

MEMORANDUM

Date : April 03, 2008

**To : The Commission
(Meeting of April 10, 2008)**

**From : Colette Kersten, Energy Division
Lisa-Marie Salvacion, Legal Division**

Subject : Staff Seeks Authority to File Comments on FERC's Notice of Proposed Rulemaking Regarding Wholesale Competition In Regions With Organized Electric Markets. (FERC Docket No. RM07-19-000 and AD07-7-000) issued February 22, 2008.

On February 22, 2008, the Federal Energy Regulatory Commission ("FERC") issued a Notice of Proposed Rulemaking ("NOPR") on "Wholesale Competition in Regions with Organized Electric Markets" in Docket Nos. RM07-19-000 and AD07-7-000. The NOPR addresses four specific topic areas where possible reforms may advance the operation of organized wholesale electric markets¹: (1) demand response and market pricing during a period of operating reserve shortage; (2) long-term power contracting; (3) market monitoring policies; and (4) the responsiveness of RTOs and ISOs to customers and other stakeholders. Comments on the proposed rules are due by April 21, 2008.

In the CPUC's comments to FERC's previously issued Advanced Notice of Proposed Rulemaking² ("ANOPR"), Staff illustrated that California's current efforts already advance many of the concerns addressed in FERC's potential reforms to its organized markets. The comments noted the diversity among the various organized markets, both geographically and in terms of their individual organizations and practices, and asserted

¹ Organized market regions are areas of the country in which a regional transmission organization ("RTO") or independent system operator ("ISO") operates day-ahead and/or real-time energy markets.

² FERC issued an Advanced Notice of Proposed Rulemaking ("ANOPR") on June 22, 2007 in the same docket. CPUC and many other stakeholders filed comments on September 14, 2007. This NOPR then issued.

that any concerns FERC has in regard to a given RTO/ISO are more appropriately addressed in an RTO or ISO-specific proceeding.³ CPUC comments also observed potential jurisdictional conflicts, and questioned whether FERC has the legal authority to impose some of its proposed requirements. Staff will again emphasize these concerns in the response to the NOPR, as appropriate.

Staff seeks the Commission's approval to submit comments consistent with the policy points set forth below.

(1) Role of Demand Response

FERC proposes the following reforms: (1) require markets to accept bids from demand response resources for certain ancillary services; (2) eliminate, during a system emergency, a charge to a buyer in the energy market for taking less electric energy in the real-time market than purchased in the day-ahead market; (3) permit an ARC⁴ to bid demand response on behalf of retail customers directly into the organized energy market; (4) modify market rules, as necessary, to allow the market-clearing price, during periods of operating reserve shortage, to reach a level that rebalances supply and demand so as to maintain reliability while providing sufficient provisions for mitigating market power; and (5) study whether further reforms are necessary to eliminate barriers to demand response in organized markets.

In general, staff is encouraged by and generally agrees with the proposed rules for demand response participation in the wholesale markets. However, Staff will comment on a few concerns regarding FERC's proposal to require RTOs and ISOs to amend their market rules as necessary to permit an ARC to bid demand response on behalf of retail customers directly into the wholesale market, as follows:

- **States should be allowed to explore the relative benefits of permitting an ARC to bid demand response on behalf of retail customers.** Staff has significant concerns about retail consumer protection if the wholesale markets allow an ARC to bid demand response on behalf of retail customers, as FERC proposes. Staff's comments will point out that this is an area requiring FERC deference to state regulations and initiatives. It is important that state regulators retain the ability to ensure that retail customers receive proper value for the demand response they provide, and establish a system of rules to protect California's customers, before permitting an ARC to bid demand response for those customers. Staff will note that the California Independent System Operator ("CAISO"), working closely

³ CPUC Comments to FERC's ANOPR, p. 3

⁴ "ARC" refers to "aggregated retail customers" also known in California as "aggregators."

with the CPUC, the California Energy Commission, investor-owned utilities and other third parties, has recently issued a Demand Response Straw Proposal for MRTU⁵ Post Release 1, which contemplates implementing nearly all of FERC's proposed market reforms. In addition, the CPUC's Demand Response Rulemaking also contemplates the role of demand response in CAISO's markets.

- **The NOPR does not go far enough to open access to smaller providers of demand response, in addition to ARCs.** Many of California's demand response providers are large enough and technically capable, once rules are in place, to independently supply the wholesale market with "negawatts." By proposing to require the RTOs to accept demand response bids from an ARC, it is unclear if FERC contemplates that individual customers may also participate as a demand response provider. In California, Staff has worked hard with the CAISO to ensure a 100kW minimum bid-in threshold for demand response providers. This minimum was requested by the Energy Division Demand Response team to ensure that independent entities capable of individually meeting the minimum 100kW threshold would be allowed by the CAISO to bid their "negawatts" into the market *without* third party or ARC assistance. The FERC should allow flexibility in allowing states to decide who can provide demand response into the wholesale market and clarify that it is not limiting the providers of demand response to only ARCs.
- **FERC's proposed reform could infringe upon the CPUC's jurisdiction over its preferred resource mix and retail rates.** The FERC's proposal could require complex tariff changes that may interfere with the state's jurisdiction to regulate demand response transactions. Currently CAISO's Tariff 4.5.1.1.3 mirrors a CPUC rule developed in a 2002 Direct Access ruling allowing only one scheduling coordinator per meter. FERC's proposal to allow an ARC to bid in retail demand could require the CAISO to amend section 4.5.1.1.3 of its tariff, ultimately infringing upon the CPUC's jurisdiction over the sale of demand response negawatts, which have a direct impact upon retail rates. As demand response is one of California's preferred resources, FERC should defer to California (and other individual states) and allow them to manage their own demand response programs in a manner that best protects consumers.

Assigned Staff: Charlyn Hook (CHH/3-3050), Jason Salmi-Klotz (JK1/3-2421).

⁵ "MRTU" refers to the CAISO's Market Redesign and Technology Upgrade, which will begin in 2008.

(2) Increasing Opportunities for Long-Term Power Contracting

Long-term contracting reduces ratepayer risk and supports the development of new generation by providing a predictable revenue stream that is generally needed to secure financing for the construction of new generation facilities. Also, long-term contracts limit the immediate impact of volatile spot markets by insulating a substantial share of the market from short term price fluctuations. Lastly, long-term contracts decrease the incentives for market manipulation because the share of the market subject to manipulation in spot markets is reduced by the exclusion of the share of energy supply secured by long-term contracts, making the potential gains from gaming the market much smaller.

The CPUC actively supervises the majority of long-term energy supply contracts between generators and load serving entities (“LSEs”) in California under the auspices of its authority over retail energy rates as well as long-term energy supply reliability. The CPUC has a variety of long-term contracting programs in place, including the Long Term Procurement Proceeding (“LTPP”) and Resource Adequacy (“RA”) proceedings. The CPUC RA program requires the payment of capacity payments, which spur the development of new infrastructure and generation. Staff understands that many of these RA contracts include tolling agreements, whereby the LSE takes responsibility for hedging fuel costs and decides when and how to operate the plant and bid resulting energy into CAISO markets. The RA program also assures a robust energy market by establishing a contractual obligation to offer energy into the CAISO markets.⁶ In addition, the CPUC requires the utilities to establish long-term contracts through LTPP, in which utilities procure energy necessary for both the utilities’ bundled customers and system needs.⁷

In the NOPR, FERC proposes requiring ISOs/RTOs to establish a dedicated space on their websites where market participants can post offers to buy or sell long-term contracts for energy. FERC states its “bulletin board” proposal is designed to facilitate the long-term contracting process by increasing the transparency of sellers and buyers for market participants and should encourage more long-term contracting and improve efficiency in the market at little cost. FERC does not propose to mandate the specific type of bulletin board that each ISO and RTO must post. Instead, FERC proposes that each ISO work with its stakeholders to design a solution that works for its market participants. FERC intends, however, that an RTO/ISO bulletin board would allow persons to post offers to buy or sell without making the transmission operator responsible for the content of the offers. FERC specifically recognizes that it cannot compel buyers and sellers to enter

⁶ D05-10-042 pg. 7

⁷ D07-12-052 pg. 8 and 17

into long-term contracts and notes that the purchasing practices are dictated, if at all, by state policies, not by FERC.

Nonetheless, the Staff recommends the CPUC should not support, at this time, FERC's proposal to require ISO/RTOs to create voluntary long-term energy contracting bulletin board for several reasons. First, it may be unnecessary, at least for California, given the substantial processes under CPUC purview supporting long-term contracting as noted above. Second, it is premature for the CPUC to comment on FERC's proposal to require all ISOs/RTOs to establish bulletin boards, because proposals for an electronic bulletin board for trading RA capacity are currently pending before the CPUC as part of Phase 2 of the Resource Adequacy proceeding. Staff also notes that energy contracts are already bought and sold on the Intercontinental Exchange.⁸ It is unclear what, if any, additional benefit would accrue to California markets or ratepayers if CAISO were required to also post opportunities to buy and sell energy.

Third, staff is concerned about possible FERC encroachment in the definitions of products that are the subject of state jurisdiction. The requirement to create a bulletin board, by virtue of the fact that each ISO/RTO will then be required to file it for approval by FERC six months after the final rule issues, must not become a vehicle to allow FERC to do what it specifically recognizes it has no authority to do, to dictate state purchasing practices, regardless of whether the product in question is energy or capacity. While an electronic bulletin board could in theory be a useful tool for creating liquidity and promoting long-term energy contracts, FERC must allow capacity products and procurement processes in California to be defined by the CPUC. Staff will ask the FERC to clarify that in requiring the establishment of bulletin boards, it does not intend to dictate the definitions of products or the list of products that must be exchanged there, since such products are subject to state regulation.

Assigned Staff: Elizabeth Dorman (EDD/3-1415), Michael Dorsi (MDO/3-2317).

(3) Strengthening Market Monitoring

FERC seeks comment on proposals intended to clarify and strengthen the RTO/ISO's market monitoring functions and responsibilities. Staff seeks authority to develop positions and file comments, regarding the following three areas:

- **Proposals to ensure market monitor independence and function.** The market monitor role should be independent, and should avoid a relationship with RTO/ISO management or with market participants that would create a conflict of interest. In California, CAISO's external market monitor, the Market Surveillance

⁸ See www.theice.com.

Committee, maintains an independent status while providing market oversight, beyond the oversight provided by the CAISO's internal Department of Market Monitoring. Staff recommends the CPUC support the principle that market monitors can and should help provide effective enforcement and market power mitigation in RTO/ISO markets. Market monitors should not be barred from administering mitigation, because they tend to be more knowledgeable about market manipulation issues and less conflicted than RTO staff responsible for administering the RTO markets through the use of independent market monitors.

- **The content and proper recipients of the market data and analysis developed by the market monitors.** The NOPR proposes limitations to data access that would impede the ability of state regulators such as the CPUC to effectively oversee wholesale and retail markets and protect California ratepayers. State regulators have a responsibility to monitor 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 may have a significant impact on long-term power procurement, retail rates, and the long-term reliability of the state's electricity grids. Access to RTO/ISO data allows the states to fulfill their statutory responsibilities to ensure reliable electricity service at rates that are just and reasonable. Staff will outline how state agencies and the RTO/ISO market monitor could exchange this information and work cooperatively, while still maintaining the integrity and confidentiality of sensitive data.
- **The definition of functions and duties of market monitors.** The NOPR proposes to define the core functions of the market monitor in this proceeding, and then once those functions have been defined, incorporate them into the RTOs' tariffs. How the market monitor's responsibilities are defined will in large part determine its authority to perform all of the requisite tasks of monitoring and evaluating how the markets are operating. Certain of the market monitoring functions proposed in the NOPR may not be appropriate, adequate, or feasible, and should be modified in certain respects. For example, the definition must be expansive enough so as to allow the market monitor to oversee the workings of the CAISO's market independently and without any undue influence from the CAISO management, staff, or board. At the same time, the market monitor must have unimpeded access to all data in the control of the CAISO. To achieve this delicate balance between free access and freedom from influence may be difficult, but it is the only way to assure that the market monitor will serve a useful and effective role.

Assigned Staff: Karen Paull (KPP/3-2630), Karl Meeusen (KKM/3-1567).

(4) Analyzing the Responsiveness of RTO/ISOs

This section of the proposed rulemaking deals with the responsiveness of RTOs and 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 RTOs and ISOs. If such mechanisms are already in place, or when such mechanisms are put in place, each ISO/RTO must submit a compliance filing showing that customers and stakeholders have direct access to the board. The NOPR suggests three possible vehicles to achieve this:

- 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; such committees would be distinct from technical advisory committees that already exist in most RTOs/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 NOPR should highlight the following points:

- The CAISO already complies because stakeholders have access to the board of directors. Thus, board advisory committees are not necessary in California, since CAISO already has a technical advisory committee;
- FERC does not have the legal authority to reform the board of directors of a state-created ISO. This principle was affirmed by the U.S. Court of Appeals for the D.C. Circuit in *CAISO v. FERC*, 372 F.3d 395 (2004), a case 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, which as a nonprofit corporation in California, is governed by state law;
- A hybrid board of directors would violate FERC Order Nos. 888 and 2000, requiring ISO or RTO board independence from market participants;
- The CPUC has a collaborative working relationship with the CAISO's staff and management, and will continue working with the CAISO toward improvements in its governance, especially with regard to enhancing

communications on policy issues. This ongoing process does not require intervention by FERC at this time.

Assigned Staff: Laurence Chaset (LAU/5-5595), Mihai Cosman (MR2/5-5504).

ACTION REQUESTED:

Staff request authorization to submit comments on the FERC's NOPR along the lines discussed above.

cc: Sean Gallagher, Energy Division
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