UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Uplift Cost Allocation and Transparency in Markets Operated by Regional Transmission Organizations and Independent System Operators	Docket No. RM17-2-000

COMMENTS OF THE
ELECTRICITY CONSUMERS RESOURCE COUNCIL
(ELCON)

The Electricity Consumers Resource Council (ELCON) appreciates the opportunity to submit comments on the Commission's Notice of Proposed Rulemaking (NOPR) in the above-captioned docket. This is the fourth in a series of NOPRs in which the Commission is pursuing certain pricing reforms on a piecemeal basis, arising of a notice issued in June 2014 in Docket No. AD14-14 and a subsequent series of technical workshops.

ELCON's members will be impacted by the NOPR, in which the Commission proposes that the RTOs/ISOs: (i) if and when allocating real time uplift costs to deviations would be required to allocate them only to market participants whose transactions are reasonably expected to have caused the costs; and (ii) implement transparency procedures including posting uplift costs paid and operator initiated commitments on their websites,[1] and to define in their tariffs their transmission constraint penalty factors, including the circumstances under which the penalty factors can set locational marginal prices, and any procedure for temporarily changing the factors.

ELCON is the national association representing large industrial consumers of electricity. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. ELCON members operate hundreds of major facilities and are consumers of electricity in the footprints of all organized markets and other regions throughout the United States. Reliable electricity supply at just and reasonable rates is essential to our members' operations. ELCON submitted comments on price formation issues to Docket AD14-14.

I. BACKGROUND ON UPLIFT AND THE NEED FOR THE NOPR

Commission staff has described uplift as follows:

> Uplift credits are payments made to resources whose commitment and dispatch by an RTO or ISO result in a shortfall between the resource's offer and the revenue earned through market clearing prices. While shortfalls can occur for many reasons, three primary reasons are: (1) a resource's operating costs and limits not being reflected in prices; (2) unmodeled system constraints; and (3) the dispatch and commitment of inflexible resources or the commitment of resources ineligible to set price.[2]

ELCON recognizes that, in view of the imperfections in the organized markets, or in connection with unusual and unpredictable occurrences, uplift charges will be

[1] Specifically, the NOPR would require that each RTO/ISO: (1) report total uplift payments for each transmission zone on a monthly basis, broken out by day and uplift category; (2) report on a monthly basis uplift payments for each unit; and (3) report megawatts of operator-initiated commitments in or near real-time and after the close of the day-ahead market, broken out by transmission zone and commitment reason.
[2] Staff Analysis of Uplift in RTO and ISO Markets, Aug. 2014, at p. 4 ("Staff Analysis Paper").

necessary from time to time to ensure reliable electricity supply. This is because the design of the organized markets and the practicalities of their day to day operations are imperfect, though not because they are intentionally imperfect or necessarily the result of bad behavior. A common cause is the fact that system operators have to take actions in real time that the market cannot respond to. There are also software impediments and data measurement problems that give system operators less than perfect information and tools for matching resources with the load. This is in part an artifact of the day-ahead market construct where resources are committed for next day real-time dispatch. A lot can change in 24 hours, and last minute forced outages wreak havoc with real-time dispatch. Reactive power also has inherent unpredictability. Overall, uplift costs are a relatively small component of consumer bills and forcing a more market-like solution with the objective of eliminating all uplift likely would be more costly to consumers.

In this regard, looking to the longer term, ELCON endorses the findings of FERC staff that:

> understanding the reasons for uplift payments, the magnitude of uplift payments, and the impact on market participants and customers may help to shed light on markets, operations or infrastructure improvements to reduce the need for uplift payments. Preliminary findings indicate that:
>
> - Uplift payments (i.e., credits) have been highly concentrated and recurring on a geographic or resource basis.
> - Uplift payments are closely related to market fundamentals, including energy and fuel costs.
> - Uplift payments are closely related to price divergences between day-ahead and real-time markets.
> - The volatility of uplift costs varies across RTOs and ISOs and is trending upwards in three of the five markets studied.

- Uplift payments and the reasons they are incurred lack transparency.[3]

As some uplift is likely to play a useful role in supplementing market pricing for the foreseeable future,[4] however, the more focused, process-oriented reforms proposed in the NOPR are worth pursuing. In particular, uplift charges must be imposed only when justified at rates that are just and reasonable, and allocated on the basis of cost causation principles. And regardless of the amount of uplift and the underlying trigger for it, transparency is essential. As FERC staff further noted on this topic:

> Regardless of the underlying causes of uplift, a failure to make the causes transparent and to price them into the energy and ancillary services markets can undermine the effectiveness of price signals and efficient system utilization, and mute investment signals. Volatile uplift charges may also create financial uncertainty for customers, depress liquidity and reduce market efficiency.[5]

However, ELCON offers the caveat that the RTOs/ISOs should not view the NOPR's requirements and procedures as countenancing an increase in use of uplift. As FERC staff stated at the January 19, 2017 Commission meeting, "the uplift allocation proposal only requires that, if an RTO/ISO allocates real-time uplift costs to deviations, it must do so based on cost causation. If an RTO/ISO does not currently allocate real-time uplift costs to deviations, this NOPR would not impose a requirement on those RTOs/ISOs to allocate real-time uplift costs to deviations."[6] While offering support for this initiative, ELCON believes that the focus of the Commission's efforts on price

---

[3] Staff Analysis Paper at 2.

[4] In this regard, the NOPR states that "[s]ince the limitations in representing the complexity of the electric system in market models are unlikely to ever be fully resolved, uplift costs are also unlikely to be completely eliminated." NOPR at ¶ 2.

[5] *Id.*

[6] See also NOPR at ¶¶ 31, 36.

formation should be to redress issues that are considerably more significant, such as improper subsidization of wind generation and zero emissions credit ("ZEC") charges.

II. PROCEDURES FOR DETERMINING THE AMOUNT AND ALLOCATION OF UPLIFT COSTS MUST NOT RESULT IN UNJUST AND UNREASONABLE RATES

ELCON agrees with FERC that current RTO/ISO practices for uplift cost allocation are inconsistent with cost causation and may distort market outcomes, resulting in rates that are not just and reasonable. As stated in the NOPR, if an RTO or ISO allocates real-time uplift to deviations from day-ahead schedules, it must do so based on cost causation.

The NOPR sets out a detailed process for implementing cost causation. The NOPR proposes to require the RTOs/ISOs to allocate deviation-related real-time uplift costs only to those market participants whose transactions are reasonably expected to have caused the uplift costs. It does so first by proposing that they separate real-time uplift costs allocated to deviations into at least two categories based on the reason uplift costs were incurred: a system-wide capacity category and a congestion management category. Then, within each uplift category, the RTOs/ISOs would distinguish between two classes of deviations -- those that "help" address system needs and those that "harm" system needs -- that would be netted against each other. However, deviations resulting from a resource responding to an RTO- or ISO-initiated real-time dispatch instruction should not be allocated real-time uplift costs as a deviation. The stated basis for netting is to "ensure[] that only market participants deviating from their day-ahead schedules in a manner that increases uplift payments will incur those costs.[7]

As expressed in practical terms in the NOPR, for current purposes cost causation means that "an RTO/ISO . . . must allocate [real time uplift] costs only to deviations that can reasonably be expected to have caused those costs." Although the NOPR does not explain the basis of cost causation principles, they are directly sourced from the Federal Power Act as explained by a long line of FERC precedents.

Principles of Cost Causation

The principle of "beneficiary pays" has been considered by the courts, particularly in electricity cases, under the rubric of "cost causation." As the D.C. Circuit has explained, although "just and reasonable" provides a "spartan" statutory standard, "FERC and the courts have added flesh to these bare statutory bones, establishing what has become known . . . as the 'cost-causation' principle."[8] The cost-causation principle is the "touchstone in any legal analysis of FERC-approved rate schemes," and it requires "that all approved rates reflect to some degree the costs actually caused by the customer who must pay them." *Id.; see also Village of Bethany v. FERC*, 276 F.3d 934, 937 (7th Cir. 2002) ("The overriding policy concern in a ratemaking proceeding is to establish rates that require each customer to bear a fair and proportional share of . . . costs."). The D.C. Circuit has stated that compliance with the cost-causation principle must be evaluated "by comparing the costs assessed against a party to the burdens

---

[7] NOPR at ¶ 24.

[8] *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992).

imposed or benefits drawn by that party."[9] The court in *Midwest ISO* described FERC's cost-causation principle as "requir[ing] that all approved rates reflect to some degree the costs actually caused by the customers who must pay them.… Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or the benefits drawn by that party."[10] FERC has treated as black-letter law the principle that customers using a facility or service, or benefiting from a facility or service, must pay their fair share of the costs of the facility or service. FERC refers to this principle as "cost causation."[11] Implicit in the cost-causation analysis is the principle that each "customer pay[s] for the service [it] receive[s] and do[es] not subsidize service rendered on behalf of others."[12]

The Role for Uplift Charges in the Organized Markets

That uplift should be avoided as much as possible is a truism. It is alleged for example, that uplift can mute market signals, that units that receive uplift are at least partially insulated from competition, and that load, which ultimately bears the uplift costs, generally cannot adequately hedge them through bilateral contracts or otherwise because they are unpredictable. These points have some theoretical merit, but in

---

[9] *Midwest ISO Transmission Owners*, 373 F.3d 1361, 1368-69 (D.C. Cir. 2004).

[10] *Id.* (Citations omitted); *see also United Distribution Cos. v. FERC*, 88 F.3d 1105, 1188-89 (D.C. Cir. 1996) ("[c]ost causation correlates costs with those customers for whom a service is rendered or a cost is incurred"); *Cities of Riverside and Colton, California v. FERC*, 765 F.2d 1434, 1439 (9th Cir. 1985). The Commission has described its "long standing policy" on utility cost allocation in these words: "Properly designed rates should produce revenues from each class of customers which match, as closely as practicable, the cost to serve each class or individual customer." *New Dominion Energy Cooperative*, 122 FERC ¶ 61,174, P 41 (2008), *citing Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

[11] *See, e.g., California Power Exchange Corp.*, 106 FERC ¶ 61,196, P 17 (2004), (the "well-established principle of cost causation requires that costs should be allocated, where possible, to customers based on customer benefits and cost incurrence"). *See also CAISO*, 103 FERC ¶ 61,114, P 26 ("[w]hile this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which 'should be borne by those who benefit from them'" (*quoting Gulf Power Co. v. FERC*, 983 F.2d 1095, 1100 (D.C. Cir. 1993))).

[12] *Empire State Pipeline and Empire Pipeline, Inc.*, 116 FERC ¶ 61,074 at P 115 (2006).

practical effect they have little significance. Uplift represents a relatively small portion of costs to consumers, and given the current imperfections and inefficiencies in the organized markets, redressing the sources of the need for uplift is at most a long-term goal. In any event, a process for make-whole payments through verified, cost-based uplift charges, depending on the circumstances, can preferable to incorporation into market prices because uplift can be focused and limited to the resources that specifically correct the supply-demand imbalance. In other words, a process limiting payments to the resources that are necessary to actually balance the market, rather than to all resources, achieves cost-recovery objectives for the impacted units without giving others an unnecessary windfall. In many cases, such as conditions that are limited in scope and duration and might not recur, there is no need to send market-wide price signals, and eliminating uplift could be more costly than the uplift itself.

Applying Cost Causation Analysis to Uplift Charges

Accepting the premise that when used properly, uplift can be an appropriate and cost-effective mechanism to address certain narrowly-defined market issues, any such truly necessary uplift costs then must be allocated on the basis of cost causation. This is not only a just and reasonable outcome consistent with Commission precedent, but it also will create a meaningful incentive to minimize the need for uplift payments. When determining the amount of necessary uplift and how it should be allocated, considerable care is needed. Because improper assignment of uplift costs can distort market behavior and prices, "do no harm" must be the overarching consideration. ELCON recognizes that the NOPR's proposal for two specific uplift cost allocation categories and its netting procedure enable better alignment with cost causation principles. By classifying uplift costs, they can be more precisely and efficiently allocated to those participants that cause them.

However, ELCON urges each of the RTOs/ISOs to carefully consider these issues and when revising their own rules avoid the temptation, in the interest of expedition, to simply rubber stamp the NOPR's concepts. The NOPR emphasizes, for example, that in addition to the two specified categories (system-wide capacity and congestion management) the RTOs/ISOs have the flexibility to establish additional categories.[13] For example, local-reliability uplift is another possible category that has been identified. To ensure just and reasonable rates based on cost causation, the individual needs of each region, and particularly the state of each individual organized market, should be carefully assessed and taken into account.

III. ADDITIONAL TRANSPARENCY WOULD BENEFIT THE MARKETS, BUT SHOULD BE BETTER SUPPORTED BY BALANCING WITH THE COSTS

Uplift inherently lacks market transparency, as uplift costs are outside the market and thus are not included in the price signals that are visible to the market.[14] Accordingly, ELCON agrees with the NOPR that special procedures to improve information flow may benefit the functioning of the organized markets by, among other things, promoting the identification of system needs, facilitating investment, entry and

[13] NOPR at ¶ 40.

[14] Nonetheless, FERC staff analysis demonstrates that uplift costs and LMPs are highly correlated. Staff Analysis Paper at pp.10-15.

exit decisions, and supporting financial transactions such as hedging.[15] With the caveat that the costs of additional transparency obligations must be weighed against their benefits, ELCON supports FERC staff's discussion of the critical role of transparency:

> With added transparency, market participants and other stakeholders are in the best position to develop solutions to address the causes giving rise to uplift. For instance, knowing that the vast majority of uplift in a particular import-constrained zone is related to the provision of reactive power could make clear to market participants that the zone is reactive power deficient. This could lead to proposals to address reactive power compensation and potentially send a price signal to enhance reactive power capability. On the other hand, knowing that a majority of uplift in a particular zone is related to local "reliability" could suggest that the model is not incorporating certain constraints or the operators are conservatively committing units to address generic concerns. In either case, this raises the possibility that energy prices do not fully reflect the marginal cost of production. Further, enhancing the transparency of the cost of such local reliability concerns may provide information necessary to appreciate the full cost of managing such local reliability concerns and to consider alternative solutions. This is particularly important when uplift costs are allocated in a manner different than the cost of alternative solutions.[16]

IV. CONCLUSION

As discussed in these comments, ELCON supports the NOPR, with the important provisos that: (1) recognizing that uplift has a narrow but essential role given the nature of the organized markets and the practicalities of their implementation, more formalized procedures and requirements governing uplift charges should not be interpreted as countenancing expanded use of uplift; (2) additional transparency is particularly important so that the sources and amount of uplift can be better assessed and the principles of cost causation more readily applied; (3) the RTOs/ISOs should

---

[15] NOPR at ¶ 58.

[16] Staff Analysis Paper at p. 28.

have the flexibility to impose additional or alternative procedures and requirements that reflect their market terms and conditions and other region-specific circumstances; and (4) this rulemaking should not distract the Commission from price formation issues of greater current relevance (and cost to industrial consumers) such as wind subsidies and ZECs.

NOTICES AND COMMUNICATIONS

Notices and communications with regard to these proceedings should be addressed to:

John P. Hughes
President and CEO
ELECTRICITY CONSUMERS RESOURCE COUNCIL
1101 K Street, NW, Suite 700
Washington, DC 20005
Email: jhughes@elcon.org
Phone: (202) 682-1390

W. Richard Bidstrup
CLEARY GOTTLIEB STEEN & HAMILTON LLP
2000 Pennsylvania Avenue, NW, Suite 900
Washington, DC 20006
Email: rbidstrup@cgsh.com
Phone: (202) 974-1500

Respectfully submitted,

/s/ W. RICHARD BIDSTRUP
W. Richard Bidstrup
CLEARY GOTTLIEB STEEN & HAMILTON LLP
2000 Pennsylvania Avenue, N.W., Suite 900
Washington, D.C. 20006
Counsel for ELCON

Dated: April 10, 2017

<u>CERTIFICATE OF SERVICE</u>

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of this proceeding.

Dated at Washington, D.C.: April 10, 2017

/s/ W. RICHARD BIDSTRUP
W. Richard Bidstrup