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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Conference on Competition in Wholesale Power Markets	Docket No. AD07-7-000

Panel 3: Enhancing the Responsiveness of RTOs and ISOs

Oral Remarks of:

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Introduction.

Good afternoon. I am Lloyd Webb, Procurement Manager for Eastman Chemical Company, which is headquartered in Kingsport, Tenn. Eastman is a FORTUNE 500 company with 2006 sales of $7.5 billion and approximately 11,000 employees. We manufacture and market more than 1,200 chemical, fiber and plastic products worldwide. We have facilities in PJM, SPP, ERCOT and SERC. I am also appearing here today as ELCON's chairman.

In the mid-1990s, ISOs and later, RTOs, were established with widespread support in regions of the country with high electricity rates. ISOs or RTOs were promoted as a platform for competition that would bring consumers lower rates, choice and product innovation.

An important measure of success for a competitive market is the degree to which it is self-regulating. This means that the need for regulatory intervention is greatly minimized. Not altogether eliminated, but minimized. Markets that require frequent regulatory intervention are considered market failures.

An unusual feature of ISOs and RTOs was the addition of a quasi-regulatory/quasi-advisory stakeholder process to the governance structure. In every ISO or RTO that was established and approved by FERC, the determination of a "balanced" stakeholder process was a long, drawn out battle of competing interests. These battles continue at great cost to consumers.

There are few examples of markets that allow an ad hoc stakeholder process to literally dictate the manner in which business is conducted. While certain financial securities markets were created as self-regulating organizations, there has been no

Congressional authorization that gives the ISO or RTO stakeholder processes the same market oversight rights.

No existing FERC-approved ISO or RTO stakeholder process consists of balanced representation between supply-side and demand-side interests. All stakeholder processes are skewed in favor of supply-side interests. While the interests of supply-side participants are diverse on many supply-related issues, it is not so diverse on issues of importance to demand-side interests and we often see supply-side interests quickly converge to unanimity on these issues. Thus, supply-side interests can often stop any initiative with strong demand-side support, but demand-side interests cannot stop any initiative with strong supply-side support.

While it is true that ISOs and RTOs were established as more-or-less non-profit entities to ensure independence from any market participants, it is clear that ISO or RTO management may be increasingly aligned with the commercial interests of some market participants. In order to protect their interests, generators and ISO/RTO management increasingly share the same need to talk up the benefits of the markets as consumers consistently question the presence of these benefits.

There is often a high cost to consumers of NOT participating in the stakeholder process. Yet, when all stakeholders are at the table, they may never agree on any important matter. And when they do agree on something, the ISO/RTO Board may override them. Thus, our participation tends to be for defensive purposes only.

It is not clear what the role of the ISO/RTO stakeholder process should be. Is its role advisory or was the intent a subtle delegation of FERC's regulatory functions? An exclusively advisory role would make stakeholder groups develop a consensus view on any issue, with minority views made public as well. The actual decision making would reside with the ISO/RTO Board. But an exclusively regulatory role can always be preempted by the ISO/RTO Board. There may be no difference, except in the expectations of the stakeholders themselves, and these expectations impact the quality and quantity of participation.

ISOs and RTOs are evolving into a third layer of regulation that may be creating a harmful regulatory gap for retail customers. Under state jurisdictional cost-of-service regulation, industrial groups and other organized representatives of consumer interests had their day in court and state PUCs were generally respectful of consumer views and needs. But as jurisdiction over grid operation, planning and markets has shifted to FERC, and as FERC has delegated authorities to ISO and RTO stakeholder processes, we are increasingly being disenfranchised.

While the RTO stakeholder process in most instances works satisfactorily on incremental changes or enhancements to RTO market rules, it tends to breakdown on more critical threshold issues. Here are some examples:

1. The Midwest ISO Stakeholders' Advisory Committee overwhelmingly rejected the proposed Ancillary Services Market (ASM) by a vote of 19½ against and 3½ abstentions. MISO overruled the stakeholders and filed the proposal.

2. PJM sponsored extensive stakeholder discussions on its proposed Reliability Pricing Model (RPM) but was never able to get even a simple majority of stakeholder support for the proposal, yet a super-majority was needed under PJM rules for it to pass. As we all know, PJM filed the proposal anyways, which led to a costly settlement process that may eventually have to be resolved by a federal court.

3. There were also voting irregularities on the Management Committee prior to the New York ISO's filing of its "demand curve" capacity market proposal in 2003. The irregularities included calling a second vote after the motion to approve the demand curve failed the first time by circumventing the meeting notice time and arbitrarily disqualifying four parties that were known dissenters of the motion. The motion narrowly passed the second time, thus permitting the ISO Board to move ahead with the controversial filing.

These examples are representative of a history of problems consumer interests have with the stakeholder process. It does not inspire trust or confidence that end-user interests are afforded adequate protection. To the contrary, the primary objective seems to be to give generators everything they ask for.

<u>Recommendations</u>:

1. Clarify the role and rules of the stakeholder process, require stakeholder balance between the two sides of the market, and establish a super-majority vote requirement. Dismiss recent efforts by generator owners to increase their representation because they have "assets at risk." Industrial consumers also have "assets at risk" as exemplified by the demand destruction created by high LMP prices that was mentioned by the Alcoa representative on the previous panel.

2. To promote greater accountability, FERC should consider adding stakeholder representatives including consumers to each ISO and RTO board. Supply-side and demand-side representation on the board must be balanced. While the independent members would still constitute the majority, the stakeholder minority would serve as the proverbial canary in the mine shaft and bring some much needed transparency to Board-management communications.

3. FERC should reconsider the scope of each ISO or RTO's authorities and whether the vertically integrated industry is functionally being reassembled at each ISO or RTO. The ISOs and RTOs are increasingly replicating the wholesale functions of a vertically integrated utility. This scope may be too broad and complex to be efficient. They must also not evolve into a third layer of regulation. ELCON has long sought an RTO business model patterned after air-traffic controllers. In that model, the controllers operate the runways and airspace for the safety of all airlines and their passengers, but market functions are reserved to the airlines.

4. Stakeholders must have adequate access to ISO/RTO management and their Boards. Lack of access by stakeholders leads to decision making in a vacuum. We applaud PJMs recent efforts to improve stakeholder access.

5. Use the settlement process as a last resort and not as a default decision making process. Consumer interests do not have the resources to be effective in the settlement process and are overwhelmed by supply side assaults.

The Commission must be mindful that promoting greater demand response, forward contracting and ISO/RTO accountability—the three topics of this conference—cannot be done in a vacuum. Other problems must be fixed as well and all are interdependent. To get back on the path to wholesale competition it will first be necessary to begin a careful process of eliminating all the proxy mechanisms and replace these with the necessary pre-conditions for real competition.

In conclusion, we recommend that FERC dedicate a conference in this series to whether the necessary pre-conditions are achievable. If after adequate public debate it is evident that they are not, large industrial consumers believe that FERC must consider alternative regimes including a return to cost-of-service regulation.