

## **FERC Issues Notice of Proposed Rulemaking Concerning Compensation for Frequency Regulation Service in Organized Wholesale Electric Markets**

**February 22, 2011**

On February 17, the Federal Energy Regulatory Commission (FERC or the Commission) issued a Notice of Proposed Rulemaking to ensure just and reasonable compensation for the procurement of frequency regulation service in the Regional Transmission Organization (RTO) and Independent System Operator (ISO) organized wholesale electric markets. The Commission preliminarily found that, within the RTO and ISO markets, frequency regulation service for faster-ramping resources have been compensated at the same rate as frequency regulation service for slower-ramping resources, and as such, the current compensation practices for these services may result in unjust, unreasonable, and unduly discriminatory service compensation.

Frequency regulation service is an ancillary service within the RTO and ISO markets that involves the injection (i.e., ramping up) or withdrawal (i.e., ramping down) of power by resources capable of responding to a transmission system's frequency deviations or interchange power imbalance, as measured by the Area Control Error. The Commission was careful to distinguish frequency regulation service from frequency response, which is an automatic and autonomous response to frequency changes; frequency regulation service responds to a dispatch signal. The Commission found that, in a number of instances, RTOs and ISOs do not acknowledge—or compensate for—the greater amount of Area Control Error correction that more efficient ramping resources provide when compared with the correction offered by less efficient resources, thus leading to potentially unjust and discriminatory service rates paid to these generators.

To correct this problem, the Commission proposed to implement a two-part payment structure for resources that provide frequency regulation service to RTOs and ISOs. The first part of the payment would be a capacity payment, where offers into a frequency regulation market would include all opportunity costs and the ultimate clearing price would include the marginal unit's opportunity costs, which would be paid to all cleared resources. The second part of the payment would require all resources that are dispatched to provide frequency regulation service to receive a payment for performance (i.e., a unit would be compensated for each MW that it dispatches regulating the frequency up or down). Under the Commission's approach, the absolute value of ramping up and ramping down would be summed to calculate payments for the service provided for Area Control Error correction. The Commission viewed this two-part payment structure as an effective mechanism for enabling just, reasonable, and nondiscriminatory frequency regulation service rates within RTO and ISO markets.

Commissioner Spitzer dissented in part, arguing that the record in the proceeding is insufficient, and

thus the Commission should have issued a notice of inquiry or advanced notice of rulemaking first. While Commissioner Spitzer shared the concerns of the Commission with compensating at the same rate for resources with different ramping efficiencies, he argued that a one-size-fits-all approach to frequency regulation compensation across all RTO and ISO regions may not be appropriate.

Comments on the proposed rulemaking may be submitted in Docket No. RM11-7-000, and are due within 60 days of publication in the *Federal Register*.

If you have any questions or would like more information on the issues discussed in the LawFlash, please contact any of the following Morgan Lewis attorneys:

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