



## National Energy Marketers Association

**Remedying Undue Discrimination** )  
**Through Open Access Transmission Service** ) **Docket No. RM01-12-00**  
**And Standard Electricity Market Design** )

### Executive Summary

NEM strongly supports FERC's efforts to implement a Standard Market Design, electronic data protocols and regional markets that can support liquid, transparent and competitively neutral energy trading and delivery operations. The recommendations set forth in NEM's Comments should be read in the context of its strong overall support for the Commission's initiative.

NEM's comments set forth the following recommendations:

- **Congestion Revenue Rights**
  - CRRs should be tradable and should be immediately auctioned to permit the right price signals to reach the market.
  - CRR auction revenues should go to LSEs in proportion to the load they serve.
  - CRRs should follow load as it migrates amongst LSEs.
  - Those that expand the transmission system or otherwise relieve congestion should get the CRRs associated therewith.
- **Transmission Pricing**
  - The network access charge should be in the form of a license plate rate.
  - Rate pancaking must be eliminated.

- **Resource Adequacy Requirement**
  - The use of contracts should be permitted to satisfy the resource adequacy requirement. There should then be a residual capacity auction administered by the ITP, and subsequent auctions as deemed, necessary, to meet shortfalls.
  - The RAR should be flexible enough to utilize physical resources as well as financial resources backed by physical resources to satisfy the resource adequacy requirement.
  - Contracts should be permitted to be backed by a portfolio of resources rather than requiring identification of specific resources.
  - There should be a standard certification process that a generator has a specified amount of MWs.
  - In regions without an existing capacity market, there should be a mechanism to either convert or grandfather existing contracts that do not identify specific resources toward meeting the resource adequacy requirement.
- **State Advisory Committees**
  - The Commission should clarify the roles and responsibilities of the state advisory committees.

NEM appreciates this opportunity to comment on the Commission's proposed Standard Market Design. NEM reiterates our commitment to work with the Commission and the other stakeholders to devise fair and effective ways to implement competitive restructuring of the wholesale electric market.



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### Comments of the National Energy Marketers Association

The National Energy Marketers Association (NEM) hereby submits comments on the Commission's Notice of Proposed Rulemaking issued July 31, 2002, in the above-referenced proceeding. NEM previously submitted a filing dated November 14, 2002, in this docket on the first set of issues for which the Commission requested comments. NEM reiterates its recommendation that the Commission adopt the proposals set forth in its previous filing.

NEM applauds the Commission for the leadership it has exhibited in issuing the standard market design rulemaking and submits that the rulemaking provisions are well within FERC's statutory authority to require, implement and enforce.<sup>1</sup> NEM strongly urges the Commission to insist on adherence to the principles originally enunciated in the NOPR and as set forth in Order 2000 that would ensure large, highly standardized RTOs/ITPs. It is imperative that the Commission remain committed to these principles in order for

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<sup>1</sup> See Docket No. RM01-12-00, Comments of the National Energy Marketers Association, dated November 14, 2002, at pages 6-8.

Standard Market Design to achieve the laudable goals of efficiency, uniformity, equity, liquidity and comparability for the wholesale electric marketplace. Certain recent activities have caused NEM to fear that these objectives may not be achieved. For instance, NYISO and ISONE's withdrawal of their joint application to form the Northeastern RTO<sup>2</sup> would appear to indicate that smaller ITPs may be the unintended outcome of the NOPR.

Furthermore, recent Commission decisions with respect to the western RTOs and SeTrans appear to be relaxing the NOPR implementation timetable and permitting a greater degree of regional differences. In the SeTrans Order the Commission stated that unless it,

has specifically indicated in this order that an element of the RTO proposal is inconsistent with the SMD proposal or needs further work in light of the SMD proposal, we do not intend, in the final SMD rule, to revisit prior approvals or acceptances of RTO provisions because of possible inconsistencies with the details of the final rule.<sup>3</sup>

In his dissent to the SeTrans Order, Commission Massey noted his concerns with such an approach. He explained that, "subordinating aspects of our SMD policy to provisions agreed to in RTO venues risks compromising the objectives of SMD: eliminating undue discrimination, ensuring customer protection, and creating seamless efficient wholesale

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<sup>2</sup> Docket RT02-03, Letter filing of ISONE and NYISO to withdraw joint petition for declaratory order on creation of a Northeastern RTO, dated November 22, 2002.

<sup>3</sup> Docket No. EL02-101-000, Order Granting Petition for Declaratory Order, issued October 10, 2002, para. 2. The Commission also made this statement in its review of the WestConnect RTO proposal. ("unless the Commission has specifically indicated in this order that an element of the RTO proposal is inconsistent with the Standard Market Design proposal or needs further work in light of the Standard Market Design proposal, we do not intend, in the final Standard Market Design rule, to revisit prior approvals or acceptances of RTO provisions because of possible inconsistencies with the details of the final rule.") Docket Nos. RT02-1-000 and EL02-9-000, Declaratory Order on Regional Transmission Organization, issued October 10, 2002, para. 4.

electricity markets."<sup>4</sup> NEM urges that the Commission not permit regional variations that will ultimately undermine the purpose of Standard Market Design.

NEM also submits that there are certain basic market design characteristics for which the Commission must insist on uniformity. These areas include a real resource adequacy requirement and the use of a day-ahead market. At a very minimum, if the Commission does decide to permit some degree of regional differences, it must seriously consider the seams that will be created by such regional differences. The Commission must recognize that the more regional differences that are tolerated, the greater the opportunities will be for arbitrage between RTOs/ITPs.

In responding to requests for regional variation, the Commission should also insist that regions making such requests demonstrate how their local circumstances cannot be accommodated effectively in the base SMD model. A great advantage of the financial rights/LMP market design underlying SMD is its considerable flexibility. NEM expects that many of the contractual issues raised in the West, for example, could be handled easily under the SMD market design, while not preventing efficient dispatch and transmission congestion pricing that occurs under SMD. As an example, almost any existing physical contract form could be converted into a financial hedging contract as used in PJM and other LMP-based markets.

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4 Docket No. EL02-101-000, Order Granting Petition for Declaratory Order, issued October 10, 2002, Commissioner Massey, dissenting in part, page 2. Commissioner Massey voiced similar concerns in his dissent to the WestConnect RTO Order. Docket Nos. RT02-1-000 and EL02-9-000, Declaratory Order on Regional Transmission Organization, issued October 10, 2002, Commissioner Massey, dissenting in part, page 2.

Accordingly, NEM reiterates its strong support for the original and underlying purposes and goals of Standard Market Design. The comments set forth below should be construed consistently with NEM's support for the Commission's initiative.

### **I. Congestion Revenue Rights**

The NOPR, "establishes a preference for the auction of Congestion Revenue Rights." (Para. 382). The NOPR provides that, "[a]fter a transition period, all Independent Transmission Providers would be required to auction their Congestion Revenue Rights. However, for an initial transition period of four years, this rulemaking proposes to allow regional flexibility on this issue." (Para. 382). During the transition, a direct allocation of Congestion Revenue Rights (CRRs) would be permitted. (Para. 382). The Commission questioned, "whether to allow a transition period before the start of Congestion Revenue Rights auction allocations and, if so, what the length of the transition should be." (Para. 382).

**NEM strongly supports the concept of tradable CRRs. NEM also supports the immediate auction of CRRs because it will aid in the development of liquid CRR markets, which are important for market efficiency.** CRR auctions should be of varying duration including daily, monthly, seasonally, semi-annually, annually and multi-year. FERC should not limit access to CRRs thereby creating barriers to entry. If CRRs are allocated directly to LSEs, particularly incumbent LSEs, it could close the market off to competition and new entrants. This was recognized in the NOPR wherein the Commission stated, "if Congestion Revenue Rights are directly assigned, holders of the Congestion Revenue Rights on congested paths may be reluctant to offer these in the secondary market. This could limit the ability of new suppliers to enter the market."

(Para. 381). NEM notes that PJM, which initially allocated Financial Transmission Rights to LSEs, plans to eliminate the allocation and move to a full auction approach in 2003.

Such a concern is especially relevant in states with retail competition, where new entrant retailers must compete head-on with incumbent LSEs. If LSEs are not required to acquire CRRs on equal terms, the scope for retail competition is greatly reduced. This has implications not just for the retail market, but also for the success of wholesale markets under Commission jurisdiction as well. It is well recognized by economists that getting accurate forward-looking price signals to customers is a critical step in achieving the Commission's electric restructuring objectives. A robust retail market for power does just that - provide binding forward-looking prices to all customers that allow them to make more efficient consumption decisions.

The NOPR also provides that, "[i]n states that have retail competition, provisions would also be needed to ensure that the Congestion Revenue Rights stay with the load. So if a new retail marketer starts serving load previously served by the local utility, the retail marketer would get a proportionate share of the Congestion Revenue Rights." (Para. 378, n. 186). NEM recommends that auction revenues go to LSEs in proportion to the load they serve. Furthermore, these auction revenues should follow the load as it migrates from one LSE to another. Furthermore, if allocation of CRRs is ordered, there must be a clear methodology set forth for the allocation that supports the load following of CRRs. **NEM also supports the proposal that those who expand the transmission system or otherwise relieve congestion should get CRRs associated therewith.**

## **II. Transmission Pricing**

A network access charge is proposed to recover the embedded costs of the transmission grid. The charge may be in the form of a license plate or a postage stamp rate. License plate rates utilize, "a different charge for the use of the entire regional transmission system that is based on the revenue requirement of the transmission owner's facilities, or 'zone,' where the transaction sinks." (Para. 168). This system is employed by PJM and NYISO. Postage stamp rates utilize, "the same charge for all customers' use of the utility's grid." (Para. 168). The Commission has proposed to, "permit the use of license plate rates such as those currently in effect within the ISOs." (Para. 173). However, the Commission also asked whether they, "should retain license plate ratemaking only for a transitional period and at some later date, require that all regions have postage stamp rates." (Para. 174).

**NEM recommends the use of license plate rates. NEM submits that postage stamp rates may be more transparent but license plate rates are less complicated. In addition, license plate rates also eliminate cost shifting, at least with respect to intra-ITP transactions. Accordingly, NEM recommends that it may be worthwhile to retain the simpler method.**

**NEM submits the more important issue is that the standard market design rules should not allow for the imposition of import and export fees for moving power in and out of a region.** The NOPR states that,

the design of rates for Network Access Service should eliminate the payment of multiple access charges, such that only one access charge is paid for power to reach load. Accordingly, an export and through-and-out

transaction originating in an Independent Transmission Provider's system and terminating at a load in another Independent Transmission Provider's system would pay only the access charge for the transmission system where power is ultimately delivered to load. (Para. 180).

The Commission's stated rationale for this policy is that, "[r]ate pancaking impedes the ability of distant generators to compete with nearby generators by imposing charges to transmit energy from distant generators that are unrelated to actual variable transmission costs," (Para. 170) and that, "[i]n a competitive market environment, reliability and the supplier's cost of generation, rather than sunk transmission costs, should be the primary drivers for a customer's choice of power suppliers." (Para. 183). NEM strongly agrees that rate pancaking must be eliminated. Additionally, inasmuch as it appears that ITPs could be smaller than RTOs, eliminating rate pancaking becomes even more significant.

Elimination of rate pancaking between ITPs is a desirable policy objective that will enhance efficient dispatch across regions without regard to ITP footprints. Ideally, this should be no different from the question of eliminating rate pancaking within an RTO or ITP footprint. NEM is cognizant of the complexities that may arise among ITPs with an imbalance of imports versus exports or vice versa.

Elimination of rate pancaking within and across ITP boundaries remains an important objective. If transfer payments between ITPs becomes an issue we request an additional opportunity to comment at that time. However, it is vital to minimize both pancaking and complexity during the transition to greater liquidity.

### **III. Long Term Resource Adequacy Requirement**

The resource adequacy requirement is proposed to be satisfied, "by a combination of generation, transmission, and demand response infrastructure." (Para. 503). The NOPR

states that, "[t]he supply requirement could be satisfied by self-owned generation, local distributed generation, or firm bilateral contracts for power that are backed by specific generating units (or a portfolio of designated generation units). The firm bilateral contract could be either a forward contract for the purchase of power or an option to purchase energy under specified shortage or price conditions, as long as the firm contract is backed by specified generating units." (Para. 504). Additionally, "[g]eneration under contract must specify that the generator will be available to the load-serving entity - or at least to the market that the load-serving entity participates in - under conditions set out in the contract." (Para. 505). Furthermore, "generating units under contract must be real and specific generators." (Para. 511). The NOPR also provided that, "a contract with a marketer to deliver power at a future time from unspecified sources cannot satisfy the requirement." (Para. 513).

The processes underlying any resource adequacy requirement mechanism are extremely complicated. RAR mechanisms based on LSE load allocations, such as the mechanism described by the Commission in the NOPR, require that load serving entities that continuously swap loads forecast load requirements three to five years out. The administration of a mechanism to allocate future load requirements is quite cumbersome, and it may prove difficult or impossible to create accurate incentives on individual load serving entities, thus increasing the administrative and monitoring burdens on the ITP. This is especially true in markets with retail competition.

Ideally, the most efficient means to determine the price of future capacity would be highly liquid, tradable three to five year futures contracts with guaranteed physical delivery at each of the ITP trading hubs. However, these instruments do not currently

exist and will not exist without implementation of standard market design processes, electronic data protocols and regional markets that can support liquid, transparent and competitively neutral energy trading and delivery operations. Consequently, NEM is addressing what appears to be a government mandate to purchase future capacity, which by historical experience has always produced anomalous results. The recommendations that NEM submits below are given in this context.

**NEM recommends that the use of contracts should be permitted to satisfy the resource adequacy requirement. There should then be a residual capacity auction administered by the ITP, and subsequent auctions as deemed necessary, to meet shortfalls. The market clearing price will be set by the RAR suppliers' bids, and the loads that had not procured their requirements bilaterally, in advance, and have a shortfall would pay the ITP the cost of procuring RAR in its auction for residual requirements not covered by advance bilateral contracts. This would preclude the need for the penalty provisions specified in the NOPR. The auctions should also establish a revenue stream guaranteed to be payable to generators. This is a necessary counterbalance to the negative incentive of the price ceilings proposed in the NOPR. Market participant credit issues attendant with the auction should be dealt with by the ITP. Additionally, reconfiguration auctions should be permitted to allow market participants to exchange their obligations after an auction. Market participants must be able to buy and sell to have requisite flexibility.**

**NEM recommends that the ITP should be flexible enough to utilize physical resources as well as financial resources backed by physical resources to satisfy the**

**resource adequacy requirement. Market participants, including wholesalers and retailers, should establish rules to preclude double counting of resources.**

**FERC should also establish flexible credit requirements for the ITP for the capacity auctions to ensure that smaller companies subject to greater financial and credit constraints have the opportunity to obtain capacity commensurate with the larger companies. For example, retail contracts could be linked to auctions so that the capacity would follow the customer in the circumstance in which its retail supplier were to go out of business.**

**NEM also recommends that contracts should be permitted to be backed by a portfolio of resources rather than requiring identification of specific resources.** The resource adequacy requirement process, as compared to the short lead time in current ICAP markets, introduces a much larger risk component into the process (for example load forecast uncertainty). At the same time, by tying the requirement strictly to physical assets, the resource adequacy process minimizes the role of the financial and risk management professionals out of the market. Furthermore, there will in any event be a requirement for "near real time" reallocation of capacity obligation based on retail load shifting.

NEM submits that it is unclear what the inherent difference is between a physical obligation on a load serving entity with a non-performance penalty and a financial obligation on a marketer/risk manager without a specific resource (at least at the time of contracting three to five years before delivery) with a non-performance penalty. Whether the LSE contracts with an entity that will build generation to meet the three year resource

adequacy requirement or will contract with a marketer to deliver the resources from some yet-to-be-defined resource, the contract will specify the mutually agreeable allocation of risk of non-performance between the LSE and the supplier. NEM sees no harm in allowing existing and prospective suppliers to participate in the auction and any supplier including LSEs submitting bilaterals, and prospective suppliers should be permitted to assume the risk for not showing up three years hence.

**NEM also recommends that there should be a standard certification process that a generator has a specified amount of MWs. This certification process should be established at the federal level but administered by the ITP.**

**NEM is also concerned that retailers with an existing contractual portfolio do not know where the specific electrons come from. NEM recommends that in regions without an existing capacity market, there be a mechanism to either convert or grandfather existing contracts that do not identify specific resources toward meeting the resource adequacy requirement.** This will avoid the problem of having to "find" capacity in existing contracts. The liquidated damages provisions in many existing contracts should be sufficient during the transition period.

The Commission proposes a two-prong enforcement mechanism for the resource adequacy requirement. By the terms of the first prong, "[i]f shortage conditions develop to the point where the Independent Transmission Provider cannot serve all load and maintain the minimum level of operating reserves," (Para. 528) then, "during such a shortage the Independent Transmission Provider must add a per-megawatt-hour penalty price to the price of energy taken from the spot market by a load-serving entity that did

not meet its share of the regional needs for that year. This rate would apply only to spot energy purchases, not to power received from the load-serving entity's self-generation or bilaterally contracted energy." (Para. 529). The second prong of the enforcement mechanism is employed, "when the operating reserve level decreases to the point that some load must be curtailed." (Para 532). At that point, "spot energy purchases of that load-serving entity load would be reduced by the amount of its resource deficiency and consequently some of its customers would be curtailed before the loads of other load-serving entities." (Para. 532). As an additional penalty the Commission proposes to, "charge the applicable Locational Marginal Price plus \$1000/MWh for all unauthorized energy taken following an instruction to implement curtailment." (Para. 534).

**NEM submits that the proposed curtailment remedy is not workable because of the impossibility of selectively cutting off transmission customers. NEM submits that a better approach to assure resource adequacy is to have the ITP conduct auctions to procure sufficient resources if LSEs do not supply enough bilaterally.**

#### **IV. State Advisory Committees**

It is unclear from the NOPR what exact role the state advisory committee will play and what information they will have access to. NEM is concerned that these bodies would be provided with access to confidential information the sharing of which could present significant problems. **NEM requests that the Commission clarify the roles and responsibilities of the state advisory committees.**

## V. Conclusion

NEM's comments as set forth above should be construed consistently with NEM's strong overall support for the original goals and purposes to be accomplished by the proposed rules - standardization, efficiency, equity, liquidity and comparability. It is within this context that NEM recommends that: 1) CRRs should be immediately auctioned; 2) CRR auction revenues should go to LSEs in proportion to the load they serve, and the revenues should follow load as it migrates amongst LSEs; 3) the network access charge should be a license plate rate; 4) rate pancaking must be eliminated; 5) contracts should satisfy the resource adequacy requirement; 6) the RAR mechanism should incorporate a residual capacity auction administered by the ITP to meet shortfalls; 7) physical resources and financial resources backed by physical resources should satisfy the RAR; 8) contracts should be permitted to be backed by a portfolio of resources rather than requiring the identification of specific resources; 9) a standard certification process to ensure a generator has a specified amount of MWs should be utilized; and 10) in regions without an existing capacity market, grandfathering of existing contracts that do not identify specific resources should be permitted to meet to the RAR.

Respectfully submitted,

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