existing contracts and obligations with respect to QFs with a net capacity of less than 20 MW remains unchanged by the decision. The decision denying relief to Xcel was unanimous.

Commissioner Kelly filed a partial dissent to the decision on January 25, 2008, in which she stated her view that all applicants should have been denied PURPA relief. She concluded that the factual cases set forth by the Applicants and the Protestors were equally credible, and, accordingly, that all Applicants’ requests should have been denied for failure to meet their burden of proof.

On February 21, 2008, Xcel Energy Services filed on behalf of Southwestern Public Service Company (SPS) a request for clarification and rehearing. Xcel asks the Commission in the filing to clarify whether its market findings under PURPA Section

210(m)(1)(B)(ii) apply to SPS. Excel also requested rehearing of FERC’s denial, arguing that: (1) the Commission erred in its January 22 order because the evidence did not support the Commission’s conclusion that transmission constraints prevent QFs that are attached to SPS’s system from reaching other buyers; (2) that the Commission failed to properly consider that “[e]ven if protestors had demonstrated that transmission constraints currently impede a QF’s ability to make sales to buyers other than SPS, the SPP [OATT] provides a nondiscriminatory mechanism to alleviate those constraints, which ensures continued access to other buyers”; and (3) the Commission should not have applied certain findings it made regarding JD Wind to the entire SPS transmission system.

On the same day, the American Wind Energy Association, the Wind Coalition, and John Deere Renewables also file a request for clarification and rehearing. Those organizations requested that FERC clarify whether it determined in its January 22 order that the SPS balancing authority meets the competitive market standard of PURPA section 210(m)(1)(B)(ii). They also sought rehearing of the order, and argued that FERC erred by: (1) “arbitrarily and capriciously disregarding record evidence demonstrating that QFs in SPP do not have meaningful opportunities to sell power to third parties”; (2) improperly applying the statutory test for when utilities may be relieved of their “Day 1” market purchase obligations under PURPA; and (3) by improperly shifting the burden of proof away from the Applicants onto the Joint Requestors and other protestors by failing to consider evidence that undermined the Applicants’ case. PowerSmith Cogeneration Project also filed a rehearing request on the same day in which it incorporated the above rehearing request, with the exception of the request for clarification of the Commission’s finding regarding markets in the SPS balancing markets.

II. COURT PROCEEDINGS

A. Challenge to FERC's PURPA Sec. 210(m) Implementation Rules (U.S. Court of Appeals for the D.C. Circuit, Case No. 07-1328)

On August 16, 2007, the AF&PA filed a petition for review in the D.C. Circuit challenging FERC's new rules implementing PURPA Section 210(m) establishing the procedures and conditions under which a utility may seek relief from PURPA mandatory QF purchase obligations. (Order Nos. 688, 117 FERC ¶61,078 (October 20, 2006) and 688A, 119 FERC ¶61,305, (June 22, 2007).)

On November 6, 2007, the Court granted ELCON's motion to participate as *amicus curie* in support of AF&PA. ELCON will seek to address FERC's poor rationale for finding the existence of long-term markets, and may raise other issues that it had raised in the proceeding before FERC. **On February 14, 2008, the court ordered intervenors in the case to file a joint brief of limited length.** The D.C. Circuit has not yet set a schedule for briefing or oral argument.

B. Court dismisses Petition for Review of FERC's Order on MISO's Ancillary Services Market Proposal (U.S. Court of Appeals for the Seventh Circuit, Case No. 07-3592)

On October 26, 2007, the MISO industrials (Coalition of Midwest Transmission Customers or CMTC) filed a petition for review with the Seventh Circuit of FERC's orders regarding MISO's proposed implementation of day-ahead and real-time ancillary service markets (ASM). **On February 21, 2008, the court dismissed the petition, reasoning that it was premature to review the case because FERC had not yet made a final decision on the MISO's proposal.** The court noted that, if FERC does eventually approve the proposal, the

CMTC could then seek review of the final order. The court also suggested in the alternative that CMTC might potentially seek to raise this issue if it properly presents itself in another proceeding.

In the underlying FERC proceeding (Docket No. ER07-550), the Commission issued an order rejecting, without prejudice, MISO's ASM proposal, in part because MISO had not submitted a market power analysis and had not submitted a sufficient readiness plan or otherwise developed adequate safeguards for the transition to operation of a centralized ASM. However, as MISO had interpreted the order as approving the key concepts of its ASM proposal, CMTC filed a petition for rehearing, which FERC denied. CMTC states that the central issue to be presented to the Court is "whether FERC must find that a market is competitive before authorizing sales into that market at market-based rates." Regarding this issue, FERC held:

The Commission rejects MISO Industrial Customers' argument that, as a prerequisite to reliance upon market-based rate pricing to produce just and reasonable rates, the Commission must, in addition to finding that applicants lack or have adequately mitigated market power, make a separate and independent finding that a competitive market exists. In the Commission's recent market-based rate rulemaking, commenters raised these same general arguments. We therefore incorporate by reference the Commission's discussion in its final rule on market-based rates (Order No. 697) of the legality of its approach to market-based rates. The Commission's long-established approach involves assessing whether a seller lacks market power, which includes an assessment of seller-specific market power. This approach, combined with the Commission's filing requirements and ongoing monitoring, allows the Commission to ensure that market-based rates remain just and reasonable. Additionally, for sellers in RTO/ISO organized markets, the Commission has in place market monitoring and mitigation rules to mitigate the exercise of market power, including price caps where appropriate, and the Commission also uses RTO/ISO market monitors to help oversee market behavior and market conditions.

MISO Industrial Customers have read a "separate and independent finding" requirement into precedent where it does not exist. Indeed, the Commission has never imposed such a requirement and MISO Industrial Customers provide no justification for doing so in this proceeding. Moreover, no court has taken exception to the Commission's approach of focusing on applicants' market power in determining whether to approve market-based rate pricing.

120 FERC ¶ 61,202 Paras. 9-10 (Aug. 30, 2007 Order Denying Rehearing; footnotes omitted).

MISO, Indianapolis Power & Light Company, Reliant Energy, the Wisconsin Public Service Corporation, Integrys Energy Group, Inc., and Wisconsin Electric Power Company intervened in the case.

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