

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Wholesale Competition in Regions with
Organized Electric Markets

Docket Nos. RM07-19-000 and
AD07-7-000

**COMMENTS OF THE
TRANSMISSION ACCESS POLICY STUDY GROUP**

The Transmission Access Policy Study Group (“TAPS”) has long advocated that the Commission take steps to reform RTOs to make them more responsive to customers that depend upon them for reliable, affordable service, to contain and reduce RTO costs, and to otherwise ensure that RTOs produce rates that are just and reasonable as the Federal Power Act (“FPA”) requires. TAPS therefore appreciates that on June 22, 2007, the Commission issued “an Advanced Notice of Proposed Rulemaking (ANOPR) with regard to potential reforms to improve the operation of organized wholesale electric markets” and invited comments. ANOPR Summary.¹ While the Commission characterizes the issues addressed in the ANOPR as “specific and narrow,” ANOPR at P 1, and assumes the benefits RTO-operated centralized markets,² the issues in fact implicate the Commission’s FPA obligation to ensure the lowest possible reasonable rates. The fact that the ANOPR addresses potential reforms in organized wholesale electric markets operated by Regional Transmission Organizations

¹ Wholesale Competition in Regions with Organized Electric Markets, Advanced Notice of Proposed Rulemaking, 72 Fed. Reg. 36,276 (proposed July 2, 2007), IV F.E.R.C. Stat. & Regs. ¶ 32,617, *comment period extended*, 72 Fed. Reg. 44,437 (Aug. 8, 2007) (“ANOPR”).

² TAPS shares the concerns reflected in comments filed today American Public Power Association that such benefits should not be assumed, and supports APPA’s request for further examination of the more fundamental premises underlying the ANOPR.

(“RTOs”)/Independent System Operators (“ISOs”) that are creatures of the Commission’s policy choices, and that have tended to view the Commission as their primary constituency, underscores this fundamental issue.

Foremost, the Commission must establish a mission for all RTOs/ISOs, and judge all RTO proposals in a manner, that is consonant with the FPA’s requirement that just and reasonable rates be the lowest possible reasonable rate. The achievement of such rates must be the chief goal of RTOs, and the ANOPR’s suggested “reforms to improve the operation of organized wholesale electricity markets,” ANOPR at P 1, must help RTOs attain that goal. While TAPS supports certain of the ANOPR’s proposal, the Commission’s efforts will be far more likely to produce benefits for consumers if its proposals reflect, and direct RTOs to pursue, this mission.

TAPS addresses the ANOPR’s numerous proposals below but adds at the outset that consumer-oriented policies are not advanced by the ANOPR’s proposal to eliminate or raise offer and bid caps under shortage conditions. As Commissioner Kelly rightly points out, “the technology and associated demand response capability must be in place before we consider raising or eliminating these price caps.” ANOPR Kelly, Comm’r, dissenting. The FPA’s requirement for the lowest possible reasonable rate does not permit the Commission to treat consumers as guinea pigs to see whether demand response adequate to mitigate market power will develop in reaction to exorbitant prices.

The Commission’s allowing hybrid boards, on the other hand, would represent a consumer-oriented policy. RTO boards with an independent-director majority and stakeholders in the minority would ensure that major RTO decisions benefit from direct input from stakeholders with “skin in the game.” Direct access to information about the

impact of RTO decisions, unfiltered by RTO management, increases the likelihood that RTO boards will hear and respond to consumer needs.

I. EXECUTIVE SUMMARY

- Competition and well-functioning markets are not ends in themselves. Rather, they must produce just and reasonable rates that are “the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.” *Atl. Ref. Co. v. Pub. Serv. Comm’n*, 360 U.S. 378, 388 (1959). While the Commission specifically identified lower prices as the aim of Order Nos. 888 and 2000, there is no mention of this aim in Order No. 890 and the ANOPR. The Commission must return to its statutory roots and articulate an RTO mission that includes the achievement of the lowest possible reasonable rate.
- While TAPS supports certain of the ANOPR’s demand response proposals, it urges the Commission to continue its work to identify and eliminate unintended barriers to demand response and to support existing LSE-based demand response programs. Such programs are crucial to TAPS members’ providing economic, reliable electric service to their customers.
 - TAPS supports the ANOPR’s proposal to eliminate deviation charges during system emergencies, so long as such charges are also waived for LSEs for any deviations that result from demand reduction. TAPS opposes elimination of such charges absent emergencies. TAPS also supports allowing demand resources to provide certain ancillary services without also having to sell into the energy market, though technical hurdles may practically limit the amount of reserves provided from such resources.
 - The Commission should identify and address other barriers to demand response in RTO-run markets. These barriers include RTO rules that do not “synch up” with LSEs’ contracts with retail customers and demand response programs that interrupt more broadly or more frequently than justified by reliability or economics.
 - The Commission’s promotion of demand response should not reflect a one-size-fits-all approach that assumes that demand response occurs only in areas with retail choice. A significant percentage of demand response does and can take place pursuant to programs operated by LSEs that retain obligations to serve. Formulation of policies from only a retail choice perspective could impair existing LSE-based programs, such as existing programs developed and adopted by TAPS members.
 - Relaxing mitigation bid and offer caps at this time would merely punish consumers with little means to protect themselves from high prices, which would lead to unjust and unreasonable rates. Advanced metering that would allow retail loads to be price responsive has not sufficiently penetrated retail markets. The

four proposals to lift or modify existing bid and offer caps will put consumers at great risk for harm from market power exercise.

- Because the success or failure of demand response policies is integrally affected by retail customers' conduct, the Commission should initiate a stakeholder process that is close to those customers, the LSEs that serve them, and the state and local regulatory bodies that ensure that their rates are just and reasonable. Only then will the Commission have confidence that its policies are not counterproductive.
- The ANOPR's proposed transparency and liquidity proposals may have limited benefits to the extent a buyer's portfolio is primarily financial, but most LSEs with obligations to serve need base load, intermediate and peaking generation products, which the ANOPR's proposals do not address. Part of the solution is successful implementation of the Long-Term Rights Final Rule and building a robust transmission grid so that LSEs can economically deliver base load and renewable generation from often remote locations. As requested by APPA, however, the Commission also needs to investigate why LSEs in certain areas are unable to secure needed long-term power supply products and develop solutions based upon that investigation.
- The ANOPR's proposals are necessary to bring accountability and responsiveness to RTOs, but more must be done.
 - The Commission must define a consumer-focused mission for RTOs to which RTOs must be held accountable.
 - TAPS strongly supports hybrid RTO boards in order to make RTOs more responsive to stakeholders, to combat board isolation and to render boards less susceptible to capture by RTO management. As the attached WPPI White Paper shows,³ a hybrid board with an independent majority marries the benefits of independent governance with stakeholder input from high-level executives integrated into the decision-making process. The ANOPR's alternative, a board advisory committee, would not likely receive the same level of commitment from executives and generally is inferior to a hybrid board.
 - RTO accountability can be advanced as well through a number of measures, including:
 - benchmarking that compare an RTO's costs to other RTOs and non-RTO transmission providers;
 - biennial, independent cost-benefit analyses;

³ Wisconsin Public Power Inc. ("WPPI"), *RTO Accountability and Governance* (Sept. 2007), Attachment A hereto.

- RTO cost-benefit analyses of major new rule or market initiatives prior to their adoption;
 - performance measures that examine (1) success at relieving congestion costs, (2) responses to transmission requests, (3) reliability and outage statistics, and (4) whether RTO transmission planning and expansion targets are met; and
 - tying RTO senior management compensation to consumer-focused performance measures.
- To introduce meaningful stakeholder oversight and allow the Commission to reasonably rely on the stakeholder process as a check on RTO expenditures, there should be advance stakeholder review of an RTO's annual budget.
- Market monitoring must be mission-focused, independent and effective, which requires the following:
 - The market monitor's assessment of consumer benefit must measure whether rates produced by RTO markets yield the lowest possible reasonable rates. Consumers must receive a significant share of RTO-facilitated cost reductions.
 - Under the ANOPR proposal that the market monitor report to the RTO board or a committee thereof, the market monitor should function similarly to an independent auditor and should have sufficient resources to be effective.
 - The ANOPR's information sharing proposals are steps in the right direction, but the time lag for release of information can be reduced significantly to a week without an appreciable increase in collusion risks, while market monitor briefings and the ability to make tailored requests for information should be open to all market participants.

II. INTERESTS OF TAPS AND COMMUNICATIONS

TAPS is an informal association of transmission-dependent utilities in more than 30 states, promoting open and non-discriminatory transmission access.⁴ As entities entirely or predominantly dependent on transmission facilities owned and controlled by

⁴ TAPS is chaired by Roy Thilly, CEO of Wisconsin Public Power Inc. Current members of the TAPS Executive Committee include, in addition to WPPI, representatives of: American Municipal Power-Ohio; Blue Ridge Power Agency; Clarksdale, Mississippi; Electricities of North Carolina, Inc.; Florida Municipal Power Agency; Illinois Municipal Electric Agency; Indiana Municipal Power Agency; Madison Gas & Electric Co.; Massachusetts Municipal Wholesale Electric Company; Missouri River Energy Services; Municipal Energy Agency of Nebraska; Northern California Power Agency; and Southern Minnesota Municipal Power Agency.

others, TAPS members have long supported the Commission's initiative to form truly independent, regional transmission organizations and to foster efficient investment in transmission and generation facilities. TAPS recognizes the critical importance of non-discriminatory open access and efficient, accountable RTOs, and the availability of long-term contracts to TAPS members' ability to continue to provide reliable service to their customers at a reasonable, predictable cost. They are also keenly interested in preserving and expanding demand response programs, while protecting consumers against market power exercise.⁵

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III. COMMENTS

A. *The Goal of Improving the Operation of Wholesale Markets Must Be to Provide Consumer Value, Including Lowering Prices*

Repeatedly, the ANOPR refers to the Commission's focus on "foster[ing] competition" and "improving the operation of wholesale competitive markets in organized market regions." *See, e.g.*, ANOPR at PP 1, 3, 4, 8, 13. Wholesale

⁵ TAPS has commented on nearly all major rulemakings and policy inquiries involving the electricity industry over the past decade.

competition and well-oiled markets, however, are not ends in themselves. Rather, the end is the one articulated in Section 205: just and reasonable rates. 16 U.S.C. § 824d. In ensuring that rates are just and reasonable, the Commission must “curb abusive activities by public utilities ... and ... protect consumers of electrical services from excessive rates.”⁶ As the Supreme Court has explained, Congress intended jurisdictional sales “at the *lowest possible reasonable rate* consistent with the maintenance of adequate service in the public interest,” and the Act was “framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges.” *Atl. Ref. Co.*, 360 U.S. at 388 (emphasis added).⁷ Competition is not itself the goal but rather the means by which the Act’s directive for “lowest possible reasonable rates” is achieved.

In the past, the Commission has specifically tied competition and non-discriminatory transmission access through independent grid operation to the goal of price reduction. In Order No. 888,⁸ the Commission stated that “[n]on-discriminatory open access to transmission services is critical to the full development of competitive wholesale generation markets and *the lower consumer prices* achievable through such

⁶*Fla. Power & Light Co. v. FERC*, 617 F.2d 809, 816 (D.C. Cir. 1980). See also *FPC v. La. Power & Light Co.*, 406 U.S. 621, 631 (1972) (“The Natural Gas Act of 1938 granted FPC broad powers to protect consumers against exploitation at the hands of natural gas companies.”) (internal quotation omitted); *Pub. Sys. v. FERC*, 606 F.2d 973, 979 n.27 (D.C. Cir. 1979) (“Both the Natural Gas Act and the Federal Power Act aim to protect consumers from exorbitant prices and unfair business practices.”).

⁷ While *Atlantic Refining* arose under Natural Gas Act, courts have “repeatedly recognized the similarity of the two statutes and held that they should be interpreted consistently.” *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 686 (D.C. Cir. 2000), *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002).

⁸ Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,539 (May 10, 1996), [1991–1996 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,036, *clarified*, 76 F.E.R.C. ¶ 61,009 (1996), *modified*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), [1996–2000 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,048, *order on reh’g*, Order No. 888-B, 62 Fed. Reg. 64,688 (Dec. 9, 1997), 81 F.E.R.C. ¶ 61,248 (1997), *order on reh’g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046 (1998), *aff’d in part and remanded in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002)).

competition.” Order No. 888 at 31,652. In Order No. 2000 (at 30,993) (emphasis added),⁹ the Commission was more emphatic:

The comments on the NOPR overwhelmingly support the conclusion that independent regionally operated transmissions grids will enhance the benefits of competitive electricity markets. Competition in wholesale electricity markets is the best way to protect the public interest and ensure that electricity *consumers pay the lowest price possible for reliable service.*

The Commission recently affirmed Order No. 2000’s price-lowering objective, stating:¹⁰

In Order No. 2000, in which the Commission’s goal was to promote efficiency in wholesale electricity markets and to ensure that electricity consumers pay the lowest price possible for reliable service, the Commission stated that:

These benefits [of RTOs] will include: increased efficiency through regional transmission pricing and the elimination of rate pancaking; improved congestion management; more accurate estimates of ATC; more effective management of parallel path flows; more efficient planning for transmission and generation investments; increased coordination among state regulatory agencies; reduced transaction costs; facilitation of the success of state retail access programs; facilitation of the development of environmentally preferred generation in states with retail access programs; improved grid reliability; and fewer opportunities for discriminatory transmission practices. All of

⁹ Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), [1996–2000 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,089 (to be codified at 18 C.F.R. pt. 35), *order on reh’g*, Order No. 2000–A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), [1996–2000 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,092, *appeal dismissed for want of standing sub nom. Pub. Util. Dist. No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

¹⁰ *Promoting Transmission Investment through Pricing Reform*, Order No. 679-A, 72 Fed. Reg. 1,152, 1,166 (Jan. 10, 2007), III F.E.R.C. Stat. & Regs. ¶ 31,236, P 86 n.141, *clarified*, 119 F.E.R.C. ¶ 61,062 (2007, P 86 n.141 (2006) (quoting Order No. 2000, FERC Stats. & Reg. ¶ 31,089 at 31,024)).

these improvements to the efficiencies in the transmission grid will help improve power market performance, which will ultimately result in lower prices to the Nation's electricity consumers.

Furthermore, the Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy, by the Electric Energy Market Competition Task Force, at 2, tied the allocative efficiency that competitive markets are supposed to promote to the goal of lowering prices.¹¹

TAPS is concerned, however, that statements similar to the foregoing do not appear in the ANOPR or Order No. 890.¹² In the ANOPR, the Commission properly acknowledges its “core responsibility ... to ‘guard the consumer from exploitation by non-competitive electric power companies,’”¹³ but does not explicitly mention the lowest possible reasonable rate as a means by which such protection is achieved. Nor does the Commission define the goal of competition and organized markets in terms of lowering rates for consumers, as it has in the past. The Commission must adhere to the FPA's fundamentals and ensure that RTOs, the entities created by the Commission to provide non-discriminatory transmission service and operate RTO markets, fulfill the overarching mission of providing value to the consuming public through lower prices. *See*

¹¹ The Electric Energy Market Competition Task Force, *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy* (2007), <http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact-final-rpt.pdf>.

¹² Preventing Undue Discrimination and Preferences in Transmission Service, Order No. 890, 72 Fed. Reg. 12,226 (Mar. 15, 2007), III F.E.R.C. Stat. & Regs. ¶ 31,241 (to be codified at 18 C.F.R. pts. 35 and 37), *reh'g granted*, Nos. RM05-17-001 and RM05-25-001 (Apr. 12, 2007), *compliance deadlines extended*, 72 Fed. Reg. 19,112 (Apr. 17, 2007), 119 F.E.R.C. ¶ 61,037 (2007), and 120 F.E.R.C. ¶ 61,103 (2007), *effective date deferred in part*, 120 F.E.R.C. ¶ 61,222 (2007).

¹³ ANOPR at P 5 (quoting *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975), *aff'd*, 425 U.S. 662 (1976)).

WPPI White Paper. End users ultimately must be better off because an RTO is functioning. If the Commission's policies and ISO/RTO operations do not serve this mission, they should not be found just and reasonable.

This FPA-mandated consumer focus for Commission policies and RTOs' mission must guide the Commission's decision on the ANOPR. For example, demand response rules must help markets be directly responsive to consumer needs and lead to the lowest possible reasonable rate.¹⁴ RTO-run markets must help LSEs obtain long-term contracts needed to meet their service obligations with reliable, reasonably priced electricity. RTOs must be accountable for producing consumer benefits in the form of lower electricity prices and must be governed so that RTO decisions reflect the RTO's consumer-focused mission. Market monitors should assess whether RTO markets are achieving the lowest possible reasonable rates.

The Commission's reaffirmation of the RTOs' mission is essential. After nearly 10 years of operation, hundreds of millions of dollars in RTO-related expenditures, and countless stakeholder meetings, RTOs themselves seem confused, and their mission remains misunderstood and the subject of ongoing debate. RTO boards, management and stakeholders still do not share a common understanding of the RTOs' fundamental purpose. TAPS members have heard RTO executives describe their job as maintaining reliability and operating the markets, to the exclusion of any obligation to consider cost impact on consumers. That needs to change. By defining the RTOs' mission to focus on reducing costs of electric service and communicating it clearly to the RTOs and the larger

¹⁴ The ANOPR recognizes that demand response can contribute to lower prices. ANOPR at P 37. TAPS's concern is that the ANOPR does not link reliance on competitive markets and organized markets to the goal of lower prices.

stakeholder community, the Commission can end the debate and help to ensure that its policies and the RTOs those policies have spawned fulfill the FPA's objectives.

B. While Some of the ANOPR's Proposals Head in the Right Direction, the Commission Needs to Understand Better the Barriers to Demand Response and to Support Existing LSE-Based Demand Response Programs

TAPS recognizes and strongly supports the role of demand response in enhancing reliability and reducing cost, *e.g.*, by avoiding construction of generation that is needed only in very few hours of the year.¹⁵ Many TAPS members are actively involved in demand response and believe there are steps the Commission can take to foster greater use and development of demand response, as discussed below. TAPS also urges the Commission to recognize that demand response takes place through programs operated by LSEs, in addition to direct retail load participation in wholesale markets. The Commission's efforts should support these LSE-based programs as well.

While TAPS supports some of the ANOPR's proposals, TAPS also recommends that the Commission establish a ground-up process that involves retail regulatory authorities and the LSEs that serve retail consumers to identify for each organized market specific market rules that impede, or that are needed to support, demand response, and to develop approaches consistent with legal and practical impediments to demand response in a particular region. As discussed below, elimination of deviation charges for load reductions in emergencies is a good example of the types of barriers that can be identified

¹⁵ For example, in recent years, ISO-NE's capacity factor has eroded from 67% to 55% (a decline that continues), which creates a need for larger amounts of less frequently utilized peaking capacity. In 2006, over 2500 MW of peaking capacity, totaling more than \$2 billion of investment, was needed to serve load for less than 60 hours per year. Demand response could diminish ISO-NE's peaking capacity requirements. *See Connecticut Municipal Electric Energy Cooperative; ISO-New England Demand Response Programs: CMEEC Experience*, at 2 (2007), which is Attachment B hereto.

and eliminated in this manner, while lifting RTO price and bid caps should not be considered until it is clear that other more fundamental barriers to demand response have been addressed.

1. The Commission Correctly Identifies Several Barriers to Demand Response

TAPS supports the Commission's proposal to "modify RTO and ISO tariffs to 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." ANOPR at P 62. As the Commission recognizes, market rules should send signals to encourage, and not penalize, appropriate actions such as demand reductions needed during a system emergency. ANOPR at P 65. Unfortunately, existing market rules do penalize load for taking appropriate action, such as the Midwest ISO's assessment of revenue sufficiency guarantee charges on LSEs that had marshaled nearly 3,000 MW of demand reductions in response to a reserve shortage in the Midwest. ANOPR at P 52 n.52. While TAPS supports deviation charge waiver in cases of emergencies, it opposes such waivers where there is no system emergency. *See* ANOPR at P 67. Absent emergencies, accurate scheduling and anti-gaming concerns take precedence.

If the Commission requires steps such as the elimination of deviation charges during emergencies, it should direct such relief to load reductions that, in fact, occur and thus provide reliability benefits during the emergency. So, for example, a virtual trader should not be rewarded for reducing "load," if that reduction exists only on paper and does not provide actual relief for the shortage situation. If the Commission were to permit financial traders to take demand response positions that could not produce actual demand reductions when called upon, the traders could siphon millions of dollars away

from consumers without the consumers realizing any benefit. Comparable monetary diversions already occur in FTR markets approved by the Commission where financial traders receive millions of dollars of FTR revenues that they pocket rather than re-invest in needed transmission facilities. For similar reasons, TAPS shares the ANOPR's apparent concern for gaming associated with demand reductions that would occur anyway, such as could arise if an aggregator bid into the market loads during maintenance, vacation, or holiday periods when demand would be lower in any event. *See ANOPR at P 73 n.65.*

On other hand, the Commission should not deny waiver of the deviation charge to a wholesale load simply because the load reduction is not achieved by direct retail participation in the wholesale market. Many demand response programs operate "behind the meter" of the LSE with a reduction reflected in the wholesale market participant's demand figures. Demand reductions associated with such programs should also be eligible for the deviation charge waiver.

TAPS also supports the ANOPR proposal to require that demand resources be "allowed to provide spinning and supplemental reserves without also being required to sell into the energy market." ANOPR at P 60. Any demand response that seeks to provide ancillary services, however, must meet technical requirements for such services. Because such services support the grid's reliability, there should be no watering down of technical requirements simply to open reserves markets to demand resources. The reliability-based need for demand resources may practically limit the amount of ancillary services that could come from such sources. Regarding the Commission's question asking whether minimum requirements should be subject to Commission rule or

determined on an RTO-by-RTO basis, ANOPR at P 61, TAPS believes the RTO-specific basis is preferable. As the Commission recognizes, “[a]ny proposal must comply with the ERO mandatory reliability standards.” *Id.* Implementation of such standards can and does vary from ERO region to ERO region.

2. The Commission Should Address Other Existing Barriers to Demand Response

TAPS members have encountered other barriers to demand response that should be addressed besides the ones identified in the ANOPR. Accordingly, the Commission should continue to identify such barriers and potential solutions to them, including through the process discussed in Part III.B.5 below.

As an example of prior Commission action to address demand response, the ANOPR cites its approval of ISO-NE’s “Forward Capacity Market” and its allowing “demand response to be used as a capacity resource and as a resource during system emergencies.” ANOPR at P 42 (citing, *inter alia*, *Devon Power LLC*, 115 F.E.R.C. ¶ 61,340, *order on reh’g and clarification*, 117 F.E.R.C. ¶ 61,133 (2006)). Rather than encouraging demand response participation in the Forward Capacity Market, however, the program as now being implemented appears to be increasing barriers to participation of demand response resources that already exist and have proven their value, as TAPS member Connecticut Municipal Electric Energy Cooperative (“CMEEC”) has learned.¹⁶

While CMEEC’s load is only about 1.5% of ISO-NE’s total load, CMEEC has a considerable amount of demand response that CMEEC and its members offer. These loads’ demand response interface is with an LSE, not direct retail access to ISO-NE

¹⁶ The CMEEC presentation on demand response and the Forward Capacity Market is Attachment B to these comments.

markets. During ISO-NE's August 6, 2006 "OP-4" emergency, ISO-NE called upon CMEEC's demand response, which represented over 12% of total demand response in ISO-NE during that event. The requirements for participation in the Forward Capacity Market, however, have discouraged the participation of this relatively significant amount of demand response. Out of 10 CMEEC customers representing 27 MW of demand response resources, only 1 such customer representing only 180 kW of demand response load was able or willing to participate.

At least part of the problem lies in the Commission-approved Forward Capacity Market rules, which require, *inter alia*, a 4-year participation commitment from demand response resources and an overly burdensome application requirement. Commercial and industrial customers make widgets, not watts. They are frequently adverse to the risks associated with a 4-year commitment to the electricity market because, for example, they may need to reduce, eliminate, or re-locate operations during the relatively long commitment period. Market rules that discourage participation of commercial and industrial customers already committed to providing demand response are unfortunate; as the above-described OP-4 experience demonstrates, CMEEC's demand response load can play a significant and verifiable role in reducing system demands. Thus, the market rules must be examined and revised to ensure that they do not discourage participation of demand response.

Demand response programs must also accommodate the fact that it can be very costly for a commercial or industrial customer to reduce load or do so frequently. Even if the company can safely interrupt the manufacturing process, it still has a workforce to pay. Customers that earn money from manufacturing goods or providing services may be

willing to interrupt their business to assist the grid during a shortage when the alternative is that everyone's lights go off. Interruptions that are too frequent or too long, however, could be too costly in terms of disruption and forgone production to justify demand response participation. Working with state commissions, LSEs and retail customers, the Commission should determine how such demand response barriers can be overcome.

RTOs need to do a better job "synching up" their market rules to retail demand response programs. Existing demand response programs are largely a matter of contract (and in some cases a long-standing contract) between the customer and the local utility. MISO, for example, will have to implement programs that accommodate that relationship. In addition, under MISO operating protocols, load interruption can occur across a rather wide electrical area, even though only a smaller area needs to be interrupted to provide the desired relief. As a result, customers in Wisconsin could be interrupted to address problems in another area. Better targeting areas for interruption would mean less frequent interruptions for commercial and industrial customers for which it is a significant burden and thus would encourage such customers to sign up for demand response programs.

Other retail demand response programs are intended to be triggered only as last ditch efforts to ensure reliability, but MISO rules can lead to interruptions before the triggers defined in the program are reached. LSEs are then forced to step in and find ways to protect their customers from interruption in these less-than-dire situations. Still other demand response programs are customer-specific, but the RTO rules do not accommodate them. As described below, a "demand-driven" approach to demand

response would provide a forum for RTOs to better understand existing programs and identify RTO rule changes necessary to allow greater demand response participation.

The Commission must also be cognizant that the principal value of some demand resources is their value as capacity. LSEs will sometimes pay for the right to interrupt load during reserves shortages, for example, in exchange for which the LSE can count the interruptible load towards satisfaction of reserves requirements. MISO's demand response programs, however, do not compensate LSEs for these kinds of reliability-based programs. RTO demand response policies need to facilitate all types of demand response.

Even economic demand response, however, does not always fare well. It appears from the Commission's 2007 Assessment of Demand Response and Advance Metering that enrollment is declining in ISO-NE's economic demand response programs,¹⁷ which may suggest a need to retool such programs. TAPS members in New England report that price triggers for economic-based demand response programs have not kept pace with rising energy market prices, which leads to a growing number of occasions when demand reductions might be called upon, thus disrupting retail customer business activities and discouraging participation. The answer is to set the price triggers at an appropriate level that considers both customer needs and overall price levels. TAPS notes, however, that setting triggers at levels below mitigation bid and offers caps so that retail loads do not face an excessive number of disruptions does not require lifting mitigation bid and offer caps, as described below. Rather, given relatively low triggers, there is sufficient room to

¹⁷ Federal Energy Regulatory Commission, Staff Report, *Assessment of Demand Response & Advanced Metering*, 18 (2007), <http://www.ferc.gov/legal/staff-reports/09-07-demand-response.pdf>.

raise them to reduce the frequency of load interruption without disturbing existing offer and bid caps.

3. Promotion of Demand Response Must Respect Existing LSE-Based Demand Response Programs and LSEs' Obligations to Serve

In its zeal to promote demand response, the Commission must take care not to assume that demand response can occur only in areas with retail choice. In fact, LSEs with obligations to serve also operate demand response programs that are important to their providing economic, reliable electricity and that are not driven by retail customers responding to spot prices. In short, the Commission should not take a one-size-fits all approach in formulating demand response policies.

The Commission's formulating demand response policies solely from the perspective of retail choice could have the unintended consequence of impairing LSE-based demand response programs, such as interfering with an LSE's tariffs and contracts with its largest customers. In many cases, LSEs may have worked out arrangements with these customers to provide demand response that are quite different from and inconsistent with allowing the customer to receive payment through an RTO market for reducing demand. Rather, these programs may provide the customer with reductions in its demand charge in exchange for permitting the LSE to interrupt it under certain circumstances, *i.e.*, when needed to keep the lights on. The Commission should take care not to trample on these contractual and tariff arrangements, and reliability-based programs.

Examples of LSE-based demand response programs that should be respected include:

- As described above, municipal systems in Connecticut, while representing a small part of total New England load, contribute significantly to New England demand

response resources. Approximately 27 MW participates in ISO-NE's load reduction program. Another 29 MW participates as demand response through ISO-NE's emergency generation program where generation sited a retail customer's facility is dispatched during emergencies, thus reducing or eliminating that customer's load from the system.

- In Vermont where there is no retail access, LSEs have nonetheless had the contractual ability to call for load reductions for over 20 years. At present, TAPS member Vermont Public Power Supply Authority has over 10% of its load under such contracts. Another TAPS member in Vermont, Burlington, has about 8 to 10 percent of its load participating in ISO-NE's emergency demand response program.
- TAPS member systems in Wisconsin have adopted a variety of primarily reliability-focused demand response programs. These includes programs for the LSE to interrupt directly residential air conditioners, operate back-up generation located at commercial/industrial customer sites, and interrupt commercial/industrial load when customer demand exceeds generation or transmission capacity. In addition to providing relief during emergencies, the programs help LSEs meet reserve requirements and delay the construction or acquisition of new generation. These programs are reflected in tariffs and contracts which, in some cases, provide for a very valuable demand charge credits in exchange for being willing to be interrupted under specified conditions. Such a demand-charge based programs would mesh poorly with an RTO program that rewards demand response through the spot energy market. Significantly, last year when MISO called a reliability emergency and LSEs responded by contributing close to 3000 MW in demand reductions (*see* ANOPR at P 52 n.52), Wisconsin contributed disproportionately (compared to its share of total load) to that reduction.
- Demand response programs on TAPS member systems in California cover a broad range, including advanced metering that allows retail customers to manage their overall consumption and respond to utility requests for curtailment, air conditioning load interruption, firm load curtailment, and emergency generators at municipal facilities. The programs are largely aimed at providing demand response during emergencies.

Any policies proposed or adopted as a result of the ANOPR should not impair the foregoing programs and countless others like them. Nor should the Commission adopt policies that force retail choice or direct retail load participation on LSEs in non-retail choice states or on LSEs in retail choice states that have lawfully opted not to open up their systems. While the ANOPR apparently seeks to respect state law, it does so in a possibly unduly narrow way.

For example, the ANOPR states that “the Commission is considering a proposal to obligate each RTO or ISO to purchase demand resources in its markets for certain ancillary services, similar to any other resources, if the resources meet the necessary technical requirements and the resources submit a bid under the generally-applicable bidding rules at or below the market-clearing price, *unless the seller is not permitted to do so by state retail laws or regulations.*” ANOPR at P 59 (emphasis added). Elsewhere, the ANOPR states that RTO/ISO “market rules may not exclude a demand response bid from a third-party ARC [aggregator of retail customers] that is not a LSE *unless state retail electric laws or regulations do not permit this.*” ANOPR at P 70 (emphasis added).

It appears from the italicized text the Commission means to distinguish between states that have enacted retail access regimes allowing retail end users of state-regulated utilities to choose their power suppliers, and perhaps even participate directly in RTO wholesale markets, and those that continue to employ a more traditional bundled retail service model. However, this distinction does not go far enough to protect all LSEs that continue to have a traditional “obligation to serve” relationship with their end use customers, whether due to contract or regulation. Specifically, the Commission must make clear that the italicized limitation applies equally where the retail choice decision is placed in the hands of local governments (which are themselves political subdivisions of states) or is the result of contracts.

Many TAPS members are located in states that do not authorize retail customers to choose their power suppliers. And even in retail access states, most have statutory provisions relating specifically to public power systems that permit them to “opt in” to retail access or not to do so. In such states, TAPS members have largely chosen to retain

their obligations to serve their end users and not to participate in retail access. Hence, technically it is not just “state retail laws or regulations” that govern these matters in the case of many TAPS member, but the local choices of consumer-owned systems. The Commission’s policies must respect these decisions.

4. Relaxing Mitigation Measures is Inconsistent with FPA Requirements and, in any Event, Premature

TAPS heartily endorses Commissioner Kelly’s view that it is premature to consider modifications to market power mitigation rules as a means to encourage demand response given that lack of evidence that consumers can participate in demand response programs that rely upon price signals. She correctly concludes:

Without the necessary technology already in place that would allow demand resources to respond to price signals in wholesale or retail markets, it is unclear how quickly they could develop the ability to respond after energy bid caps or market-wide caps are raised or eliminated. In other words, the technology and associated demand response capability must be in place before we consider raising or eliminating these price caps. Otherwise these higher energy prices may not elicit any demand reduction in a fashion capable of disciplining those prices and keeping them just and reasonable.

ANOPR Kelly, Comm’r, dissenting.

The just-released 2007 Commission Staff Assessment of Demand Response and Advanced Metering confirms the very limited penetration of the advanced metering technologies that would be required for consumers to actively participate as demand response. The Report describes plans and initiatives in support of advance metering, but actual installation of the technology in numbers sufficient to make it a price-disciplining force is far from imminent. 2007 Assessment of Demand Response and Advanced Metering at 23-35. TAPS members confirm that the advance metering is still very much

an objective for the future, not a present reality. For example, in 2003 California set a goal that price responsive demand response would represent 5% of peak in 2007.¹⁸ The actual 2007 amount is estimated to be 2.2%, and the lack of advanced metering penetration was recently identified as the leading barrier to demand response.¹⁹ Absent significant penetration of advance metering equipment that would enable consumers to respond, lifting the price caps simply punishes customers by increasing prices and the opportunity for the exercise of market power. Lifting the price caps is plainly inconsistent with the FPA under these circumstances.

The FPA's requirement that the Commission pursue electricity rates that are the lowest possible reasonable rates does not tolerate the Commission's putting the cart before the horse and relying upon exorbitant prices as a cruel experiment to see if such shock treatments force or speed development of technology and consumer demand for it. TAPS does not see how Congress or state regulators would accept such a policy. Nor does the Commission cite any evidence that electricity demand is sufficiently elastic that consumers can defeat or protect against anticompetitive price increases simply by reducing demand. If the Commission's policy is to rely upon demand response to ensure that market-based rates are just and reasonable, it must at a minimum have evidence, such as critical loss analyses,²⁰ that the demand response drives prices down to competitive

¹⁸ Ahmad Faruqui, Ph.D., Presentation on behalf of the Brattle Group to the California Energy Commission, *Demand Response in California: Goals, Accomplishments & Barriers*, at 9 (Apr. 19, 2007), [http://www.energy.ca.gov/2007_energypolicy/documents/2007-04-19_workshop/presentations/Workshop%20I%20Presentation%20\(04-18-07\)%20Morning%20Session.pdf](http://www.energy.ca.gov/2007_energypolicy/documents/2007-04-19_workshop/presentations/Workshop%20I%20Presentation%20(04-18-07)%20Morning%20Session.pdf).

¹⁹ *Id.* at 13, 18.

²⁰ A typical critical loss analysis examines, for any given price increase, the amount of sales that can be lost before the price increase becomes unprofitable. Thus, if consumers can render a price increase unprofitable by reducing consumption, it suggests that they have a means to protect themselves from such a price increase.

levels. If, as the Commission says, “the wholesale electric power market works best when demand can respond to the wholesale price,” ANOPR at P 34, the ANOPR’s proposal to relax mitigation rules in the face of unresponsive demand is a guarantee of a dysfunctional market.

TAPS appreciates the Commission’s desire to support and promote demand response. It implores the Commission, however, not to build a field of dreams where, if you relax mitigation, effective demand response will come. There must be a real infrastructure to support demand response first.

The ANOPR discussion of mitigation rule relaxation starts from the unsupported premise that during supply shortages “market rules that limit the market price may have the unintended effect of making demand response less attractive.” ANOPR at P 75. The Commission, however, cites no evidence that mitigation rules serve as barriers to demand response. Especially in the absence of evidence that consumers can respond through demand response programs and that other barriers such as state regulation or RTO rules have been removed, the Commission cannot conclude that market mitigation measures are chilling their deployment of demand response.

TAPS is also troubled by the Commission’s apparent view that, because “the value of electric power to customers is not always the same,” ANOPR at P 34, it can rely upon that value to determine just and reasonable rates:

The value can be very different for two customers at the same time and place, one of whom may prefer to reduce consumption if the price is high and another who may be willing to pay a high price to avoid curtailment in an emergency.

Id. The Supreme Court has rejected seller claims justifying higher prices for electricity based upon the value ascribed to the product by the buyer, noting that a “focus on the willingness or ability of the purchaser to pay for a service is the concern of the monopolist, not of a governmental agency charged both with assuring the industry a fair return and with assuring the public reliable and efficient service, at a reasonable price.” *Gainesville Utils. Dep’t. v. Fla. Power Corp.*, 402 U.S. 515, 528 (1971). Electricity service is not a Picasso painting up for auction at Sotheby’s. It remains essential to the nation’s economy and the lives of its residents, which explains why the Supreme Court in *Atlantic Refining* emphasized the requirement for service “at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.” *See Atl. Ref. Co.*, 360 U.S. at 388. The Commission’s value pricing policy, if adopted, could lead to unconscionable results: should an isolated village in the Allegheny Mountains of Pennsylvania go without electricity during an emergency simply because consumers there cannot outbid those in a Philadelphia Main Line suburb?

Furthermore, market forces may not always do a good job of assigning value to products such as reliable electricity. The *Report to Congress on Competition in Wholesale and Retail Electric Markets for Electric Energy* of the Electric Energy Market Competition Task Force (on which a Commission representative served and to which several other Commission staff contributed) stated (at 54 n.148):

It is important to note that competition in wholesale electric markets may not lead to an efficient allocation of resources involving the services that prevent network collapse. Where there are “public good” aspects to the delivery of a good or service, such as with reliability, regulation may be the best way to ensure that the correct level of the good or service is provided. In some circumstances, however,

market remedies may be available that are superior to regulation.

As the Task Force *Report* suggests, an approach where individual consumers are assigning value to electricity may actually lead to a misallocation of this essential resource.

Because the Commission has not shown that consumers have the tools to respond effectively to price increases, that market mitigation rules stand in the way of deployment of those tools that exist, and that the Commission can rely upon “value pricing” during times of emergency, TAPS strongly opposes the ANOPR’s proposals to “modify mitigation rules to allow the market price to better reflect the value of lost load in an emergency situation.” *See* ANOPR at P 75. Its concerns with the ANOPR’s specific proposals include the following.

- The first proposal – raising energy bid caps and market-wide caps in an emergency (ANOPR at PP 76-77) – offers consumers no protection against market power exercise and thus would only produce unjust and unreasonable rates. *Cal. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1013 (9th Cir. 2004), *cert. denied sub nom.*, *Coral Power, L.L.C. v. Cal. ex rel. Brown*, 127 S. Ct. 2972 (2007) (Nos. 06-888, 1100). In the absence of adequate demand response tools for consumers, the Commission would have to rely upon generators to limit their bids to non-exploitative levels. Generators, however, have neither the ability nor the incentive to determine a price that is just and reasonable under scarcity conditions. The generator would need to figure out what the efficient market price is and then bid at that level. Because electricity markets can change dramatically from hour to hour, this is a near impossibility. Further, the generator is in no position to determine the value buyers place on keeping the lights on, assuming value pricing were permissible. The generator would thus lack sufficient information to accurately estimate the efficient market price. And even assuming the marginal generator could develop an accurate estimate, it has no incentive to do so where it has market power, which it almost always will have under scarcity conditions because of the absence of competing suppliers and of the very limited ability of load to reduce consumption. The price level that the generator finds most profitable may well be very different from the efficient price. Without the risk that load would decrease its demand substantially (enough to make the price increase unprofitable) in response to a high price and knowing that they must be called by the system operator to maintain reliable service in the load pocket, generators would have no incentive to

“get the price right.” Their only incentive would be to get the price high. Thus, this proposal is not consistent with the “Commission’s core responsibility ... to ‘guard the consumer from exploitation by non-competitive electric power companies.’” ANOPR at P 5 (quoting *NAACP v. FPC*, 520 F.2d at 438 (D.C. Cir. 1975)).

- The second proposal – raising bid caps only for demand bids (ANOPR at P 78) – also suffers from a lack of proof that consumers can effectively express a value for electricity and, even assuming they can, that the Commission could lawfully allow prices to be set by the highest bidder, as would be the case for the sale of a masterpiece painting. While the Commission observes that this proposal “raises fewer concerns about market power than the first approach, which raises bid caps for all market participants,” ANOPR at P 78, that effect could be very limited if the market participant submitting a demand bid also had generation that could benefit from a price increase. If the higher price yielded additional revenues that exceeded the added cost to load associated with the price increase, the proposal would do little to discourage artificially high load offers.
- The third proposal – requiring RTOs/ISOs to rely upon demand curve pricing for operating reserves (ANOPR at P 79) – suffers from an additional set of problems. As described below, a hallmark of the absence of RTO accountability has been the tendency of RTOs to enlarge their domains, including over the opposition of their customers, by proposing new markets. The third proposal effectively imposes an across-the-board requirement that RTOs create ancillary services markets and utilize a particular regulatory device – a demand curve – to jack up the price, regardless of the views of stakeholders and regulators in the region. The Midwest ISO’s recent ancillary service market proposal did not win over the stakeholders who would have borne its costs.²¹ Further, the ANOPR proposal could force an RTO like SPP to move in directions inconsistent with its more consensus-based decision-making and unjustified by cost/benefit studies.²² One can readily imagine the cries directed to Capitol Hill that the Commission is proposing “Son of SMD.”
- The fourth proposal – setting market-clearing prices at the payment made to participants in an emergency demand response program (ANOPR at P 80) – seems unworkable and overly bureaucratic. The Commission does not explain how it will set the payment, and the \$500/MWh example given is pulled from thin air. One possibility for such payment is at the value of lost load which, even if the Commission could lawfully allow value-based pricing, is extremely difficult to determine, especially for an administrative agency and its bureaucratic progeny, the RTO.²³ Another possibility for such payment is the cost of the resource needed to

²¹ See *Midwest Indep. Transmission Sys. Operator, Inc.*, 119 F.E.R.C. ¶ 61,311, *reh’g denied*, 120 F.E.R.C. ¶ 61,202 (2007).

²² *Sw. Power Pool, Inc.*, 106 F.E.R.C. ¶ 61,110, P 122, *order on compliance filing*, 108 F.E.R.C. ¶ 61,003, P 13, *order on reh’g*, 109 F.E.R.C. ¶ 61,010 P 13 (2004), (accepting SPP’s commitment to conduct cost-benefit analyses before proceeding with further development of market).

²³ See Prepared Direct Testimony of Steven E. Stoft, Exhibit No. ISO-17, *Devon Power LLC*, Docket No.

keep the lights on, but that approach similarly seems complex and laborious. The cost might depend upon the cause of the emergency, whether the outage of a transmission line, the tripping of a nuclear plant, or an extended heat wave that reveals the need for more capacity investment. The Commission also says that the proposal “would avoid the problem caused by the drop in market price that results from calling on an emergency demand response provider, which sends the wrong price signal to both suppliers and consumers.” TAPS fails to see the problem. As the Commission states: “A well-functioning competitive wholesale electric market should reflect current supply and demand conditions.” ANOPR at P 34. If demand decreases, the expected market reaction is a decline in price.

Finally, if the Commission proposes nonetheless to relax or remove offer and bid caps, then it must revisit its approval of RTO/ISO markets that were justified on grounds that such caps prevented generators from earning revenues needed to recover investment costs. For example, a primary justification of ISO-NE’s locational installed capacity market proposal, which eventually became the Forward Capacity Market, is that caps, such as \$1,000/MWh, “take [] away” revenues needed for cost recovery. *See* Prepared Direct Testimony of Steven E. Stoft, Exhibit No. ISO-17, *Devon Power LLC*, Docket No. ER03-563-030, at 6, 8. If, due to the raising or lifting of mitigation caps, spot market prices can rise to the levels claimed needed to recover generator investment costs, a principal justification for organized capacity markets is eliminated, while at the same time consumers get hit with a double whammy – the high energy prices the capacity market was intended to replace plus the capacity market charges. Prices in organized markets will not be the lowest possible reasonable rates if consumers are forced to pay for generation capacity twice, once via scarcity prices and again via capacity market purchases. Thus, adoption of the ANOPR proposals will require the Commission to re-

ER03-563-030, at 5, *available at* eLibrary Accession No. 20040901-0142 (“[value of lost load] cannot be accurately determined.”). Dr. Stoft identified other serious problems with reliance on value of lost load pricing, including costly market risk associated with extreme spot prices, creation of excessive market power, and the risk of political intervention due to occasional large payments by load to generation. *Id.*

think other elements of organized market designed to ensure that they remain just and reasonable.

5. The Commission Should Establish a Demand-Driven Approach to Demand Response

TAPS shares the Commission's goal of finding ways for wholesale market to accommodate and support demand response. Because demand response is intimately tied to the sale of electricity at retail, however, TAPS urges that the Commission establish a process that involves retail regulatory authorities and the LSEs that serve retail customers to identify, for each organized market, the specific market rules that impede, or that should be adopted to promote, demand response. This approach moves the stakeholder process closer to the retail customers whose "demands" will be a principal factor in the success or failure of demand response programs. It builds upon the Commission's commendable efforts in the NARUC-FERC Collaborative Dialogue on Demand Response. *See* ANOPR at P 45. It could provide LSEs an opportunity to make their specific demand response needs known to RTOs/ISOs and state regulatory officials without those needs being overlooked in a Washington policy process that, inherently, deals with issues in a broad manner that can gloss over important details.

If there were a process to address the demand response needs of LSEs in a particular organized market, the Commission could require RTOs/ISOs to report back to the Commission and respond to the concerns identified as to barriers to participation of demand response, including via proposed modifications to market rules. If the RTO/ISO failed to respond, stakeholders, including state commission and LSEs, could then bring their concerns to the Commission, which could then take further steps such as technical conferences or investigations.

The point is not to bog down the Commission's demand response policies in endless processes. Rather, the process outlined here recognizes that, perhaps more than other issues with which the Commission deals, the success or failure of demand response policies depend upon retail customers, state and local regulators that represent them, and the LSEs that serve them.

C. The Long-Term Contracting Proposals Largely Do Not Address the Needs of LSEs

TAPS agrees with the discussion that opens the ANOPR's section on long-term contracting, particularly the statement that "[l]ong-term contracts are an important tool to achieve and maintain a strong power infrastructure, particularly for new entrants into the generation sector and especially for many renewable energy developers," ANOPR at P 83, which is consistent with TAPS's long-held positions. The ANOPR continues by proposing a number of measures aimed at increasing transparency of long-term contract information and liquidity of long-term products, including posting requirements on RTO/ISO websites, additional data on long-term contracts in Electronic Quarterly Reports and potential development of standardized products. ANOPR at PP 93-94. These measures could be helpful, because transparency and liquidity generally deepen and broaden markets, though TAPS would leave the task of defining standardized products to market participants in the industry, not regulators in Washington or RTO headquarters. On the other hand, these measures are unlikely to benefit many LSEs, including TAPS members, because the measures spring from a view of electricity markets as primarily financial, while TAPS members' long-term contracting needs are more focused on long-term products tied to physical assets, such as base load, intermediate, peaking and renewable generation, as well as system power purchases.

Fundamentally, the ANOPR misperceives the long-term contracting problem. It states (at P 85):

It is important that wholesale sellers and buyers have adequate opportunities to sell and buy electric power through long-term power contracts to allow them to manage their exposure to uncertain future spot market prices. Sellers and buyers should also have the opportunity to sell and buy electric power in the spot market. The Commission believes that it is important for buyers and sellers in organized markets to be able to choose a portfolio of short-term, intermediate-term, and long-term power supplies. Having portfolio choice allows market participants to manage the risk that comes from uncertainty. Forward power contracting by buyers combined with purchases from a spot market with demand response can be an efficient and low-cost way of meeting customer needs because both buyers and sellers can hedge risk as well as adapt to actual real-time supply and demand conditions.

TAPS members, however, like virtually all LSEs with obligations to serve, do not view power supply portfolios solely in the temporal terms expressed in the ANOPR. Equally if not more important are the physical and cost aspects of a portfolio that help TAPS members to serve their wholesale and retail customers at the lowest reasonable cost over the long-term, consistent with reliable service and good environmental stewardship. They accomplish this objective with a diversified mix of resources, with transmission service commitments matched to the duration of the associated resource commitment. The overwhelming majority of the energy that TAPS members supply to their customers is produced from the resources in their portfolios, particularly baseload, intermediate and, increasingly, renewable resources. On a daily basis, if economic, they substitute spot market energy for energy that they would otherwise obtain from their own resources. While this optimization function is valuable, spot market energy purchases represent a

very small percentage of total energy they provide to their customers. By contrast, the design focus of RTOs is the spot market.

For an LSE with an obligation to serve, a standardized, long-term financial product priced on the basis of natural gas is no substitute for a long-term contract or investment in base load capacity (*e.g.*, coal). The operating costs of the unit matter – energy reflecting spot gas prices is not an economic way to serve base load needs. The assurance that there is a physical unit backing up the supply matters – liquidated damages will not satisfy customers or utility boards that expect their supplier to have iron in the ground to ensure that the lights stay on. When LSE representatives express concerns about the absence of long-term contracts at prices that they find attractive, *see* ANOPR at P 87, what they are saying is that they cannot find sellers of long-term products that have the physical and cost characteristics that they need to build a portfolio for economic, reliable and renewable power supply. It is not so much that there are no long-term contracts, it's that not all RTO market designs are responding with products that LSEs need.

Part of the solution is ensuring that LSEs can secure transmission needed to economically deliver base load, and renewable capacity from its location often remote from LSEs loads.²⁴ TAPS is hopeful that the Commission's Long-Term Rights Final Rule will enable LSEs to secure long-term rights for new and existing power supply arrangements.²⁵ Long-term rights are key elements of the resource- and load-specific

²⁴ Peaking generation can often be sited locally.

²⁵ Long-Term Firm Transmission Rights in Organized Electricity Markets, Order No. 681, 71 Fed. Reg. 43,564 (Aug. 1, 2006), III F.E.R.C. Stat. & Regs. ¶ 31,226 (to be codified at 18 C.F.R. pt. 42), *corrected*, 71 Fed. Reg. 46,078 (Aug. 11, 2006), *clarified*, Order No. 681-A, 71 Fed. Reg. 98,440 (Nov. 27, 2006), 117 F.E.R.C. ¶ 61,201 (Nov. 16, 2006).

deliverability hedge that LSEs need to make and finance investments in new resources, and to enter into the long-term power purchase commitments that IPPs require for financing. However, the availability of these rights depends on follow through — RTOs constructing the transmission needed to support the continued simultaneous feasibility of existing and new long-term rights. As discussed in Part III.D.3.b. below, TAPS urges the Commission to measure an RTOs' performance on this all-important effort and take steps to hold RTOs (and transmission owners) accountable, if they do not timely construct the transmission facilities needed to support these rights. TAPS is also supporting the Commission's efforts to build a robust grid, including through successful implementation of Order No. 890's joint, regional transmission planning process. But the success of this effort similarly requires more than pronouncements in a rulemaking proceeding.

The rest of the solution requires a better understanding of the problem. As the comments of the American Public Power Association in this proceeding establish, organized markets appear not to be producing just and reasonable rates, and thus APPA is requesting that the Commission investigate whether RTO organized markets are in fact producing unjust and unreasonable rates and undue preferences, and if so, what remedies are appropriate to protect electric consumers. The results of that investigation are likely to help explain why LSEs have had difficulty obtaining the kinds of long-term contracts they need to construct portfolios for reliable, economic power supply and reveal further solutions.

***D. Responsiveness and Accountability of RTOs and ISOs
Can Be Significantly Improved by Hybrid Boards and
Other Measures***

1. A Consumer-Focused Mission Statement is a Necessary Predicate to An Accountable RTO

Part of the reason why RTO efforts seem disconnected with the interests of the consumers that ultimately depend on them for reliable and affordable electric service is that the RTO's job description seems to be primarily focused on two missions: operating the RTO markets and reliably operating the grid. Consistent with this incomplete mission, TAPS members have heard RTO executives disclaim any obligation to have their actions guided by consideration of cost impact on consumers, despite all the stakeholder involvement and trappings of a collaborative process. It is apparent that RTO management views this Commission and state regulators as the only entities to which they are responsible and accountable.

If the Commission is serious about the need for RTOs to have a "customer orientation" (ANOPR at P 147) to which the RTO would be accountable, the RTOs' mission must be clearly defined and specific, so that there is a standard to which the RTOs and their management can be held. Thus, as discussed in Part III.A. above, the first step in achieving a responsive, accountable RTO is redefining its mission to include reliable service at the lowest possible reasonable rates. The Commission will not fulfill its obligation to consumers unless it clearly states consumer-oriented goals and in turn requires RTOs to meet these goals. By establishing consumer value as a core goal of the RTO markets and setting forth the requirements directed to accomplishing the goal, the Commission would focus the entire RTO organization on the achievement of this goal. This in turn would align the RTOs' mission with the objectives of state regulators, federal

policy makers, LSEs, and the consumers who ultimately bear the cost of the RTO's operations.

2. A Hybrid Board is the Best Way to Achieve a Responsive Board
 - a) A Hybrid Board is Needed to Combat RTO Isolation and Capture by RTO Management

TAPS strongly supports hybrid boards, by which TAPS does not mean stakeholder boards, such as was tried in California and resulted in endless debate and deadlock. In TAPS's view, independent directors should hold a majority of board seats (including on board committees) to prevent capture of the board by stakeholders. The stakeholder minority, however, should be substantial and balanced among stakeholder interests. The goal is to give stakeholders a meaningful voice at the table, not veto power over the disinterested majority.²⁶

The ANOPR got it right when it recognized (at P 147):

Customer responsiveness must begin with the RTO/ISO board. A well-functioning and responsive board of directors is necessary for establishing the strategic direction of the RTO or ISO, including customer orientation.

TAPS applauds the ANOPR for recognizing and seeking to address the concern that in the zeal to create truly independent RTOs, we have achieved RTOs that are isolated from and not responsive to customers that depend on them for affordable and reliable service.

TAPS believes that the pendulum has swung too far in the direction of independence at

²⁶ Any such stakeholder involvement would need to be consistent with Order 2000's requirement that "[t]he Regional Transmission Organization must have a decision making process that is independent of control by any market participant or class of participants," 18 C.F.R. § 35.34(j)(1)(ii), and its general guidance that "[w]here there is a governing board with classes of market participants, we would expect that no one class would be allowed to veto a decision reached by the rest of the board and that no two classes could force through a decision that is opposed by the rest of the board." Order No. 2000, at 31,074.

the price of loss of accountability, and strongly supports the ANOPR's preliminary conclusion that stakeholders require direct access to the board, including through a hybrid board. ANOPR at P 148. TAPS believes that hybrid boards are the best way to achieve direct access, and asks the Commission to make clear its preference for hybrid boards as the means to ensure responsive RTOs.²⁷

While well-intentioned, the Commission's prior insistence on RTO boards with only independent (*i.e.*, non-stakeholder) directors, rather than boards that include both independent and stakeholder directors, has resulted in RTO boards that are remote from the issues they should oversee and unaffected by the RTO's costs or actions. This unfortunate aspect of RTO governance is seen in recent RTO actions. The Midwest ISO's Board voted to proceed with an incomplete Ancillary Services Market filing despite the overwhelming opposition to that proposal as premature by MISO's stakeholders and despite insufficient, reliable evidence that the costs of the proposal justified any benefits.²⁸ PJM's recent history reflects similar self-aggrandizement, whether in the form of the Reliability Pricing Model or now in the "Smart Grid" proposal being promulgated as part of PJM's strategic planning process. *Id.*

²⁷ While the Commission may be limited in its ability to directly dictate RTO governance, *see California Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004), it has other tools at its disposal to make RTOs more responsive to customer. The Commission can set and presumably adjust the standards for obtaining and retaining approval as an RTO. Indeed, the D.C. Court's decision strongly affirmed the Commission's conditioning power. *Id.* at 404. The Commission could find that the absence of a hybrid board renders an RTO's organic documents and operations are unjust and unreasonable and, accordingly, define the requirements to find them just and reasonable.

Further, the Commission determines which costs RTOs will be permitted to pass through to customers as part of its responsibilities to ensure that RTO transmission and wholesale rates are just and reasonable. Thus, the Commission is not powerless to effect needed change.

²⁸ *See also* Written Statement of Marc Gerken on Behalf of American Municipal Power-Ohio, Inc., at 4-5, Docket No. AD07-7, May 8, 2007 ("Gerken Comments").

As described in the attached WPPI White Paper,²⁹ the single-minded focus on board independence has been at the cost of accountability (at 2-3, footnote omitted):

RTO governance creates tension between the needs for independence and accountability. FERC's current governance requirements focus almost exclusively on independence. This has come at a cost to accountability. Independent board members, no matter how talented and diligent, are not exposed to the consequence of the RTO's action. Given the RTO structure, good governance should include representation from those with "skin in the game."

Boards comprising only independent directors are more prone to capture by RTO management. It is not surprising that management representatives of PJM and the California ISO opposed the hybrid board at the May 8 technical conference.³⁰ Upper management, without intent, acts as an informational filter to the board. Independent directors are less likely to have sufficiently detailed knowledge of the facts on the ground to press management on the difficult questions, and may instead defer to management expertise.

In contrast, stakeholder directors from senior executive ranks, whose companies have a financial stake in the RTO's decisions and pay its bills, are more likely to ask the tough questions and to evaluate management's responses with the benefit of knowledge

²⁹ Attachment A hereto.

³⁰ See Testimony of Audrey Zibelman on Behalf of PJM Interconnection, L.L.C., at 9-10, Docket No. AD07-7, May 8, 2007, available at <http://www.ferc.gov/EventCalendar/Files/20070508160117-Zibelman,%20PJM.pdf>; Comments of Yakout Mansour, President and Chief Executive Office of California Independent System Operator Corp., at 1, Docket No. AD07-7, May 8, 2007, available at <http://www.ferc.gov/EventCalendar/Files/20070508084010-Mansour,%20California%20ISO.pdf>. It maybe, however, that Ms. Zibelman's and Mr. Mansour's Comments were directed more at majority stakeholder (or all stakeholder) boards, because their comments do not address the independence safeguards associated with minority stakeholder boards.

of the region and sensitivity to the impacts of RTO decisions on the costs borne by those in the region. The results directly affect their companies' bottom line.

A hybrid board provides the best avenue to obtain independence with accountability. As explained in the WPPI White Paper (at 3, footnote omitted):

A hybrid board will better balance the need for both independence and accountability. The hybrid model marries the benefits of independent governance through control by independent directors with the added benefit of direct, high-level stakeholder input and involvement in policy decisions. Independent board members will retain control, but exercise that control with the advantage of direct, high-level discussion and debate with stakeholder board representatives. This communication should be much more productive than stakeholder meetings with a large number of members, each primarily focused on protecting parochial interests.

While hybrid RTO boards would be a change from the apparently Commission-preferred disinterested board currently used by RTOs and ISOs, hybrid boards would not violate Order No. 2000. As the ANOPR correctly recognizes (at P 141), Order No. 2000 was not specific as to how independent governance was to be achieved. Indeed, Order No. 2000 expressly envisioned achievement of RTO independence through disinterested or balanced stakeholder boards.³¹ A hybrid board comprising both independent and senior executive level stakeholder directors, with appropriate safeguards to ensure both

³¹ See Order No. 2000, at 31,073: "Many commenters urge us to impose specific, detailed requirements on RTO governance. Commenters make recommendations on many different aspects of governance: the desirability of stakeholder, non-stakeholder or hybrid boards.... In the Final Rule, we have decided not to impose any specific requirements on RTO governing boards other than the general requirement that they must satisfy the overall principle that their decisionmaking process should be independent of any market participant or class of participants." The Commission discussed various stakeholder and non-stakeholder board models in the Northeast, California and Texas, concluding: "Given the variety of governance forms that exist or are proposed for ISOs and the limited experience with these different approaches, the Commission believes it is premature to conclude that one form of governance is clearly superior to all other forms in every situation." *Id.*

independence and balance,³² will enable RTOs to achieve their intended purpose. And it will do so while avoiding the pitfalls of disinterested boards that have left RTOs dangerously unresponsive to the stakeholders they serve.

TAPS members know from their own experiences the close connection between organizational responsiveness and board composition. The track record of joint action agencies and generation and transmission cooperatives, where member customers serve on the boards, demonstrates that this model leads to organizations highly responsive to costs.

TAPS members also have had positive direct experiences with hybrid boards. Several served on the hybrid SPP board before it was limited to disinterested board members in connection with achieving RTO status. Others have served on the VELCO board.³³ Two TAPS members serve on the board of the American Transmission Company, LLC (“ATCLLC”), which reflects the hybrid structure proposed above. All have found that stakeholder representation means better communications between stakeholders and independent board members (with less opportunity for management to selectively screen the information available to the board), more open and informed decision-making, and more open debate – all goals the Commission should seek to foster. The knowledge of the region that stakeholder board members can bring to the table will enable them to ask management the hard questions, and thus permit the RTO board to operate in a truly independent manner by preventing capture by RTO management.

³² TAPS discusses below how the hybrid board could be constructed to provide the necessary safeguards.

³³ VELCO is the transmission company owned by distribution utilities in Vermont. The VELCO board includes three disinterested members plus fourteen owner-members.

Stakeholder representation on the board does not mean the loss of independence.

According to the President and CEO of ATCLLC:

Our company has had a hybrid board since its inception, and the board has always upheld the corporate mandate for independence from all users. To the satisfaction of all observers, ATCLLC has always acted independently while benefiting from the support, experience and expertise of utility and non-utility board members.

Prepared Statement of José Delgado, President and Chief Executive Officer of American Transmission Company, LLC, at 6, Docket No. AD07-7, May 8, 2007.³⁴ Indeed, the

Commission itself has found that ATCLLC retains independence:

The Commission has approved the creation of a stand-alone transmission company, and allowed innovative rate treatments, for American Transmission Company (ATC), which is jointly-owned by investor-owned utilities which contributed their systems, and by public power customers which contributed cash in return for equity stakes in ATC with limited voting and governance rights. The Commission remains comfortable that the governance structure of ATC allows some degree of participation by market participants, but ensures the operational and managerial independence of the stand-alone transmission company.

Policy Statement Regarding Evaluation of Independent Ownership and Operation of Transmission, 111 F.E.R.C. ¶ 61,473, P 9 (2005) (footnote omitted). The preservation of independence would be particularly clear where, as contemplated by the ANOPR and by TAPS, the majority, independent directors would remain in control.

Experience has also taught us that direct involvement of senior executives of representative stakeholders on a hybrid board would make a big difference. The RTO stakeholder process today typically involves middle-level employees of stakeholder

³⁴ Available at <http://www.ferc.gov/EventCalendar/Files/20070508084032-Delgado,%20ATC.pdf>.

companies, because the committees have no decision-making power. Employees at this level are likely to be most concerned about protecting their company's narrow interest and may lack the broad perspective of senior executives in fashioning practical accommodations without the need to consult back home. TAPS believes that the current structure contributes to polarization and deadlock. In contrast, direct involvement of senior executives on a hybrid board will bring a different and broader perspective that should be valuable to independent board members and RTO management. Participation of stakeholder executives in a hybrid board could fundamentally alter the nature of the stakeholder input provided and the degree to which independent board members are responsive to that input. Executives are often involved in major issues and can more readily compromise to break deadlocks than can mid-level managers.

TAPS recognizes that the ANOPR's second alternative solution – a board advisory committee – is intended to be comprised of senior executives (ANOPR at P 153). However, TAPS is skeptical as to whether senior executives would make the same commitment of time and energy to a merely advisory body as they would to a structure where they sat as equals, albeit as a minority, on a decision-making board. Without stakeholder involvement at the time of board decision, management and the board can always blow past stakeholder concerns. TAPS is therefore concerned that what is intended as a high-level advisory committee is likely to devolve into yet another RTO stakeholder committee manned by mid-level employees. More generally, the advisory committee alternative is inferior to hybrid boards from a number of perspectives.³⁵

³⁵ Deficiencies include the absence of stakeholders during the crucial decision-making process, continued management-only access to the board in a manner in which stakeholders are excluded, lack of assurance of board member attendance at and attention to the liaison meetings, and perpetuation of a "we/them"

Nor does direct stakeholder election of board members provide advantages comparable to institution of a hybrid board. While direct stakeholder election of board members would be a step forward particularly where the RTO board selection process now creates an effectively self-perpetuating board, it remains an after-the-fact accountability mechanism. It does not provide for the information exchange and opportunity for discussion of critical issues simultaneously with the board vote that make inclusion of stakeholders on a hybrid board contribute to better, more-responsive RTO decision-making. Rather, stakeholder election of board members allows stakeholders an opportunity for after-the-fact “feedback,” by removing board members found non-responsive. While such steps, with considerable effort, can bring some improvements, they are no substitute for a hybrid board.³⁶

TAPS also believes that RTOs’ apparent deafness to stakeholder concerns is not a question of the for-profit or not-for-profit status of the RTO. Responsiveness to customers is hardly the hallmark of monopoly service providers, which RTOs are. Where an organization has to compete for customers, board members can judge whether the organization is responding to customer needs by tracking sales; if customers are unhappy, they take their business elsewhere. By contrast, customers of RTOs who are stuck paying the costs of RTO initiatives, especially transmission-dependent LSEs that

dichotomy that is not conducive to the level of responsiveness the Commission is seeking to foster.

³⁶ In 2004, MISO stakeholders voted two directors off the MISO RTO board. Subsequently, some improvements occurred in terms of board members’ accessibility to stakeholders and efforts to understand stakeholder concerns. Nonetheless, problems remain. Board members seem focused almost exclusively on issues important to management, not the functions set forth in MISO’s organizational documents and the Commission’s orders. This has contributed to “scope creep,” whereby MISO expands functions beyond its members’ original vision. These shortcomings likely contributed to the MISO board’s vote to file a premature ancillary services market proposal despite the near unanimous opposition of stakeholders.

are members by virtue of the choice made by their host transmission owner to join, cannot take their business elsewhere. Although customers, through the stakeholder process, may be able to provide advice to the board, such advice can be overlooked or ignored without consequence for the board. Adding a profit motive would not fundamentally alter this dynamic.

As the WPPI White Paper explains (at 4-5), an appropriately structured hybrid board can achieve responsive and accountable RTOs, and yield the following important benefits:

- CEO or high level senior executives from the stakeholder community would enhance the quality and sophistication of the advice the board receives from stakeholders through the normal advisory process given their on-the-ground knowledge. The addition of a stakeholder perspective at the board level should lead to a more rich and thorough discussion of key policy issues.
- Given their level of decision-making authority, and thus freedom from second guessing within their own companies, CEO and high level senior executive representatives on the board are less likely to view their primary mission as holding the line on a predetermined corporate position, as often occurs in the existing advisory processes. High level senior executives are more likely to seek creative solutions and help craft acceptable compromises when the board addresses delicate policy and financial matters.
- Stakeholder participation at the board level would allow those directly affected by the RTO's action to have a seat at the table when key cost issues are addressed. Given that RTOs/ISOs are not-for-profit entities that pass all costs directly through to their members, it should be no surprise that there is concern among stakeholders that the incentives to control costs are insufficient.

- Through board membership, CEOs and other board members representing the stakeholder community would obtain a full appreciation of what the RTO is attempting to accomplish and the challenges it faces. CEOs talk to one another. An explanation of why the RTO is undertaking particular initiatives may be better received by other RTO members if it is heard from interested board members, as well as management.

In short, among all the potential accountability solutions included in the ANOPR, the hybrid board has the greatest potential to efficiently and effectively refocus the RTO to be accountable and responsive to stakeholders, in a manner that can permeate the RTO's entire organization. By making stakeholders vested partners in decision-making, hybrid boards can change the existing dynamic, which all too often pits stakeholders against RTO management and fundamentally realign RTOs with a consumer-focused mission.

b) A Hybrid Board Can Be Structured to Achieve Responsive RTOs While Mitigating Concerns

Because TAPS members strongly believe that direct and meaningful stakeholder access to RTO decision-making through a hybrid board is the most effective and efficient means to make RTOs responsive and accountable, we have focused our efforts on developing a proposal for structuring a hybrid board. In particular, the attached proposal developed by TAPS member WPPI achieves the benefits of stakeholder representation on the RTO board, with safeguards to ensure independence is maintained and that the stakeholder members use their position for its intended purpose of enhancing RTO responsiveness, rather than to inappropriately advance the interests of that particular stakeholder or its segment.³⁷

³⁷ See Attachment A hereto.

As the ANOPR recognizes, and Commissioner Kelly's dissent highlights, to accomplish the purpose of maintaining independence with accountability, hybrid boards require safeguards so that they do not devolve into the "legislative model with no overarching independent judge making the final calls," and where "cooperative decision-making [is] more difficult and time consuming." *See* ANOPR Kelly, Comm'r, dissenting. The ANOPR (at P 152) identified several needed protections, including limiting stakeholders to a minority of the board and all subcommittees of the board, so that the stakeholders together cannot overcome the vote of the disinterested board members. Rather, the stakeholder minority provides direct input without RTO management filtering what is communicated to the board.

In addition, TAPS suggests that further assurance that the stakeholder board members do not "serve their own interests inappropriately" (ANOPR at P 152) can be achieved by placing additional restrictions in the manner in which the stakeholder board members are selected. As described in the WPPI White Paper (at 5):

A key element of any successful hybrid board structure would be the quality of the stakeholder representation on the board. This element should be addressed in at least two ways: (1) stakeholder board candidates should be required to meet strict eligibility criteria like all other board members. Such criteria, at a minimum, should require CEO or high senior level executive, and (2) selection of the interested board members should require supermajority voting approval....

Specifically, TAPS's proposal would limit stakeholder board members to persons viewed as deserving of the trust of stakeholders as a whole, rather than the narrow interests of a particular sector or the even narrower interests of a particular market participant. TAPS

achieves that objective by requiring a super-majority vote, as described by WPPI's paper (at 5):

With respect to the selection process, the interested board members should not be elected only by their own sectors. Instead, an election of an interested board member should require an affirmative vote of 67% of all sectors. The supermajority voting requirement would help promote board membership of individuals widely acceptable to stakeholders and give the interested board members an incentive to broadly represent the stakeholder community.

The super-majority vote requirement would go a long way to mitigate concerns that the stakeholder board members would use their position inappropriately to advance their parochial interests.

A further check on stakeholder board members would be achieved through requiring hybrid board meetings to be open (except for personnel, litigation, and other sensitive matters).³⁸ Open meetings would ensure that the stakeholder board members not only “talk the talk” as they are lining up the needed super-majority for their selection, but also “walk the walk” when participating in the board. A stakeholder board member who inappropriately steps out of line won't last long. More generally, opening up board meetings would enhance a board's sense of public responsibility and purpose. Because RTOs are not-for-profit entities, with public interest responsibilities, secrecy serves no legitimate purpose and contributes to board isolation and capture by management. While

³⁸ Confidential information (such as market monitoring information not appropriately shared with stakeholders) could also be provided behind closed doors if necessary. As to the stakeholder board members, such information could be addressed through appropriate confidentiality agreements or, if necessary, by recusal. Such confidentiality issues plainly should not be an obstacle to a more generalized open meeting requirement or hybrid boards.

some RTOs are more open than in the past, others have a long way to go, continuing to meet primarily behind closed doors with open meetings as staged events.

Further, although TAPS would limit stakeholder participation to a minority of the board, we would ensure a range of stakeholder views. For example, the WPPI White Paper proposes (at 5-6) inclusion of the following categories with an aim toward bringing specific perspectives and unique experience to board discussions:

- Generator (any type of generation owner, including IPPs)
- Transmission owner with obligation to serve (includes stand-alone transmission companies).
- End-use customers, either an industry management person with primary internal responsibility for energy decision making or the heads of ratepayer consumer advocacy groups.
- Transmission-dependent, load-serving utilities.⁴
- Others – this category should cover stakeholders that do not fit into the above categories, including marketers, financial traders, and environmental representatives.

⁴ This seat should rotate between for profit and not for profit companies, unless they agree unanimously on a candidate..

Restricting board membership to senior executives would also enhance the ability of the stakeholder representatives to take a broader view, as contrasted with the more partisan viewpoints that typically characterize participants in the RTO stakeholder process. This difference in perspective is reinforced by fact that unlike company-representation-focus of participants in the RTO stakeholder process or an advisory or “liaison” committee, stakeholder board members will owe a fiduciary duty to the RTO. TAPS members who have sat on hybrid boards report that they have cast votes that reflect the best interest of the organization even though the position was at odds with the more parochial view of their own system. As explained in the WPPI White Paper (at 3):

The stakeholder board members would have a fiduciary duty to Midwest ISO as directors. Their job would not be to represent their individual company's interests, but instead to represent the interests of the stakeholder group as a whole in assisting Midwest ISO to achieve its mission of providing value to the consuming public through lower prices, greater stability and increased reliability.

In summary, TAPS believes that with the safeguards included in the WPPI proposal, the hybrid board would be well-equipped to achieve its objectives of enhancing RTO responsiveness and accountability, while preserving independence, in a manner that should permeate the whole organization.

3. Making RTO Management Customer-Focused

As the ANOPR correctly recognizes (at P 157), executive RTO management ensures that the RTO's "goals set by the board are met." A clear, customer-focused mission, reinforced by a hybrid board, should establish consumer-focused marching orders for RTO management. But more can be done to ensure follow-through. It is not a matter of RTO management "mak[ing] their responsiveness more apparent to their stakeholders" (ANOPR at P 156), but actually being more responsive to customers and a cost-lowering mission. While TAPS generally agrees with the ANOPR's suggestions for focusing management on customer needs (*see* ANOPR at P 159), we ask the Commission to consider the following specific suggestions.

a) Cost Accountability Can Be Advanced Through Benchmarking and Cost-Benefit Studies

The Commission can bring discipline to RTO costs as part of the rate and budget review process. In addition, various mechanisms can be put in place individually, or in combination, to bring a "reality" check on RTO expenditures.

TAPS supports a requirement for an **independent, biennial study of all RTOs that benchmarks each RTO's operating costs, as well as the costs of particular RTO functions, against the costs of other RTOs and, where possible, against the costs of non-RTO transmission providers.** *See* Gerken Comments at 6. Benchmarking can serve as a guide to the prudence of RTO costs, especially those that exceed the benchmark, and permit assessment of whether the RTO is achieving the goal of lowering consumers' costs. Benchmarking will also serve to provide a form of "yardstick" competition," whereby differences in costs can point higher-cost RTOs to the best practices of those with lower costs. However, while the information provided by benchmarking is useful, it cannot be deemed dispositive. If all RTOs are performing poorly, consumers are not protected if the least poorly performing RTO sets the bar. To counteract this regression towards a mediocre mean, the Commission should consider some form of "zero-based budgeting" that requires each RTO to justify its expenditures from the bottom up, based upon its own characteristics and functions. In any event, setting RTO rates based upon benchmarks may not work, because rates could end up too high or too low, given a particular RTO's costs and those reflected in the benchmark.

Other mechanisms that would benefit from benchmarking studies are **detailed, biennial, independent cost-benefit analyses (with results shown by state at delivery point levels) and RTO efficiency audits.** These analyses should not be limited to whether the RTO achieves product cost-savings. Rather, the standard should be tied to the RTO mission – bringing value via reduced consumer costs. Such value cannot be delivered to end-use customers unless (a) the RTO generates cost savings through efficiencies, and (b) those savings, or a very significant portion of them, are reflected in

the delivered price of wholesale energy, or at least the prices charged load-serving entities (recognizing the state role in determining charges to end-users).

Assuming a hybrid board recommended above, the independent firm conducting the analyses and audits could be selected by the board. Otherwise, stakeholders should select the firm. In either case, the firm should report to both stakeholders and the board, and provide an opportunity for comments. These reports need to examine not only the RTO's costs, but also the costs imposed on the RTO's customers because of the RTO's actions and programs. For example, an RTO that does not properly carry out its transmission planning and expansion obligations, such that reliability deteriorates and congestion costs increase, should receive a negative assessment. Public reporting of the results of these studies could put significant pressure on RTO management.

In addition, to achieve effective cost controls, **the Commission should require RTOs to assess the cost/benefits of new initiatives or major rule changes *before* undertaking them, taking into account both RTO costs and costs to market participants, to track the actual costs and benefits of such implementation, and to be accountable for their projections.** For example, Phase II development of the SPP RTO would involve the addition of financial transmission rights for market-based congestion management. Once SPP develops a high level design for Phase II, it says it will conduct a cost-benefit analysis to determine if the benefits of FTRs outweigh their costs. *See Sw. Power Pool, Inc.*, 106 F.E.R.C. ¶ 61,110 at P 121, *order on compliance filing*, 108 F.E.R.C. ¶ 61,003, P 13, *order on reh'g*, 109 F.E.R.C. ¶ 61,010, P 13 (2004). If (as a result of the study's positive results) the new initiative/major rule change is undertaken, the RTO should be required to track the real costs and benefits (including both those of

the RTO and market participants). Accountability will not be achieved if the RTO is not measured against its own expectations.

b) Performance Measures, Including Accountability for Building Transmission Needed for Long-Term Rights

Annual public reporting of RTO performance measurements, with an opportunity for comment, is critical to accountability. In addition, mechanisms should be put in place to hold RTOs accountable for meeting planning and expansion obligations, particularly as to long-term rights.

One performance measure is congestion. A congestion report should (1) quantify congestion costs, (2) identify the location of congestion, (3) specify measures taken to reduce congestion costs, and (4) track progress of the congestion cost reduction efforts (*e.g.*, transmission siting/construction). A second measure involves interconnection and service queue reports that would describe (1) interconnection and transmission service queues, (2) any backlogs/delays in proceedings such requests,³⁹ and (3) specific measures taken or to be taken to eliminate such backlogs. A third measure is annual reporting on reliability/outage statistics.

A fourth measure should be structured to track whether RTO planning and expansion targets are being met. In particular, this measure should track whether the RTO fulfills its obligations to plan and expand the transmission system to meet the reasonable needs of LSEs and to enable them to secure long-term rights for their long-

³⁹ Mr. Gerken described the unacceptable delays in PJM's responding to AMP-Ohio's interconnection application for a new baseload plant. Gerken Comments at 5; *see also* Tr. 241-42.

term power supply arrangements, as Congress directed in Section 217(b)(4),⁴⁰ as added by Section 1233 of the Energy Policy Act 2005, Pub. L. No. 109-58, 119 Stat. 594, 958 (2005). The ANOPR seems to “check off” this task as accomplished by virtue of promulgation of the long-term rights rule. *See* ANOPR at P 26 (“Long-term transmission rights in RTOs and ISOs were strengthened in Order Nos. 681 and 681-A”). But the hard work is ahead. Creation and maintenance of needed long-term rights, through expansion of the transmission grid to support those rights, is not self-effectuating. As TAPS Chairman Roy Thilly described at the February 27, 2007 Technical Conference in this proceeding, where an RTO determines long-term rights based upon a simultaneous feasibility test, the grid must be built to maintain the simultaneous feasibility of long-term rights for both existing and new resources in order for these rights to fulfill the goals of FPA Section 217(b)(4).⁴¹ RTOs must be held accountable for timely constructing transmission to support needed long-term rights.

The Order accepting MISO’s Long-Term Transmission Rights (“LTTR”) Proposal, *Midwest Independent Transmission System Operator, Inc.*, 119 F.E.R.C. ¶ 61,143 (2007), illustrates the basic problem. Although the Commission directed MISO to strengthen the link between long-term rights and transmission planning and expansion (*id.* at P 193), the Order suggests that it is LSEs that will end up holding the bag if either MISO or specific MISO Transmission Owners fail to construct upgrades needed to maintain the feasibility of existing long-term rights.⁴² In addition, with respect to long-

⁴⁰ 16 U.S.C. § 824q(b)(4).

⁴¹ 16 U.S.C. § 824q(b)(4).

⁴² If long-term rights within MISO become infeasible during their term, LSEs no longer have the right to automatically convert them into FTRs (*id.* at P 55); and the Order suggests that the term of already-

term rights for LSEs' *new* long-term baseload resources, the Order concludes that MISO is not required "to provide advance guarantees of LTTRs before the [new] generation facilities go into service." *Id.* at P 155. In other words, transmission customers are expected to finance and make huge generation and transmission investments with no assurance that they will receive long-term rights needed to make reasonably priced deliveries from their units to serve their own loads.

These provisions put the risk of RTOs' failure to plan on LSEs that have no control over the planning and construction process. The Commission should adopt performance measures that track construction of transmission needed for long-term rights and should use those measures to hold RTOs and Transmission Owners — the entities in the best position to control and manage the risks of that process — accountable, by requiring them to share the burden of failing to plan and build necessary transmission upgrades.

c) Tie RTO Senior Management Compensation to Consumer-Focused Performance Measures

TAPS strongly supports the ANOPR's suggestion (at P 159) of tying RTO senior management compensation to specific performance measures. Top executives will focus effort on those matters that will have a significant impact on their own compensation. TAPS understands that performance-based compensation goes on in some RTOs today, but the measures are not directly tied to a consumer-focused RTO mission.

TAPS recommends that senior management compensation be tied to such measures as:

allocated long-term rights could be curtailed by subsequent Commission decisions (*id.* at P 149).

- achievement of the RTO's consumer-cost lowering mission;
- independently-determined measures of customer satisfaction;
- reductions in congestion costs;
- RTO cost containment;
- reduction in interconnection and transmission queues;
- meeting aggressive planning and construction targets;
- strategic planning and internal analyses that reflect a consumer-focused mission; and
- other objective measures of high quality service quality.

The intent would be to develop performance criteria that truly measure whether the RTO is meeting the transmission needs of those in its region in a cost-effective manner.

Customer surveys, performed by an independent entity retained by stakeholders, could play an important role. Management of RTOs that exceeds demanding performance goals should be rewarded with compensation bonuses. On the other hand, management of RTOs that falls short should share in the RTOs' customers' pain.

The benchmarking and diagnostic tools described above, including adherence to an RTO mission of attaining the lowest possible reasonable rates, provide criteria by which performance can be judged. Plainly others will need to be developed. Identifying the appropriate measures against which performance must be assessed is not a simple proposition. The bar must be set high so it truly incents good performance, but should not be set at an impossible-to-achieve level. Care must be taken to develop standards that are not readily gamed. Unintended consequences must also be a concern. Nevertheless,

because incentive compensation can be a crucial step in making management think of their customers as their constituents, not a nuisance, this effort is worth pursuing.

4. Stakeholder Budget Approval, with Timely Commission Review

The current advisory processes do not effectively check RTO expenditures. TAPS members' experiences are that the RTO gets a blank check to get the job done, regardless of cost. A hybrid board would be the best means of achieving cost containment and accountability. However, to introduce meaningful stakeholder oversight and allow the Commission to reasonably rely upon the stakeholder process to provide some semblance of a check, advance review of the budget is essential.

Specifically, there should be advance stakeholder committee review of each RTO's annual budget, with a specific allowance for stakeholder rejection or modification of the budget where a substantial majority of stakeholder sectors agrees. If the RTO board believes that a modified budget jeopardizes its ability to meet its obligations, the board should be permitted to appeal to the Commission. Such an appeal should occur with sufficient time and factual support to permit the Commission to resolve the issue, with meaningful consideration of the stakeholder rejection, *before* the budget takes effect.

The annual budget review process should include capital budgets reflecting the total expected costs of a major project, rather than just the current year's cost for a multi-year project, with the cost-benefit process and tracking discussed above. Stakeholder review of RTO decisions involving major expenditures is essential if costs are to be contained. Once the undertaking is made, and the initial money is spent, the board and stakeholders will have no choice but to approve increased expenditures, time and time

again, to get the job done well. Commission review of later RTO budgets will be ineffective to rein in these costs.

Timing of budget review is everything. Refunds will be ineffective to remedy excessive RTO expenditures. If advance review by the stakeholders and, if necessary, the Commission is not completed before the budget goes into effect, not only would market participants pay for an RTO's budget, but they would also pay for any refunds. As a result, traditional refund mechanisms are effectively useless in making market participants whole. The RTO budget expenditures need to be limited to those approved by stakeholders or, in the event of RTO appeal to the Commission, otherwise found just and reasonable, *before* they are incurred.

E. Market Monitoring Must Be Mission-Focused, Independent and Effective

1. The Market Monitor's Assessment of Consumer Benefit Must Measure Whether the Rates Produced by RTO Markets are the Lowest Possible Reasonable Rates

As set forth above, the Commission should establish a mission for RTOs/ISOs that includes the achievement of consumer benefits, including the lowest possible reasonable rates. Accordingly, the market monitor's assessment of RTO/ISO markets should not be limited only to whether market rules are working smoothly, but also to whether market outcomes are consistent with a consumer-oriented RTO mission.

As described in the ANOPR (at P 102) and the Commission's Policy Statement on Market Monitoring Units,⁴³ the market monitor's duties are:

⁴³ *Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, 111 F.E.R.C. ¶ 61,267 (2005).

- a. To identify ineffective market rules and tariff provisions and recommend proposed rule and tariff changes to the ISO or RTO that promote wholesale competition and efficient market behavior.
- b. To review and report on the performance of wholesale markets in achieving customer benefits.
- c. To provide support to the ISO or RTO in the administration of Commission-approved tariff provisions related to markets administered by the ISO or RTO (e.g., day-ahead and real-time markets).
- d. To identify instances in which a market participant's behavior may require investigation and evaluation to determine whether a tariff violation has occurred, or which may be a potential Market Behavior Rule violation, and immediately notify appropriate Commission staff for possible investigation.

The Commission should clarify that the market monitor's duty "[t]o review and report on the performance of wholesale markets in achieving customer benefits" includes the consumer benefit of the lowest possible reasonable rates. If RTO-run markets are not producing the lowest possible reasonable rates, the rates cannot be deemed just and reasonable. *Atl. Ref. Co.*, 360 U.S. at 388.

The market monitor can make this consumer-value assessment by examining, for example, the extent to which the economies of centralized dispatch are achieved and whether the majority of the savings are flowing to consumers rather than being captured by sellers. If such savings are flowing to consumers, the Commission and the consumers it serves can have greater confidence that rates are the lowest possible reasonable rates.

2. The ANOPR's Proposals for Market Monitor Independence Move in the Right Direction but Must Be Accompanied by Requirements that the Market Monitor Have Resources Sufficient to Do Its Job

TAPS concurs with the Commission's and numerous commenters' views that the location of a market monitoring unit inside an RTO/ISO as a department or outside the RTO/ISO as an independent contractor does not drive the question of the market monitor's independence or whether it can do its job. Prior to the recent allegations of management interference with the work of PJM's market monitor, the fact that the unit was internal to PJM seemed to make it no less effective than other market monitors that are external, such as MISO's. Rather, more important are requirements that RTOs guarantee the independence of their market monitors and provide them with resources sufficient to do their jobs. TAPS believes that the ANOPR is headed in the right direction in these regards and offers the following observations on the ANOPR's proposals.

a) The Market Monitor Should Function Similarly to an Independent Auditor

The ANOPR proposes that the market monitor "report either directly to the RTO's or ISO's board of directors or to a committee of independent board directors." ANOPR at P 113. TAPS supports this proposal and urges the Commission to consider a model similar to the Sarbanes-Oxley law whereby the board or committee thereof would select the market monitor without management involvement. The board should have a permanent committee responsible for the market monitoring function that would interact with the market monitor, keep the board informed, and bring issues of concern to management's attention. Board members that serve on this committee should have

backgrounds or expertise that permit them to interact effectively with the market monitor.⁴⁴ Board members should also receive training on how to ensure that their interactions with the market monitor do not compromise its independence.

The RTO board can and should periodically review the market monitor's performance, but any change in the market monitor's status, *e.g.*, contract termination or renewal, should be reviewed and approved by the Commission. Performance criteria should not be based upon market monitor's conclusions about the RTO and the market it administers. Rather, the board and the Commission should assess the market monitor's performance by the rigor, independence, and soundness of the market monitor's work.

Consistent with market monitor's independent role, it should not be an advocate for RTO rules. While the RTO could seek the market monitor's views on proposed rule changes or new market proposals, the market monitor should not submit testimony, as often occurs today, in support of an RTO market proposal. Otherwise, the market monitor risks becoming invested in the success of those proposals, which could affect its subsequent assessment of the RTO's markets. The Commission should, however, require the market monitor to be an intervenor in Commission proceedings on RTO market rule proposals so that the Commission has the benefit of the market monitor's independent views. Consistent with the ANOPR's proposal that the market monitor advise the Commission and other interested parties on recommended rule changes, ANOPR at P 115, the market monitor's filing with the Commission should include the views the market monitor expressed to the RTO during the process of their development.

⁴⁴ RTOs may need to recruit specifically for board members with the required background or expertise.

b) The Market Monitor Must Have Sufficient Resources

The market monitor's structural independence alone will not ensure effective, credible market monitoring. It must have resources. Appropriately, the Commission:

proposes requiring each RTO and ISO to include in its tariff a provision imposing upon itself the obligation to provide its MMU with access to market data, resources, and personnel sufficient to enable the MMU to carry out its functions. In addition, the tariff should include a provision directing the MMU to report to the Commission any concerns it has with inadequate access to market data, resources, or personnel, and describe the steps it has taken with the RTO or ISO to resolve these concerns.

ANOPR at P 111 (footnote omitted). TAPS supports this proposal, but the Commission should obtain information from market monitors to define more specifically what resources are needed.

Resource sufficiency will be all the more important if the Commission adopts the proposal (ANOPR at P 119) to prohibit market monitors from administering market mitigation. Hands-on administration of mitigation provides market monitor staff with valuable information about how the market works. That knowledge can assist the market monitor, for example, to glean from often voluminous data whether certain bidding conduct suggests attempts to manipulate the market or exercise market power. TAPS is thus concerned that the Commission proposal to prohibit market monitors from administering market mitigation will make the market monitor less effective. To address these concerns, the Commission must require that the market monitor's resources be sufficient to allow it to understand RTO market operations as well as if the market monitor were administering mitigation. The Commission should also require frequent examinations (at a minimum quarterly but preferably monthly) of market performance by

the market monitor so that its staff does not need to ascend a learning curve each time it conducts an assessment.

The Commission should also require RTOs to offer whistleblower protections to RTO employees, especially those involved in mitigation administration, so that they can report suspicious conduct by market participants or deficient performance by the RTO to the market monitor without fear of retaliation from RTO management.

c) The Commission's Information Sharing Proposals Are Helpful But Require Refinements

TAPS welcomes the Commission's statement that it "favors both a fuller sharing of information and identification of the relevant information desired, so that the needs of the Commission, the state commissions, market participants, and the public may be satisfied." ANOPR at P 122. As NRECA's recent report card on RTO markets demonstrates,⁴⁵ the ability to assess RTO market performance is presently hampered by difficulties of obtaining needed information. The Commission's proposals regarding information sharing may help to address these difficulties. TAPS suggests the following modifications to increase the likely effectiveness of the proposals.

The Commission proposes that masked offer and bid data be posted on RTO/ISO websites with a lag of three months. ANOPR at P 127. The proposal moves the right direction from the prevailing 6-month standard, but the Commission can safely shorten lag even further to a week. There are successful models for making information, including bid-offer data, available on a real or close-to-real time basis.⁴⁶ In other

⁴⁵ Mathew J. Morey et al., *The Regional Transmission Organization Report Card: Wholesale Electricity Markets and RTO Performance Evaluations*, Nat'l Rural Elec. Coop. Ass'n, viii (2d Ed. 2007), http://www.nreca.org/Documents/PublicPolicy/RTO_RC_Final_071807_Revised.pdf.

⁴⁶ In other contexts, such as securities regulation, transparency is favored because it breeds investor

functioning, competitive electricity markets, market data is released routinely, and without the confidentiality protections that FERC has required or approved to date. In the Australian National Electricity Market, for example, generating unit bid data is available on a next-day basis.⁴⁷ Likewise, the Balancing Mechanism Reporting System (“BMRS”) website for the England and Wales market provides near real-time and historical data — including bid-offer data — on the National Grid Company’s balancing of power flows in the electricity transmission system in England and Wales.⁴⁸ Data disclosures have not caused those markets to collapse.⁴⁹ On the contrary, competitive markets thrive on information, not secrecy. On the New York Stock Exchange, trade information is immediately available, and actions are traceable to those commanding the activity.

Faster release of more information does not necessarily raise collusion concerns and may well help mitigate them. From antitrust law and economics, we know that concentration levels and ease of entry are leading factors affecting the ability of firms to collude. Other factors, such as information transparency, firm size, product homogeneity or heterogeneity, and prior evidence of coordinated activity, can play a role in specific

confidence, strengthens capital markets and leads to economic growth. See Claire Moore Dickerson, *Ozymandias as Community Project: Managerial/Corporate Social Responsibility and the Failure of Transparency*, 35 Conn. L. Rev. 1035, 1052 (2003) (citing Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. Rev. 781, 786-87, 835-38 (2001) and Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. Corp. L. 1 (1983)).

⁴⁷ This data is found at NEMMCO Market Management System (MMS) CSV Files, <http://www.nemmco.com.au/data/csv.htm> (last visited Sept. 14, 2007).

⁴⁸ On the BMRS website (<http://www.bmreports.com>), a wide range of data, including bid-offer data for each BM Unit, can be retrieved at http://www.bmreports.com/bwx_reporting.htm (last visited Sept. 14, 2007).

⁴⁹ See, e.g., Comptroller and Auditor General, *The New Electricity Trading Arrangements in England and Wales*, http://www.nao.org.uk/publications/nao_reports/02-03/0203624.pdf.

cases, but are far from dispositive in all circumstances.⁵⁰ More information in the hands of a larger number of competitors reduces the value of the information as a coordination tool, because there is a greater likelihood that individual competitors will use the information to compete harder and better. On the other hand, if only a few players with a sufficiently large share of the market have access to information, the risks of collusion increase. Moreover, transparency rules can be refined to keep confidential, or delay the release of, information that is the most sensitive and otherwise not available.

In fact, the current approach involving a significant time delay likely increases collusion risks. The greatest danger to LMP market design involves generators that derive market power from their control of multiple resources, because the intellectual foundation for the single-price auction model assumes that each offeror owns only one asset.⁵¹ Large generation-portfolio holders know their offers for each of their multiple resources. Further, sources like Genscape already sell information on generator operating status. Consequently, those that would use such information to manipulate markets or for other improper purposes⁵² can already obtain it, and a 3- or 6-month lag will not prevent

⁵⁰ See Margaret C. Levenstein & Valerie Y. Suslow, *What Determines Cartel Success?*, 44 J. Econ. Literature 43 (2006); see also U.S. Dep't of Justice & Fed. Trade Comm'n *Horizontal Merger Guidelines*, §§ 2.11, 2.12 (1997); *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651 (7th Cir. 2002), cert. denied, 537 U.S. 1188 (2003); *Fed. Trade Comm'n v. Elders Grain, Inc.*, 868 F.2d 901 (7th Cir. 1989); *Hosp. Corp. of America v. Federal Trade Comm'n*, 807 F.2d 1381 (7th Cir. 1986).

⁵¹ See Robert C. McDiarmid, Lisa G. Dowden, & Daniel I. Davidson, *A Modest Proposal: Revoke the Nobel Prize? Recognize the Limitations of Theory? Or Grant a License to Steal?* 14 Elec. J. 11 (2001).

⁵² Given the public availability of Genscape information and other means of acquiring information on a target plant's operating status, TAPS doubts that a homeland security basis should keep such information non-public exists. If that case can be made, however, the proper response is to make the generator status information available to all industry stakeholders that demonstrate their bona fides as North American market participants. Critical Energy Infrastructure Information, Order No. 630-A, 68 Fed. Reg. 46,456 (Aug. 6, 2003), [2001-2005 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,147, P 7 (to be codified at 18 C.F.R. pt. 38) ("The Commission encourages these entities [RTOs and others] to provide information to legitimate requesters").

them from doing so. Allowing RTOs to make it available for free and more quickly would have the salutary effect of enabling smaller market participants to compete on a level playing field, and enabling them and low-budget consumer representatives (*e.g.*, official state consumer advocates) to assist with market monitoring. The result should be more competitive markets than would otherwise be the case.

The Commission also proposes that market monitors report at least quarterly to “Commission staff, to staff of interested state commissions, and to the management and board of directors of the RTOs and ISOs.” ANOPR at P 125. It would also allow state commissions to make tailored requests for information from the market monitor. ANOPR at P 128. The Commission should not exclude market participants from such briefings or opportunities to make information requests. Market participants have as great a stake as state commissions and the Commission staff in knowing whether RTO markets are performing well. They are also positioned to provide feedback to market monitors that could assist the market monitor in its responsibilities. Market monitors should have discretion, however, to deny requests for information that they deem to be overly burdensome or that distract the market monitor from other required tasks. Market monitors should also be permitted to provide confidential briefs to RTO/ISO boards and management as well as to Commission staff, if necessary to protect confidential or sensitive information.

CONCLUSION

TAPS appreciates the Commission’s interest in RTO market reform. It should examine demand response policies that promote demand response and that are sensitive to LSEs’ existing programs and load serving obligations, while rejecting proposals to lift

offer and bid caps. The Commission should examine ways to make long-term contracts for base load and intermediate resources available on an economic basis. The Commission should permit hybrid boards with majority independent directors as the most effective way to increase RTO responsiveness and accountability. Finally, the Commission should empower market monitors that are independent and have the resources to be effective.

Respectfully submitted,

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September 14, 2007

ATTACHMENT A

WPPI White Paper

RTO ACCOUNTABILITY AND GOVERNANCE

INTRODUCTION

This paper responds to concerns of many stakeholders and state commissions about RTO accountability and governance.¹ Because RTOs have been operational for several years in various regions, there now has been an opportunity to examine their performance and evaluate the steps that may be necessary to improve governance and accountability. This paper proposes constructive first steps that should be implemented as soon as possible.

ACCOUNTABILITY

Before RTOs can be held accountable, the RTOs' mission must be clearly defined and specific, so that there is a standard to which the RTOs and their management can be held. The RTOs' mission should be to provide value to the consuming public, meaning lower prices.² End users ultimately must be better off because an RTO is functioning. For instance, if economies of centralized dispatch are achieved, but the majority of the savings

¹ This paper is written with the goal of improving RTOs, addressing stakeholder and state regulator concerns and bringing greater benefit to consumers of electricity in the RTO regions. This paper is not intended to be critical of RTO managements or boards. Each have faced an overwhelming set of tasks. Start-up has been predictably and understandably somewhat rocky. We do not question the good faith or dedication of either the RTO staffs or boards.

² When the Federal Energy Regulatory Commission (FERC) implemented an electric restructuring, its stated goal was "efficient, lower cost power to the [n]ations electric consumers." See *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities*, FERC Stats & Regs., Regs. Preambles, Jan. 1991-June 1996, ¶ 31, 036, p. 31,632, 61 Fed. Reg. 21,540 (1996), *aff'd sub nom. New York, et al. v. Federal Energy Regulatory Comm'n*, 535 U.S. 1 (2002) ("Order No. 888"). The stated objective of minimizing power costs also reflects the requirements of the Federal Power Act as interpreted by the federal courts.

are captured by generators or traders -- not consumers --the RTO will not have met its mission.

FERC reaffirmation of the RTOs' mission is essential. While RTOs have been in operation for a number of years, their mission remains misunderstood and the subject of ongoing debate. RTO boards, management and stakeholders still do not share a common understanding of the RTOs' fundamental purpose. By defining the RTOs' mission and communicating it clearly to the RTOs and the larger stakeholder community, FERC can end the debate and promote accountability.

FERC will not achieve its consumer-oriented goals unless it clearly states them and in turn requires RTOs to meet these goals. By establishing consumer value as a core goal of the RTO markets and setting forth the requirements directed to accomplishing the goal, FERC would focus the entire RTO organization on the achievement of this goal. This in turn would align the RTOs mission with the objectives of state regulators, federal policy makers and the consumers who ultimately bear the cost of the RTO's operations.

GOVERNANCE

A key element of achieving RTO accountability is good governance. A hybrid board can dramatically improve RTO governance.

RTO governance creates tension between the needs for independence and accountability. FERC's current governance requirements focus almost exclusively on independence. This

has come at a cost to accountability. Independent board members, no matter how talented and diligent, are not exposed to the consequence of the RTO's action. Given the RTO structure, good governance should include representation from those with "skin in the game."

A hybrid board will better balance the need for both independence and accountability.³ The hybrid model marries the benefits of independent governance through control by independent directors with the added benefit of direct, high-level stakeholder input and involvement in policy decisions. Independent board members will retain control, but exercise that control with the advantage of direct, high-level discussion and debate with stakeholder board representatives. This communication should be much more productive than stakeholder meetings with a large number of members, each primarily focused on protecting parochial interests.

The stakeholder board members would have a fiduciary duty to Midwest ISO as directors. Their job would not be to represent their individual company's interests, but instead to represent the interests of the stakeholder group as a whole in assisting Midwest ISO to achieve its mission of providing value to the consuming public through lower prices, greater stability and increased reliability.

The benefits of hybrid boards include:

³ This paper is not advocating a balanced stakeholder board model, such as was tried in California and resulted in endless debate and deadlock with each stakeholder representing its parochial interests. Instead, it advocates a hybrid board controlled by independent directors as today, with a minority of non-independent board members elected by a supermajority vote of stakeholder sectors.

- CEO or high level senior executives from the stakeholder community would enhance the quality and sophistication of the advice the board receives from stakeholders through the normal advisory process given their on-the-ground knowledge. The addition of a stakeholder perspective at the board level should lead to a more rich and thorough discussion of key policy issues.
- Given their level of decision-making authority, and thus freedom from second guessing within their own companies, CEO and high level senior executive representatives on the board are less likely to view their primary mission as holding the line on a predetermined corporate position, as often occurs in the existing advisory processes. High level senior executives are more likely to seek creative solutions and help craft acceptable compromises when the board addresses delicate policy and financial matters.
- Stakeholder participation at the board level would allow those directly affected by the RTO's action to have a seat at the table when key cost issues are addressed. Given that RTOs/ISOs are not-for-profit entities which pass all costs directly through to their members, it should be no surprise that there is concern among stakeholders that the incentives to control costs are insufficient.
- Through board membership, CEOs and other board members representing the stakeholder community would obtain a full appreciation of what the RTO is attempting to accomplish, why and the challenges it faces. CEOs talk to one another. An explanation of why the RTO is undertaking particular initiatives may

be better received by other RTO members if it is heard from interested board members, as well as management.

A key element of any successful hybrid board structure would be the quality of the stakeholder representation on the board. This element should be addressed in at least two ways: (1) stakeholder board candidates should be required to meet strict eligibility criteria like all other board members. Such criteria, at a minimum, should require CEO or high senior level executive, and (2) selection of the interested board members should require supermajority voting approval (as described below).

With respect to the selection process, the interested board members should not be elected only by their own sectors. Instead, an election of an interested board member should require an affirmative vote of 67% of all sectors. The supermajority voting requirement would help promote board membership of individuals widely acceptable to stakeholders and give the interested board members an incentive to broadly represent the stakeholder community. However, the categories below are proposed with an aim toward bringing specific perspectives and unique experience to board discussions.

We propose stakeholders elect a representative from each of the following categories:

- Generator (any type of generation owner, including IPPs)
- Transmission owner with obligation to serve (includes stand-alone transmission companies).

- End-Use customers, either an industry management person with primary internal responsibility for energy decision making or the heads of ratepayer consumer advocacy groups.
- Transmission-dependent, load-serving utilities.⁴
- Others – this category should cover stakeholders that do not fit into the above categories, including marketers, financial traders, and environmental representatives.

As FERC evaluates various means for increasing RTO/ISO accountability, hybrid boards deserve very serious consideration. Hybrid boards can change the existing dynamic, which all too often pits stakeholders against RTO management. They also make stakeholders vested partners in the decision-making process and increase accountability.

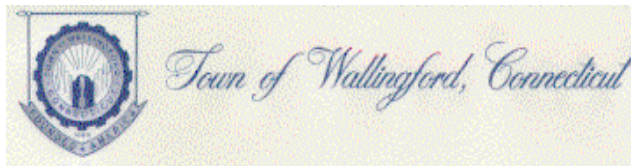
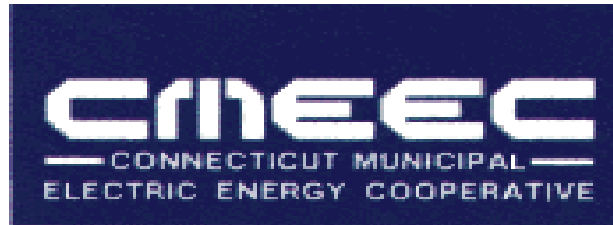
Changes to RTO governance will enable greater accountability that will permeate throughout the organization. Other changes beyond those addressed in this paper are needed to enhance RTO accountability (budgetary reforms, compensation incentives, cross RTO benchmarking), but these activities are long-term and more complex to implement.

⁴ This seat should rotate between for profit and not for profit companies, unless they agree unanimously on a candidate.

ATTACHMENT B

ISO-New England Demand Response Programs

CMEEC Experience



**Norwich
Public Utilities**



**GROTON UTILITIES
BOZRAH LIGHT & POWER COMPANY**

At Your Service



**JEWETT CITY
DEPT. OF PUBLIC
UTILITIES**

CMEEC represents approximately 1.5% of load in ISO-New England.

On August 6, 2006 (OP-4 Event) CMEEC contributed over 12% of Total Demand Response in ISO-NE.

CMEEC currently has 10 customers representing 27 MW in ISO-NE Demand Response Programs as Load Reduction. Only 1 customer representing 180 kW was willing to commit to qualifications requirements for Demand Response as Load Reduction in 2010 as part of the Forward Capacity Auction.

CMEEC currently has 21 assets representing 29 MW in ISO-NE Demand Response as Emergency Generation. Only 2 customers (excluding CMEEC controlled assets) representing 2.8 MW was willing to commit to the qualifications requirements.

Demand Response of customers is critical in New England

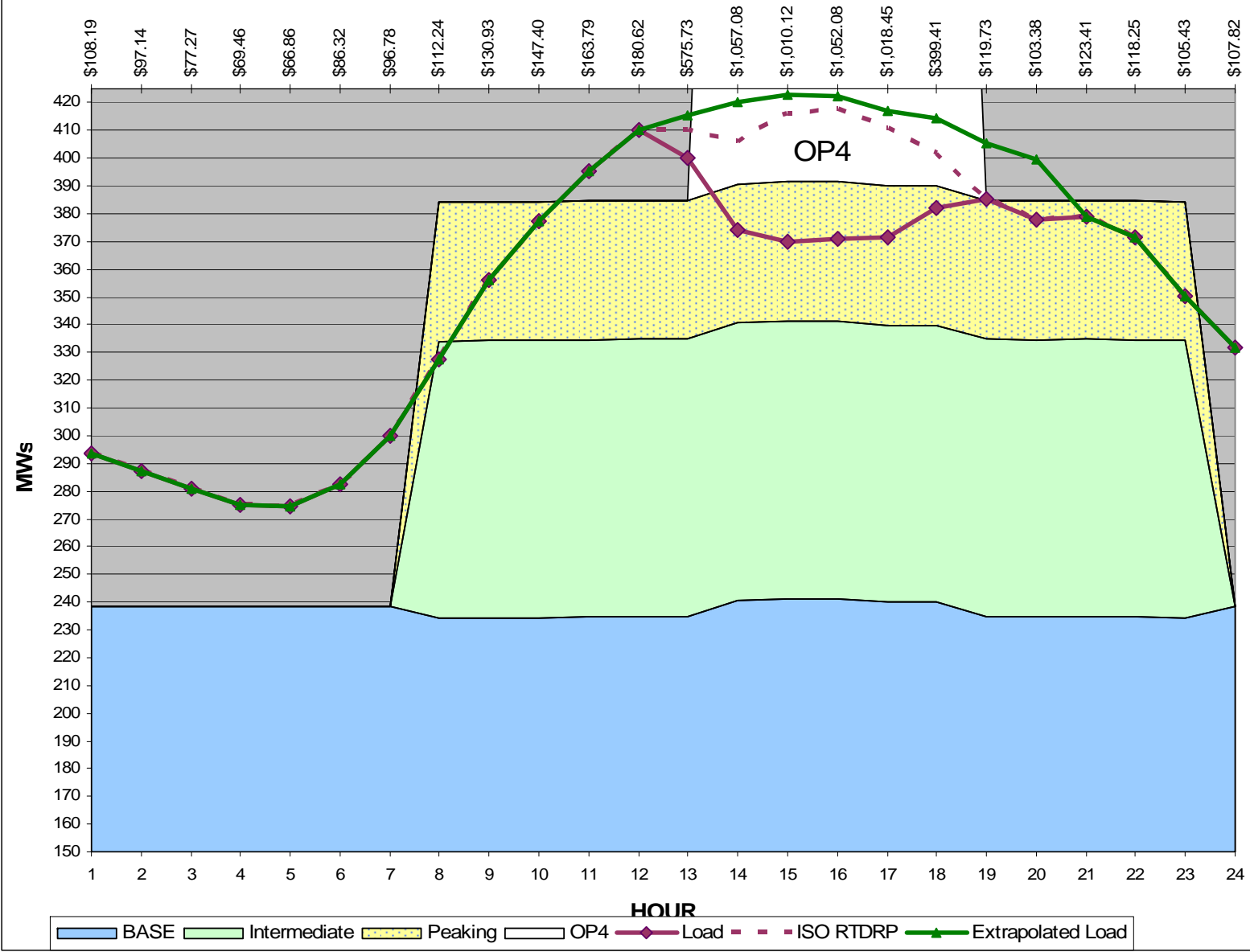
The New England load factor has eroded from 67% to 55% and continues to decline each year

In 2006, over 2500 MW of capacity was needed to serve load for less than 60 hours per year.

The capital cost of replacing 2500 MW of peaking capacity is in excess of \$2 billion.

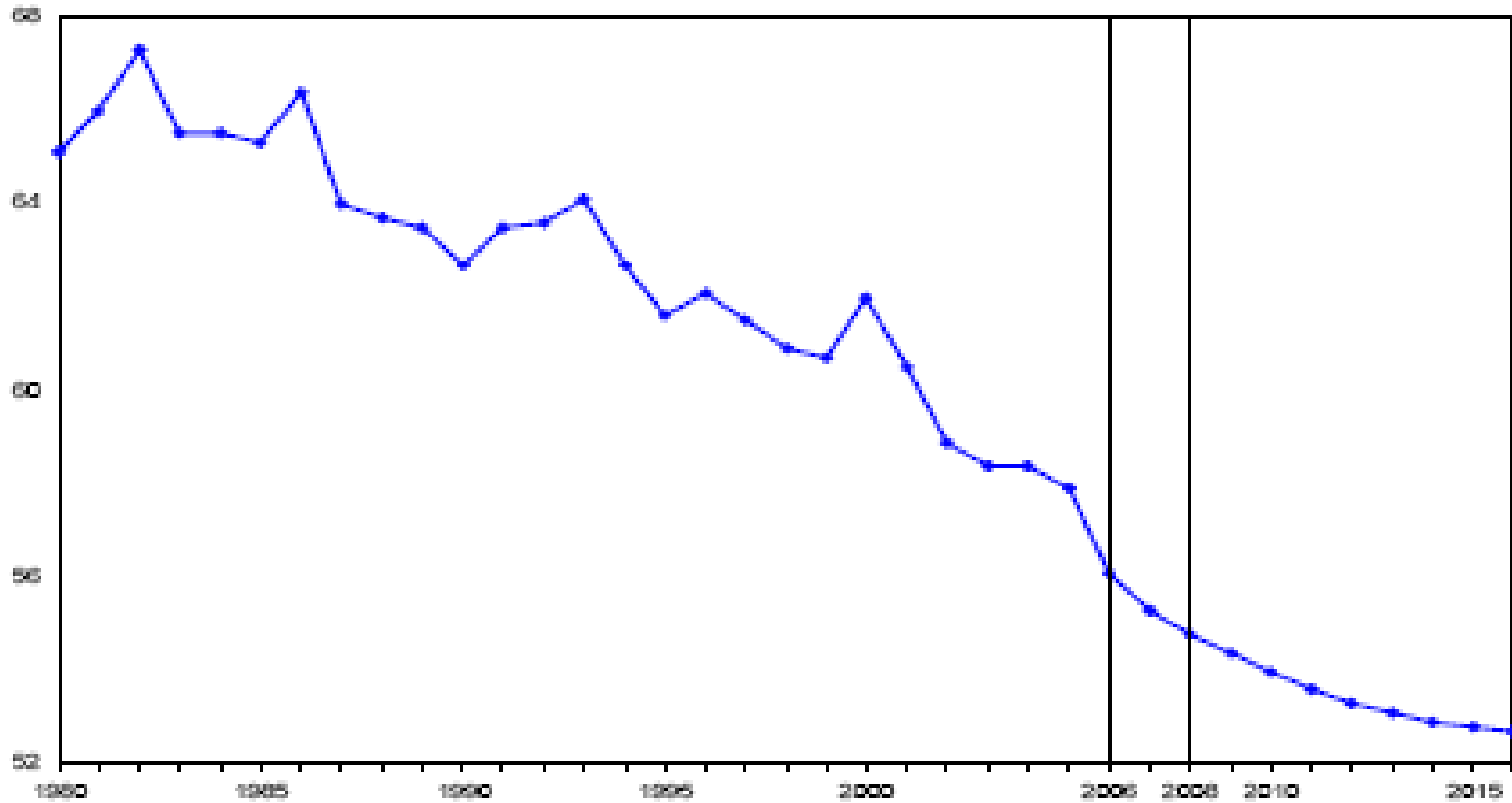
ISO Demand Response participation under the new Forward Capacity Markets favors business models of Energy Services Companies rather than being user friendly for commercial/industrial customers.

CMEEC Load and Resources - August 2, 2006



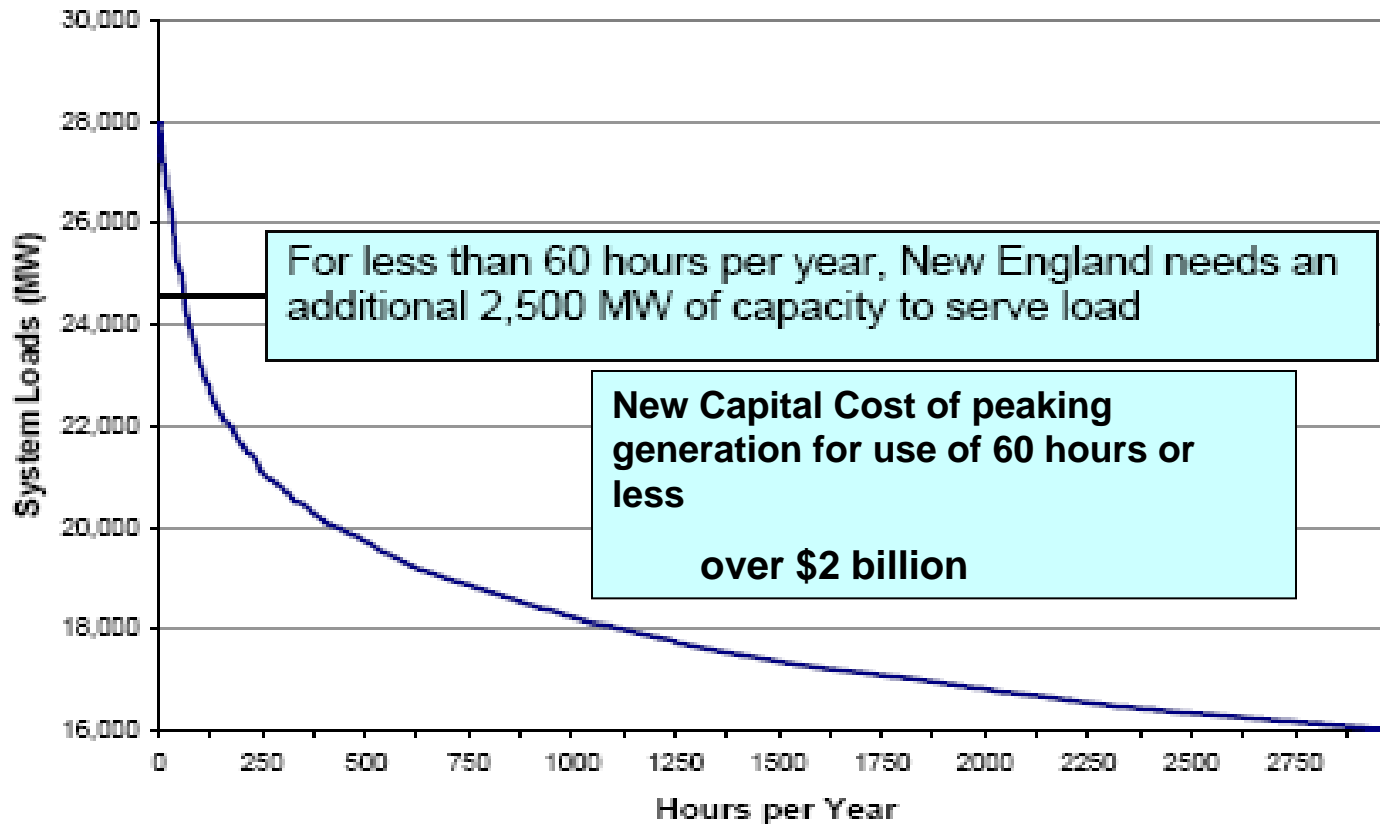
ISO-NE Summer Peak Load Factors

History 1980-2006, Forecast 2007-2016



Courtesy of ISO-NE

New England Load Duration Curve (2006)



Courtesy of ISO-NE