

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

Wholesale Competition in Regions )  
with Organized Electric Markets )

Docket Nos. RM07-19-000  
AD07-7-000

**COMMENTS OF NSTAR ELECTRIC COMPANY ON THE NOPR  
ON WHOLESALE COMPETITION IN REGIONS  
WITH ORGANIZED ELECTRIC MARKETS**

NSTAR Electric Company (“NSTAR” or the “Company”) is providing these comments in response to the Notice of Proposed Rulemaking titled “Wholesale Competition in Regions with Organized Electric Markets,” which was issued by the Commission in the above-captioned dockets on February 22, 2008.<sup>1</sup> The Company wishes to provide clarifications on some limited market issues and express its concerns and suggestions regarding the market monitoring and governance processes for ISO New England Inc. (“ISO-NE”).

**I. INTRODUCTION**

NSTAR Electric Company is the electric operating company of NSTAR, a Massachusetts business trust and participant in the New England electricity markets administered by ISO-NE. NSTAR provides distribution service to 1.1 million commercial and residential end-use customers located throughout eastern Massachusetts. Pursuant to Massachusetts law, NSTAR is required to offer service to customers that do not acquire electric energy from an alternative supplier.

In early 2007, the Commission held a number of conferences on competition in organized wholesale electric markets to learn more about issues of concern to energy market participants. Based on comments received at these conferences, the Commission identified certain issues

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<sup>1</sup> *Wholesale Competition in Regions with Organized Electric Markets*, Notice of Proposed Rulemaking, 122 FERC ¶ 61,167 (2008) (“NOPR”).

pertaining to organized markets that it thought could be appropriate for a generic proceeding. These issues were set forth in the Commission's Advance Notice of Proposed Rulemaking ("ANOPR"), which was issued on June 22, 2007.<sup>2</sup> The ANOPR grouped the issues under discussion into four major areas: (1) demand response and pricing during power shortages, (2) long-term power contracting, (3) market monitoring, and (4) responsiveness of Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs") to various constituents. NSTAR submitted extensive comments on the ANOPR, both individually and jointly through the New England Power Pool ("NEPOOL") Participants Committee. Upon review of submitted comments, the Commission issued the instant NOPR proposing to revise its regulations governing organized electricity markets and their operators in the four areas identified above.

On April 4, 2008, the NEPOOL Participants Committee adopted comments to be filed in this NOPR. NSTAR participated in developing those comments, but has some specific concerns that were not captured in the NEPOOL consensus. Specifically, NSTAR further comments that (1) emergency demand response payments should not set energy clearing prices; (2) dedicating a portion of the ISO-NE's website to facilitate long term power contracting is a good idea, so long as the principal intent of the service remains the promotion of liquidity and information flow in the New England market and does not negatively influence power prices; (3) the activities of the market monitor in ISO-NE should be more proactive in ensuring markets are competitive and the level of reporting needs to be increased and not be curtailed in any way by ISO-NE management; and, (4) the governance processes need to be improved through (a) more customer representation on the ISO-NE Board and (b) more balanced representation among stakeholders.

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<sup>2</sup> *Advance Notice of Proposed Rulemaking: Wholesale Competition in Regions with Organized Electric Markets*, 119 FERC ¶ 61,306 (2007) ("ANOPR").

## II. DEMAND RESPONSE AND PRICING DURING SHORTAGE PERIODS

With regard to the issue of demand response, the NOPR set forth reform proposals in the following areas: (1) ancillary services provided by demand response resources; (2) deviation charges; (3) aggregation of retail customers; (4) potential future demand response reforms; and (5) market rules governing price formation during periods of operating reserve shortages.<sup>3</sup> Particular to pricing during shortage conditions, the NOPR proposes to require each organized market to make a compliance filing, proposing any necessary reforms to ensure that the market price for energy accurately reflects the value of such energy during periods of scarcity (i.e., an operating reserve shortage).<sup>4</sup> Each region may propose one of the four approaches described in the ANOPR<sup>5</sup> or it may propose a different approach. As noted by the Commission, New England has already implemented one of the four reforms proposed, which is the establishment of a demand curve for operating reserves.<sup>6</sup>

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<sup>3</sup> NOPR at P 46.

<sup>4</sup> *Id.* at P 117.

<sup>5</sup> The ANOPR presented the following four approaches for ensuring that the market price for energy is accurately reflected during periods of scarcity: (1) requiring that RTOs/ ISOs increase the energy supply offer caps and demand bid caps above the current levels only during an emergency; (2) requiring RTOs/ISOs to allow only demand bid caps to be raised above the current level, while keeping generation offer caps in place; (3) requiring a demand curve for operating reserves in each RTO/ISO market; and (4) requiring RTOs/ISOs to amend their market rules to set the market-clearing price for all supply and demand response resources dispatched during an emergency at the payment made to participants in an emergency demand response program. ANOPR at PP 76, 77, 79, 80.

<sup>6</sup> NOPR at P 125.

However, with respect to the fourth proposed reform, requiring RTOs/ISOs to amend their market rules to set the market-clearing price for all supply and demand response resources dispatched during an emergency at the payment made to participants in an emergency demand response program, NSTAR notes that if such a proposal were imposed on the region by the Commission, it would be an ill-advised approach for New England at this time.

First, stakeholders in New England have approved, and are in the process of implementing, a new Forward Capacity Market (“FCM”) that fully incorporates demand and energy efficiency resources into its design, and treats demand resources, including emergency resources, on a comparable basis with traditional capacity supply resources. The existing Load Response Programs are currently set to expire on May 31, 2010.<sup>7</sup> Demand resources will be eligible to set the Forward Capacity Auction (“FCA”) clearing price, will receive comparable compensation, and will have a comparable obligation to supply capacity.

Second, as noted above, New England has an ancillary service market design that includes a demand curve (in New England termed “Reserve Constraint Penalty Factors”) that administratively increases the energy clearing price in response to a reserve deficiency. This is a regional solution to the problem of the suppression of energy prices when emergency measures would otherwise dampen the price signal.

Third, and most importantly, the Commission should not conflate emergency response programs with the market. To preserve the integrity of the electric power system there have always been some actions taken, and incentive given, to perform out-of-market actions. The \$500/MWh

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<sup>7</sup> See ISO New England Inc. Transmission, Markets and Services Tariff, Section III - Market Rule 1, Appendix E.1.3.

minimum payment guarantee is part of New England's emergency demand response program because it is acknowledged that calling upon emergency demand response is done to protect the integrity of the system and no other reason. Customers that choose to participate in the emergency program may not want to participate in the market for operational or environmental reasons, but are willing to assist in an emergency. This minimum payment guarantee subsidy they receive should not be confused with a marginal price signal in a normal market. If the Commission were to require emergency demand response price incentives to set the marginal-clearing price, it would upset the agreed upon balance of the costs versus benefits of achieving incremental reliability, in that some customers would subsidize others in return for emergency (non-market) response, and these programs would require significant alterations.

Simply put, allowing emergency demand response programs that are paid a floor price to set the energy clearing price would not be an appropriate approach for the ISO-NE region for the reasons stated above.

### **III. LONG-TERM POWER CONTRACTING**

In the section on long-term power contracting, the NOPR proposes that ISOs and RTOs be required to dedicate a portion of their websites for market participants to post offers to buy or sell power on a long-term basis.<sup>8</sup> NSTAR supports the Commission's proposal to require a dedicated portion of ISO-NE's website for market participants to post offers to buy or sell power on a long term basis, and believes that the service can be instrumental in promoting liquidity and transparency in the New England energy market as a long term goal. However, because data containing prices for long term power could have an effect on market electricity prices, NSTAR remains concerned that the mechanism not be used to influence power prices. Accordingly, the

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<sup>8</sup> NOPR at P 155.

Commission should consider whether additional measures need to be developed to ensure that information posted on the RTO/ISO bulletin boards represents a diverse segment of market participants and does not negatively affect power prices in the market.

#### **IV. MARKET MONITORING POLICIES**

In the NOPR, the Commission requested comments on a number of proposals regarding its market monitoring policies. NSTAR agrees with the Commission emphasis on the independence and objectivity of the market monitors. Both of ISO-NE's market monitors, the Independent Market Monitor and the Internal Market Monitor, are capable of achieving independence from ISO-NE management due to their direct reporting relationship with the ISO-NE board of directors. However, the internal market monitor appears hesitant to uncover and expose flaws in ISO-NE's market design and failures in proper administration of the markets. Market monitoring in New England today is opaque and needs to be more proactive and transparent in its action.

The NOPR proposes that the Market Monitoring Unit ("MMU"): (1) evaluate existing and proposed market rules, tariff provisions and market design elements for their effectiveness, and recommend proposed rule and tariff changes not only to the RTO or ISO, but also to the Commission's Office of Energy Market Regulation 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 and 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; (2) review and report on the performance of the wholesale markets to the RTO or ISO, the Commission, and other interested entities, such as state commissions and market participants; and (3) identify and notify the Commission's Office of Enforcement 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>9</sup>

NSTAR supports the NOPR's proactive and transparent approach to MMU responsibilities. While NSTAR understands that market monitors in New England are required to report tariff violations by ISO-NE staff, they do not actively look for such violations. Compliance audits are instead performed by third-party auditors. This passive approach to market monitoring is unacceptable. Third-party auditors have limited opportunities to observe operator and administrative actions at ISO-NE, and are less equipped than internal personnel to understand the impacts of such decisions in the administration of the markets. Market administration must be reviewed by personnel who both understand the letter and the intent of the tariffs. As the Commission is well aware, tariffs often boil down highly complex procedures into a few lines, leaving system operators and administrative personnel to sometimes interpret the intent. NSTAR hopes that with implementation of the NOPR's proposal, the ISO-NE market monitors will take it upon themselves to continuously review the actions, and participate in internal audits of, the market operators and administrative personnel to ensure that the tariffs are being followed in a way that results in fair market results. The market monitor must actively ensure that the existing tariff rules are implemented as written.

Both internal and external market monitors risk reproach if they criticize their employer. External monitors have a financial disincentive to engage in a protracted dispute with the sponsoring RTO, which may explain the lack of rigorous critique that has occurred to date. NSTAR has no specific recommendation on this issue, but it is one that must be addressed if market monitors are to be encouraged to perform their assigned tasks.

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<sup>9</sup> *Id.* at P 198.

Moreover, pursuant to the NOPR, the market monitor should actively review participant actions to ensure they align with the spirit of the tariff rules. When an existing rule is being violated or results in unintended behaviors, the market monitor should aggressively pursue corrective actions and report these concerns to the ISO-NE Board, to the Commission, and to the regional stakeholders. To instill confidence in the market structure, market monitoring in New England must transform in accordance with the Commission's NOPR to a transparent proactive independent function that interacts frequently and communicates clearly with stakeholders.

In addition to reports on how the markets are working generally, the NOPR requires the market monitor to report on participant behaviors in exercising market power. If market rules allow participants to exercise market power, the market monitor should identify the required changes in market rules to eliminate such power. In addition, NSTAR recommends that the market monitor should also compare the theoretical cost of an unconstrained dispatch against the actual dispatch and identify units that earn significantly above the unconstrained market dispatch so that actions can be taken to eliminate transmission constraints or market power abuses.

To ensure confidence in the markets, NSTAR strongly supports the NOPR's proposal that the market monitor report on instances of market abuses to market participants in addition to the Commission, the states, and the RTO/ISO boards. Information policy restrictions should be eliminated when reporting such violations. The reporting should be transparent, providing market participants with information useful in assessing how well the markets are working and whether changes to market design and administration are necessary, and should be used as a deterrent to prevent conscious violations.



## **V. RESPONSIVENESS OF RTOs AND ISOs**

The NOPR proposes that each RTO/ISO be required to make a compliance filing showing that its board of directors is responsive to stakeholder concerns.<sup>10</sup> Responsiveness is to be assessed against four criteria: (1) inclusiveness; (2) fairness in balancing diverse interests; (3) representation of minority positions; and (4) ongoing responsiveness.

### **A. Responsiveness of the Board**

The present governance structure for ISO-NE was approved by the Commission in March 2004 as part of the RTO arrangements in New England.<sup>11</sup> Under this structure, ISO-NE is governed by a ten-member board, comprised of nine independent members and the ISO-NE Chief Executive Officer, who serves as the sole non-voting member. The ISO-NE Board has exclusive decision-making authority for ISO-NE, including ultimate authority over the ISO-NE Tariff and Market Rules and ISO-NE's operating and capital budgets. Pursuant to the Participants Agreement, the members of this board "shall possess a cross-section of skills and experience . . . to ensure that ISO has sufficient knowledge and expertise to act as the RTO for New England."<sup>12</sup> The Participants Agreement directs that at least three of the directors shall have prior relevant experience in the electric industry and notes a strong preference to consider candidates from New England to the extent such qualified candidates are available.

ISO-NE has generally been able to attract exemplary persons to sit on the Board. However, there is a key voice on the board that is missing: the voice of the consumer. While there are requirements of business and technical expertise to serve on the ISO-NE board, there is no

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<sup>10</sup> *Id.* at P 275.

<sup>11</sup> *ISO New England Inc.*, 106 FERC ¶ 61,280, at P 51 (2004).

<sup>12</sup> Participants Agreement at 9.2.2.

requirement that any of the members have any experience serving the customers who ultimately pay for the entire market. While there are benefits to an independent board, this independence is not beneficial if the board is isolated from the impacts of its decisions. Independence may lead to insensitivity to the needs of its customers. Many state regulatory commissions require that at least one commissioner have a background in consumer protection. The same principle should be true of independent RTO/ISO boards to ensure that those responsible for overseeing an RTO/ISO are always mindful of the impacts their decisions will have upon the citizens of their region or state. A consumer perspective provides the necessary checks and balances to market design. The overall cost of market designs would be a major consideration and studies delineating costs and alternatives would be developed for stakeholder evaluation prior to pursuing a particular market design.

The Commission should consider providing guidance on the composition of boards to include more consumer representatives. The transformation need not be disruptive but can be accomplished as ISO-NE board members are replaced over time. After transition, the composition of the board would be sufficiently diverse to ensure proper consideration of the concerns of all stakeholders.

## **B. Review of the Stakeholder Process**

The voting structure outlined in the Participants Agreement in New England is intended to provide a mechanism to ensure diverse and balanced stakeholder representation. At the major technical committees and at the Participants Committee, participant advisory recommendations are determined by a sector-weighted voting process. There are currently six participant sectors in New England, each with a purported unique perspective – Transmission, Generation, Supplier, Public Power, Alternate Resources and End User. Each sector receives a minimum of 16.67% of the NEPOOL vote. While each sector nominally has its own unique interests, the voting is generally

split between those who receive service and pay, and those who provide services and get paid. The sector voting structure can be skewed when representatives of one sector have the option to fill multiple sectors. For example, in New England, it is possible for a generation developer to become a member of the End User sector by simply having an office which uses electricity, or for a conventional generation owner with a minor business interest in renewable generation to become a member of the Alternate Resource sector. The presence of these entities in the sectors dilutes the voting power of the “pure” sector members.

In addition, as voting shares become equally distributed when a sector is not represented, the voting process can quickly become unrepresentative of a balanced outcome if one or more sectors is not present in a meeting. For example, at a recent Reliability Committee meeting, both the End User and Public Power sectors were unrepresented.<sup>13</sup> This is not an isolated case, but rather quite common. While it is not the fault of the Generators or Suppliers that the End User and Public Power representatives did not attend the meeting to cast votes, decisions with significant cost and reliability implications should not be made without the participation of end user interests.

It would be very difficult for stakeholders in New England to dispassionately review and analyze their stakeholder processes. Every stakeholder strives to protect that element that they believe serves them best, and there is a natural tendency in any organization to preserve the *status quo*. Therefore, NSTAR encourages the Commission to require the New England RTO to undergo a periodic, independent review of its stakeholder processes including sector membership qualifications, voting weights, etc. The Commission should oversee the review rather than leave it to the stakeholders. This review and recommendation should be used to make constructive changes to the stakeholder processes to ensure that all parties are being properly represented.

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<sup>13</sup> August 21, 2007 Reliability Committee meeting.

## VI. CONCLUSION

For the reasons stated herein, NSTAR Electric Company respectfully requests that the Commission consider the foregoing comments on the NOPR on Wholesale Competition in Regions with Organized Electric Markets and in the application of any future proposed rulemaking or rules.

Respectfully submitted,

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