State of California **Public Utilities Commission**
San Francisco

M E M O R A N D U M

Date : July 19, 2007

To : The Commission
(Meeting of July 26, 2007)

From : Lisa-Marie Salvacion, Legal Division
Bishu Chatterjee, Energy Division

Subject : Staff Seeks Authority to File Comments in Response to the Federal Energy Regulatory Commission's Advanced Notice of Proposed Rulemaking, Regarding Wholesale Competition in Regions with Organized Electric Markets (FERC Docket No. RM07-19-000 and AD07-7-000) issued June 22, 2007.

I. INTRODUCTION

On June 22, 2007, the Federal Energy Regulatory Commission ("FERC") issued an Advanced Notice of Proposed Rulemaking ("ANOPR") on "Wholesale Competition in Regions with Organized Electric Markets" in Docket Nos. RM07-19-000 and AD07-7-000. The ANOPR addresses four specific topic areas where possible reforms may advance the operation of organized wholesale electric markets. These four areas are: (1) encouraging the role of demand response; (2) increasing opportunities for long-term power contracting; (3) strengthening market monitoring; and (4) analyzing the responsiveness of Regional Transmission Organizations and Independent System Operators ("RTO/ISO").[1] The ANOPR offers certain concerns within each area and FERC's proposed remedies. The proposed rulemaking ends with a request for comments from interested parties on the areas addressed.

[1] A Regional Transmission Organization ("RTO") or Independent System Operator ("ISO") is an entity, which controls and operates a transmission system and operates day-ahead and/or real-time energy markets in a state or multi-state region. The California Independent System Operator is an ISO.

Staff seeks the Commission's authorization to file comments on FERC's ANOPR. These comments must be submitted by August 16, 2007. Because of the time constraints under which we are operating, staff will need further time to fully develop its comments. We are accordingly seeking the Commission's approval to submit comments consistent with the various policy points set forth below.

II. DISCUSSION

Based on its review of the FERC's ANOPR, staff is of the view that it should file comments covering the following points:

(1) Role of Demand Response

In order to increase the role of demand response in organized markets, FERC seeks to ensure that demand resources are treated comparably to supply resources, and proposes the following mechanisms:

- Requiring RTO/ISOs to allow demand resources to provide ancillary services;
- Eliminating "deviation charges" for load reduction, assessed to a buyer in the energy market for taking less electric energy in the real-time market than purchased in the day-ahead market;
- Allowing aggregators to bid demand reductions directly the RTO/ISO's markets;
- Modifying the market power mitigation rules and other market rules when demand is nearing the amount of available supply.

The Commission is generally supportive of FERC's proposals to encourage demand response in wholesale power markets. However, additional staff analysis is necessary to understand all the implications of FERC's proposals and how they would work consistent with state policy.

Allowing aggregators to bid a demand reduction directly into the RTO/ISO's organized markets also represents a key paradigm shift from the role aggregators play today in California. Aggregators currently are able to supply demand response resources to the utilities, but do not schedule or bid such resources directly into the California Independent System Operator ("CAISO") markets. Staff believes the proposal to allow aggregators to bid demand resources directly into the CAISO markets is worth further exploration because it could enable greater demand response in the state.

Staff requests permission to file comments on the issues set forth above, consistent with Commission's policies on demand response, the Order Instituting Rulemaking (R.) 07-01-

041,[2] and Commission comments submitted to FERC regarding the Market Redesign Technology Upgrade ("MRTU") and related dockets.

(2) Increasing Opportunities for Long-Term Power Contracting

The ANOPR discusses potential steps to facilitate greater long-term power contracting in organized market regions, such as encouraging or requiring development of standardized long-term products and providing greater market transparency by posting information about recent and future long term power agreement offers and signed contracts.

Staff seeks authority to develop positions and file comments consistent with the Commission's Long Term Procurement[3] and Resource Adequacy[4] proceedings and programs as they continue to develop, as well as Commission comments submitted in the CAISO's MRTU proceeding at FERC[5] (i.e., regarding how Commission programs act/work in concert with CAISO operations/tariff). Commission comments will emphasize:

- The Commission is aggressively pursuing the procurement of sufficient capacity to supply California's long-term energy needs.
- Capacity procured through the Commission's Resource Adequacy program must submit energy bids to the CAISO, providing a robust short-term energy market.

(3) Strengthening Market Monitoring

In this ANOPR, FERC discusses strengthening the RTO/ISO's market monitoring functions in order to uphold nationwide competitive markets. In this ANOPR, FERC seeks comments regarding (1) the need for, and suggested methods for market monitor independence, and (2) the content and proper recipients of the market data and analysis developed by the market monitors. Staff seeks authority to develop positions and file comments, addressing the following concerns:

- The market monitor role should be independent, and should avoid a relationship with RTO/ISO management or from market participants that would create a conflict of interest. For example, CAISO's external market monitor, the Market

[2] *Order Instituting Rulemaking Regarding Policies and Protocols For Demand Response Load Impact Estimates, Cost-Effectiveness Methodologies, Megawatt Goals And Alignment With California System Operator Market Design Protocols,* R.07-01-041.
[3] *Order Instituting Rulemaking to Integrate Procurement Policies and Consider Long-Term Procurement Plans,* R.06-02-013.
[4] *Order Instituting Rulemaking to Consider Refinements to and Further Development of the Commission's Resource Adequacy Requirements Program,* R.05-12-013.
[5] See FERC Docket No. ER06-615, *California Independent System Operator Corporation Electric Tariff Filing To Reflect Market Redesign And Technology Upgrade.*

Surveillance Committee, acts as an independent market oversight body. Staff comments will also explore whether market monitors can help provide more effective enforcement.

- State regulators have an interest in overseeing competition in the state's electricity markets and should have access to RTO/ISO market monitor data. Any anomaly in the RTO/ISO wholesale electricity markets has a significant impact on the retail customers' rates and the long-term reliability of the electricity grids. Access to the RTO/ISO data will allow the states to fulfill their statutory responsibilities while preserving the independence of the RTO/ISO and the interests of the market participants. Staff will present a discussion on how state agencies and the RTO/ISO market monitor could exchange this information and work cooperatively.

(4) Analyzing the Responsiveness of RTO/ISOs

The proposed rulemaking deals with the responsiveness of RTO/ISOs to customers and other stakeholders. The apparent intent of this section is to assure a process for customers and stakeholders to have direct access to the boards of directors of RTO/ISOs. The ANOPR suggests three possible reforms in this area:

- The creation of hybrid boards of directors composed of independent members and representatives of stakeholders;
- The creation of committees of stakeholder representatives with some form of direct access to the board of directors, distinct from the technical advisory committees that already exist in most RTO/ISOs; and
- Such other alternatives as may be proposed by an RTO or ISO.

Staff recommends that the Commission's comments on this section of the ANOPR should highlight the following points:

- A hybrid board of directors would violate FERC Order Nos. 888 and 2000, which require that an RTO/ISO boards be independent from market participants.
- FERC does not have the legal authority to reform a state-created ISO. This principle was affirmed by the U.S. Court of Appeals for the D.C. Circuit in *CAISO v. FERC*, (2004) 372 F.3d 395, in which the Commission actively participated on behalf of the CAISO. In this decision, the Court ruled that FERC has no authority to reform the selection method of the governing board of the CAISO.
- The CAISO already has a built-in mechanism for stakeholder access to its Board of Governors before it votes. The CAISO has also implemented

several improvements in its stakeholder processes, which have aided the transparency and functionality of such discussions.

- The creation by CAISO of board advisory committees is acceptable in principle, but such a committee is not necessary in the case of the CAISO, because it already has a technical advisory committee, and its stakeholders already have sufficient access to its Board of Directors.
- The Commission has a productive, on-going collaborative working relationship with the CAISO's staff, management, and Board of Governors, and Commission staff are willing to continue working with the CAISO toward improvements in its governance, especially with regard to enhancing communications on policy issues. However, this on-going process does not necessarily require active FERC intervention.

III. ACTION REQUESTED:

Staff request authorization to submit comments on the FERC's ANOPR along the lines of the foregoing discussion. Since comments will not be due for several weeks from the date of this memorandum, staff is still developing its proposed comments. However, staff will distribute to each of the Commissioners a draft of the comments prior to filing the comments.

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