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March 22, 2004

Honorable Magalie Roman Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

VIA ELECTRONIC FILING

RE: Devon Power LLC, et al.
ISO New England, Inc. Locational ICAP Proposal
Docket No. ER03-563-030

Dear Secretary Salas:

Enclosed for filing with the Commission in the above-referenced proceeding is the Motion To Intervene of the Electricity Consumer Resource Council ("ELCON") and the American Iron and Steel Institute ("AISI").

As evidenced by the attached Certificate of Service, copies have been served upon all parties of record. Thank you.

Very truly yours,

CLEARY GOTTLIEB STEEN & HAMILTON

By: Sara D. Schotland

Counsel to the Electricity Consumers Resource Council and the American Iron and Steel Institute

Enclosure
cc: All parties on official service list

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Devon Power LLC et al.	**:**	**Docket No. ER03-563-030**
	:	

MOTION TO INTERVENE AND COMMENTS OF THE ELECTRICITY CONSUMERS RESOURCE COUNCIL AND THE AMERICAN IRON AND STEEL INSTITUTE

Pursuant to Rule 214 of the Federal Energy Regulatory Commission's Rules of Practice and Procedure, and the Commission's March 4, 2004 Notice of Filing, the Electricity Consumers Resource Council ("ELCON") and the American Iron and Steel Institute ("AISI") hereby submit this Motion to Intervene and Comments regarding the proposal of ISO New England ("ISO-NE") to implement a locational ICAP mechanism.

ELCON and AISI have joined with other industrial consumers to file joint comments in support of demand response as an alternative to locational ICAP. In this filing, ELCON and AISI will demonstrate that the courts considering prior incentive ratemaking proposals have required that the Commission justify the incentive rate and that the Commission consider whether there are more cost effective alternatives to achieve the regulatory objective. Demand Response is the alternative that will better serve regulatory objectives, foster competitive markets, counter market power and prove more cost effective to consumers.

I. DESCRIPTION AND STANDING OF INTERVENORS

ELCON is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate,

reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. The member companies of ELCON consume approximately five percent of all electricity in the United States. ELCON members have significant operations in ISO-NE that will be directly impacted by the Commission's resolution of this matter.

AISI is the principal trade association of the North American steel industry. Its member companies account for about seventy percent of the raw steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity for AISI members may constitute as much as twenty percent of the manufacturing cost of a steel mill product.

II. DESCRIPTION OF THE ISO-NE LOCATIONAL ICAP PROPOSAL

FERC issued an order in April 2003 instituting a Peaking Unit Safe Harbor ("PUSH") mechanism, designed to provide generators having a capacity factor of 10% or less as of 2002 a reasonable opportunity to recover fixed and variable cost through market bids. ISO-NE was required to have locational ICAP in place by Summer 2004. In language that echoes arguments made by supporters of the NYISO Demand Curve, the ISO-NE proposal states that when installed capacity is close to impairing reliability, the vertical demand curve causes even small changes in capacity to result in large price swings between zero and the deficiency charge. "With a vertical demand curve, capacity payments may drop to zero when there is only slightly more capacity than required."

The stated purpose of the ISO-NE locational price cap proposal is to (1) properly value capacity by location through the introduction of a locational element in the capacity market and (2) improve the current capacity market by replacing the existing vertical demand curve with a

downward-sloping demand curve, i.e., implementing a NYISO-styled administratively-set "Demand Curve."

The proposal would price capacity separately for four regions, effective 6/1/04: Maine, Connecticut, Northeast Massachusetts/Boston ("NEMA/Boston), and the remainder of the New England pool. There is a five-year phase in. Price increases in the constrained sub-regions will be capped at $1 during the first year, and then increase by $1 per year until the cap reaches $5 in the fifth year. Transition payments of $5.34 kW-month will additionally be made to units in constrained sub regions that operated 15% or less of the time in 2003. A financial hedging mechanism -- Capacity Transfer Rights -- will be allocated to load or generation to prove for hedgeable transfer of capacity.

III. SUMMARY OF COMMENTS

The courts will apply a demanding test to determine that the demand curve is not excessively costly in relation to its benefits. The courts do not give FERC carte blanche on incentive pricing, rather FERC must show that incentives are an efficient means to achieve the desired goal and FERC must reflect consideration of reasonable alternatives presented. In this case, demand response is the superior alternative. Given the high cost of the ISO-NE LICAP alternative, FERC should require that the market provide a real, downward sloping demand curve by establishing energy markets for demand response and avoid the temptation to fabricate a demand curve by administrative fiat. FERC is referred to the supplemental comments in favor of the demand response alternative submitted by ELCON and AISI.

IV. COMMENTS

A. Under the Case Law, Courts Will Require Justification Of The Costs Of Locational ICAP And Demonstration That Costs Are Not Excessive As Against Alternatives

ISO-NE ICAP programs have not fared well in the courts and FERC should expect that the courts will closely scrutinize any order approving the current locational ICAP proposal.

In *Central Maine Power Co. v. FERC*, 252 F.3d 34 (1st Cir. 2001), the court considered FERC's rejection of ISO-NE's $0.17 ICAP charge and its reinstatement of the $8.75 charge previously in effect. FERC had defended the $8.75 charge because it "represents an approximation of the cost to install a peaking unit and represents a reasonable basis for setting a level to incent the construction of new generation." *Id.* at 40. The court remanded for further explanation by FERC of the reason for the rejection of the $0.17 charge. FERC "owed petitioners (and the public who will likely pay some of any ICAP charge through passed-on retail rate increases) some explanation as to why FERC was not persuaded by petitioners' efforts to discredit the notion of a substantial charge in general or the $8.75 charge in particular." *Id.* at 43. FERC was "not entitled to ignore claims that the cost of peaking facilities is less than it was in the past." *Id.* at 44. The court observed that PJM's ICAP charge was $5.25 per kW-month while NYISO's net charge was $8.75 per kW-month for much of 2000.

> The principal questions that FERC needs to answer more fully are these: why, despite petitioners' various claims to the contrary, a substantial ICAP charge is still required to enforce reserve obligations; why, in light of petitioners' claims of a lower present cost of peaking capacity, $8.75 is the proper interim figure; and why any alternatives already proffered by opponents are inadequate or are otherwise not properly considered at this time. Answers can be imagined, but it is FERC that must formulate and adopt them in the first instance.

Id. at 48. The *Central Maine* case affirms that FERC tariffs may set an appropriate level of ICAP charges as a vehicle to "assure adequate energy supplies" and "to encourage suppliers to maintain marginal (*i.e.*, high cost) existing plant or to build new facilities for peak demand." *Id.* at 48. However, the lesson of *Central Maine* is that excessive ICAP charges are not sustainable.

In *Sithe New England Holdings v. FERC*, the First Circuit revisited the question of ISO-NE's ICAP charge and whether sellers could demand a higher charge than $0.17 kW-month for a 13-month period. The court admonished that ICAP is not a statutory entitlement to sellers, rather ICAP is justified as "an extra incentive to construct new plants" and a penalty on those buyers who fail to acquire reserve capacity. Petitioners:

> **. . .** are fatally wrong in thinking that ICAP is any part of a supposed statutory entitlement. The classic just and reasonable rate -- which utilities were entitled to implement, cf. *Mkt. St. Ry. Co.*, 324 U.S. at 566-67 -- is a rate that allows for revenues that compensate carriers for their investment and expenses, not necessarily for the individual service but (taken together with revenues from all of their rates) for their services as a whole. *See Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 614-15, 88 L. Ed. 333, 64 S. Ct. 281 (1944). In this instance, the rates that perform this office are the rates that petitioners charge when they sell their surplus power or sell standby rights assuring access to that power.

Sithe New England Holdings, LLC v. FERC, 308 F.3d 71, 77 (1st Cir. 2002). The court concluded that ICAP is appropriately treated as an incentive rate:

> The ICAP charge, by contrast, is not of this ilk. Rather, it is a payment to suppliers over and above the amount they charge for power sold to or reserved for buyers. Its aim is not private compensation for past investment; instead, it is designed to serve two different public purposes: one is to give providers an extra incentive to construct new plants and the other -- this time the stick rather than the carrot, *see, e.g., ISO New Eng., Inc.*, 96 FERC 61,234 at 61,942 (2001) -- is to impose a hefty penalty on those buyers who fail to acquire the reserve capacity that FERC has decreed they shall have.

In *City of Charlottesville v. FERC*, 661 F.2d 945 (D.C. Cir. 1981), the D.C. Circuit struck down the Commission's consolidated tax policy for gas pipelines that gave shareholders, rather than ratepayers, the benefits of consolidated tax savings that come from production losses. The court insisted that a stricter standard of review would apply to Commission ratemaking endeavors that seek to encourage certain behaviors through increased rates to consumers: "[If] the Commission contemplates increasing rates for the purpose of encouraging exploration and development…it must see to it that the increase is in fact needed and is no more than is needed for the purpose. Further than this we think the Commission cannot go without additional authority from Congress." *Id.* at 950 (emphasis added) (quoting *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955)). The D.C. Circuit also held in *City of Charlottesville* that the Commission must demonstrate that the incentive is effective in achieving the desired outcome.[1]

In *Farmers Union Central Exchange Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir.) *cert. denied*, 469 U.S. 1034 (1984), the Commission remanded to FERC a generic ratemaking methodology for oil pipelines intended to stimulate new capacity. The opinion sums up several cases that establish that incentive rates must be justified with findings that the particular incentive increment will result in the intended outcome:

> In the absence of such a reasoned inquiry, we cannot countenance FERC's approval of oil pipeline rates which, by FERC's own admission, ensure "creamy returns" to the carriers, 21 FERC at 61,650, and are "far more generous than those [rates] that [FERC] or other regulators give elsewhere," *id.*, at 61,646.

Id. at 1503. *Farmers Union* concludes by reiterating the importance of carefully calibrated incentive rate mechanisms: "Departures from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking

[1] As FERC is well aware, the natural gas precedent is directly relevant to the electricity precedent since the FPA and the Natural Gas Act. *See, e.g., Kentucky Util. Co. v. FERC*, 760 F.2d 1321 (1985) (comparable provisions of Natural Gas Act and Federal Power Act are to be construed *in pari materia*).

methods ensure that the resulting rate levels are justified by those factors." *Farmers Union*, 734 F.2d at 1530.

Of direct relevance here, the court admonished the Commission: it is well established that an agency has a duty to consider reasonable alternatives to its chosen policy, and to give a reasoned explanation for its rejection of such alternatives. In this case demand response is the superior alternative.

B. FERC Should Require That A Real Demand Curve Be Established By Expanding the Role of Customer Demand Response in New England. This Will Eliminate Any Perceived Need to Administratively Create A Downward Sloping Demand Curve.

As set forth more fully in the Joint Industrial Consumers' Comments in support of demand response filed in this docket, a fundamental requirement of complete markets is energy markets for customer demand response. Demand response is essential to assure the efficient interaction of supply and demand, as a check on supplier and locational market power, and as an opportunity for choice by wholesale and end-use customers.

When fully consummated, markets for demand response will make it difficult for gaming strategies to exploit the inelastic demand of incomplete organized markets and bring about generator bids at levels closer to marginal cost as intended by theory. Demand response bids contribute an essential market dynamic to the extent that demand bids reveal the value of lost load (VOLL) at any given hour in the marketplace and therefore deserve the right to compete on a kWh to kWh basis with supply bids. This is a real demand curve, not an administratively-determined curve that is exposed to manipulation by market participants in the ISO stakeholder process.

The requirements of an organized market for demand response is relatively simple to implement. Demand response as a resource must have equal and symmetrical rights of access to

all ISO/RTO energy and capacity markets (including ancillary services) that are open to any other competitive resource such as generation resources. If a competitive bulk power market is the desired end-state of the Commission's policy, price-responsive load must have non-discriminatory access to any and all markets (bid-based or otherwise) that are available to other resources.

Demand response as a resource will also not happen unless customers with price-responsive loads are compensated on the same basis as any generator.[2] Customers must not be forced to "split the savings" with intermediaries (*e.g.*, LSEs) as a pre-condition to access to any demand response market. The compensation issue must be established as a matter of Commission policy (*e.g.*, made part of the OATT) to avoid the need to further fight this matter separately in every biased ISO or RTO stakeholder process and ultimately in every ISO or RTO tariff proceeding. The mechanics of price determination for any resource should be the same for both supply and demand resources, *i.e.*, the price at the margin for a unit decrement of demand response must be calculated in the same manner as the price for a unit increment of supply. The prices must not be the result of two separate protocols, procedures or software packages.

We urge the Commission to be very wary of delegating the responsibility for developing markets for demand response to ISO/RTO stakeholder processes as currently constituted because they are all dominated by supply-side market participants whose market power (or jurisdiction in the case of public power) is eroded by demand response.

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[2] Additional investments in real-time metering and telemetry by price-responsive customers who do not already have such equipment will only materialize after the requisite markets are in place and the customers have confidence that the market work.

V. NOTICES AND COMMUNICATIONS

The following persons are designated by ELCON and AISI to receive service and communications on their behalf with regard to these proceedings:

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VI. CONCLUSION

For the reasons discussed herein, ELCON and AISI respectfully request that the Commission grant this Motion to Intervene.

Respectfully submitted,

/s/ Sara D. Schotland

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Dated: March 22, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served, via first-class mail, the foregoing Motion to Intervene and Comments of the Electricity Consumer Resource Council ("ELCON") upon each person designated on the official service list compiled by the Secretary in this proceeding.

/s/ Jennifer A. Morrissey

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Dated at Washington, D.C., this 22nd day of March 2004.

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Devon Power LLC, *et al.*	Docket No. ER03-563-030

Supplemental Comments of the Electricity Consumers Resource Council (ELCON) and American Iron and Steel Institute (AISI)

Dated: March 22, 2004

The Electricity Consumers Resource Council (ELCON) and the American Iron and Steel Institute (AISI) hereby offer the following supplemental comments on the "Demand Curve" aspect of ISO-NE's Locational ICAP (LICAP) compliance filing. Our main argument is that the administratively-determined (and adjudicated) "Demand Curve" in the proposal should be replaced with a real, market-determined demand curve. More specifically, price-responsive demand bids should be allowed to compete in *all* bid-based markets that any other resource providers—such as a generator—is allowed to bid, and directly influence the calculation of market clearing prices in each relevant market. We believe that the Commission has an opportunity in this case to set an important precedent that other ISOs and RTOs should also follow.

I. Introduction.

The Commission's June 6, 2004 Order on Rehearing of NEPOOL and ISO-NE's Standard Market Design proposal included several directives on demand response with the intent

to "foster greater participation in the programs and create additional demand response in the New England market."[1] The Commission accepted all of the demand response-related proposals in the compliance filing. However, the filing only included preliminary recommendations of the New England Demand Response Initiative (NEDRI) that NEDRI "concluded were required."[2] The Commission directed that other preliminary NEDRI recommendations be considered, including, (1) inclusion in the ISO's market rules more flexible bidding processes by removing the require-ment that no bid can be smaller than one MW, (2) implementation of location-based ICAP resource credit, and (3) development of an economic, price-driven day-ahead market demand response program (with $50/MWh bid floor) by 2004. The Commission also directed ISO-NE to consider other requirements based on recommendations in NEDRI's final report: (1) allowing fixed bids each month or capability period in the Day-Ahead Demand Response program instead of the daily bidding requirement, and (2) permitting demand resources to enroll in both the Day-Ahead and Real-Time Demand Response programs. Finally, the June 6 Order required ISO-NE to prepare and submit an "independent in-depth process and impact evaluation and market assessment of the 2003 demand response programs by December 31, 2003, and to provide a similar evaluation by the end of each calendar year until and including December 31, 2005."[3]

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[1] New England Power Pool and ISO New England, Inc. 103 FERC ¶ 61,304 (2003) (June 6 Order). The relevant discussion is in paragraphs 57 through 70 of the Rehearing Order.

[2] NEDRI was a multi-stakeholder collaborative effort whose members included all six New England state PUCs, ISO-NE, PJM, NYISO, state and federal environmental agencies, market participants (utilities, merchant generators and marketers), consumer and environmental advocacy organizations, and consumer groups. FERC and DOE participated as non-voting members. *See* New England Demand Response Initiative, *Dimensions of Demand Response: Capturing Customer Based Resources in New England's Power Systems and Markets, Report and Recommendations of the New England Demand Response Initiative,* July 23, 2003.

[3] June 6 Order at paragraph 68.

On July 7, 2003, ISO-NE filed a request for clarification, or in the alternative, request for rehearing of the June 6 Order, that the Commission will "defer to the ISO's development of a comprehensive market enhancement plan and the NEPOOL stakeholder process in creating timelines for the implementation of approved NEDRI recommendations." The filing implied that the Day-Ahead Demand Response Program (DADRP) was less important compared with other matters (arguably all supply oriented), and therefore, ISO-NE was seeking "an order from the Commission that eliminates firm implementation deadlines for the DADRP." The filing also sought Commission approval to significantly reduce the scope of the annual filing requirements on the performance of the ISO's demand response programs.

In a separate request for rehearing of the June 6 Order, NXEGEN, Inc., an energy services company based in Connecticut, sought rehearing of the Commission's approval of a $50/MWh minimum bid for any hour in the "economic, price-driven" demand response program. NXEGEN argued that the "arbitrarily-selected" bid floor restricts the participation of demand resources in the New England markets.

In the Commission's November 17, 2003 Order on Requests for Rehearing and Compliance Filing, FERC insisted that the Day-Ahead Demand Response (DADRP) program be implemented as soon as it is feasible, but no later than March 31, 2004. The Commission rejected the ISO's request for a modification of the deadline for filing the annual evaluation reports. The Order also rejected NXEGEN's request to remove the $50/MWh DADRP bid floor because the floor:

> "[w]ill encourage reduced consumption during peak periods when demand is high relative to supply and when energy prices rise. We also believe that it is

reasonable to limit payment, as an incentive for reducing demand, when supply is ample, relative to demand."[4]

This chronology is abbreviated and other demand response-related filings and orders have since been exchanged between ISO-NE/NEPOOL and the Commission. However, this case history captures an important and unfortunate disconnect between the Commission's advocacy of wholesale competition and the guidance it gives ISOs and RTOs in establishing such markets. The "Demand Curve" aspect of the instant ISO-NE filing is one more example. [5]

II. FERC Should Require That The New England Market Provide Real, Downward Sloping Demand Curves By Allowing Price-Responsive Demand Bids Directly Into All ISO-NE Bid-based Markets.

A. Integrating Demand Bids With All Other ISO-Sponsored Bid-based Markets Will Eliminate Any Perceived Need to Administratively Fabricate An Artificial Downward-Sloping Demand Curve.

The imposition of an administratively-determined Demand Curve to implement LICAP opens the door to all kinds of regulatory inefficiencies that competitive markets were intended to avoid. For example, under ISO-NE's proposal, the Demand Curve's shape and slope have to be approximated by adjudication, a slow and highly costly process. These Supplemental Comments offer a better and more straightforward solution: *create real demand curves with price-responsive demand bids in the same markets in which generators are eligible to bid*.

In recent comments on compensating RMR generators (Docket No. PL04-2-000), ELCON stated that a fundamental requirement of complete markets is markets for customer demand response. This will reduce the market power and resource adequacy problems in

[4] New England Power Pool and ISO New England, Inc. 105 FERC ¶ 61,211 (2003) at Paragraph 21.

[5] NEPOOL's Demand Response Working Group is working on an expanded "Load Response Program" but the group does not publish meeting minutes at NEPOOL or ISO-NE's web sites, so it is not clear what is happening behind the scenes.

existing organized markets where suppliers are competitive merchant suppliers or price-setting pivotal suppliers, and both face a vertical (inelastic) demand curve. These comments offer the following proposition: *price-responsive demand bids should be allowed to compete in all bid-based markets (market-wide, locational or nodal) in which any other resource provider—such as a generator—is allowed to bid, and directly influence the calculation of market clearing prices in each relevant market.*

Demand response is essential to assure the efficient interaction of supply and demand, as a check on supplier and locational market power, and as an opportunity for choice by wholesale and end-use customers. Demand response will contribute to long-term resource adequacy and short-term capacity needs *if this resource is allowed to be priced in the market*. Demand response is the true market substitute for out-of-market conditions necessary to balance supply and demand to maintain reliability. It avoids the need for involuntary load curtailments. Demand response increases the efficiencies of the spot markets and markets for ancillary services. It rationalizes the Commission's market power mitigation policies by obviating the need to mitigate except for the most egregious abuses of market power.

In the long run, demand response is a more flexible and valuable resource than generation alone because it does not face the hurdles of siting problems and related environmental issues that confront new generators (or transmission facilities).[6] Every large load typically has a large payroll with local multiplier effects that more than offset land use, water and

[6] All else equal, a net 100-MW reduction in peak load (from demand response) is more valuable than a net 100-MW increase in peak load because of the economic costs of ancillary services (and other costs, *e.g.*, FTRs or any applicable installed capacity or deficiency charges) needed to service the higher load, especially during periods of real economic scarcity or congestion. It is a truism that competitive markets are more economically efficient than regulated markets, but the actual sources of the efficiency gains are often not fully appreciated or acknowledged.

air emissions concerns. Demand response is also more geographically dispersed and granular than generation – both positive network externalities in any locational or nodal pricing market construct. Finally, demand response is not generally co-dependent on natural gas prices and is therefore a potential hedge to consumers from the merchant generator sector's exposure to natural gas pricing volatility and tolling contracts.

B. Demand Response "Programs" Do Not Adequately Integrate The Available Price Response Into Actual Markets for Energy, Capacity And Ancillary Services, And Therefore Such Programs Should Be Phased-Out As Demand Is Allowed to Directly Participate in Real Markets.

Progress has been made with some ISO/RTO sponsored demand response programs but these successes only demonstrate the efficacy of the concept—such programs are not suitable proxies for real markets. In general, demand response "programs" do not solicit the same range of product offerings available to generators, and the locational price responses are not sufficiently integrated in the market clearing price algorithms and settlement processes operated by the ISOs. In other words, an ISO can create all kinds of "programs" for demand response (as does ISO-NE) but without a true demand response market, participants continue to behave as if there were a vertical demand curve. This, in turn, creates the need for administrative impositions such as LICAP to correct the very problem that an adequate market for demand response might have eliminated. So far, this chance has been denied by all existing organized markets – including NYISO, PJM and California. Direct integration of demand bids into the same market mechanics for energy, capacity and ancillary services that handle supply bids is an essential prerequisite of bid-based markets if the market efficiencies of demand response (and competition) are to be successfully realized. And, depending on the ISO-specific bidding rules, which generally were drawn to satisfy the requirements of generators only, it may be necessary

to make accommodations to enhance participation by demand resources. For example, bidding requirements that require bidders to combine day-ahead energy and ancillary services bids are not appropriate for demand resources, who do not share the generators desire to be taken in the daily energy market but may be fully competent to supply ancillary services.

Allowing "programs" for demand response and "markets" for supply resources, fragments the market place and dampens or kills efficiency gains of competition. It is indeed ironic that federal and state policies intended to promote competition are implemented by forcing two essential elements of a competitive market—demand and supply—to operate in isolation of one another. Moreover, demand response "programs" also are discriminatory because they treat these resources as inferior products compared to generation. [7] The Commission's reasons for rejecting inclusion of demand response in the markets when the price is below a $50/MWh bid floor are illogical and discriminatory because it is denying head-on competition at the lower price levels. Setting an artificial floor on demand resources equates to picking winners in the market irrespective of market forces that would otherwise bring the market into appropriate equilibrium.

Regulatory "programs" are inferior to truly competitive markets in that they are not deemed permanent or trustworthy by investors. This discourages the owners of price responsive loads from making new investments that would maximize their opportunities to engage in these markets.

[7] ISOs have developed a separate jargon for demand response that highlights the discriminatory attitude toward this resource of which the use of the term "program" is the most obvious. Demand response never gets "priced" but is instead eligible for "credits" or "payments." A customer who wants to offer demand resources must be "enrolled" to become an "Enrolling Participant."

A true market for demand response will make it difficult for gaming strategies such as "hockey stick" bidding to exploit the inelastic demand of incomplete organized markets and will bring about generator bids at levels closer to marginal cost, as intended by theory and policy. Price-responsive demand bids contribute an essential market dynamic to the extent that the bids reveal the value of lost load (VOLL) at any given hour in the marketplace and therefore deserve the right to compete on a kWh-to-kWh basis with supply bids.

C. The Commission Should Take the Next Step in Competitive Market Evolution By Mandating Integration of Demand Bids in Organized Markets. This Proceeding Provides An Important Opportunity to Take That Step.

The requirements of an organized market for demand response are relatively simple to implement. Demand response as a resource must have equal and symmetrical rights of access to all ISO/RTO energy and capacity markets (including ancillary services) that are open to any other competitive resource such as generation. If a generator is allowed to bid at a single nodal, so should demand bids. If a competitive bulk power market is the desired end-state of the Commission's policy, price-responsive load must have non-discriminatory access to any and all markets (bid-based or otherwise) that are available to other resources.

As exemplified by the New England Demand Response Initiative, the New England market is an excellent candidate for making this important advancement in organized markets. All the states in the ISO's footprint are supportive of demand response and will likely embrace any expanded role for this resource in the region.

Demand response as a resource will not happen unless customers with price-responsive loads are compensated on the same basis as any generator.[8] Customers must not be forced to "split the savings" with intermediaries (*e.g.,* LSEs) as a pre-condition to access to any demand response market. The compensation issue must be resolved as a matter of Commission policy (*e.g.,* made part of the OATT) in order to avoid the need to further dispute this matter separately in every ISO or RTO stakeholder process and ultimately in every ISO or RTO tariff proceeding. The mechanics of price determination for any resource should be the same for both supply and demand resources, *i.e.,* the price at the margin for a unit decrement of demand response must be calculated in the same manner as the price for a unit increment of supply. The prices must not be the result of two separate protocols, procedures or software packages although there may be a need for adjustments to ISO-specific bidding rules in order to allow demand resources to participate fairly in the markets.

D. The Commission Should Direct ISO-NE and Other ISOs/RTOs On the Terms and Conditions of Demand Response Integration And Not Allow Stakeholder Processes to Further Delay Or Hamstring These Markets.

Implementation of real competitive markets—not regulatory era programs—has been mired in some cases by ISO/RTO stakeholder processes that are dominated by supply-side interests who resist competition from the demand side and whose positions in the market may be eroded by demand response. We urge the Commission to send a strong signal to ISO-NE, and the market in general, that further delays in fully incorporating demand resources into all bid-based markets, and ensuring that such resources are compensated in the same manner as

[8] Additional investments in real-time metering and telemetry by price-responsive customers who do not already have such equipment will only materialize after the requisite markets are in place and the customers have confidence that the markets work and priced accordingly.

generators, will not be tolerated. In addition, it should direct the ISOs to ensure that their stakeholder processes are currently undertaking the changes necessary to ensure the full integration of demand resources into the energy, capacity and ancillary services markets.

Respectfully submitted,

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Dated: March 22, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served, via first-class mail, the foregoing Motion to Intervene and Comments of the Electricity Consumer Resource Council ("ELCON") upon each person designated on the official service list compiled by the Secretary in this proceeding.

/s/ Jennifer A. Morrissey

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Dated at Washington, D.C., this 22nd day of March 2004.

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