

(2) Demand Response

1. Allowing demand response infrastructure to satisfy the requirement removes bias toward exclusive reliance on new generation to meet regional needs. Better demand response to high prices when a shortage condition approaches will lower demand and reduce the use of high-cost power resources. Demand response will help ensure reliability, prevent a shortage that could produce a curtailment, act as a check against market power, and provide a yardstick for the value that buyers place on supply.
2. Biddable and interruptible load can satisfy the resource adequacy requirement as well as generation.¹ A load-serving entity that does not want to pay for generating reserves can substitute a demand response alternative to meet its resource adequacy requirement. Under some state programs, the larger retail customer may be rewarded for reducing its electric use in addition to enjoying a reduced bill for reduced consumption. Several states have this type of biddable load reduction; it is one way to allow the customer to determine how much it is willing to pay for power. Further, competitive energy service suppliers can compete for load by offering lower rates to customers who agree to participate in demand response programs such as remote air conditioner cycling, aggregate building load management, and other proven demand response and load management options.

3. Resource Standards

3. The Independent Transmission Provider must determine if each load-serving entity's planned resources meet certain standards. The resources must meet the standards to count toward satisfying the entity's share of the regional resource requirement. Both generation and interruptible or biddable load must meet standards to satisfy the requirement.
4. We propose here certain minimum standards for comment. We also are considering in the Final Rule to ask the North American Energy Standards Board (NAESB) to develop more detailed standards for determining whether resources satisfy the resource adequacy requirement, and we seek comments on this approach.
 - a. **Generation Standards**
5. Generation must be owned by or under contract to the load-serving entity and committed to meet the resource needs of the load-serving entity at least during certain conditions such as an operating reserve shortage. The Independent Transmission Provider must be satisfied that the generation is physically feasible; that is, the generating units are capable of generating the power planned, and enough transmission is available to deliver the power from the generating station to the particular load. The generating units under contract must be real and specific generators. This is so that only real generation that can avert a supply

¹The traditional reliability reserve margin allows interruptible load to be counted equally with generation resources, with some exceptions.

shortage is counted and so that its transmission over the grid can be assured. For example, it does no good for a load on Long Island to claim a generator in western New York as a resource if the power cannot be delivered to Long Island during a Long Island shortage.

6. Because the purpose of this requirement is to encourage the development of new resources including new generation, generation under contract for development within the planning horizon should satisfy the requirement. Should the Commission specify the contract content needed to rely on generation under development? If so, should we refer this matter to NAESB to determine the content?

7. For these reasons also, a contract with a marketer to deliver power at a future time from unspecified sources cannot satisfy the requirement. The purpose here is not to transfer financial risk for nonperformance to a marketer but to ensure performance, that is, to ensure that enough actual, deliverable generating capacity is available or developed at satisfactory locations to avert a future shortage. However, a forward contract with a marketer that is linked to specific generation and demonstrates transmission adequacy would satisfy the requirement. We ask for comment on whether we should allow a liquidated damages contract for power from unspecified sources to be included in the resource adequacy plan, and also on whether we should allow a load-serving entity that initially fails to satisfy the resource adequacy contract, but later brings in new resources under a liquidated damages contract for the amount of its resource deficiency, to avoid the penalty price and first curtailment in the spot market during a shortage.

b. Transmission Standards

8. Generation must be deliverable to satisfy the requirement. A Congestion Revenue Right for the appropriate year is one way to satisfy this requirement. We propose to adopt a practice (used in PJM) that allows a resource owner to pay for the development of adequate transmission to deliver its energy to a load and then to sell its Congestion Revenue Rights while still satisfying the requirement that its generation be deliverable. Should a commitment by any load-serving entity to pay congestion costs no matter how high also satisfy the requirement? If so, how should the Independent Transmission Provider respond if the sum total of all such commitments exceeds the available capacity of a bottleneck interface?

9. A robust transmission system with few constraints may allow a load to rely on generation and demand response reserves that are farther away than if the transmission system is weak. Supply reserves that are not deliverable to the load claiming them when needed cannot be counted as satisfying that load's reserve requirement.

10. For transmission as well as for generation and demand response, the purpose of this requirement is to encourage the development of least-cost resources, which may include new transmission needed to access existing or new generation. We believe therefore that planned transmission with full siting approval and completion expected within the planning horizon should satisfy the

adequacy requirement.

c. Demand Response Standards

11. Demand response must also be verifiable to satisfy the adequacy requirement. The Independent Transmission Provider must have confidence that the demand response resource will be able to contribute when called on during a shortage. Demand response may be obtained through biddable demand reduction, interruptible load, or other dependable load management program. Distributed generation that is interconnected with a customer, a load-serving entity, or an energy services company, although it is technically generation and not demand response, can also be used by a local distributor to reduce the demand that the distribution system places on the grid. With biddable demand reduction, certain loads will be assured of dropping off the system at known price levels; the amount of load dropped should increase with the price.
 12. With interruptible load, a customer pays a lower power price year round but will be interrupted under defined shortage conditions; the load is subject to a simple on-off criterion. An important feature of this proposal is that the load-serving entity plan that depends on interruptible load to meet its resource adequacy requirement must be capable of being implemented. The Independent Transmission Provider may require, for example, that the load-serving entity install equipment that gives it direct control over the loads of the customers that are subject to the interruption. We recognize, however, that installation of such equipment may be too costly or otherwise impractical in some situations. In that case, the load-serving entity must have a satisfactory arrangement for implementing its interruptible load program under the instructions of the Independent Transmission Provider.
 13. If load in an area "buys" demand reduction from another area (in effect buying some of that other area's freed-up generation), the transmission needed to deliver the freed-up generation to the load that relies on it must be available.
- 4. Planning Horizon**
14. The purpose of a forward-looking resource adequacy requirement is to create a demand for new resource entry in advance of a shortage so that enough supply construction and demand response infrastructure installation are begun in time to avert the shortage. The planning horizon for each region is the number of years ahead for which the Independent Transmission Provider must forecast annually its area's load, as well as the number of years ahead for which load-serving entities must show that they have adequate resources. For example, the Independent Transmission Provider could forecast its area's peak load three years from the present and require that each load-serving entity in its area have acceptable plans today to have enough resources three years from now to meet the forecast peak with a reserve margin of 12 percent. In this example, the planning horizon is three years and the reserve level is the minimum 12 percent.
 15. The choice of the planning horizon affects the lead time for construction and the duration of forward contracts that can satisfy a resource adequacy

requirement.² The traditional state-required electric company planning horizon was 10 to 20 years. The horizons were established when the industry relied on new large hydroelectric, coal, or nuclear facilities to meet growing load, and these facilities could take 10 or more years to site and construct. Today, most new resources are planned and developed over a much shorter time frame, in part because of the reliance on low cost natural gas. However, this planning horizon could change again if natural gas were no longer the main fuel of choice.

16. Because the planning horizon should be no less than the time frame for developing new resources and development times vary from region to region, the planning horizon can depend on that region's reliance on coal, gas, wind, hydropower or new demand-response technology for new supply. This argues for allowing each region to determine its own appropriate planning horizon.

17. We propose to make the planning horizon a matter for regional choice. Regions should consider several factors in selecting the planning horizon. Most important, the planning horizon chosen should not be so short that it fails to motivate and achieve construction of generation and demand response resources in time to avert a shortage. Greater fuel diversity may be achieved with a longer planning horizon. If the horizon is short, two years for example, load-serving entities may have an incentive to select resources that can be developed in two years or less, such as peaking units and some other gas-fired generators. A longer planning horizon allows time for development of other resources such as coal-fired generation, hydroelectric resources, and some advanced demand response programs. Load-serving entities in retail choice states would benefit from a shorter planning horizon because it would reduce their business risk associated with demand forecast error. Also, they may not want to enter into bilateral contracts for supplies for a time period that is longer than the duration of their contracts with their customers.

18. We propose to have the Regional State Advisory Committee determine the planning horizon for the region. The Independent Transmission Provider (including each Independent Transmission Provider in a region with more than one Independent Transmission Provider) must provide information and support to the Committee, as requested, to help it to determine the region's planning horizon. We request comment on how to resolve any lack of consensus within the Committee regarding the appropriate planning horizon. We also ask for comment on whether the Commission should establish limits on the region's choice of planning horizon, such as at least three years and no more than five years.

19. We also ask for comment on whether to have a resource adequacy requirement before the end of the first planning horizon period. For example, if

²For example, forward-contracting for supply with one-year contracts that begin today and end after one year would not satisfy an adequacy requirement with a three-year planning horizon. A one-year contract for the third year forward would satisfy the goal for that year.

the horizon is three years, should there be a requirement for resource adequacy in the first two years?

5. Enforcement

20. Here we explain in more detail our proposal to enforce the resource adequacy requirement, along with some alternative enforcement procedures, and ask for comment on the most effective enforcement method.
21. Unlike some ICAP requirements, the approach adopted here does not require a load-serving entity to pay a penalty in the near term for failure to have adequate future resources. Our proposed approach relies primarily on two enforcement mechanisms: (1) a Commission-set tariff penalty imposed on a load-serving entity that threatens reliable transmission operation by taking energy from the spot market during a shortage in a year for which it fails to meet its resource adequacy requirement, and (2) a Commission requirement that the spot market electric service of such a load-serving entity must be curtailed first when the shortage that is severe enough to require that some customers be curtailed. Each of these mechanisms, the penalty rate and the load curtailment, would occur at the end of the planning horizon, not the beginning.³
22. . The first mechanism applies during a power shortage in which the Independent Transmission Provider is unable to satisfy demand in the spot market and also meet its reliability requirement for a minimum level of operating reserves.⁴ As a shortage develops, price is expected to increase in the spot energy

³For example, if the planning horizon is three years, a demand forecast would be made in 2004 for the year 2007. The Independent Transmission Provider would assess the adequacy of resources for 2007 and allocate the resource adequacy requirement for 2007 among the load serving entities. The entities would submit to the Independent Transmission Provider in 2004 their plans to meet their share of the 2007 resource adequacy requirement. An entity fails to submit in 2004 a satisfactory resource plan for 2007 would not be subject to the penalty rate or be among the first curtailed during a shortage in 2004 but would be subject to the penalty rate and be among the first curtailed during a shortage in 2007. Next year, in 2005, the same process repeats: the Independent Transmission Provider would forecast demand in 2008, and so on.

⁴Operating reserves are generation and demand response resources needed to keep the system in balance, follow changes in load, and make up for a "contingency" such as the loss of the largest generating unit or of a major transmission line that delivers more power than any one generating unit. The North American Electric Reliability Council and the regional reliability councils set rules regarding the minimum operating reserves that must be maintained by the system operator for reliable operation. The rules are expressed in a formula so that the value of the minimum operating reserves changes during the day with load conditions and with the sources of supply. Typically, for a large utility, the minimum operating reserves are in the range of 5 to 8 percent of load, but this can vary significant with changing conditions. An operator that operates with less than minimum operating reserves threatens not only its own reliable operation but the

market. A load-serving entity that is short on self-generation, bilateral contracts (including affiliate generation and call contracts), and demand response resources will be dependent on the spot markets to meet its resource needs. The rising price in the spot market is, of course, a principal incentive for the load-serving entity to develop adequate supply and demand resources. If shortage conditions develop to the point where the Independent Transmission Provider cannot serve all load and maintain the minimum level of operating reserves, it must take some action to maintain reliable operation. Some load must be given either an economic incentive to exit the spot market or an order to stop taking power from the spot market. We propose that these measures be applied first to the load of the load-serving entities that did not meet their share of the resource adequacy requirement. However, the load-serving entity is subject to a penalty and first curtailment during a shortage only for spot energy purchases⁵ and only in the amount by which it falls short of meeting its resource adequacy requirement.

23. Specifically, we propose that 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. However, it would apply to spot market energy sales needed to correct for imbalances associated with energy from these sources. We would set the penalty price high enough that we do not suggest that failing to meet a resource adequacy requirement and paying a penalty rate is an acceptable alternative to developing new resources, which would be the case if the paying the penalty appears to be less costly over time.
24. The penalty price would increase in stages as the shortage becomes more severe. For example, the penalty price could be \$500 (in addition to the spot market energy price) when operating reserves are just below the minimum level, \$600 when operating reserves are more than below 1 percent below the minimum

reliability of its electrical neighbors.

⁵These actions apply to spot energy purchases only. In the event that the load-serving entity that failed to meet its share of the resource adequacy requirement has adequate supply and demand resources outside the spot market available to it at the time of the shortage, the Independent Transmission Provider would continue to provide transmission to support delivery of these resources. This proposal gives deference to the ownership and contractual right to use self-generation, bilateral contracts, and demand response resources, and it encourages the development of such resources during the planning horizon period by those entities that failed to plan adequately at the beginning. It also discourages contracting with unreliable resources to meet the resource adequacy requirement because each load-serving entity must actually rely on its resources to meet its resource needs.

level, \$700 when operating reserves are more than 2 percent below the minimum level, and so on. We ask for comment on having such a graduated penalty and the appropriate penalty rates.

25. This first enforcement mechanism provides a price-based mechanism to enforce a resource adequacy requirement and to restore the transmission system to a reliable condition. Most system operators – and their regulators – treat load curtailment (voltage reductions and blackouts) as a last resort measure, and operators may violate the reliability rule for minimum operating reserves rather than implement a load curtailment to satisfy the minimum operating reserve criterion.⁶ We believe that the penalty price should be set high enough to bring about voluntary load reduction by a load-serving entity and thus restore the system to a reliable condition.
26. The second enforcement mechanism is applied when the operating reserve level decreases to the point that some load must be curtailed.⁷ The 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.⁸
27. In support of this second mechanism, we will require the Independent Transmission Provider to inform the load-serving entity's state regulatory

⁶We will not overturn this practice by requiring curtailment of load immediately to restore the minimum operating reserve level. Some regions have a regional policy of taking action to reduce voltage or shed load only when operating reserves fall to some fraction, such as three-fourths or three-fifths, of the minimum operating reserve requirements of the reliability organizations.

⁷Regional practice will determine when load must be curtailed to maintain reliable operation. Operators may continue to follow their existing reliability practices: those that do not curtail service immediately when the operating reserve level goes below the minimum must impose the penalty price on resource-deficient load-serving entities. However, it is not our intent to require an operator to violate a reliability rule by providing service with a penalty price instead of enforcing its reliability rule through load curtailment. We believe that a high penalty price may result in the needed load reduction. Whenever the operator must curtail load to maintain reliability, it should do so. Our requirement goes to which load must be curtailed first when curtailment of load is necessary, not to when curtailment becomes necessary.

⁸An individual load-serving entity may run short of planned-for resources when its region is not experiencing a regionwide shortage, for example, because of a combination of high demand on its own system and unplanned outages of its own resources. In this case it is not required to be curtailed because that load-serving entity may procure additional supplies from the short-term or long-term bilateral market or from the spot market. Since the region is not short, others are likely to sell power, including perhaps a portion of their reserves on the basis that the reserves can be recalled if a regionwide shortage occurs.

authority⁹ if the load-serving entity fails to submit a satisfactory plan for adequate future resources, thereby exposing its customers to possible penalties and future first curtailment during a shortage. Our intent is to rely on the traditional state role of enforcing a load-serving entity's reserve obligation. We believe that in most cases the state regulatory authority would prefer to have the load-serving entity meet the adequacy requirement as a condition of doing business in the state, rather than expose its retail customers to first curtailment. The state regulatory authority may wish to consider any decision of a load-serving entity not meet its resource adequacy requirement. It may want to ask the load-serving entity to identify which of its customers will be subject to first curtailment if the region is short of power.¹⁰

28. If the Independent Transmission Provider does not have direct control of the circuit equipment needed to implement a curtailment and relies on the load-serving entity to follow its instructions to implement a curtailment, the load-serving entity would be subject to a severe penalty for the unauthorized taking of power from the spot energy market because this jeopardizes grid reliability. We propose to charge the applicable Locational Marginal Price plus \$1000/MWh for all unauthorized energy taken following an instruction to implement curtailment.¹¹ We also seek comment on whether the \$1000/MWh penalty would be sufficient to deter unauthorized taking of energy and, if these penalties are paid, who should receive these revenues.
29. We believe that load-serving entities, under these enforcement provisions and under the oversight of state regulatory authorities, will meet their resource adequacy requirement and not be subject to these curtailment penalty and first curtailment provisions at all. If most meet the requirement as we expect, shortages and first curtailment of any that do not should occur infrequently.
30. Having presented our enforcement proposal, we suggest variations of this proposal and ask for comments on these alternatives. As mentioned, under our proposal the penalty rate or load curtailment would occur at the end of the planning horizon, not the beginning. However, we ask for comment on this approach compared to an alternative approach that may provide a more immediate and effective incentive to a load-serving entity to take action to provide for future resources well in advance of facing a penalty or first curtailment. This is to impose a penalty on the load-serving entity immediately (that is, in year 2004 to continue the example in an earlier footnote) if it fails to submit a satisfactory plan to meet its 2007 resource adequacy requirement. We did not propose this option

⁹In this section, the term "state regulatory authority" includes the retail rate regulating authority for load-serving entities not regulated by a state utility commission.

¹⁰Any necessary curtailment action, whether a first curtailment or any subsequent curtailment action may have to satisfy applicable state or local rules for ensuring that essential retail services (such as police, hospitals, fire stations) are maintained.

¹¹See SMD Tariff, Appendix B, Section I.5.

as our first choice because it has some of the unfavorable features of some ICAP programs that focus more on avoiding immediate penalties than on motivating long term resource development. However, we ask for comments on the merits of this alternative approach.

31. As presented, the Independent Transmission Provider audits the plan of each load-serving entity only at the beginning of the planning period (in 2004 in the example above). We are concerned that a load-serving entity may submit a satisfactory plan but fail to fully implement the plan. The proposal permits but does not require the Independent Transmission Provider to audit each year the progress of the load-serving entity in implementing its plan, and we ask whether we should explicitly require this. If the load-serving entity's progress is unsatisfactory, should the Independent Transmission Provider find that it fails to satisfy its resource adequacy requirement? If the load-serving entity implements its plan but some of its resources fail to perform when needed during a shortage, should that load-serving entity, in addition to having a greater need for spot market energy at a presumably higher spot market price, also be subject to either of the enforcement mechanisms set out above?
32. Another feature of our proposal is that it would not affect electric service from the self-generation and bilateral contracts of a load-serving entity that fails to meet its resource adequacy requirement (except that it would be subject to a penalty price during a shortage for balancing energy in the spot energy market). We ask for comment on whether this proposal unduly weakens the incentive to develop regional resources and whether, in the alternative, the Independent Transmission Provider should first curtail service to the load serving entities that failed to meet their share of the resource adequacy requirement, including transmission service from resources acquired outside the spot market, freeing up those resources for the use of those that planned adequately.
33. Finally, our proposed enforcement mechanisms are designed to create an incentive to avoid a future penalty or first curtailment. During the public outreach process for developing this proposed rule, some commenters recommended a stronger Independent Transmission Provider role in compliance with a mandatory resource adequacy requirement. One proposal is for the Commission to require the Independent Transmission Provider to procure resources on behalf of load-serving entities that fail to meet fully their requirement and charge them for the cost of the resources.¹² Another is for us to require the Independent Transmission Provider to either (1) calculate an expected capacity deficiency and purchase the call options necessary to meet the adequacy requirement on behalf of the load-serving entities, allocating costs pro rata, or (2) require load-serving entities to purchase reserves at the price produced by an Independent Transmission Provider-

¹²See, e.g., Electricity Market Design and Structure, Docket No. RM01-12-000, comments of Reliant Resources, Inc., filed May 3, 2002, at pages 11-12, in Docket No. RM01-12-000.

run auction.¹³

34. These approaches have advantages as well as disadvantages. Among the advantages are that they provide a greater assurance of achieving adequate resources and avoid the possible pitfalls of applying penalty rates or first curtailment. Among the disadvantages are that they take away one demand response option, namely curtailment, from the range of policy choices. Also, the latter approaches appear to require the Independent Transmission Provider to take a position in the capacity market, which places the Independent Transmission Provider in a role that may be incompatible with its independence.¹⁴

35. What is the effect of these alternate enforcement mechanisms on the incentives and business risks of the load serving entities in the region? Is there another enforcement mechanism that is both appropriate and effective?

6. Regional Flexibility

36. We propose to apply the requirement set out above to all regions, including regions that already have an ICAP requirement that has been previously approved by the Commission. This requirement would replace the current ICAP program.

37. Some regulators, customers, and market participants have expressed dissatisfaction with the ICAP models presently in place. Some customers view ICAP as an added cost with no tangible benefits; they assert that the commodity being traded has little value because customers are paying for installed capacity but not receiving any greater assurance that generation adequacy is maintained. Some commenters say that, in some ICAP programs, a generator can receive an ICAP payment and later be released from the ICAP obligation for a relatively small penalty to sell its capacity in another market with a high wholesale price.

38. Existing local generators are said to have preferential ability to participate in the ICAP market. The ICAP payment goes to the existing generators and does not necessarily lead others to enter the market to increase capacity. Depending on how the ICAP rules are designed, existing generators may be able to exercise market power, forcing up ICAP prices. In some markets, trading has been so thin at times that there is a question about whether there is a competitive market price.

39. In some such cases, the ISO has intervened to set the price administratively, and market participants are concerned that the price does not reflect the forward value of generating capacity. Some contend that prices in the spot markets and

¹³See, e.g., Electricity Market Design and Structure, Docket No. RM01-12-000, comments of Mirant Americas, Inc. and Mirant Americas Energy Marketing, L.P. filed May 2, 2002.

¹⁴They also raises difficult jurisdictional questions, in that Commission has regulated the seller's side of wholesale transactions and the states have regulated the buyer's side. Under some of these proposals, we would have to distinguish a transmission penalty levied by the Independent Transmission Provider for a load-serving entity's failure to procure the resources needed to maintain transmission security from a Commission-enforced mandatory purchase of reserves by the load-serving entity.

bilateral markets, including long-term forward contract markets, appear to be not well correlated with ICAP market prices.

40. The generators object to ICAP price controls. Some power generators see short-term ICAP payments as providing inadequate assurance of capital cost recovery to motivate new investment. They prefer longer-term contracts to ensure that their investment costs will be recovered.

41. Finally, many parties object that ICAP focuses on power generation, ignoring the potential of demand response.

42. Although we propose that every region must adopt our approach, this approach offers significant regional flexibility. Our approach allows each region to set its own level of resource adequacy, set its own planning horizon, and select from a combination of supply and demand response resources for meeting its needs.

43. Our proposal permits but does not require a region to have its Independent Transmission Provider establish a market for acquiring and trading adequate resources. We believe that the bilateral market and other means can be adequate for acquiring and trading resources. Nevertheless, we ask for comment on whether, under the approach to resource adequacy proposed here, we should require an Independent Transmission Provider to create a market to facilitate load-serving entities meeting their resource adequacy requirement efficiently.

44. Despite the flexibility of our proposed approach, regions with a historical reliance on a tight pool for sharing reserve may argue for a continuation of some form of ICAP program. We ask for comment on how existing Commission-approved ICAP mechanisms can be transitioned and modified so as to be made consistent with our resource adequacy proposal here without disrupting financial commitments made under existing rules. What are the disadvantages of particular elements of the ICAP approach that should be avoided in the approach proposed here? Do any of the enforcement proposals or alternatives discussed above re-introduce any such disadvantageous elements?

K. State Participation in RTO Operations

45. States have an important role in the process of creating and sustaining an efficient competitive wholesale market for electricity. The Commission has already established state-federal RTO panels as a forum for the Commission and state commissioners to discuss issues related to RTO development. However, there currently is not a formal process for state representatives to engage in a similar dialogue with the independent entity that will operate the electric grid under Standard Market Design. Therefore, the Commission is proposing to establish a formal role for state representatives to participate on an ongoing basis in the decision-making process of these organizations.

46. We envision that the Independent Transmission Provider that operates the grid would have a Regional State Advisory Committee. The Regional State Advisory Committee should be formed and should have direct contact with the governing board, in a manner which recognizes its public interest responsibilities,

and be designed to provide the board as well as market participants and the Commission with a consensus view from states in the area. The specifics of how this advisory committee would be formed and operate would be decided on a regional basis. This coordinated oversight will ensure fulfillment of federal public interest responsibilities in a manner that includes the views of states throughout the region. In this regard, we also encourage the participation of Canadian provincial authorities in this process.

47. We take note of the recent report by the National Governors' Association entitled "Interstate Strategies for Transmission Planning," which recommends establishing "Multi-State Entities" to facilitate state coordination on transmission planning, certification, and siting at a regional level.¹⁵ The report recognizes the critical role states currently play in siting as well as the need to address regional needs. The institution we propose here appears complementary to the National Governors Association's recommendation. In fact, it may be useful to have a single Regional State Advisory Committee rather than separate committees for siting and other issues. We seek comment on whether there should be a single Regional State Advisory Committee, or separate committees for siting and other issues. We also seek comment on how the state representatives should be selected (e.g., whether the governor should select them or some other process should be used).

48. The Regional State Advisory Committee may work with the regional transmission organization to seek regional solutions to issues that may fall under federal, state, or shared jurisdiction, which may include but are not limited to:

- a. Resource adequacy standards;
- b. Transmission planning, expansion;
- c. Rate design and revenue requirements;
- d. Market power and market monitoring;
- e. Demand response and load management;
- f. Distributed generation and interconnection policies;
- g. Energy efficiency and environmental issues;
- h. RTO management and budget review.

Further duties may evolve with the development and operation of the regional councils.

49. As discussed, the Commission is proposing to require that the independent entity that operates the markets under Standard Market Design will have a Market Monitoring Unit (MMU). The MMU will be required to report directly to the Commission and the independent governing board of the Independent Transmission Provider. The MMU should also provide its reports directly to the Regional State Advisory Committee. Finally, because of the regional nature of these organizations, there are many new issues involving rate design and revenue requirements. We believe that the Regional State Advisory Committees can bring

¹⁵Available in

http://www.nga.org/center/divisions/1,1188,C_ISSUE_BRIEF^D_4110,00.html

a valuable regional perspective to these issues and should play a role in deciding these issues in partnership with the Commission. Once the advisory committees are established, we intend to work with them to establish protocols for deciding these regional rate issues. Additionally, the Independent Transmission Provider will be required to develop regional plans for transmission planning and expansion. We believe this is also an area where the Regional State Advisory Committee can bring a valuable regional perspective and should be consulted in developing these regional plans.

L. Governance for Independent Transmission Providers

50. The Commission has previously recognized the importance of independent governance of regional organizations in both Order No. 888 and Order No. 2000. In Order No. 888, the Commission required that ISO governance be structured in a fair and non-discriminatory manner and that the ISO be independent of any individual market participant or any one class of participants. The Commission also required that the ISO's rules of governance should prevent control, and appearance of control, of decision-making by any class of participants. Order No. 2000 built upon and extended this independence requirement to RTOs. In Order No. 2000, we reaffirmed our commitment to independence as a bedrock principle for regional organizations, and in this rulemaking we find that our commitment to independence also is critical to the successful implementation of Standard Market Design. Compliance with the independence requirement of Order No. 2000 is based on the independence of the Board of Directors and all employees of the RTO. The governance requirements for the Board of Directors is critical to ensuring that the RTO is independent and that the RTO's interests are aligned with the interests of the market as a whole rather than with particular market participants of classes or market participants. While we did not mandate detailed governance requirements for RTO boards in Order No. 2000, we stated that we would review on a case-by-case basis the RTO governance proposals and judge them against the overarching standard that the RTO's decisionmaking process must be independent of individual market participants and classes of market participants. We also required an audit of the independence of an ISO's governance process two years after its approval as an RTO.¹⁶

51. The Commission has considered on a case-by-case basis whether individual RTO proposals satisfy the Commission's requirements for independence.¹⁷ We have required changes where they did not.¹⁸ However, we are concerned that the lack of more definitive guidance from the Commission on governance may be hindering the development of larger RTOs. Also, we are concerned that the

¹⁶See California Operational Audit of the California Independent System Operator issued January 25, 2002 in PA02-1-000 and Order Concerning Governance of the California Independent System Operator 100 FERC ¶ 61,059 (2002).

¹⁷See *Avista Corporation, et al.*, 95 FERC ¶ 61,114 (2001).

¹⁸See *Carolina Power & Light Company*, 94 FERC ¶ 61,273 (2001).

existing stakeholder process may not provide adequate representation for all market participants and interested parties. The lack of adequate representation may hinder development of alternative energy resources, such as distributed generation, renewable energy, or demand response programs, since these programs may be contrary to the business interests of certain market participants. Therefore, we are proposing to require that all Independent Transmission Providers satisfy specific governance requirements. Specifically, we are proposing to more clearly define the responsibilities of the Board of Directors, more clearly define the role of stakeholders in selection of the board and in the management of the Independent Transmission Provider, and to establish a process that would be used for selecting the Board of Directors by Independent Transmission Providers.