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April 21, 2008

**VIA ELECTRONIC FILING**

Honorable Kimberly D. Bose  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, DC 20426

**Re: Wholesale Competition in Regions with Organized Electricity  
Markets, Docket Nos. RM07-19-000, AD07-7-000; Comments  
of ISO New England Inc.**

Dear Ms. Bose:

Transmitted electronically for filing in the above-referenced dockets are the  
Comments of ISO New England Inc.

If there are any questions concerning this filing, please call me at (202) 661-2205.

Very truly yours,

/s/

Howard H. Shafferman  
Counsel for  
ISO New England Inc.

Enclosure

**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 ISO NEW ENGLAND INC.**

Pursuant to the Notice of Proposed Rulemaking (“NOPR”) issued by the Federal Energy Regulatory Commission (the “Commission”) in the above-captioned proceedings, ISO New England Inc. (“ISO-NE”) respectfully submits these comments.

**I. BACKGROUND**

ISO-NE is the private, non-profit entity that serves as the Regional Transmission Organization (“RTO”) for New England. ISO-NE administers the New England energy markets and operates the regional bulk power system (*i.e.*, those facilities located in the New England region) pursuant to the ISO New England Inc. Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3 (the “ISO-NE Tariff”)<sup>1</sup> and Operating Agreements with the New England transmission owners. In its capacity as the RTO for New England, ISO-NE has the responsibility to protect the short-term reliability and plan for the long-term reliability of the control area, a six-state region that includes approximately 6.5 million businesses and households.

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<sup>1</sup> Capitalized terms used but not defined in this filing are intended to have the meaning given to such terms in the ISO-NE Tariff or in the Participants Agreement among ISO-NE and the New England Power Pool and any individual Participants (the “Participants Agreement”). The Participants Agreement was accepted by the Commission in *ISO New England, et al.*, 109 FERC ¶ 61,147 (2004).

As an RTO, ISO-NE is engaged in measures in each of the areas addressed by the NOPR. ISO-NE is commenting herein on proposals in the NOPR with which it has concerns or to which it is advocating specific modifications. In order to provide context, each area of ISO-NE comment is generally preceded by a summary of the Commission's proposals and a review of ISO-NE's existing structures and activities.

## **II. COMMENTS**

### **A. Demand Response and Pricing During Periods of Operating Reserve Shortages in Organized Markets**

In the NOPR, the Commission proposes several requirements for RTOs and independent system operators ("ISOs") in the area of demand response and the use of market prices to elicit demand response. By way of overview, these proposals would require that RTOs/ISOs:

- accept bids from demand response resources in their markets for certain ancillary services, comparable to any other resources;
- 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;
- permit an aggregator of retail customers ("ARC") to bid demand response on behalf of retail customers directly into the organized energy market;
- modify their market rules, as necessary, to allow the market-clearing price, during periods of operating reserve shortage, to reach a level that rebalances supply and demand so as to maintain reliability while providing sufficient provisions for mitigating market power; and
- study whether further reforms are necessary to eliminate barriers to demand response in organized markets.<sup>2</sup>

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<sup>2</sup> NOPR, at P 6.

## **1. Ancillary Services Provided by Demand Response Resources**

### **a. NOPR**

Under the proposed rule, market participants would be allowed to submit bids to provide ancillary services from demand resources for services that are acquired as part of a competitive bidding process.<sup>3</sup> The Commission also proposes that each RTO must allow market participants to specify the maximum duration of time and the maximum number of times that a demand resource may be dispatched to provide ancillary services during a day, as well as the maximum amount of energy that a demand resource would provide on a daily or weekly basis.<sup>4</sup> In the NOPR, the Commission clarifies that demand resources must satisfy reasonable requirements relating to metering, telemetry and other technical operating issues. Finally, the Commission proposes to require each RTO to assess the technical feasibility and market value of allowing small demand resources to provide ancillary services within one year from the effective date of a final rule.<sup>5</sup>

### **b. Current New England Approach**

In New England, the following ancillary services are acquired as part of a competitive bidding process: Operating Reserves, Ten-Minute Non-Spinning Reserve, Thirty-Minute Operating Reserve), and Regulation.

New England is actively encouraging provision of ancillary services by demand resources, consistent with ISO-NE's core market design, which co-optimizes the reserve and

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<sup>3</sup> NOPR, at P 56.

<sup>4</sup> NOPR, at P 62.

<sup>5</sup> NOPR, at P 59.

energy markets.<sup>6</sup> For example, ISO-NE's Demand Response Reserve Pilot Program<sup>7</sup> permits small, dispersed resources (less than 5 MW) to provide operating reserves, and the Asset Related Demand infrastructure<sup>8</sup> permits Dispatchable Asset Related Demand to participate directly in the wholesale energy and reserve markets and the Locational Forward Reserve Market.

ISO-NE treats larger demand resources (greater than or equal to 5 MW) comparably to generation resources in each of the foregoing contexts, by requiring both types of resources to offer into the energy markets if they desire to provide reserves or forward reserves. The intent of the Demand Response Reserve Pilot Program is to assess the ability of smaller demand resources to provide reserve products to the wholesale market, and to develop comparable communication, metering, telemetry and other technical infrastructure solutions that are more suitable and cost-effective for smaller, dispersed demand resources. "Comparable," in this context, means that using demand resources for provision of ancillary services will not compromise reliability. The ultimate goal of the Demand Response Reserve Pilot Program is to fully integrate small demand

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<sup>6</sup> ISO-NE's core market design does not allow for separate bids to be placed in the energy and real-time reserve markets for any resource. The decision to schedule a resource to provide energy as opposed to real-time reserves is based on the resource's bid in the energy market. Allowing for separate bids to be placed in the energy and real-time reserve markets would undermine this core market design, which co-optimizes the pricing of energy and reserves in real-time. *See ISO New England Inc. and New England Power Pool*, 115 FERC ¶ 61,175 (2006). Prior to its introduction, this co-optimization was referred to by the Commission as a "high-priority market improvement." *See New England Power Pool and ISO New England Inc.*, 105 FERC ¶ 61,211, at P 34 (2003). *See also* NOPR, at P 60 ("The Commission is mindful of these concerns and does not intend to negatively affect the market efficiencies created by co-optimized market designs.")

<sup>7</sup> This program is also referred to as the "Small Resource Reserves Pilot Program" to recognize that Settlement-Only Generators can participate as well as demand resources.

<sup>8</sup> For a fuller discussion of Asset Related Demand, see page 48 of the testimony of Marc D. Montalvo, Attachment 2 to the February 6, 2006 filing of ISO-NE and NEPOOL in Docket No. ER06-613-000.

resources into the wholesale energy and reserve markets. The planned extension of the pilot program is discussed further in Section II.A.5.b of these comments.

In addition, the ISO will undertake an 18-month pilot program beginning in November 2008 to consider how non-generation resources can be integrated into the regulation market.

### **c. Comments**

With respect to the Commission's proposal to permit demand resources to specify the maximum duration of time and the maximum number of times that a demand resource may be dispatched to provide ancillary services during a day, as well as the maximum amount of energy that a demand resource would provide on a daily or weekly basis, ISO-NE notes that generation and demand resources bidding into New England's Forward Reserve Market must meet certain minimum standards of availability.<sup>9</sup> For example, a Fast Start Generator participating in the market must (1) be able to start within 10 or 30 minutes, and (2) have a minimum downtime not exceeding one hour and a minimum run time not exceeding one hour.<sup>10</sup>

For this reason, although ISO-NE does not oppose granting individual demand resources the opportunity to specify availability parameters, such specification may limit their qualification (under market rules) *on an individual basis* to bid to supply operating reserves.<sup>11</sup> Nonetheless, demand response aggregators should be in a position to formulate bids combining individual demand resources so as to be able to meet the availability requirements of the reserves market in a manner comparable to that of generation. That is, while it might be true that the electricity

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<sup>9</sup> See ISO-NE Tariff § III.9.5.2 ("Forward Reserve Resource Eligibility Requirements").

<sup>10</sup> See definition of "Fast Start Generator" in ISO-NE Tariff § III.1.3.2.

<sup>11</sup> Limitations on generation resources' parameters comparably affect those resources' opportunities, because Limited Energy Resources similarly must meet availability requirements in order to supply operating reserves.

demands of specific, individual customers are available for interruption only for limited periods, the diversity among customers should enable an aggregator (or several aggregators) to combine such customers so as to meet the availability requirements of the reserves markets while addressing the needs and limitations of individual customers in the aggregation. It is important to emphasize that the aggregated resources will have to be at a similar electrical location, however. At the present time, 1,700 MW of Real-Time Demand Response resources currently participating in New England's markets are provided by about 2,600 separate assets – certainly, some combination of these 2,600 assets would provide the market place with a consistent strip of reserve capacity comparable to that of generation.

In any event, if the Commission requires RTOs/ISOs to accept inflexible parameters for demand resources, it should permit RTOs/ISOs to undertake stakeholder processes to develop compliance measures that are technically feasible and cost-effective, and consistent with existing systems and regional practices.

## **2. Deviation Charges**

### **a. NOPR**

The proposed rule would eliminate “deviation charges” during system emergencies for load-serving entities that use less energy in real-time than was cleared in the day-ahead market.<sup>12</sup> The Commission states in the NOPR that deviation charges include start-up costs and costs associated with generators that are committed after the close of the day-ahead market.<sup>13</sup> The Commission states that these costs would be charged to “all loads of the RTO or ISO.”<sup>14</sup>

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<sup>12</sup> NOPR, at P 72.

<sup>13</sup> NOPR, at n. 82.

<sup>14</sup> NOPR, at P 77.

The Commission also seeks comment on whether deviation charges should also be eliminated for “virtual purchases” during system emergencies.<sup>15</sup>

**b. Current New England Approach**

In New England, the majority of the uplift costs (in terms of relative dollars) resulting from deviations between day-ahead commitments and real-time consumption are charged to load, as part of the Net Commitment Period Compensation (“NCPC”) mechanism. As discussed below, a small portion of these uplift costs are charged to parties based on their relative contribution to the overall deviation.

Thus, if adopted, the proposed rule would appear to require changes to the existing allocation of certain costs in New England. Specifically, several sub-categories of NCPC charges are allocated based on deviations (positive and negative)<sup>16</sup> between day-ahead cleared demand and real-time demand.<sup>17</sup>

By way of illustration, Real-Time Economic NCPC<sup>18</sup> is the largest category of costs that are allocated based on deviations. From January 2006 through February 2008, the total amount of Real-Time Economic NCPC costs was approximately \$59 million (or about 11% of total NCPC costs over the period). Of this total amount, the ISO's preliminary analysis indicates that

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<sup>15</sup> NOPR, at P 78.

<sup>16</sup> In New England, when the day-ahead cleared demand of a load-serving entity (“LSE”) is greater than its actual real-time demand, the LSE is said to have a “positive deviation.”

<sup>17</sup> These categories of expense are Real-Time Economic NCPC (see ISO-NE Tariff § III.F.3.2.15), Cancellation Fees (see ISO-NE Tariff §§ III.F.2.5.3, III.F.2.5.4, III.F.2.5.5) and Resources Pool-Scheduled in Day-ahead and not dispatched in Real-Time (see ISO-NE Tariff § III.F.2.1.17).

<sup>18</sup> Real-Time Economic NCPC generally comprises the costs associated with providing protection against a first contingency event.



approximately \$8.8 million is associated with days that could be considered to have experienced a reserve and/or capacity shortage.<sup>19</sup>

**c. Comments**

While the ISO agrees that eliminating the deviation charges as proposed by the Commission could improve incentives for demand to respond during emergencies, the improvement in incentives in New England is likely to be small because, as indicated in the illustration in the prior subsection, only a small proportion of NCPC charges in New England are allocated based on deviations, and an even smaller portion, in turn, of the deviation-allocated NCPC charges are likely to be incurred on days in which a reserve and/or capacity shortage occurs. In this context, the benefits of changing the cost allocation must be weighed against the costs in terms of the time and effort of the ISO and stakeholders to develop the alternative allocation mechanism, and to accomplish software changes necessary to implement it.

Further, as noted in ISO-NE's ANOPR comments, overall NCPC charges in New England (i.e., those allocated both to load and to deviations) are likely to be low during an operating reserve shortage, because the existing shortage pricing rules send the proper price signal on which users should base their consumption decisions. NCPC is paid to resources whose cost in providing energy or operating reserves exceeds its revenue. During a reserve shortage, most resources would likely be dispatched and would earn shortage prices that can exceed the \$1,000/MWh offer cap. At such high prices, it is likely that revenues to resources providing energy or operating reserves would exceed their costs, thereby minimizing NCPC charges.

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<sup>19</sup> *I.e.*, any days in which Reserve Zone/Reserve Product RCPF was used in any hour.

If the Commission nonetheless formulates the final rule so as to direct the allocation of all deviation uplift charges to load during an “operating reserve shortage,” ISO-NE requests that the Commission allow each RTO/ISO, through its stakeholder processes, the flexibility to further refine and implement the “operating reserve shortage” trigger in a manner that is clearly consistent with terminologies utilized in its tariff and operating procedures.

With respect to whether deviation charges should be eliminated for virtual purchasers during system emergencies, ISO-NE recognizes that virtual purchases increase day-ahead commitment of resources thereby reducing the likelihood of a system emergency. However, exempting virtual purchases from deviation-based charges may encourage speculation and result in over-commitment of generation when it is not needed, thereby distorting the market. For these reasons, ISO-NE does not support exempting virtual purchases from deviation charges.

### **3. Aggregation of Retail Customers**

#### **a. NOPR**

The Commission proposes to require that RTOs/ISOs allow demand response aggregators, including entities that are not load-serving entities, to participate in the wholesale markets.<sup>20</sup>

#### **b. Current New England Approach**

. ISO-NE’s market rules allow and encourage demand response aggregators’ participation. Specifically, current provisions of Market Rule 1 permit ARCs – both retail suppliers (*i.e.*, LSEs) and non-LSE demand response providers – to aggregate retail customers

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<sup>20</sup> NOPR, at P 86.

for the purposes of participating in the Demand Response Programs and in the Forward Capacity Market.<sup>21</sup>

In fact, ARCs are the most substantial contributor of demand resources in the ISO-NE market. Certain provisions in ISO-NE's market rules are intended to encourage the participation of ARCs in the New England wholesale markets. For example, ARCs are not required to be LSEs in order to aggregate customers for participation in the Demand Response Programs or the Forward Capacity Market.<sup>22</sup>

#### **4. Market Rules Governing Price Formation During Periods of Operating Reserve Shortage**

##### **a. NOPR**

In the proposed rule, the Commission declines to adopt a specific, uniform policy on pricing during reserve shortages.<sup>23</sup> Instead, the Commission proposes to require each RTO/ISO to either: (1) demonstrate that its existing market rules appropriately reflect the value of energy

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<sup>21</sup> See, e.g., ISO-NE Tariff § III.E.2.2, indicating that, for the Day-Ahead Load Response Program, "Resources may be aggregated to reach the 100 kW minimum." See also definition of "Demand Resources" in ISO-NE Tariff § III.1.3.2 ("A Demand Resource may include a portfolio of measures aggregated together to meet or exceed the minimum Resource size requirements of the Forward Capacity Auction.")

The ANOPR had incorrectly stated that while ISO-NE permits aggregation of retail customers, aggregation is not integrated into its market rules.

<sup>22</sup> Further special classes of market participants, namely Demand Response Provider-only and Other Demand Resource-only Market Participants, have been created that pay a much lower fee than traditional LSEs to participate in the ISO-NE-administered markets. All types of market participants participate in ISO-NE's Demand Response Programs and in the Forward Capacity Market, including (1) regulated utility distribution companies, (2) competitive LSEs, (3) non-utility/non-LSE Demand Response Provider-only and Other Demand Resource-only Market Participants, (4) governmental and quasi-governmental agencies, (5) public power entities, and (6) individual large commercial and industrial customers.

<sup>23</sup> NOPR, at P 115.

during reserve shortage periods;<sup>24</sup> or (2) adopt one of the four options identified in the ANOPR<sup>25</sup> or an alternative approach to appropriately price energy during a reserve shortage. For RTOs/ISOs that seek to demonstrate that their existing market rules appropriately price energy during a reserve shortage, the Commission proposes to require the submission of factual support, including historical evidence regarding the interaction of supply and demand during reserve shortages.<sup>26</sup>

The Commission specifies the criteria that it will use to evaluate each RTO's/ISO's filing<sup>27</sup> and requests comments on the proposed criteria. The Commission also proposes to require that each RTO's independent market monitor provide its views on any proposed reforms in this area.<sup>28</sup>

#### **b. Current New England Approach**

As the Commission notes in the NOPR, ISO-NE has implemented a demand curve for pricing reserves.

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<sup>24</sup> NOPR, at P 117.

<sup>25</sup> The four options are: (1) increasing the existing caps on supply offers and demand bids during reserve shortage periods; (2) increasing only the existing caps on demand bids during reserve shortage periods; (3) establishing demand curves for operating reserves; and (4) setting energy prices during a reserve shortage at the level of any payment made to participants in an emergency demand response program. NOPR at PP 123-126.

<sup>26</sup> NOPR, at P 118.

<sup>27</sup> NOPR, at P 119.

<sup>28</sup> NOPR, at P 122.

**c. Comments**

Through its implementation of a demand curve for pricing reserves, ISO-NE has already adopted one of the four ANOPR options, and would be in compliance at the outset if the proposed rule is adopted.<sup>29</sup>

**5. Further Reforms to Eliminate Barriers to Demand Response**

**a. NOPR**

In the NOPR, the Commission announces that it will direct staff to hold a technical conference shortly after receiving NOPR comments to consider the following issues for demand response participation in the wholesale markets: (1) if there are barriers to comparable treatment of demand response that have not previously been identified and what they are; (2) potential solutions to eliminate any potential barriers to comparable treatment of demand response; (3) appropriate compensation for demand response; and (4) the need for and the ability to standardize terms, practices, rules and procedures associated with demand response, among other things.<sup>30</sup>

**b. Current New England Approach**

ISO-NE has been a pioneer in the area of demand response and its integration into competitive energy, ancillary service and capacity markets.<sup>31</sup> ISO-NE and NEPOOL continue to explore additional improvements to demand response programs and integration.

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<sup>29</sup> Because the demand curves are already in place, there would be no “proposed reforms” for New England that would require comments from ISO-NE’s external MMU. *See* NOPR, at P 122.

<sup>30</sup> NOPR, at P 95.

<sup>31</sup> *See, e.g., PJM Interconnection, LLC*, 119 FERC ¶ 61,318 at P 203 and n.158 (urging PJM to consider the applicability, for its capacity market, of New England’s approach to integrating energy efficiency into the Forward Capacity Market).

To remove barriers to small demand response resources, ISO-NE has recently initiated discussions with NEPOOL on a proposal to modify and extend the current Demand Response Reserve Pilot Program through June 1, 2010. The current Demand Response Reserve Pilot Program is scheduled to expire on October 1, 2008. The intent of this program extension is to enable ISO-NE to complete its work to more fully integrate demand response resources into ancillary service markets, in coordination with the energy market.

The extension of the Demand Response Reserve Pilot Program would enable ISO-NE to finalize requirements for:

- Communication, dispatch, metering, and telemetry sufficient for demand response resources to provide ancillary services;
- Implement identified lower-cost communications and telemetry solutions and verify compliance with operational requirements; and
- Integrate communications infrastructure with operations and market systems.

Additionally, work to integrate Demand Resources into system operation and planning, especially given the tremendous response that ISO-NE received from demand resources in response to the first Forward Capacity Auction, will be continuing from now through 2010. Given that a large proportion of total resources that will be used to meet Installed Capacity Requirements in the 2010 Power Year and beyond will be demand resources, ISO-NE must upgrade its market rules, operating and planning procedures, and system infrastructure to effectively operate the future electric system. This work has already commenced and will continue through the beginning of 2010. Of course, this work will be conducted in addition to the administration of the FCM qualification and auction processes.

## **B. Market Monitoring Policies**

In the NOPR, the Commission proposes, in order to improve market monitoring, that each RTO and ISO provide its market monitoring unit (“MMU”) with access to market data, resources and personnel sufficient to carry out its duties, and that the MMU (or the external MMU in a hybrid structure) report directly to the RTO or ISO board.<sup>32</sup>

In addition, the Commission proposes to require that the MMU’s functions include:

- identifying ineffective market rules and recommending proposed rules and tariff changes;
- reviewing and reporting on the performance of the wholesale markets to the RTO or ISO, the Commission, and other interested entities; and
- notifying appropriate Commission staff of instances in which a market participant’s behavior requires investigation.<sup>33</sup>

The Commission also proposes to:

- expand the list of recipients of MMU recommendations on rule and tariff changes;
- broaden the scope of reportable behavior;
- remove the MMU from tariff administration;
- require each RTO and ISO to include ethics standards for MMU employees in its tariff; and
- require each RTO and ISO to consolidate all its MMU provisions in one section of its tariff.<sup>34</sup>

The Commission also proposes broader dissemination of MMU market information, more frequent reports, and a reduced time period for public release of energy market bid and offer data.<sup>35</sup>

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<sup>32</sup> NOPR, at P 8.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

The market monitoring structure implemented by ISO-NE relies on two independent market monitoring units: ISO-NE’s Internal Market Monitoring Unit (“INTMMU”) and the external Independent Market Monitoring Unit (“IMMU”). The IMMU role currently is performed by Dr. David Patton and his firm, Potomac Economics, LTD.

**1. Independence and Function**

**a. Structure and Tools**

**i. NOPR**

In the NOPR, the Commission observes that the nature of the MMU structure is not determinative of either independence or quality of performance, and proposes that each RTO and ISO decide for itself, through its appropriate stakeholder process, whether it will have an external, internal or hybrid MMU structure.<sup>36</sup> Further, the Commission declines to remove MMUs from overview by their RTOs and ISOs, as the MMU’s principal duties involve monitoring RTO/ISO markets and advising the RTO or ISO on market performance.<sup>37</sup>

Instead, the proposed rule would require each RTO to adopt a tariff provision imposing on 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.<sup>38</sup> The tariff provisions would specifically provide that the MMU would have access to the RTO’s market information database.<sup>39</sup> The tariff provisions would also provide that any data created by an MMU, including

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(...continued)

<sup>35</sup> *Id.*

<sup>36</sup> NOPR, at P 179.

<sup>37</sup> *Id.*

<sup>38</sup> NOPR, at P 180.

<sup>39</sup> *Id.*



reconfiguration of original RTO database information, would be kept within the exclusive control of the MMU.<sup>40</sup>

## **ii. Current New England Approach**

The ISO-NE Tariff already provides for access by the INTMMU to any information gathered by the ISO in the course of administering the markets.<sup>41</sup> Similar provisions are included in the contract between ISO-NE and its external IMMU, Potomac Economics, LTD.<sup>42</sup>

## **iii. Comments**

ISO-NE is prepared to work with NEPOOL to develop any necessary tariff modifications to comply with the final rule.

### **b. Oversight**

#### **i. NOPR**

The Commission proposes that MMUs, for purposes of supervision over their market monitoring functions, report to an RTO's board of directors rather than to management.<sup>43</sup> The Commission also proposes that any management representatives on an RTO board be excluded from oversight of an MMU's market monitoring functions.<sup>44</sup> The Commission clarifies that MMUs may report to management for administrative purposes.<sup>45</sup> Furthermore, in cases where an RTO has both an external and internal MMU, the internal MMU may report to management

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<sup>40</sup> *Id.*

<sup>41</sup> *See* ISO-NE Tariff § III.A.11.

<sup>42</sup> Section IV(b) of the Scope of Work that is Exhibit A to the contract states: "As required by Section 9.4.5 of the Participants Agreement, the parties agree that the IMMU shall have reasonable access to ISO-NE's data and personnel, including ISO-NE management responsible for market monitoring, operations and billing."

<sup>43</sup> NOPR, at P 187.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

for both market monitoring and administrative purposes, while the external MMU reports to the board.<sup>46</sup>

## **ii. Current New England Approach**

The INTMMU reports administratively to ISO-NE's Chief Executive Officer, whereas both the INTMMU and IMMUE report functionally to the ISO-NE Board of Directors through its Markets Committee. This reporting structure is analogous to the oversight structure of internal and external auditors in corporate finance. The functional reporting relationship of the INTMMU directly with the Markets Committee of an independent board provides the INTMMU with the independence that is vital to its ability to serve as an objective monitor of the competitive wholesale markets and to perform its obligation to inform regulators of any problems that require attention.

## **c. Functions**

### **i. NOPR**

The Commission proposes that the functions of an MMU include the following:

- (1) evaluating existing and proposed market rules, tariff provisions and market design elements for their effectiveness, and recommending proposed rule and tariff changes not only to the RTO or ISO, but also to the Commission's Office of Energy Market Regulation staff and to other interested entities such as state commissions and market participants, with the caveat that the MMU is not to effectuate its proposed market design itself (a task belonging to the RTO or ISO), and with the further caveat that the MMU should limit distribution of its identifications and recommendations to the RTO or ISO and to Commission staff in the event it believes broader dissemination could lead to exploitation, with an explanation of why further dissemination should be avoided at that time;
- (2) reviewing and reporting on the performance of the wholesale markets to the RTO or ISO, the Commission, and other

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<sup>46</sup> *Id.*

interested entities such as state commissions and market participants; and

(3) identifying and notifying the Commission's Office of Enforcement staff of instances in which a market participant's behavior, or that of the RTO or ISO, may require investigation, including suspected rule or tariff violations, market manipulation, inappropriate dispatch, and suspected violations of Commission-approved rules and regulations.<sup>47</sup>

The Commission does not specify that any tariff changes should be filed to reflect the proposed statement of MMU functions. However, the Commission does propose that each RTO amend its tariff to provide that the RTO may not alter reports generated by an MMU nor dictate the conclusions reached by an MMU, but may establish a reasonable mechanism for the RTO to review and comment on an MMU's draft report.<sup>48</sup>

## **ii. Current New England Approach**

The ISO-NE Tariff and the contract between ISO-NE and its IMMUs already address most of the required functions proposed by the Commission, and its compliance filing will address any areas not covered.

## **iii. Comments**

The ISO urges the Commission to add a fourth function for MMUs, encompassing their routine daily monitoring of the market, along the lines of the following text:

(4) regular daily monitoring of the wholesale markets, in order to obtain timely access to information that would provide a broader context for evaluating particular types of conduct, and that could speed and enhance detection of manipulative behavior.

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<sup>47</sup> NOPR, at P 198.

<sup>48</sup> NOPR, at P 199.

**d. Mitigation and Operations**

**i. NOPR**

The Commission proposes to remove MMUs from performing mitigation or other tariff administration functions.<sup>49</sup> While acknowledging that a majority of commenters opposed the Commission's proposal in their ANOPR comments, the Commission determined that the removal of MMUs from performing mitigation functions would strengthen MMU independence and more closely focus MMUs on the core function of monitoring the markets.<sup>50</sup> While finding that the advantages of removing MMUs from performing mitigation functions outweighs the temporary transition pains that may result, the Commission states that it is sensitive to the concerns raised by commenters and will consider additional comments, including comments related to activities that would be needed to make the transition to RTO-administered mitigation or difficulties that an MMU might experience in monitoring mitigation performed by an RTO.<sup>51</sup>

**ii. Current New England Approach**

In the New England "hybrid" MMU model, the INTMMU is the primary agent of mitigation, and consults with the IMMUE in specified circumstances.

**iii. Comments**

On principle, and based on its five years of experience with mitigation in locational marginal pricing markets, ISO-NE disagrees with the proposition that an MMU's performance of mitigation functions compromises the MMU's independence or distracts an MMU from its core functions. There are many reasons supporting the involvement of an MMU in mitigation, and the arguments against involvement are unconvincing:

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<sup>49</sup> NOPR, at P 210.

<sup>50</sup> NOPR, at P 207.

<sup>51</sup> NOPR, at P 210.

First, the MMU's participation in mitigation activities offers significant benefits through its continuous investigatory function in the day-ahead and real-time energy markets. This continuous market investigation ensures accuracy and deters proscribed conduct, reducing the need to impose price mitigation. Having a "finger on the pulse" through administration of mitigation facilitates a "rapid response" approach that keeps the MMU involved in real-time operation of the markets, in communication with market participants, and constantly evaluating behaviors in real time. This aids the MMU in keeping Commission staff and stakeholders aware of emerging market issues, and in considering market improvements.

Second, investigation conducted by experienced MMU personnel in circumstances where market rules do not precisely anticipate a market participant's bidding strategy – accompanied by the ability to examine whether a bidder's conduct should be viewed as addressed within existing market rule boundaries or should be referred to the Commission – is desirable. As a practical matter, it is infeasible for market rules to price every potential "resource shortage." However, bidding activity that, at first look, appears anomalous may stem from legitimate business purposes (for example, a combination of virtual and physical bids that is intended to provide a hedge) or to incorporate an opportunity cost (for example, recognizing the impact of emissions limitations).

Third, shifting mitigation responsibility from an MMU to RTO/ISO operations staff would deprive the MMU of timely, first-hand access to crucial information that could speed and enhance detection of manipulative behavior. Although the conduct of "bright-line" price mitigation may seem appropriate for mechanical application by operating personnel, barring the MMU from mitigation would leave the MMU unaware of cases that approach mitigation thresholds but do not trigger mitigation during investigations. This bar would deprive an MMU

of the ability to develop a timely understanding of suspect behavior patterns that exploit locally constrained areas under dynamic market conditions, and thus could significantly limit or delay detection of manipulative behavior.

Fourth, mechanistic application of mitigation criteria by RTO/ISO operations staffs would not readily address shifts in bidding behaviors. Market participants continuously search for more profitable bidding strategies. The discretion of a skilled MMU to investigate unusual bidding behavior that deviates substantially from costs or otherwise affects the competitiveness of the markets inhibits experimentation with deviant strategies and enhances deterrence. The cases that do not meet the strict requirements for mitigation are most likely to be bid strategies that reflect an attempt to exploit loopholes and ambiguities in the rules. Keeping an MMU out of the mitigation process may reduce detection of such strategies and thus reduce important referrals to the Commission.

Fifth, an MMU's role in market mitigation will not compromise the monitor's independence and objectivity, or otherwise create a "conflict of interest." The MMU's independence stems from its code of conduct or contractual obligations (in the case of an external market monitor) regarding conflicts of interest, its access to information sources, and its direct reporting relationship to the RTO/ISO Board of Directors. More fundamentally, no "conflict of interest" is presented by conducting both tariff administration and monitoring/mitigation. All other conflicts of interest proscribed by the Commission in other contexts present the prospect of financial gain. An MMU has nothing to gain financially from the mitigation exercise, or indeed any other interest that would keep it from reporting on problems with the mitigation procedures and/or evaluating market rules for improved market performance. Moreover, this unjustified and alarming extension of the conflict of interest

concept would be inconsistent with Commission policy. For example, a 2007 Commission order approved a settlement (to which stakeholders were a party) providing for the MMU's involvement in tariff administration (i.e., in connection with the Forward Capacity Market, the MMU's review of resources' de-list decisions and setting default bids for existing generating capacity).<sup>52</sup>

Finally, the prohibition on MMU mitigation activity could require additional operations staff to perform tasks that MMU employees can accomplish on a more efficient, integrated basis. This, obviously, could increase RTO/ISO costs.

If, despite the foregoing considerations, the Commission continues to believe that MMU involvement in the administration of mitigation is a "conflict of interest," the Commission should at least consider that where a hybrid MMU structure is used (as in New England), it would be appropriate for the internal MMU to administer mitigation if the external MMU is excluded from mitigation activity.

**e. Ethics**

**i. NOPR**

The Commission proposes that RTO tariffs be amended, as necessary, to provide specific ethical standards for MMUs.

The Commission states that MMU ethical standards should include, at a minimum, the following:

- (1) employees shall have no material affiliation (to be defined by the RTO or ISO) with any market participant or affiliate;
- (2) employees shall not serve as an officer, employee, or partner of a market participant;

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<sup>52</sup> *ISO New England Inc.*, 119 FERC ¶ 61,045, at P 123 (2007).

- (3) employees shall have no material financial interest in any market participant or affiliate (allowing for such potential exceptions as mutual funds and non-directed investments);
- (4) employees shall not engage in any market transactions other than the performance of their duties under the tariff;
- (5) employees shall not be compensated, other than by the RTO or ISO, for any expert witness testimony or other commercial services to the RTO or ISO or to any other party in connection with any legal or regulatory proceeding or commercial transaction relating to the RTO or ISO or to the RTO or ISO markets;
- (6) employees may not accept anything of value from a market participant in excess of a *de minimis* amount, to be decided on by the RTO or ISO; and
- (7) employees must advise their supervisor (or, in the case of the MMU manager himself, advise the RTO or ISO board) in the event they seek employment with a market participant and must disqualify themselves from participating in any matter that would have an effect on the financial interest of such market participant.<sup>53</sup>

## **ii. Current New England Approach**

These provisions and prohibitions are similar to those specified in ISO-NE's Code of Conduct, which binds all ISO-NE employees (including INTMMU employees) – and similar prohibitions are included in the contract between ISO-NE and its IMMUs.

## **f. Tariff Provisions**

### **i. NOPR**

The Commission proposes to require that each RTO include all MMU provisions in a single centralized section of its tariff.<sup>54</sup> The Commission also proposes that each RTO include an introductory “mission statement” in the centralized MMU tariff provision that sets forth the goals to be achieved by the MMU, including the protection of both consumers and market

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<sup>53</sup> NOPR, at P 214.

<sup>54</sup> NOPR, at P 217.



participants by the identification and reporting of market design flaws and market power abuses.<sup>55</sup>

## **ii. Current New England Approach**

In New England, the MMU tariff provisions generally are located in Appendices A and B of Section III of the ISO-NE Tariff. Compliance with the proposed rule would require minor editing of the appendices and a careful review to identify any MMU provisions that are not already included in Appendices A and B and to relocate those provisions to the new centralized tariff section. Existing Appendix A contains a number of introductory statements concerning the purpose of the monitoring and mitigation measures undertaken by the INTMMU.<sup>56</sup>

## **2. Information Sharing**

### **a. Enhanced Information Dissemination**

#### **i. NOPR**

The proposed rule would require MMUs to provide regular reports (no less frequently than quarterly) on market and RTO performance to Commission staff, interested state commissions, market participants and RTO management and boards. In addition, MMUs would be required to participate in quarterly conference calls, from which market participants would be excluded but attorneys general would be included. Under the proposed rule, RTO tariffs would be amended, as necessary, to require MMUs to produce annual markets reports.<sup>57</sup>

Release of masked bid data would be required following a three-month lag period (or a shorter period if an RTO provides necessary justification).<sup>58</sup> The Commission stated that if an

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<sup>55</sup> *Id.*

<sup>56</sup> *See, e.g.,* ISO-NE Tariff §§ III.A.1.1, IIIA.2.2.1.

<sup>57</sup> NOPR, at P 228.

<sup>58</sup> NOPR, at P 229.

RTO demonstrates a potential collusion concern, it may propose a four month lag period or, alternatively, some other mechanism to delay the release of data so that it does not occur in the same season.<sup>59</sup> The Commission also proposes to require each RTO to address in its compliance filing how bid data is aggregated and to discuss how the RTO's proposed bid data release policy avoids participants harm and the possibility of collusion, while fostering market transparency.<sup>60</sup>

## **ii. Current New England Approach**

ISO-NE's tariff already includes provisions requiring the INTMMU to provide quarterly and annual markets reports. In addition, the IMMUE also is required to produce an annual markets report.

ISO-NE recently proposed, and the Commission accepted, a reduction in the bid data lag period to three months for New England.<sup>61</sup>

## **iii. Comments**

It appears that ISO-NE's existing tariff provisions regarding periodic market reports, with the addition of some relatively minor details, would comply with the proposed rule. In addition, ISO-NE appears to comply with the proposed rule as it relates to bid data release.

## **b. Tailored Requests for Information**

### **i. NOPR**

The Commission proposes that state commissions may request that MMUs provide tailored information on market trends and performances, provided that such information is not related to a state enforcement action or other action against an individual company.<sup>62</sup> The

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<sup>59</sup> *Id.*

<sup>60</sup> NOPR, at P 230.

<sup>61</sup> *See ISO New England Inc. and New England Power Pool*, 121 FERC ¶ 61,035 (2007).

<sup>62</sup> NOPR, at P 234.

Commission states that each MMU will determine whether it can respond to a state commission request based on the MMU's budgetary and time limitations.<sup>63</sup>

The Commission also addresses confidentiality issues, stating that RTOs should develop confidentiality provisions that protect commercially sensitive material but are not so restrictive as to permit the release of little if any information.<sup>64</sup> In the event that a state commission requests data, other than bid data, related to a specific market participant, the Commission states that the affected market participant should be given notice and an opportunity to contest the potential release of information.<sup>65</sup>

Finally, the Commission proposes to require RTOs to adopt tariff provisions noting that state commissions may petition the Commission on a case-by-case basis to direct the release of information for which the state commission demonstrates a compelling need.<sup>66</sup>

## **ii. Current New England Approach**

The ISO-NE Information Policy already includes provisions that allow ISO-NE to release confidential market information to state commissions under certain circumstances and subject to non-disclosure protections.<sup>67</sup> While ISO-NE appears to generally comply with the proposed rule on information sharing, it may be necessary to revise and clarify tariff provisions in order to fully comply with the proposed rule.

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<sup>63</sup> NOPR, at P 233.

<sup>64</sup> NOPR, at P 235.

<sup>65</sup> NOPR, at P 236.

<sup>66</sup> NOPR, at P 237.

<sup>67</sup> *See* ISO-NE Tariff, Attachment D, Section 3.3.

**c. Commission Referrals**

**i. NOPR**

The proposed rule would require RTOs to include provisions in the market monitoring sections of their tariffs governing the referral of certain issues to the Commission. Under these provisions, MMUs would be required to establish protocols for the referral of tariff, rule and market manipulation to the Commission's Office of Enforcement and for the referral of perceived market design flaws and recommended tariff changes to the Commission's Office of Energy Market Regulation.<sup>68</sup>

**ii. Current New England Approach**

The proposed referral provisions are generally consistent with, but more detailed than, ISO-NE's existing rules concerning the obligation of its MMUs to identify and report on market design flaws and to refer potential market manipulation to the Commission. Thus, some revision to existing ISO-NE Tariff provisions may be required if the proposed rule is adopted.

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<sup>68</sup> NOPR, at P 244.

### III. CONCLUSION

ISO-NE requests the Commission to consider its comments as submitted herein.

Respectfully submitted,

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