

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Electricity Market Design and Structure)

Docket No. RM01-12-000

**COMMENTS
OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION**

The National Energy Marketers Association (NEM) hereby submits comments pursuant to the, "Notice of Working Paper," issued March 15, 2002, in the above-referenced proceeding on the "Working Paper on Standardized Transmission Service and Wholesale Electric Market Design" [hereinafter "Working Paper"].

NEM realizes that the issues addressed in this Working Paper are complex and will have a profound affect on this country's electricity delivery system. NEM applauds FERC for its vision and commitment to open, efficient and competitive energy markets throughout the United States. NEM members would be honored to meet with the Commission and its Staff on the issues contained herein that require further deliberation.

NEM is a national, non-profit trade association representing a regionally diverse cross-section of both wholesale and retail marketers of energy and energy-related products, services, information and technology throughout the United States. NEM's membership includes: small regional marketers, large international wholesale and retail energy suppliers, billing and metering firms, Internet energy providers and trading platforms, energy-related software developers, risk managers, energy brokerage firms and financial institutions, information technology providers as well as suppliers of advanced metering and distributed generation technology. Membership includes both affiliated and unaffiliated companies.

This regionally diverse, broad-based coalition of energy and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas, electricity and related products, services, information and technology in a competitively neutral fashion;
- Rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Competitively neutral standards of conduct that protect all market participants;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and
- Policies that encourage investments in new technologies, including the integration of energy, telecommunications and Internet services to lower the cost of energy and related services.

In general, NEM supports the concepts in the Working Paper and believes that these measures will aid in the development of the competitive market. NEM encourages the Commission to continue to develop its plans for a uniform, competitively neutral, flexible liquid market for transmission service and a standard competitive market design for the wholesale electricity market. NEM offers the following recommendations for the Commission's consideration for inclusion in the "Giga-NOPR" to be released this summer.

I. The Proposed Network Access Service Will Improve Upon Current Terms and Conditions for Access to Transmission Service

NEM members, indeed the country, are indebted to the Commission and its Staff for crafting a well thought-out, effective, efficient and integrated nationwide electricity delivery system that provides all customers open, non-discriminatory, flexible and reliable electric transmission services. The framework described in the Working Paper will give market participants much needed pricing and scheduling flexibility and provide increased access to transmission capacity.

A. Maximum Pricing and Scheduling Flexibility Will Enhance the Competitive Market

Maximum pricing and scheduling flexibility will provide needed liquidity and enhance the

efficiency of the wholesale marketplace. Specifically, NEM supports the Working Paper's broad definitions associated with "source" and "sink" to include, "both individual nodes as well as aggregated points such as trading hubs."¹ Determining congestion costs by offering transmission rights at a predetermined price or the full cost of congestion will clearly enhance liquidity assuming the allocation and pricing of these rights is done properly. NEM also supports FERC's proposal to, "offer source-to-sink options and flowgate rights as soon as it is technically feasible."² Each of these measures increases the efficiency of the wholesale electricity market.

B. Transmission Rights Holders That Do Not Schedule Must Sell Capacity

NEM notes that the Commission has not yet determined if the initial assignment of transmission rights will be accomplished through a direct allocation of the rights, through an auction, or perhaps a hybrid of both methods. However, the Working Paper does provide that, "[i]f a transmission rights holder chooses not to schedule transmission service at a particular time, the transmission capacity will be made available to the market and the transmission rights holder will receive the associated congestion revenue."³ NEM supports the concept that a transmission rights holder that doesn't schedule must sell the transmission rights. NEM submits that requiring the sale of unscheduled rights will provide needed liquidity, price efficiency and both minimize market power issues, while putting all market participants on an equal footing.

II. The Proposed Standard Market Design Will Lead to Greater Efficiencies, Lower Costs and Increased Participation in the Competitive Electric Market

NEM strongly supports the Commission's efforts to develop and implement a standard competitive market design. In particular, NEM supports the Commission's integration of demand response measures, an independent market monitoring unit, and standardized software systems, data formats and data transfer protocols as part of its standard market design in the forthcoming "Giga-NOPR."

A standard market design will help to reduce the seams issues between RTOs thereby allowing market participants to utilize standardized systems for doing business across the country. This

¹ Working Paper at page 7.

² Working Paper at page 11.

³ Working Paper at page 8.

will reduce the costs necessary to do business in comparison with the system investments currently required to accommodate different RTO rules and standards. Standard market design will facilitate market participants' ability to enter into and complete transactions nationwide thereby fostering market entry and growth. A standard market design will also ensure that market participants have equal access and opportunities to compete. NEM notes that standard market design should be just that - the allowance for regional variances and differences must be minimal and where permitted accommodated only upon a strong showing of need, otherwise the possibility of achieving the benefits of standard market design will be severely compromised.

A. Demand Response Measures Should be Utilized as a Part of Standard Market Design

One of the important principles set forth in the Working Paper to guide the development of standard market design is the role of demand response in the market. The Working Paper states, "[d]emand response is essential in competitive markets to assure the efficient interaction of supply and demand, as a check on supplier and locational market power, and as an opportunity for choice by wholesale and end-use customers."⁴ The Commission has repeatedly recognized the value of demand response systems to increase the availability of supply and contribute to the reliability of the grid.⁵ NEM agrees with the Commission that demand response should play a pivotal role in the market. NEM submits that market-based conservation and load-shifting measures have the ability to lower energy prices without imposing mandatory price caps that distort market signals to final end-uses. NEM urges the Commission to permit true price competition to allocate demand-side resources as it does supply-side resources. Liquidity of demand responses can be extremely cost-effective and facilitate efficient short-term solutions to both transmission and generation constraints.

⁴ Working Paper at page 7.

⁵ For example, the Commission has stated that,

"It is widely accepted that dropping even a few megawatts off the system at peak periods is more efficient and economical than the incremental cost of generating them. Demand reduction offers a short-term and cost-effective means to provide additional resources during times of scarcity. Therefore, the Commission will allow, effective on the date of this order, retail customers, as permitted by state laws and regulations, and wholesale customers to reduce consumption for the purpose of reselling their load reduction at wholesale. By providing additional load resources when generating resources are scarce, these "negawatts" should help maintain the reliability of the grid."

Docket No. EL01-47-000, Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States and Requesting Comments on Further Actions to Increase Energy Supply and Decrease Energy Consumption, issued March 14, 2001, at page 10.

B. Independence of the Market Monitoring Unit is Critical

NEM is encouraged by the initial direction taken with respect to Market Monitoring Units (MMUs). The Working Paper provides that, "[e]ach RTO should have an MMU that is independent of the RTO management."⁶ NEM submits that the independence of the MMU is critical. If the MMU is not independent, there is an inherent risk of biased and inequitable findings and actions that could harm market players and the functioning of the market as a whole.⁷

NEM submits that important issues are as yet undetermined with respect to the MMU such as the establishment of guidelines for the MMU to make a finding of the exercise of market power as well as the powers the MMU will have authority to exercise if such a finding is made. NEM submits that the following core principles identified in Staff's Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market with respect to price mitigation measures provide guidance in this area:

- Buyers and sellers need to know the rules up front and have confidence that those rules will not be subject to constant change or interpretation.
- Prices should be mitigated before they are charged, not after.
- The recommended price mitigation should be as surgical (least intrusive) as possible and last for as little time as possible. This should be no longer than needed to allow long term solutions to be attainable.
- The price mitigation should be as market oriented as possible and adopt market solutions and mechanisms to the maximum extent.
- The pricing provisions must encourage, and not discourage, the critically needed investment in infrastructure (e.g., increasing generation supply, adding required transmission, implementing demand response.)⁸

⁶ Working Paper at page 23.

⁷ See e.g., Docket No. EL00-95-000, et al., Order Directing Remedies for California Wholesale Electric Markets, issued December 15, 2000, page 61, wherein the Commission required, "that the ISO Governing Board be replaced with a non-stakeholder Board, and that the members selected to serve on the new Board be independent of market participants." This requirement was imposed subsequent to a Staff Report that found, "indications that the Boards have been susceptible to influence by market participants, particularly by the interest that they represent," leading the Commission to conclude that, "the existing California ISO stakeholder board is ineffective and must be modified." Docket No. EL00-95-000, et al., Market Order Proposing Remedies for California Wholesale Electrics, issued November 1, 2000, at page 27-28.

⁸ Docket No. EL00-95-000, et al., Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market, March 2001, at page 21.

NEM believes that to the greatest extent possible, market forces should be allowed to work with minimal intervention because of the inherent difficulties of achieving a "competitive" result through administratively-imposed rules and regulations. This concept must underlie the guidelines for the MMU to follow. Additionally, if the MMU does find that market power was exercised, subject to established guidelines, its powers to address the conduct should be narrowly circumscribed. For instance, the MMU should not have the ability to take actions that would, in effect, retroactively abrogate contracts, as this would seriously compromise market participants' ability to conduct business and would undermine confidence in the market.

C. Software Systems Should be Modular and Standardized Data Formats and Data Transfer Protocols are Critical

NEM is encouraged by the Commission's recognition that, "[t]o minimize the implementation costs of standard market design, the software should be modular to allow multiple vendors to provide the components of the overall software platform. Standardized data formats and data transfer protocols may also be appropriate to minimize implementation costs."⁹ It is vital that the energy industry be permitted to rely on both a consistent set of wholesale electric standards and a consistent set of information standards that will reduce the costs and risks of implementing new technology.

NEM notes that initial ISO software solutions were custom solutions for unique requirements. However, there has been a fundamental shift in the solutions available. As the industry has matured, software companies have begun to provide package-based, off-the-shelf software that can be configured to specific requirements. This allows costs to be shared amongst a larger number of the software providers' clients and is less expensive than the custom solutions. It also allows for reuse of work that has already been done. Accordingly, NEM urges the Commission to require this type of approach to software implementation to lower the implementation costs of standard market design.

NEM has long advocated the adoption and implementation of uniform business practices and procedures as well as standardized data transfer protocols. NEM urges this Commission to quickly address and resolve the issue of a single, integrated standards development organization

⁹ Working Paper at page 21.

or process for the wholesale electric market.¹⁰ If market participants are forced to divert scarce resources to customize back-office operations, develop and maintain non-standardized information protocols or develop specialized knowledge of different business rules in each jurisdiction, it drives energy prices higher nationwide.

The challenge to implementing wholesale electric standards is the fact that there are currently different information protocols and processes being used to transfer data. To accomplish this, it is critical to also establish energy industry specific "Standardized Information Protocols" (SIPs). To minimize costs, standardized energy information protocols must integrate Internet-based technology, preferably XML, at the earliest possible date.

III. The Proposed Standard Market Design Should Not Impose Artificial Constraints on the Functioning of the Market

Although NEM generally supports the elements of standard market design set forth in the Working Paper, NEM urges the Commission not to incorporate the limits on bidding flexibility and bid caps discussed into the "Giga-NOPR." The imposition of artificial market constraints such as these could negatively impact markets with the devastating effects of deterring competitive entry, reduced availability of supply, and lack of demand response.

A. Limits on Bidding Flexibility Should Not be Imposed

The Working Paper posits that, "[l]imits may be necessary on bidding flexibility to mitigate market power. For example, suppliers may be required to submit a start-up bid which would remain in place for a period of several months (rather than re-bid every day)." NEM urges that the proposed limits on bidding flexibility not be utilized because of the effect the bidding limits will have on the competitive market.¹¹ If suppliers must submit a multi-month start-up bid, there

¹⁰ See Comments of the National Energy Marketers Association, Docket No. RM01-12-000, Electricity Market Design and Structure, dated March 14, 2002 (urging Commission to require that a single organization or process be utilized to develop both commercial and reliability standards or alternatively that FERC lead the standard-setting process and issue proposed standards with sixty days notice and opportunity to comment as a more efficient use of time and resources than a "coordinated," yet bifurcated approach recommended in the Joint Filing).

¹¹ See also Motion to Intervene Out of Time and Comments of the National Energy Marketers Association, Docket No. EL01-63-000, PJM Interconnection, L.L.C., dated April 25, 2001 (urging the Commission to reject PJM's proposed multi-month interval commitment for LSE generation resources and interval deficiency charge because of supply shortage consequences, impact on retail competition, and likely increase to the cost of ICAP).

will be a reduced incentive to enter the market and supply shortages could result for prolonged periods. Requiring start-up bids to remain in place for several months instead of re-bidding every day may also be inconsistent with retail choice programs. To accommodate retail choice programs, LSEs must be able to true-up their load and generation owners must be able to enter the market on a daily basis. A daily market aligns well with retail choice in that customers can be added or removed on a daily basis as their meters are read. By requiring a multi-month bid, the additions of new customers may be difficult to accommodate. NEM submits that market participants should be able to re-bid on a daily basis in order to receive the best value. NEM asserts that bidding provides demand elasticity and acts as a mitigating factor in markets.

B. Bid Caps Should Not Be Utilized As Part of Standard Market Design

NEM is also concerned about the proposed use of bid caps as part of standard market design. The Working Paper states that, "[a] bid cap, as a proxy for demand bidding, must be in effect until sufficient demand response develops in the relevant wholesale power market."¹² NEM recommends that a market-clearing price should be used and that bid caps not be utilized. If the Commission wants a demand response to develop, it must allow market participants to see and respond to real-time prices. A truly competitive market will send the necessary price signals to developers that new supply is needed to meet the demand for electricity. Bid caps prevent proper price signals from being sent, received and acted upon. If the Commission does determine that bid caps should be utilized, NEM strongly urges that a hard-and-fast sunset date be firmly established for their discontinuance.

IV. Embedded Cost Concepts Related to Network Access Service and Assignment of Transmission Rights Should be Clarified

The concept of embedded costs is introduced in the Working Paper with respect to Network Access Service as well as the initial assignment of transmission rights. NEM requests that the Commission clarify what components of embedded costs will be recovered with relation to the

¹² Working Paper at page 23.

network access charge and the initial assignment of transmission rights. The embedded costs of the transmission system are proposed to be recovered as part of the network access charge.¹³ With respect to transmission rights, it is proposed that customers that have paid the embedded costs of the transmission system be entitled to direct allocation of transmission rights.¹⁴ Alternatively, transmission rights would be auctioned and the proceeds would be allocated to those that have paid the embedded costs of the system.¹⁵ NEM submits that it is imperative that a clear delineation between the embedded costs in the network access charge and the embedded costs attendant with assignment of transmission rights be made to avoid double recovery of same costs.

V. The Impact of RTO Regional Planning Decisions on Market Participants Must be Clarified

The Working Paper provides that, "[p]roactive long-term planning and expansion must be done regionally. The RTO, must offer a mechanism for participants to bring long-term planning and expansion needs and proposed solutions to the RTO. The RTO would choose an ultimate solution, whether transmission, generation or demand side, after vetting proposals through a stakeholder process."¹⁶ NEM recommends that market participants should not be forced to make investments in particular locations and is concerned about the effect of RTO siting decisions on entities that do not want to site where the RTO has recommended. The Working Paper leaves many critical elements of the RTO planning process undefined such as the scope of an RTO's authority. It is unclear: 1) whether the RTO will be the ultimate arbiter in the process, 2) if FERC will act in a review and/or enforcement capacity, and 3) what effect state and local siting authorities will have on an RTO's decision. Accordingly, NEM urges the Commission to clarify the process for review of an RTO's siting decision and whether and under what circumstances FERC would require compliance with an RTO decision.

X. Conclusion

NEM applauds the direction the Commission has charted in the Working Paper. With respect to

¹³ Working Paper at page 8.

¹⁴ Working Paper at page 8.

¹⁵ Working Paper at page 8.

¹⁶ Working Paper at page 21.

Network Access Service, NEM strongly supports FERC's proposals that provide both pricing and scheduling flexibility and the requirement that transmission rights holders must sell unscheduled transmission rights. NEM also supports the elements of the standard market design to include demand response measures, independent MMUs, the use of modular software systems and both standardized data formats and transfer protocols. However, NEM urges the Commission not to include the proposed limits on bidding flexibility and bid caps. NEM recommends that the Commission clarify the embedded cost components associated with the Network Access Charge and the assignment of transmission rights as well as the effect of the RTO regional planning process on market participants.

Respectfully submitted,

Craig G. Goodman, Esq.
President,
National Energy Marketers Association
3333 K Street, NW
Suite 425
Washington, DC 20007
Tel: (202) 333-3288
Fax: (202) 333-3266
Email: cgoodman@energymarketers.com
Website-www.energymarketers.com

Dated: March 26, 2002.