

# CLEARY GOTTlieb STEEN & HAMILTON LLP

2000 PENNSYLVANIA AVENUE, N.W.  
WASHINGTON, D.C. 20006-1801  
(202) 974-1500

## ELECTRICITY LAW DEVELOPMENTS – November 12, 2007

### 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:

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New developments since the October 2007 issue of Electricity Law Developments are **in bold**.

**I. FERC PROCEEDINGS**

**A. FERC Remands Two QF Registration Criteria Proceedings to NERC (FERC Dockets Nos. RC07-1-000, RC07-2-000)**

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On October 18, 2007, the Commission remanded to NERC two decisions in which the ERO found that QFs owned by the City of Tampa, Florida, and Mosaic Fertilizer were properly included by the Florida Reliability Coordinating Council (“FRCC”) on the NERC Compliance Registry as generator owner and generator owner/operator, respectively. The Commission instructed NERC to either reconsider its decisions to include the QFs in the Registry or provide a more detailed explanation of its decisions.

In April 2007, FRCC registered all seven QFs owned and operated by Mosaic Fertilizer, notwithstanding that two of those facilities were inoperable. FRCC at the same time registered Tampa as a generator owner of the McKay Bay Resource Recovery Facility. Both Mosaic and the City of Tampa appealed inclusion on the registry to NERC. The ERO on July 5, 2007 agreed with FRCC that the companies should be included in the registry and comply with mandatory grid reliability standards. Mosaic and Tampa asked FERC on July 26, 2007 to overturn the registration decisions citing inconsistencies with NERC’s registration criteria. This is the first time FERC has formally reviewed NERC’s decision to include an entity in the compliance registry.

Mosaic argued that it was improperly included in Compliance Registry because its generators were not directly connected to the Bulk-Power system because all of its lines run at voltages of 69 kV or less. In addition, all of its generators are connected to local utilities through radial lines. Finally, two of its facilities weren’t even operable, were in fact up for sale, and therefore should have been exempt. NERC rejected these arguments and noted that the exemption for radial transmission facilities does not apply to generators. NERC

also rejected Mosaic's argument that it should be excluded from registration because the 15 MW of power Mosaic provides to a local utility after meeting demands of "behind the meter" loads represents only a "miniscule portion" of the utility's capacity and because its contract with the utility in question is set to expire in six months. Rather, NERC concluded that Mosaic and numerous 69kV generators like it had an aggregate effect of over 2,000 MW on the bulk power system. With respect to the facilities that were inoperable, NERC did not offer any explanation.

Tampa had argued to NERC that its facility should be exempt because it was radially connected at only 69 kV, and its total firm sales contract amount to only 19 MW. NERC again rejected the appeal by concluding that generators do not qualify for the radial transmission facility exemption, and again reasoned that the Tampa facility's 19 MW of capacity had "aggregate importance" within the region.

FERC remanded the proceedings to NERC for further reconsideration. In particular, FERC faulted NERC for not explaining its basis for rejecting Mosaic's and Tampa's arguments. Though FRCC may have relied on reliability criteria providing for registration of individual generating units in excess of 20 MVA gross nameplate rating which are directly connected to the bulk power supply, FERC ordered NERC to explain on remand whether and how the QFs at issue met those criteria.

The Commission also voiced concern over NERC's aggregate treatment of generation facilities, stating that NERC "may have defined too broad of an aggregate class," which may have inappropriately included the small 15 MW and 19 MW exporting facilities. The Commission also asked NERC to explain why it believed it was justified in requiring registration of the inoperable facilities and the contract that is set to expire at the

end of 2007. Commissioners Moeller and Spitzer noted their concern about the need to harmonize reliability rules with allowing QFs to participate in the market free of undue burden.

NERC has 30 days to respond to the remand.

In a related matter, power marketer the Southeastern Power Administration (“SPA”) on October 15, 2007, claimed that the SERC Reliability Corp., the regional entity responsible for 16 central and southeastern states, erred in designating it as a resource planner and transmission operator. SPA argued that its sole operation is the marketing of electric power generated at reservoir projects owned and operated by the U.S. Army Corps of Engineers. SPA serves no end use customers and has no ultimate responsibility for developing and forecasting loads; it has no authority over the operation and planning for the physical equipment used to produce the power it markets. Thus, SPA asserted that to require it to meet the standards applicable to transmission operators or resource planners amounts to making it responsible for third parties over which it has no control.

FERC has not yet addressed this matter.

**B. Intervenors Challenge SPP Utilities’ Bid to Terminate QF Purchase Obligations (FERC Docket No. QM07-5)**

***History of the proceeding:*** On September 25, 2007, four utilities in the Southwest Power Pool (“SPP”) – Xcel subsidiaries Southwestern Public Service Co. and Oklahoma Gas and Electric Co. and AEP subsidiaries Public Service Co. of Oklahoma and Southwestern Electric Power Co. – filed a voluminous application to terminate their requirement to enter into new contracts or obligations with QFs under Section 210(m) of PURPA.

This is the first such application filed under Section 210(m) that involves a Day 1 RTO.

The applicable criteria governing such applications are those specified in Section 210(m)(1)(B):

(B)(i) transmission and interconnection services that are provided by a Commission-approved regional transmission entity and administered pursuant to an open access transmission tariff that affords nondiscriminatory treatment to all customers; and (ii) competitive wholesale markets that provide a meaningful opportunity to sell capacity, including long-term and short-term sales, and electric energy, including long-term, short-term and real-time sales, to buyers other than the utility to which the qualifying facility is interconnected. In determining whether a meaningful opportunity to sell exists, the Commission shall consider, among other factors, evidence of transactions within the relevant market . . .

By regulation, FERC has determined that SPP satisfies Section (B)(i). 18 C.F.R. § 292.309(g).

Thus, the only bases for challenge is to assert either that the applicants have not made a proper showing that there exist “competitive wholesale markets that provide a meaningful opportunity to sell capacity, including long-term and short-term sales, and electric energy, including long-term, short-term and real-time sales” or that the application does not include all of the information required by 18 C.F.R. § 292.310(d) (*e.g.*, information about transmission constraints and congestion, description of processes and practices for arranging for transmission service).

The application makes two key points:

First, the applicants assert that SPP’s Energy Imbalance Service (“EIS”) market is a robust market that sends meaningful price signals on a real time or near real time basis and that is available to all sellers. Applicants note that one QF (an ELCON member) and various IPPs actively participates in EIS and that about 8-9 percent of SPP’s total energy requirement is met through the EIS market. The applicants also cite statistics (drawn from EQR) on SPP’s short-term energy and capacity markets and long-term energy and capacity markets intended to show that each market “is deep and has numerous buyers and sellers” and therefore that there are meaningful opportunities for QFs to participate, again referencing sales of an ELCON-member

QF in these markets. The application also asserts that a number of wind projects in SPP were eligible for but did not bother to obtain QF certification because they had sufficient market access simply as non-QF EWGs. The data presented in the application are based on a supporting affidavit by Drs. William Hieronymus and Matthew Arenchild.

Second, the applicants assert that the existence of formal competitive procurement processes that do not discriminate against QFs establish further evidence of sufficient access to competitive markets. Affidavits from each utility address (i) how the procurement process is designed; (ii) how the winning bids are selected; (iii) evidence of past solicitations and winning bids; (iv) solicitation characteristics; and (v) other information about the procurement process, which track the criteria that FERC spelled out in Order No. 688 at ¶ 139. Extensive documentation about each utility's RFP process is attached.

Based on initial review of the main text and Hieronymus/Arenchild affidavit, but not the voluminous appendices and attachments that would require technical review, the application appears to do a thorough job of addressing the various applicable criteria of Section 210(m) and Order No. 688. QFs within the footprint of the applicant utilities may be able to argue that the EQR data do not reflect access to true long-term markets (a key generic issue that likely will arise in any future applications.) Additionally, the application might be challenged on the basis that, if factually supportable, the SPP EIS market (or other SPP shortcomings) and/or the utilities' RFP processes do not establish meaningful, non-discriminatory access for QFs. Such arguments would have to be based on particular aspects of the EIS or RFPs and preferably would be supported by specific anecdotes.

**Recent developments: American Wind Energy Association, North Texas Wind Center, LLC and Noble Environmental Power, LLC, requested and were granted a ten day**

**motion for extension of time in order to review the voluminous QF termination application, in part on the grounds that they owned QFs that were initially omitted in the applicants' identification of potentially affected QFs. John Deere Renewables, LLC filed an answer in support of the request.**

**Several QFs have filed motions to intervene, including Occidental Permian, AES Shady Point, Redbud Energy, and Powersmith. Golden Spread, a non-profit generation and transmission cooperative and transmission customer of SPS and SPP, and Outland Renewable Energy, a potential developer and owner operator of wind energy QFs, also have filed motions to intervene.**

**Outland urges FERC carefully to examine the Day 1 market structure within SPP to ascertain whether there is in fact evidence that it affords the competitive market conditions required under the statute. Outland asserts that this is the first case in which FERC is asked to evaluate market conditions in a Day 1 market and that it “rais[es] a threshold issue with respect to the factors that should be considered when evaluating the sales opportunities available to QFs within SPP.” Outland suggests that FERC compare SPP to ERCOT markets (and not to Day-2 markets) and suggests that FERC will find that QFs within SPP do not have nondiscriminatory access to the type of competitive wholesale markets contemplated by PURPA Section 210(m)(1)(B). Outland also requests that FERC consider the particular transmission constraints within the SPP region, as these “may impair a particular QF’s ability to access otherwise competitive wholesale markets.” According to the filing, the evidence of actual transactions filed by applicants falls short of the statutory requirements and suggests only minimal opportunities for QFs to sell energy and capacity to buyers other than utilities. It does not demonstrate the existence of the**

**robust wholesale market applicants assert exists and does not meet the statutory requirements.**

**The SPP utilities amended their application on October 24, 2007, to include the omitted and potentially affected QFs. Interventions, protests and comments in response to the amended application are due November 21, 2007.**

**C. FERC Orders SPP to Develop New Plan for Participation of External Generators in its Real-Time EIS Market (FERC Docket No. ER06-451)**

**On October 15, 2007, FERC rejected SPP's plan for how to permit external generators to participate in the RTO's real-time energy imbalance services (EIS) market. According to the Commission, SPP's plan, which places the entire financial burden of accessing the markets on the external generators, is unjust, unreasonable and unduly discriminatory since portions of the costs are appropriately borne by all parties, internal and external. If implemented, the plan would likely have the effect of unreasonably deterring external generators from entering the market, and SPP issues of market power and bid insufficiency will remain unresolved.**

*History of the proceeding:* SPP received FERC approval as an RTO in October of 2004 (109 FERC ¶ 61,009 (2004), *order on reh'g*, 110 FERC ¶ 61,137 (2005)). At that time, FERC accepted SPP's commitment to develop an imbalance market, including implementation of a real-time, offer-based energy market that will be used to calculate the price of imbalance energy. The Commission also required SPP to provide a market monitoring plan, including market power mitigation measures that address market power problems in the spot market and a clear set of rules governing market participation conduct, with the consequences for violations clearly laid

out. FERC had rejected SPP's original imbalance market proposal and mitigation and monitoring plan as inadequate and provided guidance concerning: (1) reliable and stable market operations; (2) market-based rates in the new market; and (3) mitigation and monitoring issues. 112 FERC ¶ 61,303(2005).

In March 2006, FERC had rejected in part and conditionally accepted and suspended in other parts SPP's proposed revisions to its OATT related to its proposed real time energy imbalance market and market monitoring plan, indicating that based on experience, it was reluctant to approve an incomplete plan. FERC had found that the proposed tariff provisions require modification or elaboration before it would be able to determine whether the imbalance market was designed and monitored properly. In particular, as acknowledged by SPP in its filing, the plan lacked certain key elements including an external market monitor contract, new provisions for transmission loss compensation, standard market participant and reserve sharing agreement, and a plan to measure market readiness performance. FERC had also directed the RTO to develop a plan to allow generators outside SPP's footprint to participate in the market, noting that this would help to resolve issues of market power and insufficient bidding.

On January 26, 2007, FERC had authorized SPP to launch its energy imbalance market on February 1, 2007, although a number of issues related to market operations remained outstanding.

**SPP's plan for integrating external generators involved establishing what the RTO describes as an "external resource pseudo-tie" so that external generators may received interchange and dispatch instructions on a comparable basis to internal generators. The pseudo-tie, however, would result in application of disparate terms and conditions to internal and external generators, and would require external generators to design,**

construct operate and maintain equipment to maintain the pseudo-tie mechanism, and would assign all associated costs directly to the external generators. FERC found the proposal unduly discriminatory. External generators would be responsible for the entire financial burden not only for their own communications equipment, but also for necessary upgrades to the source and sink balancing authorities equipment, while internal generators would only be required to pay for the equipment they need to receive dispatch instructions.

FERC ordered SPP to file an alternative proposal within 60 days, and suggested that the RTO consider using dynamic scheduling, which may be “a more cost-effective option, especially if large numbers of external generators are interested in participating in the market.”

**D. Numerous Protests Filed to MISO’s Proposed TEMT Changes  
(FERC Docket No. ER07-1372)**

On September 14 and 19, 2007, The Midwest ISO filed proposed changes to its Open Access Transmission and Energy Markets Tariff (“TEMT”) to implement a market for Operating Reserves, known in MISO as the Ancillary Services Market (“ASM”). The filing includes a market power analysis by Dr. David Patton of Potomac Economics, MISO’s Independent Market Monitor.

According to MISO, the proposed changes will:

- Increase the efficiency of the existing Midwest ISO Day-Ahead and Real-Time Energy Markets while minimizing total costs;
- Incorporate changes to accommodate the transfer of certain Balancing Authority functions to the Midwest ISO;
- Provide net annual benefits estimated between \$88-183 million annually from the implementation of the proposed consolidation of certain Balancing Authority functions and the proposed Ancillary Services Markets;

- **Provide for the efficient acquisition and pricing of Regulating Reserves and Contingency Reserve (collectively, "Operating Reserves");**
- **Present a mechanism for increased competition through additional available Resources, including Demand Response Resources;**
- **Provide a platform for enhanced Demand Response Resource participation in the Midwest ISO markets; and**
- **Complement the short-term market price signals by encouraging resources to provide additional flexibility.**

**According to the filing, the proposed Tariff will enhance the existing Day-Ahead and Real-Time Energy Markets by:**

- **Providing for integration of Operating Reserves into the existing two-market (i.e., Day-Ahead and Real-Time) settlement of Energy;**
- **Providing for the simultaneously co-optimized commitment and dispatch of Energy and Operating Reserves to minimize total costs and incorporate Opportunity Costs into Day-Ahead and Real-Time Market-Clearing Prices ("MCP") of Operating Reserves;**
- **Integrating scarcity pricing, through the use of Demand Curves, into the Day-Ahead and Real-Time Markets as part of the co-optimization process;**
- **Establishing the foundation and support for greater market participation by Demand Response Resources to provide Operating Reserves in a manner that is comparable to Generation Resources and that will be consistent with Commission-approved ERO standards; and**
- **Establishing comprehensive and efficient procedures for addressing pre-Emergency and Emergency conditions, including the integration of Demand Response Resources into such procedures.**

**MISO has asked the Commission act on this filing before December 31, 2007, in order for the Midwest ISO to achieve the proposed June 1, 2008 Ancillary Services Markets start date.**

**More than 30 interventions were filed in this proceeding, among them several protests by industrial consumer groups including the Coalition of Midwest Transmission**

**Customers, the Illinois Industrial Energy Consumers, and the Midwest Industrial Customers (collectively the MISO Industrial Customers). The MISO Industrial Customers fault MISO's proposal with respect to its effect on market power, dynamic reserve zone boundaries, cost allocation and reimbursement, operating procedures, demand resource proposals, implementation costs, and must-offer procedures. According to the protest, reserve zones are subdivided and can shift each quarter. MISO's proposal would result in inappropriate cost-shifting and cross-subsidization. Capacity-related costs should be allocated on a demand basis rather than on the basis of an energy allocation factor, the protesters assert. With respect to cost reimbursement, MISO should not be permitted selectively to reimburse market participants for the costs associated with infrastructure necessary to support ancillary service market implementation. MISO's proposal would subsidize market entry costs for some providers, but not others, and therefore is discriminatory. And on the subject of demand resources, MISO Industrial Customers argue that MISO has failed to develop reasonable metering requirements for demand resources.**

**Alcoa also filed a protest, citing: (i) flawed provisions which inexplicably discourage behind-the-meter generating resources from participating as reserves in the ancillary services market; (ii) provisions which effectively frustrate and invalidate grandfathered agreements that the Commission took great pains to protect in the formation of MISO; (iii) the failure to include significant requirements and limitations that effectively define the terms and conditions of service; and (iv) provisions that specifically prohibit third party arrangements from supplying ancillary services, requiring that such services be either self-supplied or purchased through the MISO market mechanism.**

**E. FERC Approves ISO-NE FCM Changes Affecting Demand Resources (FERC Docket No. ER07-1338)**

**On October 30, 2007, FERC approved revisions to the ISO-NE’s Forward Capacity Market (“FCM”) rules, including provisions designed to increase opportunities for demand resources to participate in the market. 121 FERC ¶61,106.**

**On August 31, 2007, ISO-NE and NEPOOL submitted a proposal to revise its FCM rules to create additional flexibility for separate resources (including Demand Resources) combining to provide a “composite offer” (an offer in a Forward Capacity Auction in which multiple resources join together to form an annual capacity offer). Under the current rules, a new resource clearing in the Forward Capacity Auction may elect to have the clearing price and capacity obligation acquired through that auction continue to apply for up to four additional consecutive Capacity Commitment Periods. However, this option is generally not available to an existing resource. Additionally, the rules currently do not address whether a composite offer that includes both new and existing resources is eligible for a multi-year commitment.**

**Under the approved revisions, the FCM rules will be amended to allow any existing resources providing capacity in the winter period (which is part of the composite offer) to receive a multi-year capacity obligation -- for up to a total of five years -- provided that the summer resource with which it partners to make a composite offer is a new resource. This option would be available to all capacity resources meeting these criteria, including Demand Resources.**

**Because certain information for calculating capacity values for Demand Resources cannot be known until shortly before the Forward Capacity Auction, ISO-NE will use the relevant values for the Capacity Commitment Period associated with the Forward Capacity Auction immediately preceding the Forward Capacity Auction in which the Demand Resource clears. According to ISO-NE, these values have been shown to be relatively stable from year to year, so any impacts of this change should be minor. More importantly, ISO-NE asserts that the change will provide much needed certainty in the determination of the qualified capacity for Demand Resources and will allow those resources to enter into composite offers unimpaired. For the first Forward Capacity Auction, ISO-NE will use specific values based on margin and peak transmission and distribution losses from the 2007-2008 Power Year.**

**Among other changes that FERC accepted:**

- Because of complications that risk causing a delay to the Forward Capacity Auction, capacity related to De-list Bids from Existing Import Capacity Resources and De-list or Export Bids from any resources in a capacity zone modeled as an export-constrained zone will be exempt from replacement for the first Forward Capacity Auction only.**
- ISO-NE will remove the ability of a financial sponsor of a project to withdraw a new project after qualification but before the Forward Capacity Auction, and lose only its financial assurance. The revised FCM rules state that once the sponsor submits the deposit, it may not withdraw and the project will be included in the Forward Capacity Auction at its qualified capacity at the auction starting price. ISO-NE fears that allowing withdrawal at that late stage may encourage late withdrawals in a strategic attempt to trigger inadequate supply or insufficient competition thresholds. New resources may still be withdrawn before the submission of the financial assurance deposit.**
- If separate De-list or Export Bids are submitted for the same resource, the clearing mechanism would have no means to determine which bid should be given higher priority at that price. To remedy this, ISO-NE will restrict market participants from submitting bids with identical price-quantity pairs for the same resource, which leaves the decision of priority to the market participant. Separate bid prices can be specified to \$0.001/kW-month, i.e., distinguished by as little as one-tenth of**

one cent. Where a market participant that submits any combination of certain De-list Bids for a single resource, each bid must have the same rationing election.

- The FCM rules currently provide that the Forward Capacity Auction should end when total Forward Capacity Auction costs are minimized in meeting the Installed Capacity Requirement. However, since many possible combinations can exist that fit this criteria, ISO-NE will: (1) limit the number of subsets of solutions that the auctioneer can consider based on an unbiased enumeration technique; (2) not clear De-list Bids below the clearing price that cannot be replaced in full; and (3) in the case of price separation, the auctioneer will limit the amount of capacity procured in an import-constrained zone to keep prices in check. After the first Forward Capacity Auction, ISO-NE will review the issue to determine if other changes may be necessary.
- The current FCM rules contain a “monotonicity” requirement for all new project sponsors. The requirement states that the sum total amount of capacity offered by a project sponsor for all of its new resources in the Forward Capacity Auction may not increase as the auction price falls. To enforce this limitation, ISO-NE also will establish “bidding groups”—groups of new resources of the same type (demand, import, etc.) that are located in the same capacity zone, and have the same rationing election – into which project sponsors must specify their units. The monotonicity requirement will then be applied to the bidding groups, so that as the auction price falls, the amount of quantity offered by an aggregate bidding group may not increase.

In the order accepting the ISO-NE’s revisions, FERC noted that there might be a need “for small tweaks in the FCM rules as the reality of the first Forward Capacity Auction draws near.”

**F. FERC Grants Blanket Authorizations to Financial Institutions to Acquire Electric Utility Securities (FERC Docket Nos. EC07-39, EC07-45, EC06-166)**

On October 18, 2007, FERC granted three separate blanket authorizations pursuant to Section 203(a)(2) of the Federal Power Act for financial institutions (Goldman Sachs, Morgan Stanley and Legg Mason) to purchase securities issued by electric utilities. FERC extended the blanket authorizations first granted to Goldman Sachs and Morgan Stanley in February 2006 and permitted Legg Mason to acquire up to 10% of public

**utilities companies within each of its accounts, but it may not acquire a total share in excess of 20% within any one group of its subsidiaries, if those subsidiaries are not walled off from other groups through certain informational barriers. FERC additionally allowed a Legg Mason subsidiary to acquire up to a 25% share of AES Corp. All three blanket authorizations will remain valid for three-year periods. FERC emphasized that financial investment institutions are already prevented from abusing voting powers of acquired securities through SEC regulations and reporting requirements.**

**G. FERC ANOPR on Reforms to the Organized Markets --  
Docket Nos. RM07-19, AD07-7**

On June 22, 2007, FERC announced an Advanced Notice of Proposed Rulemaking (ANOPR) to initiate certain reforms of the organized markets. “Wholesale Competition in Regions with Organized Markets,” 119 FERC ¶ 61,306. The reforms address four of the concerns or problem areas that ELCON and other consumer interests have identified with organized markets such as PJM: (1) demand response, (2) long-term contracting, (3) market monitoring, and (4) RTO governance. Some of FERC’s proposals are outlined below:

*(1) Demand Response and Pricing During Power Shortages*

- Require RTOs and ISOs to allow demand resources to provide certain ancillary services in their markets unless not permitted by state law, modify tariffs to let demand resources provide spinning and supplemental reserves without being required to sell into the energy market.
- Modify RTO and ISO tariffs to eliminate certain charges for purchasing less energy in real time than in the day ahead market during a system emergency.
- Amend market rules to permit an entity that aggregates the demand responses of individual retail consumers to bid the aggregate demand reduction directly into an RTO or ISO energy market, unless not permitted by state law.
- Modify market power mitigation rules so that pricing during an emergency can elicit more demand response.

### *(2) Long-Term Power Contracting*

- Require RTOs and ISOs to post information that would facilitate long-term contracts.
- Require or encourage efforts by RTOs and ISOs to develop standardized forward products.
- Dedicate a portion of the ISO's or RTO's website for market participants to post long-term buy/sell offers.

### *(3) Market Monitoring Policies and Information Sharing*

- Remove the market monitoring unit from RTO/ISO operations.
- Require that the MMU advise the Commission and other stakeholders of any design flaws and report to the Commission any tariff violations it believes may have been committed by the RTO or ISO.
- Regular conference calls among the market monitor, interested state commission and FERC staff.
- Release of offer and bid data, with a lag period. Release would mask market participants' identities.
- Subject to certain limitations, state regulatory commissions within an RTO or ISO may request and receive information from the RTO's or ISO's market monitoring unit.
- Develop a pro forma tariff provision to address all sections relating to market monitoring.

### *(4) Responsiveness of RTOs and ISOs*

- Provide RTO and ISO customers with direct access to the board of directors.

The issues of demand response, long-term contracts and RTO accountability were the subject of numerous comments. In summary, most comments indicate support for demand response, however views were strong on both sides of the question of raising price caps. While many commentors agreed that opportunities for long-term contracting are lacking, there was little agreement on how the problem can be resolved.

Following are a few highlights of the comments filed:

### *Structural Reforms*

ELCON, together with AISI and ACC, commended FERC for recognizing the need for reforms to improve the operation of the organized markets and urged the Commission to reconsider its current mix of regulation and competition in the organized markets to ensure that customers are not exploited by a flawed market design and that they receive the benefits they deserve from restructured markets.

Others also remarked on the need for FERC to address fundamental structural issues. A coalition of industrial customers criticized FERC for operating “from the premise that all is generally well with the existing structure and design of organized electric markets.” “[A] few ‘tweaks’ to the status quo” will not make the markets work better, they cautioned. APPA stated that it “highly doubts there is a Great and Powerful Oz of competition back there making RTO markets even ‘workably’ competitive.” And the Steel Producers noted, “there seems to be little incentive on the part of utilities and suppliers to take the steps needed to improve the operation of the markets, including building new transmission, fully integrating demand response into the markets and building or acquiring lower-cost generation capacity. Indeed, for some market participants, especially companies that own both transmission and generation, taking these steps would amount to killing the golden goose.”

### *Demand Response*

ELCON et al. strongly supported the ANOPR’s attempts to expand the role of incentive-based demand response in the organized markets and made the following recommendations:

- Each ISO or RTO should have an obligation to purchase on a non-discriminatory basis demand resources in markets for ancillary services. Demand resources should be eligible to provide any ancillary service currently required in the OATT.

- ISO or RTO protocols for purchasing demand response for ancillary services should be standardized to accommodate sales from industrial end users with DR capable facilities in multiple ISOs or RTOs.
- Sellers of demand response should have the opportunity to bid demand response as operating reserves without the obligation to sell into the energy market.
- Deviations charges to buyers who take less energy in the real-time energy market than purchased in the day-ahead market should be eliminated.
- ISO/RTO market rules should permit aggregators of retail customers (ARCs) to bid demand reduction on behalf of retail customers.
- Demand response should be compensated on the same basis as generation for the same services.
- Demand response participants should not be required to purchase energy as a precondition to a demand reduction bid unless required by contract or tariff. So-called generator offsets are unnecessary as long as non-participating loads receive net benefits.
- ELCON urges great caution with regard to modifications to market mitigation rules to allow scarcity pricing. Any proposal to raise (not eliminate) market-wide caps in emergency situations must only be considered after end-use customer loads are adequately hedged from spot market price volatility and other pre-conditions are met. This requires the establishment of a liquid forward market. Even after such conditions are met, it is preferable that a “proof of concept” be established in a carefully designed pilot test. Raising bid caps for demand bids only may not be practical until other reforms to the market have succeeded. ELCON opposes the proposal for an administratively-determined demand curve for operating reserves because it will reduce market transparency and oversight, and may be too complex to survive intact during adjudication.

Among the myriad other comments filed, EEI supported providing RTOs/ISOs with the necessary flexibility to adopt different approaches to modifying ancillary service markets for the integration of demand response consistent with the reliability purposes for which ancillary services are required but took issue with the notion of incentive payments to retail customers for demand response. Such payments, according to EEI, are unnecessary and amount to double payments, since a customer’s bill decreases with every megawatt-hour not consumed.

The FTC disagreed with EEI that retail customers receive a double payment when they are paid for wholesale demand reductions that also result in savings on their retail bills because this argument “understates the economic value of the reduction when traditional retail pricing is in place. In order to give efficient incentives for conservation during peak demand periods, the savings on the customer’s power bill must be supplemented so that the combination - savings on the bill plus the supplementary compensation – results in an efficient price to the retail customer.” Acceptance of EEI’s view, according to the FTC, would prevent or reverse FERC’s demand response regulatory reforms at the wholesale level.

The FTC commented that state retail price regulations impede reform of the electric power markets by subsidizing consumption of electricity during periods of high demand. They suggested that if state regulators would act to encourage retail demand response, then demand response would increase at wholesale levels. The FTC also took issue with the ANOPR’s failure to identify the connection between generation market power and demand response. Increased demand response would reduce generation market power and thus reduce the need for price caps or other price regulation.

AF&PA focused on technical impediments to demand response, including the lack of adequate metering and other technology. FERC, however, faces a “chicken and egg” problem in trying to increase demand response because it may need to resort to scarcity pricing to motivate participation in demand response programs. They suggest the creation of a “financial performance obligation” which would require “every unit receiving a capacity payment to financially guarantee the delivery of energy to the real time market at or below a specified strike price in any hour.” This obligation would not require physical delivery at every hour, however.

A group of financial institutions (Barclays Capital, J. Aron & Company, and Morgan Stanley Capital Group) expressed the view that capacity markets should be temporary in nature until scarcity pricing, demand response and forward contracting are further developed. “While capacity markets are generally touted as being necessary to address the ... ‘missing money’ problem, ... these markets should be viewed as transitional mechanisms ... . Market structures that limit the ability of prices to ration power during periods of scarcity effectively encourage excess consumption... .” Energy markets that rely on robust price signals and smart grid technologies and advanced metering infrastructure “would incentive significantly more forward contracting so that only a relatively small portion of customer’s demand would be subject to scarcity prices.”

The ISO-NE indicated it did not believe removing bid caps for demand resources would be effective. While it might reduce the risk of exercise of market power, it would provide incentives for inefficient trading and contracting between supply and demand resources. They suggested that their Forward Capacity Market model is a more effective solution.

#### *Long-term Power Contracts*

ELCON et al. did not think that the proposals in the ANOPR will lead to adequate opportunities to sell and buy power through long-term power contracts. The organized markets are unwittingly structured as suppliers’ markets and fundamental changes to the Day-Two market paradigm will be necessary to establish a robust forward market capable of delivery net benefits to consumers.

The Wisconsin Industrial Energy Group agreed with ELCON. Long term contracting can only be encouraged if there are steps taken to modify market design that would increase the incentive for sellers to enter into long term contracting. Buyers today, already have this incentive; the problem is how to motivate sellers. The Steel Manufacturers also agreed and

pointed out that the “core premise of the organized markets (location-based marginal pricing of energy) is a short-run model that aims to promote operational efficiencies,” however this model is inappropriate for promoting long-term capital investments “as long as the Commission, state regulators, or both, are compelled to shield consumers from scarcity price signals.”

Several commentors supported the idea of a transaction bulletin board on RTO websites where offers to buy or sell power on a long-term basis could be posted. A handful of financial institutions remarked that posting of some data might help, but were skeptical of the idea of posting specific contract details.

EPSCA did not agree that a transaction board will facilitate long-term contracting. Rather, “EPSCA believes that there are no inherent impediments to longer term contracting in the organized markets today, although an overly aggressive mitigation regime in the spot market interferes with price signals that reflect true supply and demand conditions and reduces buyers’ need, incentive and ability to hedge the risk of exposure to accurate spot prices. Buyers and sellers who seek longer term supply arrangements must have confidence in a liquid spot market in order to make economic decisions about terms and price requirements for bilateral contracts.”

NARUC cautioned FERC to coordinate any long-term contracting rules with states so as not to disrupt existing state programs, particularly those regarding LSE purchasing rules.

The financial institutions disagreed with the general assertion that long-term contracts are not available in the market, but qualified this comment with the explanation that they are available in certain regions of the country that are very liquid and subsequently have forward prices that go out many years. They also acknowledged that there are still some institutional barriers to long-term contracting between non-utility market participants, including state prudence reviews of long-term power purchase agreements.

PJM also discussed perceived risks associated with long-term contracting. In particular, they suggested that delivery risk (LMP congestion) frustrates long-term contracting, especially when this risk cannot be hedged. They believe that their FTR program is helping, but still needs improvement: there is need for longer term FTR products than those currently available; loop flows have a disruptive impact on the pricing of FTRs; and there is not enough data transparency.

#### *Market Monitoring Principles*

ELCON believes that the debate between an “internal” or “external” MMU is misplaced. In their present forms we believe that neither can be independent. We advocate a two-tiered MMU structure with the “top-tier” consisting of a small panel of part-time market experts reporting to the board. The “lower-tier” would be internal to the ISO or RTO and generally report to the board. ELCON supports other reforms proposed in the ANOPR related to MMUs.

EPSA commented that the challenge facing FERC is how to define the Market Monitor role while taking account of regional variances. However, all market monitors must do the following: (i) monitor the behavior of all market participants, including buyers, sellers and transmission owners; (ii) ensure that market rules produce efficient outcomes and are correctly implemented; and (iii) produce regular reports for FERC and market participants. Additionally, they assert that when MMUs report suspected tariff and rule violations to the Commission, information on such allegations must be held by FERC and disclosed publicly only when an investigation is completed and a finding of wrongdoing is made.

APPA commented that “the exact structure of an RTO MMU (*e.g.*, internal v. external) is less important than the day-to-day ‘rules of engagement,’ clarity regarding the role of the MMU, and “buy-in” to the MMU structure by the RTO’s stakeholders and management.” Regardless of

the structure selected, the MMU must be able to report their concerns without fear of retribution or loss of future income (either as an employee or a contractor). MMUs must have sufficient resources to carry out their duties; the RTO must provide full and complete access to RTO information staff.

PJM urged FERC to examine the practical reality of its proposed policy for market monitors. The Commission should “establish market monitors as entities with clear lines of responsibility and authority directly to the Commission, not the RTO. All market monitor responsibilities, authority, duties, obligations and procedures should be stated in a Commission-approved attachment to the RTO’s tariff. However, the RTO would *not* be ‘accountable’ for the actions of the market monitor or any other aspect of market monitoring.” Any other approach that attempts to preserve market monitors as instrumentalities of an RTO but limits the RTO’s ability to supervise the function “would raise serious legal questions about the Commission’s ability to limit a public utility’s management of its business.”

#### *ISO/RTO Governance*

ELCON et al. support a requirement that each ISO or RTO have a balanced “hybrid” board consisting of a majority of independent members and a minority of members representing stakeholder interests. The stakeholder members should be evenly split between supplier and consumer interests.

The Large Public Power Council suggested that the proposed rule include requirements for: (1) publication of meaningful, detailed strategic plans; (2) periodic measures of customer satisfaction; (3) performance criteria for RTO and ISO executives tied to specific objectives, including the ability to meet budgets. Further, stakeholders must be permitted to review, and the Commission must pass on, budgets prospectively and all substantial RTO and ISO capital expenditures and all significant tariff changes must be supported with cost-benefit analyses.

The Midwest ISO and CAISO both indicated the belief that their models worked well. MISO touted its responsiveness and CAISO stated that it has already implemented many of FERC's proposals in the ANOPR. "These measures, together with other CAISO processes and structures, are working extremely well to achieve the goals established by the Commission – i.e., independent governance, responsiveness to stakeholders, and effective market monitoring."

A number of commenters urged FERC not to require hybrid boards, but rather to use a refined board advisory committee approach that includes a role for State Commission and Consumer advocate representation.

**FERC has not yet taken further rulemaking action.**

## **II. COURT PROCEEDINGS**

### **A. ELCON Files Motion seeking to Participate as *Amicus* in AF&PA's Petition for Review in D.C. Circuit Challenging FERC's New Rules Implementing PURPA Sec. 210(m) (Case No. 07-1328)**

On August 16, 2007, the American Forest & Paper Association 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 October 12, 2007, ELCON filed an unopposed 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. The D.C. Circuit has not yet set briefing and oral argument dates.**

The rules in question represent FERC's fulfillment of Congress' mandate in EAct 2005 to grant utilities waivers from the PURPA QF purchase obligation if certain conditions described in the statute are met. On rehearing, FERC rejected the argument that Congress intended that there be a meaningfully competitive market prior to terminating a QF's purchase obligation and that such markets that do exist are predominantly for resale and very short-term. In a key passage, FERC asserted: "Congress could have stated a broad general finding to be made by the Commission such as 'workably competitive markets.' Instead Congress tailored subparagraphs (A) and (B) to establish criteria specific to each market design...". Order No. 688-A at para. 47. "While it is true that EACT 2005 did not repeal PURPA or the Commission's obligations to encourage QF development, enactment of section 210(m) of PURPA clearly changes the rights of QFs under PURPA. The Commission has no discretion other than to terminate the purchase requirement if it finds that a QF has nondiscriminatory access... It would be inappropriate for the Commission to ignore this mandate... in a way that undermines the specific standards of relief that Congress chose to establish in the statute." *Id.*, at para. 48.

FERC stressed most heavily the different standard that Congress applied in Section 210(m)(1)(B)(ii) which requires a finding of access to "competitive wholesale markets that provide a meaningful opportunity to sell capacity, including long-term and short-term sales, and electric energy including long-term, short-term and real tie sales." Such language is not contained in (A)(ii) which only requires access to markets. Order No. 688-A, at para. 24. Even if Day 2 long-term markets are nascent, Congress in (A)(ii) only required that the Commission finds that they exist, not that they be robust. *Id.*, at para. 26, 28. Without much rationale, FERC

also found that the one-year term used for EQR reports is sufficient to meet the statutory requirement that there be “wholesale markets for long-term sales of capacity and energy” within the meaning of section 210(m)(1)(A)(ii), *id.*, at para. 27.

**B. Petition for Review of FERC’s order on MISO’s ASM Proposal**

**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”). The court’s decision could have significant precedential effect on FERC’s implementation of market-based rate authority beyond the MISO proceeding at issue.**

**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).**

**The schedule for briefing and oral argument has not yet been established.**

W. Richard Bidstrup  
Jennifer A. Morrissey

#376054