

Energy Choice Matters

October 17, 2008

FERC Directs RTOs to Permit Scarcity Pricing, Allows Retail Aggregation for Demand Response

FERC yesterday acted to implement scarcity pricing and decided to allow certain market monitors to implement prospective mitigation, in addition to ordering other organized market reforms, including rules relating to demand response and long-term contracting.

FERC's final rule (AD07-7) determines that market rules currently prohibiting scarcity pricing are unjust and unreasonable, and impede demand response, new entry and innovation. Under shortage conditions, RTOs are directed to modify mitigation rules, including raising supply caps and demand bids, to allow the market price to more accurately reflect the value of energy.

Commissioner Suedeen Kelly was troubled by the scarcity pricing provision, listing it as one of the issues the final rule got wrong. Consumers first need to be given tools to respond to scarcity price signals before they are implemented, Kelly said.

FERC's final rule, which was not released yesterday, is to refine the NOPR's original proposal regarding the elimination of Market Monitoring Units (MMU) from tariff enforcement.

As Kelly described the changes from the NOPR, the final rule distinguishes between RTOs with a single MMU, and those with both an internal and external MMU (a hybrid MMU). Any MMU will be permitted to perform retrospective mitigation, but according to Kelly, only the internal MMU of a hybrid MMU may conduct prospective mitigation. Kelly disagreed with the finding that permitting all MMUs to continue mitigation duties would compromise the MMU's independence or distract the MMU.

MMUs are directed to file quarterly reports, in addition to annual filings, and are given authority to share more information with state regulators and attorneys general. Other market monitoring reforms

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FERC Investigating CAISO Exceptional Dispatch, Approves Interim Capacity Procurement

FERC instituted a Section 206 review of the California ISO's exceptional dispatch mechanism under the Market Redesign and Technology Upgrade while conditionally accepting the Interim Capacity Procurement Mechanism.

In June, CAISO submitted revisions to the exceptional dispatch mechanism after determining that some resources could potentially exercise local market power when issued exceptional dispatch instructions, because exceptional dispatches are settled out-of-market and, consequently, are not covered by the mitigation provisions of the existing MRTU Tariff. The ISO also said it expected exceptional dispatch to be far more frequent than originally anticipated.

Power marketers, however, argued that the additional mitigation was unnecessary given that exceptional dispatch is already mitigated by both its inability to set the market clearing price and by the energy bid offer cap (Matters, 7/21/08).

While FERC continues to recognize the need for some limited backstop capacity mechanism to ensure grid reliability, the Commission said it is concerned that the CAISO's expanded reliance on exceptional dispatch, coupled with its payment structure, may yield unjust and unreasonable outcomes that unduly discriminate against non-resource adequacy resources.

FERC suggested that, given the intertwined nature of exceptional dispatch and the Interim Capacity Procurement Mechanism (ICPM), as well as its goal of encouraging participation in the resource adequacy program and the voluntary ICPM, a reasonable and efficient solution would be to

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Briefly:

Delaware Staff Urges Formal Investigation of Horizon

The Delaware PSC Staff has asked to open a formal investigation of Horizon Power & Light after a series of customer complaints regarding residential contracts. Staff, in a complaint filing, said that the PSC has received over 180 complaints from customers regarding price increases on contracts they thought were fixed for 12 months, though Horizon claims customers were informed the agreements were only through May 31, 2008 (about nine months). Under the terms of service, the contract was for 12 months, "Except as may otherwise be agreed or provided in the Electricity Authorization," and Horizon says its telephonic verification informed customers that the term was only through May 31. Pricing after May 31 reverted to higher, market rates varying by month, with customers reporting jumps from 11¢/kWh to over 19¢. Staff's complaint alleged Horizon has charged "unlawfully high electric rates," and "made misrepresentations or used deceptive practices in the direct solicitation of customers," and possibly violated a 30-day notice provision for rate changes. Horizon counters that the PSC approved its terms of service, which Horizon interprets as not requiring it to notify customers of price changes after the end of the contract's term. Staff recommended refunds and urged the PSC to consider license revocation. Horizon's customer count in Delaware has fallen from 7,000 to about 2,000.

Liberty to Pay \$32,000 to Settle Texas Disclosure Investigation

Liberty Power would pay a \$32,000 administrative penalty to the PUCT under a proposed settlement between one of Liberty's certified REPs (LPT LLC) and PUCT Staff to resolve violations of customer disclosure rules by one of Liberty's agents. Staff had opened an investigation of Liberty for non-compliance with Substantive Rule §25.475 (customer disclosures) due to the receipt of a printed advertisement in the form of a facsimile transmission distributed by AEM Consulting, an entity that Staff determined was acting as an agent for Liberty and other REPs. According to Staff, AEM faxed an advertisement to 11,149

potential customers that did not comply with Substantive Rule §25.475. While Liberty did not compose or transmit the advertisement, PUCT rules hold REPs accountable for actions of their agents. According to Staff, LPT has subsequently terminated its contract with AEM. The settlement is subject to Commission approval.

Conn. DPUC Opens Docket on Regulations Relating to Collections from Billing Errors

The Connecticut DPUC has opened a docket (08-10-23) to promulgate regulations to set clear standards and requirements for all utilities to follow in implementing Conn. Gen. Stat. §16-259a. Conn. Gen. Stat. §16-259a sets rules for billing errors and the collection of unbilled or rebilled amounts, and specifically applies to any "electric supplier," including competitive suppliers. The regulations have come up in cases involving billing errors at both Connecticut Light and Power and Connecticut Natural Gas, in which the Department has harshly criticized utilities and suppliers for their lack of familiarity and compliance with §16-259a (Matters, 8/7/08).

FERC Approves NERC Assignment of Registry Responsibility for Competitive Load to Distribution Providers

FERC accepted NERC's proposed revisions to its compliance registry that provide, in the short term, for registration of certain distribution providers as load-serving entities for loads located in retail choice areas where those loads are directly connected to the distribution providers' distribution facilities (RC07-4-003, et. al., Matters 9/18/08). The change is meant to close the reliability "gap" created when NERC was forced to remove competitive retailers from the registry as LSEs since FERC found suppliers did not meet the NERC definition of an LSE. While a final order was unavailable, the Commission said that, while not a perfect solution, NERC's proposal is superior to the original plan which instead registered retail power marketers as load-serving entities, and is just and reasonable in its own right. Inclusion on the registry carries burdensome compliance obligations with NERC standards.

Duke Withdraws Proposed Transfer of Assets in Ratebase

Duke Energy Ohio notified parties to its electric security plan that it is no longer seeking an

unavoidable charge for existing newly dedicated capacity and is no longer seeking to transfer its coal generating assets from DE-Ohio to an affiliate through its ESP application (08-920-EL-SSO, Matters, 4/30/08). DE-Ohio continues to seek PUCO authority to transfer its gas generating assets, which have never been "used and useful" in the provision of electric service, or included in the utility's ratebase.

Credo Energy Files for Texas Aggregation License

Start-up Credo Energy filed for an aggregators registration with the PUCT, seeking authority to pool residential, C&Is, municipalities and political subdivisions. Principal James O'Reilly is a 20-year veteran of the financial services and lending industry, with senior positions at Citigroup.

Howell Consulting Gets Conn. Aggregators Certificate

The Connecticut DPUC granted Howell Consulting an electric aggregator certificate to serve commercial, industrial, municipal and governmental customers. Principal Derek Howell was Director of Aggregations and Associations, U.S. North, for Direct Energy, after a stint at Select Energy (Matters, 9/18/08).

FERC OKs SPP Balanced Portfolio for Economic Transmission

FERC accepted SPP's so-called balanced portfolio approach to economic upgrades to be included in the RTO's regional transmission expansion plan (ER08-1419). Costs are to be socialized using a regional postage stamp rate. The portfolio approach evaluates economic projects as a whole, rather than individually, which SPP believes will likely produce the greatest benefits to the entire region while minimizing disputes. Commissioners praised the innovative plan and suggested other RTOs evaluate incorporating elements of SPP's plan, while noting stakeholder consensus achieved by SPP on cost socialization for economic projects will be harder in much larger RTOs.

Md. PSC Staff Recommends Rejection of Delmarva Solar Proposal

In recommendations similar to its evaluation of Pepco's programs, Maryland PSC Staff reported that sister Delmarva's proposed EmPower

Maryland solar initiatives should be rejected because they are not cost effective (Case 9156). Otherwise, Staff provisionally found the remaining efficiency measures to be cost effective. The solar program includes a turnkey installation of net metered/interconnected photovoltaic systems, a 15-year maintenance program, and low-interest financing. Based on Total Resource Cost calculations, the solar program, "does not provide good value to all ratepayers or even to participating customers," Staff said. Staff also urged that the technical advisory group process continue to examine the current proposals by gas utilities regarding efficiency gains from fuel switching, suggesting Commission direction may be needed.

KEMA Starts Clean Energy Service

KEMA has launched an advisory service focusing on business issues and market dynamics of clean energy at the retail level, including carbon offsets, clean distributed generation, demand response, energy efficiency, and renewables.

FERC Accepts FirstEnergy Revised MBRs

FERC approved FirstEnergy's updated market-based rate authority, in a decision facilitated by FirstEnergy clarifying it was not seeking a waiver of the requirement for FERC approval for sales between its unregulated affiliates and Ohio distribution companies. The Ohio Consumers' Counsel dropped its objection to the revised MBRs after that clarification (Matters, 10/8/08).

FERC Conditionally Approves MISO Resource Adequacy Financial Settlement

FERC yesterday conditionally accepted the financial settlement provisions of the resource adequacy section of the Midwest ISO's Open Access Transmission and Energy Markets Tariff, but required MISO to justify the calculation of its proposed \$80,000/MW-month cost of new entry (CONE), which generated considerable debate among stakeholders (ER08-394, Matters, 8/4/08). FERC also rejected the ISO's proposal to charge the annual CONE for each month's deficiency, finding that the deficiency charges would be excessive if applied to a load-serving entity with deficiencies in multiple months. A final order was not available, nor were two orders also relating to the Module E resource

adequacy construct: an order on rehearing and an order on compliance.

Calif. Offers Solar Incentives for Multifamily Housing

California IOUs were directed to develop tariffs for "virtual net metering" as part of a California PUC decision to bring solar incentives to residents of multifamily housing. Virtual net metering will allow the electricity produced by a single solar installation to be credited to the benefit of multiple tenants in the building without requiring the system to be physically connected to each tenant's meter. It's part of the PUC's \$108 million solar incentive program for Multifamily Affordable Solar Housing (MASH), which is part of the California Solar Initiative (CSI). The MASH program will provide solar rebates to qualifying affordable housing developments, as defined in state law. Incentive levels depend on whether the solar installation provides power to common areas of the affordable housing complex or directly to tenant units, with incentive levels of \$3.30 per watt for systems offsetting common area load, and \$4 per watt for systems offsetting tenant load.

Calif. PUC Approves Final GHG Recommendation Including Transition to Allowance Auctions

The California PUC yesterday approved "final" recommendations to the Air Resources Board for implementing greenhouse gas reduction legislation which includes a market-based cap-and-trade system as well as a gradual transition to the auction of emission allowances. ARB released a draft scoping plan earlier this week, while the California Energy Commission also adopted the PUC's recommendations.

The recommendations note that they are subject to modification based on changing market conditions and policy developments outside of California.

Although the vote was unanimous, several Commissioners will be authoring concurring opinions. The inclusion of a market mechanism generated much discussion, with Commissioner Timothy Simon stating there are too many questions to answer, raising concerns about gaming. The potential for market failure should give the Commission pause, given the cost of

the GHG program, he said. Commissioner Dian Grueneich also cautioned against blind faith in markets.

Commissioner John Bohn, however, argued market mechanisms act as an important discipline, as no group knows all variations, risks and opportunities with a new policy. Commissioner Rachelle Chong added that a market system is needed to encourage innovative solutions, and countered comments that auctions were too complex to implement, noting the pedestrian nature of spectrum auctions during her time on the FCC.

Consistent with an earlier draft (Matters, 9/15/08), the PUC recommended that ARB auction 20% of the emission allowances allocated to the electricity sector in 2012, with 80% distributed administratively for free to electricity deliverers. The percentage auctioned would increase by 20% each year, so that by 2016, 100% would be auctioned.

For the emission allowances distributed to electricity deliverers, the number of allowances given to individual deliverers should be determined using a fuel-differentiated, output-based allocation with distributions limited to deliveries from emitting sources, including unspecified sources, the PUC recommended.

ARB may wish to retain a small portion of electricity sector emission allowances to fund statewide electricity programs, but otherwise all allowances that are to be auctioned should be given to the retail providers of electricity, on behalf of their customers.

The retail providers should then be required to sell the allowances in a centralized auction undertaken by ARB or its agent, which would ensure open and equal access to allowances by all deliverers who require them, the PUC said. All revenue from the auction of allowances allocated to the electricity sector should be used for the benefit of the electricity sector, including the support of investments in renewables, energy efficiency, new energy technology, infrastructure, customer bill relief (possibly through rebates), and other similar programs.

If ARB cannot design an auction that is legally separated from other State revenues, the PUC suggested an alternate mechanism be designed.

Skeptical that the costs of GHG limits will be as low as estimated, Bohn stressed that auction

proceeds must go to ratepayers, and cannot be diverted by lawmakers for other purposes. Simon also implored ARB to include a price cap on allowances to contain volatility.

Chong recommended that the form of auction proceeds, which will be determined at a later stage, should not mask the price of GHG compliance or price signals, suggesting a lump sum payment or dividend to ratepayers.

The distribution of allowances to individual retail providers for subsequent auctioning should transition over time from being based initially on historical emissions in the retail provider's portfolio to being allocated based on sales by 2020, the PUC said.

The final recommendation also maintains that participation in the GHG market and auctions should not be limited to only those entities requiring allowances, as suggested by some stakeholders, as more participants will increase liquidity and permit greater access to tools for managing risk.

The PUC recommended GHG compliance be imposed on all LSEs, including munis, which has drawn a harsh reaction from LADWP and others typically not under the PUC's jurisdiction.

Aside from cap-and-trade, GHG reductions are to be obtained by increasing the RPS to 33%, undertaking aggressive energy efficiency measures, and boosting reliance on combined heat and power (CHP) facilities.

FERC Offers More Guidance on Compliance

FERC yesterday sought to give market participants greater transparency into FERC's enforcement philosophy, although Commissioner Philip Moeller thought the Commission did not go far enough in a revised policy statement on enforcement.

The Commission has encouraged strong internal compliance programs since being granted penalty authority in the 2005 Energy Policy Act, and yesterday told market participants that entities will receive credit for good compliance practices, with FERC potentially reducing penalties for non-serious violations when companies have internal compliance programs meeting four FERC standards. The standards include (1) active engagement and leadership by senior

management; (2) preventive measures appropriate to the circumstances of the company that are effective in practice; (3) prompt detection of problems, cessation of misconduct, and reporting of a violation; and (4) remediation of the misconduct. The revised statement supplements FERC's previous policy guidance from May and may be found in docket PL09-1.

Moeller had hoped the Commission would go farther in giving companies specific direction on how to develop internal compliance programs that the Commission would view favorably, perhaps by outlining a model program or programs. But Chairman Joseph Kelliher noted that with some 4,700 entities regulated by FERC -- from small munis only subject to reliability rules to integrated holding companies covering wholesale trading, generation, high-voltage transmission, pipeline capacity and other FERC-jurisdictional activities -- it would be difficult to develop model programs.

FERC also released revised standards of conduct for transmission providers meant to simplify compliance (RM07-1). The final rule adopts the employee functional approach used in Order No. 497, the Standards of Conduct for the gas industry, and in Order No. 889, the Standards of Conduct established for the electric industry. FERC separately defined marketing functions for electric and gas companies, and removed "bids to buy" from the definition of "marketing functions" to ensure that only sales, not purchases, are included in the definition. The final order clarifies that the term "transmission functions" refers to day-to-day operation of the transmission system.

FERC also approved a final rule to ensure rules limiting contact with Commissioners and decisional staff apply in the same manner to outside parties as it does to litigation staff (Matters, 5/16/08).

Wholesale Reforms ... from 1

include requiring the MMU to report to the RTO board rather than management; and requiring the RTO to provide the MMU with data access, resources and personnel. The time lag for releasing offer and bid data by RTOs is to be reduced as well.

FERC's final rule also rejected calls to restrict

the ability of customers to participate in RTO demand response programs and markets. While some utilities had petitioned FERC to only allow customers to participate directly in RTO markets upon the express permission of state regulators (forcing customers to use utility-run demand-side programs), the final rule permits an aggregator of retail demand response to bid the combined demand response directly into an RTO's organized markets, unless such action is not permitted by the laws or regulations of the relevant electric retail regulatory authority. Therefore, absent pre-emptive action by state regulators, customers will normally not need to seek permission to enroll with third-party curtailment service providers.

Other reforms meant to open the market to demand-side resources include opening ancillary service markets to demand response on the same terms as generation where technically capable; eliminating certain charges to buyers in the energy market for voluntarily reducing demand during a system emergency; and a requirement for RTOs to report on any remaining barriers to comparable treatment of demand response resources in organized markets.

The rule also requires each RTO to dedicate a portion of its website for market participants to post offers to buy or sell power on a long-term basis.

FERC ordered each RTO to provide customers and stakeholders with some form of effective direct access to the RTO board of directors. Kelly opposed such a hybrid board structure, fearing that it will jeopardize the independence of RTO boards.

CAISO ... from 1

provide non-resource adequacy resources with an offer of an ICPM designation upon receipt of their first exceptional dispatch instruction.

The Commission noted that the exceptional dispatch mechanism does not include an explicit capacity payment comparable to the capacity compensation afforded to a resource adequacy resource, and, in certain cases, it provides no guaranteed fixed cost recovery. "[N]on-resource adequacy resources that provide reliability service to the grid should be paid in a similar manner - and subject to similar obligations - as

resource adequacy resources, which includes fixed cost recovery," FERC held.

FERC explained its concern that, under exceptional dispatch, some non-resource adequacy resources will be unable to recover any fixed costs in certain circumstances. A non-resource adequacy resource that has no bid in the market will be paid the higher of its default energy bid or the locational marginal price.

"If the locational marginal price is lower than the default energy bid - a distinct possibility, given the price-depressing effect of Exceptional Dispatch supply instructions - the non-resource adequacy resource will receive only its default energy bid, which is not designed to provide fixed cost recovery," FERC observed.

The Commission ordered a technical conference as part of the 206 proceeding.

In a separate order (ER08-556), FERC conditionally accepted the CAISO's ICPM proposal, which is an interim, tariff-based capacity procurement mechanism designed to backstop resource adequacy procurement when necessary to maintain reliable grid operations during MRTU start-up.

Under the ICPM, CAISO is permitted to designate capacity resources in order to maintain reliable grid operations if either: (1) an LSE has not procured the full amount of its local or system-wide resource adequacy requirements, when the portfolio of resources procured by all LSEs in an area is insufficient to meet the reliability criteria for the area; or (2) if an ICPM "Significant Event" occurs that creates a need to supplement resource adequacy resources.

FERC accepted the proposed ICPM price of \$41/kW-year, noting that ICPM is a mechanism for procuring capacity for short periods to meet system reliability needs and, therefore, is not designed to encourage new investment and should not reflect cost of new entry, as suggested by generators. In recognition of the California PUC's ongoing proceeding relating to the potential for a capacity market, FERC declined to adopt a pricing methodology based on the cost of new entry to support long-term capacity investments.

The Commission further noted the \$41 price is in the upper bound of bilateral prices (\$15/kW-year to \$45/kW-year), and observed that CAISO will provide resources the opportunity to cost

justify going-forward costs in excess of the \$41 backstop capacity price.

FERC accepted the voluntary nature of the ICPM proposal, which results in a minimum 30-day obligation to offer designated capacity into the MRTU markets. FERC noted CAISO retains the authority to commit any resource that is necessary for reliability reasons through exceptional dispatch in rejecting calls for longer or mandatory commitments. The Commission also accepted the CAISO's definition of "Significant Event."

FERC rejected the recommendation from Constellation, Mirant and retail marketers to award resource adequacy capacity credits to LSEs affected by ICPM procurements. "If the CAISO were to allow LSEs to count ICPM capacity resources towards their resource adequacy requirements, it would result in no additional capacity being procured," thereby leaving the CAISO with insufficient capacity to meet its reliability needs, the Commission said.