

# **"FERC Policy Will Nourish Distributed Resources"**

**Remarks by  
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## **I. Introduction**

Good morning. During my nearly nine years as a Commissioner at the FERC, we have been rather aggressively pursuing robust and efficient markets for wholesale electricity trading. This trading will take place in a marketplace enabled by an open, reliable and efficiently operated transmission grid that does not favor particular merchant interests. This is a fundamental principle, and much of our efforts are aimed at ensuring fair grid access and efficient operations.

A key element of access to the electron superhighway is generator interconnection policy. For some time now I have been championing a streamlined and standardized interconnection process. Six months ago the Commission finally took up this issue and intends to propose a rule standardizing interconnection agreements and procedures this spring.

I am fascinated by the evolution of the distributed generation industry, and I firmly believe that distributed resources have the potential to transform the competitive landscape for the electric power industry. However, this won't happen magically, because regulatory policies can either encourage or discourage the use of distributed resources. The FERC has jurisdiction over wholesale sales of power and over transmission in interstate commerce. We must ensure that our policies with respect to interconnection

and transmission access, and with respect to the design of wholesale markets, facilitate the integration of distributed generation and value it as a critical resource.

But, one might ask, why should federal regulators care about distributed resources? After all, isn't this area primarily the worry of state and local officials.

Federal policymakers should care for five important reasons. First, these resources offer the opportunity to save money. They can substitute for transmission and distribution system investment, in addition to providing capacity and energy savings. Second, they can certainly improve reliability, a strong federal concern, and provide relief for highly stressed transmission and distribution systems. They can also improve power quality. Third, distributed resources can reduce pollution, especially with some of the new technologies. This is clearly in the national interest.

The fourth reason is the customer choice. We want customers to have a wide range of choices to meet their energy needs. This is, after all, the philosophical underpinning of the entire movement at FERC toward wholesale electricity markets. What better way to offer choice than to provide an opportunity for the customer to generate his own power.

And reason number five is market power. A primary focus of regulators is sharply limiting the exercise of market power. It seems obvious that distributed resources can provide an important check on the market power of the incumbent supplier, and federal policymakers have a keen interest in achieving this goal.

For these reasons, the Commission has a growing awareness of the value of distributed resources in a market driven policy environment. We want our policy choices to reflect this awareness.

It is true that many of the policy choices that affect distributed resources must be resolved by the states rather than by FERC. It is unclear, to cite one example, what role the FERC will play in interconnecting fuel cells for residential use. That may be entirely in state hands despite our best efforts to streamline interconnection processes and procedures.

Nevertheless, in the three major policy initiatives that are currently underway at the Commission, the huge potential for distributed resources will be respected.

The first major policy area that affects distributed resources is our effort to ensure that grid operations are organized under large regional entities known as RTOs, that

function independently of any merchant interest, and that provide a solid trading platform to support efficient wholesale markets.

The second major policy initiative is aimed at implementing a Standard Market Design in wholesale markets across the country. This will be critically important for distributed resources that participate directly, or through aggregation in wholesale markets.

And third, as I mentioned earlier, the FERC is moving to standardize and streamline the interconnection of resources that plan to sell into the wholesale market or that interconnect at the transmission level. Clearly, this standardization effort will benefit at least some distributed resources.

I will briefly discuss these initiatives in turn.

## II. Open Access and RTOs

Order No. 888 was promulgated six years ago. We knew it wasn't the end game. It was a bold step at the time, but still was insufficient to eliminate discriminatory practices, and it did not create efficient markets. It was based upon the functional unbundling of transmission from supply, but did not force a corporate separation. Our experience has been mixed – vertically integrated utilities control markets operating in many regions and can still favor their own merchant interest in many respects.

Order No. 2000 was issued two and half years ago. It had three goals. First, to reorganize grid operations around large regional trading hubs. Second, to eliminate multiple transmission charges. And third, to restructure grid operations under the control of independent entities that do not own merchant interests.

The implementation of our RTO policy has been mixed, primarily because it is a voluntary program. The Commission mandated that transmission owners voluntarily participate in RTOs. Figure that one out. Nevertheless, I am convinced that the Commission will insist that an RTO form and operate in every region of the country. When that happens, grid operations will support large regional markets and the RTO will eliminate the incentive for grid operations to favor one merchant interest over another. The RTO principle of resource neutrality will obviously benefit distributed resources, as will more efficient grid operations.

Into this RTO and market soup toss three other ingredients: The first is the California market meltdown of 2000-2001. This persuaded the Commission that good market fundamentals are critical to good market performance. This catastrophe also left many with a sour taste in their mouths about the viability of electricity markets. The second is the Enron debacle, which some are construing as "strike two" for energy markets. I disagree with this perception, by the way. The third is last month's Supreme Court decision affirming broad FERC jurisdiction over the transmission grid. It now seems clear that if the Commission, for compelling reasons, chooses to assert jurisdiction over all transmission uses, there will be no legal barrier.

These last three ingredients provide a nice segue into the subject of standard market design.

### III. Standard Market Design

The Commission has recently turned its complete attention to the issue of electricity wholesale market design. This is the second major policy area I want to discuss.

When you cross the divide between cost of service and markets, you must make the markets work. We now know that a bad market is worse than no market.

We have observed what doesn't work, and we now have several years of experience with the PJM and NY ISO market design based upon the concept of bid based, security constrained dispatch for real time operations with locational marginal prices. FERC has become increasingly concerned that without a national policy, what will evolve is somewhat quirky, idiosyncratic market designs that may be inefficient and inhibit broad trading among regions. The Commission is working toward a standard market design that all jurisdictional transmission providers and power sellers will implement.

On March 13, the Commission issued its working paper on standardized transmission and wholesale market design. The standard market design we are proposing has a number of critical features, but let me emphasize five of them this morning.

First, all load would take transmission service under a single tariff. This will apply at wholesale and for both unbundled and bundled transmission services. Power is not consumed at wholesale. Thus, all transmission uses, whether wholesale or retail, must be treated equally and without preference.

Second, the Commission will define a new open access tariff that will update the old Order No. 888 tariff. The tariff will be based upon a new network transmission service available to all transmission service customers. Here are the features of this new service:

- New network service available to all customers
- Access to all sources and sinks
  - Price certainty with transmission rights
  - Congestion charges w/o transmission rights
- Locational marginal pricing (LMP) for congestion management
- Transmission service scheduling integrated with energy markets
- Network access charge to recover embedded costs

Third, the market design specifies certain energy markets that must be offered:

- Bilateral and self-schedules
- Day-ahead market
  - Voluntary, bid-based, security-constrained
  - Financially binding
- Real-time market
  - Bid-based, security constrained
  - Used to settle all imbalances
- All supply and demand resources will participate on an equal footing.

Fourth, the standard design must include operating reserves:

- Markets for operating reserves

- Bilateral arrangements and self-schedules
  - Bid-based day-ahead and real time markets
- Operated together with energy and transmission markets

And fifth, the market design promotes a strong monitoring and mitigation function:

- Market rules should enhance competition
- Preventative mitigation measures built into market rules
- Role of the Market Monitoring Unit
  - Independent of RTO management
  - Focus on withholding and market efficiency

The plan is to receive comment on this working paper by March 27, to issue a proposed rule implementing standard market design by June, and to finalize the rule by December.

This is all good for distributed generation for several reasons: The first point is obvious. The non-discriminatory access afforded by RTOs will help distributed generation to the extent these resources need to get on the grid. Another key point is that locational marginal pricing makes distributed generation more competitive. Locational marginal pricing shows the true cost of energy in congested areas. In highly congested areas (such as growing urban areas where transmission expansion is limited), the locational marginal pricing is likely to be higher than elsewhere. Distributed generation benefits from this accurate higher price in two ways: (1) distributed generation becomes economically more attractive because load served by the distributed generation avoids paying the high price, and (2) distributed generation can fetch the locational energy price to the extent it sells excess power to the market.

Another key aspect relates to planning. We will require a pro-active planning process in which all resources are treated the same.

A fourth point is that standard market design principles are distributed generation friendly. We specify that the market must be neutral with respect to technology, fuel and size; intermittent resources should be allowed to participate in the day-ahead and real-time market on same basis as other resources; and energy limited resources should be afforded additional scheduling options.

And finally, a single transmission service with tradeable rights facilitates coordinating distributed generation resources at multiple locations.

In short, the standard market design is an extraordinarily positive development for distributed generation.

#### IV. Interconnection Standardization

The last major policy initiative is interconnection standardization. The Commission will issue a proposed rule this spring. The goal here is to make it much easier for generation resources to hook up. It will eliminate interconnection legerdemain and streamline the process. This is an excellent initiative we should have taken years ago.

This can only help distributed generation. Some will benefit directly if they are hooking up either at the transmission level or to sell at wholesale. Also, this initiative states clear and positive interconnection principles that can be emulated at the state and local level.

Streamlined procedures may be developed for distributed generation even under our rule. Small generators (distributed generation) have less impact on the transmission system than larger ones, and could warrant special rules to allow even easier interconnection. A threshold for determining what's small could be based on:

- (1) The size of generator
- (2) Whether distributed generation will have the capability to inject power into the grid. Distributed generation can still participate in the market, even if doesn't inject power into the grid, by giving the transmission provider an additional redispatch option. The distributed generator can serve load and thereby remove the load from the system.

In summary, it seems obvious that the evolution of FERC policy in these three areas – RTOs, market design, and generation interconnection – will be helpful to distributed generation. The Commission must insist that its policy choices nourish the potential for those valuable distributed resources.

Thank you.