

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Market-Based Rates for Wholesale Sales  
of Electric Energy, Capacity and  
Ancillary Services by Public Utilities

Docket No. RM04-7-000

**COMMENTS OF THE  
ELECTRICITY CONSUMERS RESOURCE COUNCIL  
("ELCON")**

**DRAFT DATED AUGUST 1, 2006**

The Electricity Consumers Resource Council ("ELCON") appreciates the opportunity to comment on the Commission's proposal amending its regulations to revise Subpart H to Part 35 of Title 18 of the Code of Federal Regulations governing market-based rates for public utilities pursuant to the Federal Power Act ("FPA").

The Commission believes it is now appropriate to revise and codify the standards for market-based rates for wholesale sales of electric energy, capacity and ancillary services. Refining and codifying effective standards for market-based rates will help customers by ensuring that they are protected from the exercise of market power. It will also provide greater certainty to sellers seeking market-based rate authority. NOPR at P 7.

## **SUMMARY**

ELCON's general recommendation to the Commission is that the Final Rule in this proceeding not be used to defend markets that have failed to benefit end-use consumers, but be part of a larger effort to take stock of the flawed markets and to begin a process that restores confidence in them.

On specific proposals in the NOPR:

- The Commission's test for generation market power should eliminate any benefit of the doubt the test or subsequent mitigation gives to sellers.
- The Commission-approved OATT, as modified as a result of the pending OATT Reform rulemaking, should not be presumed to adequately mitigate transmission market power.
- ELCON supports pre-approval of interaffiliate power sales and the requirement that sellers must adopt the market-based rates (MBR) tariff.
- "Captive customers" should be defined as any end-users that do not have real competitive opportunities.
- ELCON supports codifying a uniform code of conduct to govern interaffiliate power sales.
- When in doubt, the Commission should revoke MBR authorizations.
- ELCON supports the proposals to require corporate families to consolidate MBR authorizations in a single MBR tariff and for Category 2 sellers to file a triennial review at the same time as other sellers in the relevant markets.
- ELCON supports the adoption of a market-based rate (MBR) tariff of general applicability as a condition of MBR authority.

## **INTRODUCTION**

This rulemaking will be a major opportunity for the Commission to act on what may appropriately be called a "crisis of confidence." The merits of the proposed

rulemaking must be considered in the context of the public's confidence in the power markets that exist today and whether or not a final rule based on the NOPR improves public confidence or merely preserves the status quo.

There is clearly a growing public backlash against past efforts to restructure the electric industry at both the wholesale and retail levels. At the wholesale level, the backlash results from a regulatory climate in which investment in generation and transmission has all but ceased, requiring Congressional intervention in 2005 and a series of recent FERC policies that have sharply increased rates paid by end-use consumers. Every industry problem now seems to be solved by increasing rates. There is no indication that this extra money will indeed optimize the investments necessary to maintain short-term reliability and produce the lowest possible retail rates. The exact opposite seems as likely as ISOs and RTOs “ throw good money after bad” in the name of resource adequacy.

ELCON's overarching concern with this proposed rulemaking is not so much the merits of each proposal in an ideal situation, but the problem posed by existing “hybrid” markets where regulated and deregulated markets coexist in a regional market. The proposed rules may be appropriate for a regulated bilateral market or a workably competitive market, but may create problems in hybrid markets because sellers and their affiliates can game the two. The ability of large utility holding companies to have one foot in “competition” and another in “regulation” creates a myriad of potential problems that are not easily solved.

ELCON's recommendation to the Commission is that the Final Rule in this proceeding not be used to defend markets that have failed to benefit end-use consumers, but be part of a larger effort to take stock of the flawed markets and to begin a process that restores confidence in them.

## COMMENTS

There is much to commend in the NOPR. The codification of standards for market-based rates, the modifications to the screens for horizontal market power, the creation of two categories of sellers with MBR authorization, the adoption of a MBR tariff of general applicability ("MBR Tariff"), and other largely ministerial enhancements are important examples. Our comments below emphasize the proposals for which we have the strongest concerns—both positive and negative.

**A. The Commission's Test for Generation Market Power Should Eliminate Any Benefit of the Doubt the Test or Subsequent Mitigation Gives to Sellers.**

The NOPR proposes to continue the practice of using two "indicative" screens for assessing whether a seller raises any generation market power concerns. If the seller passes both screens, there is a rebuttable presumption that the seller does not possess market power in generation. However, FERC allows intervenors to present evidence to rebut the presumption. If the seller fails either screen, this creates a rebuttable presumption that market power exists, and the seller may (1) file a "more robust" market power study (the Delivery Price Test or DPT); (2) file a mitigation proposal of the seller's own design that would eliminate its ability to exercise market power; or (3)

adopt the default cost-based rates and submit cost support for such rates. NOPR at P 19.

The evolution of these practices generally occurred in a series of highly contested proceedings, and did not benefit from the broader and more balanced review afforded by a generic rulemaking. ELCON's concern is that the practices unduly shift the burden of proof to potential victims of market power abuse. In other words, the seller is routinely given the benefit of the doubt with respect to its actions. This concern would only be academic if the market structures were truly competitive and there were strong structural protections against the exercise of market power. But the hybrid nature of most regional markets, combined with inadequate infrastructure, creates an environment that discourages trust in market outcomes.

**B. The Commission-Approved OATT, as Modified as a Result of the Pending OATT Reform Rulemaking, Should Not be Presumed to Adequately Mitigate Transmission Market Power.**

The Commission proposes to replace its existing four-prong market power analysis (i.e., generation market power, transmission market power, other barriers to entry, and affiliate abuse/reciprocal dealing) with an analysis that focuses on horizontal market power and vertical market power. The NOPR proposes that issues related to whether the seller and its affiliates lack transmission market power or whether they can erect barriers to entry be addressed together as part of the new vertical market power part of the analysis. The NOPR also continues to find that a Commission-approved

OATT, as modified as a result of the OATT Reform Rulemaking,<sup>1</sup> will adequately mitigate transmission market power. NOPR at P 89-90.

Attempting not to prejudge the Final Rule of the pending OATT Reform Rulemaking, ELCON believes that it would be premature, if not presumptuous, to assume that the Final Rule will accomplish all its stated objectives. If perfect regulation were possible, we would hardly have a need for new rulemakings.

Our main concern is whether the new OATT rulemaking will succeed on issues that have been intractable to all Commissions in recent memory: inadequate regional transmission planning, inadequate transmission investment, inadequate transparency with respect to ATC calculations, and a host of other problems. We are strongly encouraged by the proposals in the OATT Reform Rulemaking and our comments as filed will demonstrate our broad support for the rulemaking. But we are also realists and recognize that progress in an increasingly politicized industry is measured in small steps. We urge the Commission to not repeat such a sweeping generalization, as its earlier claim that any generators built after July 9, 1996 was incapable of the exercise of market power. We recommend that transmission market power be the subject of a new rulemaking.

**C. ELCON Supports Pre-Approval of Interaffiliate Power Sales and the Requirement That Sellers Must Adopt the MBR Tariff.**

---

<sup>1</sup> Docket Nos. RM05-25-000 and RM05-17-000 (“Preventing Undue Discrimination and Preference in Transmission Service”), Issued May 19, 2006.

The NOPR proposes to amend the Commission's regulations to include a provision expressly prohibiting power sales between a franchised public utility and any of its non-regulated affiliates without first receiving authorization of the transaction under section 205 of the FPA. Further, as a condition of receiving market-based rate authority, sellers must adopt the MBR tariff of general applicability, which includes a provision requiring the seller to comply with, among other things, the affiliate provisions in the regulations. Further, failure to satisfy the conditions set forth in the affiliate provisions will constitute a tariff violation. NOPR at P 109.

ELCON supports this proposal because we share the Commission's concern about the adverse impact that affiliate power sales transactions may have on captive customers.

**D. "Captive Customers" Should Be Defined As Any End-Users That Do Not Have Real Competitive Opportunities.**

The NOPR proposes that sellers seeking authorization to engage in affiliate transactions will continue to be obligated to provide evidence to support a determination as to whether there are captive customers that would trigger the application of FERC's standards for affiliate power sales. If the Commission finds, based on the evidence provided by the seller, that the seller has no captive customers, the affiliate provisions in the regulations would not apply. However, if the record does not support a finding of no captive customers, the seller must abide by all affiliate restrictions contained in the regulations in order to obtain and retain market-based rate

authority. In the Commission’s Final Rule on transactions subject to section 203, the Commission defined the term “captive customers” to mean “any wholesale or retail electric energy customers served under cost-based regulation.” NOPR at P 110.

Retail markets in most restructured states is a trainwreck in the making. Many actions taken pursuant to state restructuring legislation have failed and state legislators are only slowly awakening to the dilemma facing state regulatory commissions. The assumption underlying the NOPR’s proposed definition of captive customers is that there is a clean line between end-use customers served under cost of service (the so-called ratepayers) and customers with shopping rights in direct access states. Many customers with shopping rights were literally thrown into the market without any assurance that a real retail market was awaiting them with competitive alternatives. Where this has not happened it is the exception rather than the rule. Most customers in restructured states are now “captive” to default service that is procured with bid-based auctions. Customers in such circumstances are no less immune from potential interaffiliate abuse. We recommend that the Final Rule adopt a case-specific approach to identifying captive customers to account for the failure of retail competition in many restructured states.

**E. ELCON Supports Codifying A Uniform Code of Conduct to Govern Interaffiliate Power Sales.**

In the NOPR, it states that the Commission continues to believe that a code of conduct is necessary to protect captive customers from the potential for affiliate abuse.

Further, in light of the repeal of the Public Utility Holding Company Act of 1935 and the fact that holding company systems may have franchised public utility members with captive customers as well as numerous “non-regulated” power sales affiliates that engage in non-power goods and services transactions with each other, it is important that the Commission have in place restrictions to preclude transferring captive customer benefits to stockholders through a company’s “non-regulated” power sales business. FERC therefore believes it is appropriate to condition all MBR authorizations, including authorizations for sellers within holding companies, on the seller abiding by a code of conduct for sales of non-power goods and services between power sales affiliates. NOPR at P 127. The Commission also believes that greater uniformity and consistency in the codes of conduct is appropriate. With the experience gained over the years in approving various codes of conduct, including FERC’s “standard code of conduct,” the NOPR proposes to adopt a “uniform code of conduct” to govern the relationship between franchised public utilities with captive customers and their “non-regulated” affiliates, i.e., affiliates whose power sales are not regulated on a cost basis under the FPA. The NOPR proposes to codify such affiliate provisions in section 35.39(b)-(e) of FERC’s regulations and to require that, as a condition of receiving market-based rate authority, sellers comply with these provisions. Failure to satisfy the conditions set forth in the affiliate provisions will constitute a tariff violation. This uniformity will help ensure that captive customers are protected and that affiliate

provisions are applied and administered in an even-handed manner in harmony with legitimate current industry practices. NOPR at P 128.

ELCON strongly supports this proposed requirement and shares the Commission's reasoning for defending the need for this rule. We also recommend that our approach to defining "captive customers" above be adopted here as well.

**F. When In Doubt, the Commission Should Revoke Market-Based Rate Authorizations.**

Under FERC's current policy, if a seller loses market-based rate authority in its home control area, any sales in that control area must be pursuant to cost-based rates (i.e., the seller becomes subject to cost-based mitigation). However, there is no requirement that the seller offer its available power to customers in that home control area. Instead, the seller is free to market all its available power to purchasers outside that control area if, for example, market prices outside its control area exceed the cost-based caps. Some wholesale customers have argued that default cost-based mitigation of this kind is meaningless if a mitigated seller can simply market its excess capacity at market-based rates in other control areas. To address this concern, it has been suggested that the Commission either revoke a mitigated seller's market-based rate authority in all control areas or impose some type of mitigation that protects wholesale customers in those areas where a seller has been found to have market power or has accepted the presumption of market power. NOPR at P 145.

ELCON believes that this problem is a classic example of the skewed incentives created by hybrid markets. Any seller subject to mitigation in its home control area (and prohibited from selling at market-based rates within its home control area) may be required or willing to share the profits it makes with market-based rates with its captive customers for any sales at market-based rates outside its home control area.

We believe that the Commission should take a longer-term view of this problem and begin to create short-term economic incentives that undermine the continued existence of the hybrid market and its perverse incentives. This is best done by suspending the right of any seller that can exercise market power to sell at market-based rates in all markets it can access. An industry consensus that is needed to restore consistency across markets, and confidence in market outcomes, will never happen as long as many dominant players continue to benefit from the status quo.

In previous filings on this matter, ELCON has characterized “cost-based mitigation” as a hold-harmless policy. We continue to believe this principle if the longer view is held, and that existing markets are flawed and in need of correction. Short of this long-term fix, we believe that other proposals such as “must offer” requirements will be prone to fail because of likely unintended consequences.

**G. ELCON Supports the Proposals to Require Corporate Families to Consolidate MBR Authorizations in a Single MBR Tariff and for Category 2 Sellers to File A Triennial Review At the Same Time As Other Sellers in the Relevant Markets.**

The NOPR proposes to put in place a “structured, systematic review” to assist the Commission in analyzing sellers based on a “coherent and consistent set of data for relevant geographic markets.” In addition, some corporate families have many subsidiaries with MBR authorization, each with its own separate tariff. This has led to confusion, inconsistencies between the tariffs of a single corporate family, and difficulty in coordinating changes to the tariffs. To remedy these concerns, the NOPR proposes to streamline the administrative process associated with the filing and review of updated market power analyses and to consolidate MBR authorizations into a single tariff. NOPR at P 151.

In addition, the NOPR proposes to continue to require sellers to submit updated market power analyses for all relevant geographic markets in which they own or control generation. However, the NOPR proposes to modify this filing requirement in two ways. First, two categories of sellers with market-based rate authorization are established. The first category (“Category 1”) would include power marketers and power producers that own or control 500 MW or less of generating capacity in aggregate and that are not affiliated with a public utility with a franchised service territory or own or control transmission facilities. Category 1 sellers would be exempt from existing requirements to file a regularly scheduled Triennial Review. Instead, the Commission would monitor any market power concerns through the change in status reporting requirements and through ongoing monitoring by FERC’s Office of Enforcement. NOPR at P 152.

The second category (“Category 2”) would include all sellers that do not qualify for Category 1. Category 2 sellers, in addition to the requirement to file change in status reports, would be required to file regularly scheduled Triennial Reviews. Category 2 sellers are the larger sellers with a greater potential to dominate a market and thus are more likely to either fail one or more of the indicative screens or pass by a smaller margin than Category 1 sellers. NOPR at P 151-152.

To ensure greater consistency in the data used to evaluate Category 2 sellers, the NOPR proposes to require each seller to file updated market power analyses for its relevant geographic markets (default and any proposed alternative markets) on a schedule that will allow examination of the individual seller at the same time the Commission examines other sellers in these relevant markets and contiguous markets within a region from which power could be imported. The regional reviews would rotate by geographic region with three regions reviewed per year. NOPR at P 154. The NOPR also proposes to codify in its regulations the obligation for Category 2 sellers to timely file a Triennial Review. This includes a new requirement that corporate families owning or controlling generation in multiple control areas and different regions file a Triennial Review for each region in which members of the corporate family sell power (See below in section H). NOPR at P 155-156.

At first blush these proposals seem to reflect a desire on the part of the Commission for administrative convenience. However ELCON believes that there is merit in these changes. First, the Commission’s (and potential intervenors’) limited

resources should be focused on the dominant players, and not treat every generator as a potential threat. This is especially true as industry consolidation advances as expected. Thus, the creation of the two categories of sellers and the requirement that “corporate families” of generators consolidate their MBR authorizations in a single tariff are useful. Second, the requirement that a seller file its Triennial Review at the same time FERC examines other sellers in the relevant market and contiguous markets within a region from which power could be imported is an excellent idea because it provides a better “big picture” of movement of uncommitted capacity and imports in a given regional market. ELCON supports these proposals.

**H. ELCON Supports the Adoption of A Market-Based Rate (MBR) Tariff of General Applicability As a Condition of MBR Authority.**

As part of FERC’s effort to streamline and simplify its market-based rate policies and at the same time maintain a reasonable degree of transparency and oversight, the NOPR proposes to adopt a market-based rate tariff (“MBR Tariff”) of general applicability that all sellers authorized to sell wholesale electric power at market-based rates will be required to file as a condition of MBR authority. The MBR Tariff would require the seller to comply with the applicable provisions of the MBR regulations which the NOPR proposes to codify in 18 CFR Part 35, Subpart H. These provisions “reflect the Commission’s two decades of experience with market-based rate power sales and should serve to reduce the burden on customers of managing multiple tariffs.” In addition, the seller would be required to list in the MBR Tariff the docket

numbers and case citations of the proceedings in which the seller received Commission authorization to make sales of energy between affiliates or where its MBR authority was otherwise restricted or limited. NOPR at P 161. The NOPR also proposes that, rather than each entity having its own MBR Tariff, which can result in dozens of tariffs for each corporate family with conflicting provisions, each corporate family has only one tariff on file, with all affiliates with MBR authority separately identified in the tariff. NOPR at P 164.

These proposals benefit both the seller and the seller's customers. The benefits to customers include better transparency with regard to what each seller in a corporate family owns or controls, and a more customer-friendly tariff. NOPR at P 164. ELCON supports these proposals.

### **NOTICES AND COMMUNICATIONS**

The following persons are designated by ELCON to receive service and communications on its behalf with regard to this proceeding:

Dr. John A. Anderson  
President & CEO  
Electricity Consumers Resource  
Council ("ELCON")  
1333 H Street, NW  
West Tower, Suite 800  
Washington, DC 20005  
Voice: (202) 682-1390  
Fax: (202) 289-6370  
Email: [janderson@elcon.org](mailto:janderson@elcon.org)

John P. Hughes  
Vice President, Technical Affairs  
Electricity Consumers Resource  
Council ("ELCON")  
1333 H Street, NW  
West Tower, Suite 800  
Washington, DC 20005  
Voice: (202) 682-1390  
Fax: (202) 289-6370  
Email: [jhughes@elcon.org](mailto:jhughes@elcon.org)

Dated: August 7, 2006