

FERC Proposes Focused Reforms to Improve Organized Wholesale Electricity Markets

Washington, DC
February 26, 2008

On February 22, 2008, the Federal Energy Regulatory Commission (“FERC”) issued a notice of proposed rulemaking intended to improve the function of the wholesale organized (RTO and ISO) electricity markets. The proposed rule continues a proceeding that began in 2007 with two technical conferences and an advance notice of proposed rulemaking.

The proposed rule is relatively modest in scope, as FERC resisted proposals to expand the proceeding to a wider-ranging examination of wholesale market reforms. It has four major components: (1) demand response and market pricing during periods of reserve shortage; (2) long-term power contracting; (3) market-monitoring policies; and (4) responsiveness to stakeholders and customers. Most of the requirements would be implemented through revisions to the tariffs of RTOs and ISOs due six months after a final rule issues, and therefore would be the subject of a series of future proceedings.

Demand Response

The proposed reforms relating to demand response are quite specific in establishing a principle of comparable treatment for demand response resources and other available resources and in requiring that, during periods of operating reserve shortage, pricing proposals must be supported by an adequate record showing protection against market power and gaming, including use of demand resources to discipline bidding behavior to competitive levels. Moreover, demand response issues will be further explored in a technical conference to be held during the pendency of the rulemaking, and the dialogue at the Commission’s February open meeting suggests that there continues to be debate about whether, and how to ensure that, demand response resources are granted appropriate incentives, taking into account other generation resources.

Specifically, the proposed rule would require RTOs and ISOs to:

- Accept bids from demand response resources in their markets for certain ancillary services comparable to other resources.

- During a system emergency, eliminate the deviation charge imposed on a buyer for taking less energy in the real-time market than it purchased in the day-ahead market.
- Permit an aggregator of retail customers to bid demand response on behalf of retail customers.
- Modify market rules to allow market-clearing prices, during a period of operating reserve shortage, to reach a level that rebalances supply and demand.

In addition to the demand response issues that will be the subject of a technical conference, the proposed adoption of a scarcity-pricing requirement is expected to be particularly controversial.

Long-Term Power Contracting

Respecting long-term contracting, the proposed rule simply would require RTOs and ISOs to dedicate a portion of their websites for market participants to post offers to buy or sell power on a long-term basis. The preamble notes that FERC already has taken action in other proceedings to facilitate long-term contracting, and that transparency is the focus of this proposal. The preamble further states, however, that the Commission “will consider reasonable additional steps in response to comments on this NOPR,” and continues to encourage RTOs and ISOs to work within their authorities with stakeholders to facilitate long-term power contracting.

Improved Market Monitoring

The proposed rule contains a series of basic reforms, similar to those in the advance notice and to those already adopted by PJM, relating to market monitoring. Specifically, the proposed rule would:

- Require each RTO and ISO to provide its Market Monitoring Unit (“MMU”) with access to market data, resources and personnel necessary to carry out its duties.
- Require the MMU to report directly to the RTO or ISO board.
- Expand the list of recipients who would receive MMU recommendations regarding rule and tariff changes, and broaden the scope of behavior reported to FERC.
- Remove the MMU from tariff administration, including mitigation, and require each RTO and ISO to include in its tariff ethics standards for MMU employees.
- Expand dissemination of MMU market information to a broader constituency, with more frequent reports.

Responsiveness to Customers and Stakeholders

The proposed rule would require RTOs and ISOs to adopt procedures to ensure inclusiveness, fairness in balancing diverse interests, representation of minority positions, and ongoing responsiveness, including permitting adoption of hybrid boards with stakeholder members. It is particularly useful that the proposed rule would direct RTOs and ISOs to “provide a forum for affected consumers to voice specific concerns (and to propose regional solutions).”

Further Proceedings

The proposal also sets forth the following additional steps:

- RTOs and ISOs are to consult with their stakeholders and make compliance filings that detail their plans for compliance with tariff revisions due six months after the final rule.
- RTOs and ISOs are encouraged to study whether further reforms are necessary to eliminate barriers to demand response and ensure that demand response resources are treated on a comparable basis as other resources. The proposal also encourages RTOs and ISOs to provide a forum to consider any specific proposals from consumer organizations or other entities to strengthen competitive markets.
- A FERC technical conference will address proposals by the American Forest and Paper Association and Portland Cement Association *et al.* to modify the design of organized markets.
- As noted above, a separate technical conference, to be convened by FERC staff shortly after receiving comments on the proposed rule, will discuss barriers to demand response in organized markets, potential solutions to eliminate barriers to comparable treatment, appropriate compensation for demand response, and standardization of practices and procedures associated with demand response.

Comments on the proposed rule will be due 45 days after its publication in the *Federal Register*.

* * * *

Any questions may be discussed with Sara D. Schotland or W. Richard Bidstrup in the Washington Office (+1-202-974-1500).

CLEARY GOTTLIEB STEEN & HAMILTON LLP

Office Locations

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

PARIS

12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW

Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE

Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME

Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN

Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG

Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING

Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax