

January 29, 2001

BY HAND

The Honorable David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
Dockets Room, Room 1A  
888 First Street, N.E.  
Washington, D.C. 20426

Re: Entergy Services, Inc.; Docket No. RT01-75-000

Dear Secretary Boergers:

Enclosed for filing please find an original and fourteen (14) copies, and an electronic version on diskette, of the Industrial Consumers' motion to intervene and protest the Entergy's Inc.'s Application for Approval of Rate Structure.

We ask that two copies of this document be date-stamped and returned for our records. Thank you for your assistance.

Sincerely,

Sara D. Schotland

Enclosures

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

\_\_\_\_\_) )  
Entergy Services, Inc. ) Docket No. RT01-75-000  
\_\_\_\_\_) Docket No. ER01-\_\_\_\_\_

MOTION TO INTERVENE AND PROTEST  
OF INDUSTRIAL CONSUMERS

Industrial Consumers the Electricity Consumers Resource Council (ELCON), the American Iron and Steel Institute (AISI), American Chemistry Council (ACC), and the American Forest & Paper Association (AF&PA) hereby move to intervene and protest the Entergy Inc.'s (Entergy's) Application for Approval of Rate Structure. Industrial Consumers' comments focus on Entergy's request for incentive rates.

NOTICES AND COMMUNICATIONS

Notices and communications should be addressed to:

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### DESCRIPTION OF INTERVENORS

The Electricity Consumers Resource Council (ELCON) is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products, including: steel, aluminum, chemicals, petroleum, motor vehicles, industrial gases, machinery, glass, agricultural and food products, rubber, computer chips, paper and electronics. The member companies of ELCON consume approximately five percent of all electricity in the United States.

The American Iron and Steel Institute (AISI) is the principal trade association of the North American steel industry. Its member companies account for about seventy percent of the raw steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity for AISI members may constitute as much as twenty percent of the manufacturing cost of a steel mill product.

The American Chemistry Council (ACC) is a nonprofit trade association whose member companies represent more than ninety percent of the productive capacity of basic industrial chemicals in the United States. The manufacturing processes of many ACC member

companies are highly energy-intensive. In addition, the chemical industry used a substantial amount of self-generated electricity. Total electricity used by the industry, purchased plus self-generated, represented approximately eighteen percent of industrial electricity consumption in the U.S. and approximately six percent of national electricity consumption.

AF&PA is the trade association of the forest, pulp, paper, paperboard, and wood products industry in the United States. It represents member companies engaged in growing, harvesting and processing wood and wood fiber, manufacturing pulp, paper, and paperboard products from both virgin and recycled fiber, and producing engineered and traditional wood products. AF&PA members include manufacturers of over 80 percent of the paper, wood, and forest products produced in the United States and the members include small non-industrial private landowners, large multiproduct producers, and family-run mills. As such, AF&PA is the leading voice of the forestry, wood, and paper industries in the United States. AF&PA's members are among the nation's largest consumers of electric power, purchasing over 82 billion kilowatt-hours of electricity annually nationwide.

Industrial Consumers have standing to intervene because their members have facilities in Entergy's service territory and are directly affected by the filing. As well, Industrial Consumers are affected by the precedential nature of the filing which deals with important issues involving the Commission's implementation of incentive ratemaking. Industrial Consumers previously intervened and commented on Entergy's October 15, 2000 RTO compliance filing.

### SUMMARY

Industrial Consumers oppose Entergy's request for innovative rate treatment because Entergy does not meet the minimum threshold requirement: The Entergy Transco/SPP

Partnership proposal does not satisfy the Order 2000 RTO criteria. Entergy does not satisfy the Order 2000 scope and configuration requirements and its refusal to join Southwest Power Pool (SPP) prevents SPP from satisfying these requirements. Entergy's implementation of a binary RTO structure conflicts with Order 2000 because Entergy proposes to retain Section 205 filing rights, operational control, and rights over transmission planning that are inappropriate. Because Entergy Transco does not promote the goals of Order 2000, neither its RTO compliance filing nor its request for "innovative" rate treatment should be approved.

With respect to the specifics of Entergy's Incentive Rate proposal:

- Entergy is not entitled to a 300 basis point premium rate of return for regional expansion projects. These projects should be competitively bid to attract the lowest cost builder. In any event, Entergy has failed to justify a generic premium of 300 basis points.
- With respect to participant funded projects, if they are out of rate base Entergy should be allowed to negotiate a project specific performance reward with the owners—not a flat 5% regardless of its role.
- Entergy's proposal for a "true-up" —essentially guaranteed cost-plus recovery for three years—flies in the face of claims that transcos will operate as risk takers. The proposal should be rejected outright. The requested guarantee of three years of cost plus operations is fatally flawed because the proposal would establish an inflated baseline for future operations since the Transco would have no incentive in the first three years to contain costs.
- Entergy's performance-based ratemaking (PBR) proposal trivializes the rate-setting process. Entergy's EDI (reliability) and VFI (quality) indices are crude and

simplistic surrogates for meaningful performance review. In particular, the reliability index does not take into account critical issues such as the frequency of transmission loading relief (TLR). Unless and until incidence of TLR is improved throughout the southwest region, which at a minimum requires consolidation of SPP and Entergy, the Entergy RTO proposal does not significantly improve the status quo. In general, Industrial Consumers believe that PBR is unlikely to result in just and reasonable rates because it is too difficult to identify the accurate baseline. Opportunities to reward good performance and penalize inferior performance are consistent with rate of return ratemaking. Also, the PBR process is at least as lengthy, resource-intensive, and subject to strategic gaming as conventional ratemaking.

#### DESCRIPTION OF ENTERGY'S TRANSCO INCENTIVE PROPOSAL

Entergy is defining three categories of transmission expansion plans:

(1) Base Case Projects – projects necessary to maintain reliability of the Transco's grid and which generally do not increase total transfer capability (TTC) or the amount of tradable transmission rights under any congestion pricing model. The projects would be rate-based.

(2) Participant-Funded Projects – projects in which market participants join together to fund expansion of the system. These projects will entitle market participants who participate in the funding to a share of the transmission rights created by the expansion. The Transco would market and develop these projects. These projects would have to be approved by SPP RTO to ensure that they do not harm reliability.

(3) Regional Market Expansion Projects – these projects are not likely to obtain participant funding because the project would increase capacity on the transmission system such that new transmission rights created may have limited value as congestion hedges. These projects (which are not needed for reliability purposes) would not likely be built without a “proper” incentive.

Entergy proposes different incentive rate treatments for each category:

Enhanced Return on Equity for Certain Economic Projects. This incentive is proposed for funding Regional Market Expansion Projects. An incremental ROE of 300 basis points is proposed.

Performance-Based Regulation. Entergy proposes to place the Transco’s rates under a PBR in which performance is measured against certain benchmarks. The factors used to measure the Transco’s performance are an Energy Delivery Index (EDI) and a Voltage Fault Index (VFI). The return on equity (ROE) adjustment would be plus or minus 25 basis points outside a bandwidth of 50 basis points. EDI is an indicator of service reliability, and VFI an indicator of service quality. The PBR would not apply during the first three years of Transco operations (see below).

Transco Incentive for Participant Funded Expansion. Entergy is proposing that the Transco be allotted up to five (5) percent of the transmission rights resulting from a participant-funded project, or an individually-negotiated development fee.

Three-Year Exact Recovery Mechanism. This mechanism allows the Transco to adjust its rates (under a “formula-based rate structure”) in order to mitigate any discrepancies

between the Transco's projected costs and its actual costs. Entergy argues that since the Transco "is a new entity with no prior cost history, it is necessary to ensure that neither Transco nor its customers are benefited or harmed by formation of Transco."

**BECAUSE THE ENTERGY-SPP PARTNERSHIP DOES NOT MEET  
RTO CHARACTERISTICS, NO INCENTIVE PRICING IS APPROPRIATE**

As filed on October 15, 2000, Entergy's Transco proposal lacks key RTO characteristics that FERC requires under Order 2000. Entergy has attempted to avoid the requirements of an RTO by placing its Transco under the umbrella of the SPP RTO. While some "hybrid" structures may qualify as RTOs, e.g. the RTO West TransConnect model, the SPP/Entergy "partnership" is an uneasy alliance of two too-small RTO pretenders. Entergy does not qualify as an RTO because its transco does not qualify as an RTO and its hybrid proposal diminishes rather than enhances SPP.

Under Order 2000, only entities that meet the RTO criteria are eligible for incentive pricing. This is why FERC recently rejected American Transmission Company's request for innovative rate treatment. In American Transmission Co., 93 FERC ¶61,267 (2000), FERC observed:

In Order No. 2000, the Commission expressed its willingness in the context of approved RTOs to consider innovative rate treatments to spur the construction of new transmission facilities. The Commission stated, for example, that it would be open to, among other things, accelerated depreciation for new transmission facilities. We encourage ATCO's goal of expanding its transmission facilities to provide adequate and reliable transmission service. However, ATCO's rate proposal amounts to a request for the innovative rates that we have indicated we would consider in an RTO context. ATCO, however, seeks such rates prior to joining an approved RTO. Accordingly, the Commission will reject ATCO's innovative rate proposal, without prejudice to ATCO's submitting a new FPA section 205 rate filing.

In at least four ways, Entergy falls short of the RTO criteria: size and configuration; retention of Section 205 filing rights; operational authority; and balkanized transmission planning.

Size and Scope. The Entergy Transco fails to satisfy Characteristic 2, Scope and Configuration because it is too small to achieve economic efficiency or mitigate market power. The issue of market power from Entergy's transco is sufficiently serious that FTC's Bureau of Competition Staff has intervened both at FERC and in state proceedings to point out the danger.<sup>1</sup> SPP and Entergy have dared FERC to enforce Characteristic 2 of Order 2000, in lieu of combining into a single RTO or adopting the hybrid structure of RTO West/TransConnect ITC. As discussed below, in the case of SPP and Entergy, the independence and effective operation of SPP is threatened because key functions are stripped by Entergy.

Section 205 Filing Rights. Order No. 2000 states that "RTOs, in order to ensure their independence from market participants, must have the independent and exclusive right to make Section 205 filings that apply to the rates, terms and conditions of transmission services operated by the RTO."<sup>2</sup> The Commission clearly stated that transmission owners "will not be permitted to make Section 205 filings for RTO services to transmission customers and will not interfere with the independence of the RTO to file proposed changes to the open access tariff."<sup>3</sup>

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<sup>1</sup> Entergy Services, Inc., 88 F.E.R.C. ¶61,149 (1999).

<sup>2</sup> Order No. 2000, 65 Fed. Reg. 12088, 12096 (Mar. 8, 2000).

<sup>3</sup> Order No. 2000, 65 Fed. Reg. 810, 858 (Jan. 6, 2000).

Entergy's proposal that "[t]he SPP and Transco will share the right to propose rates, terms and conditions under Section 205 for transmission service on the Transco's and SPP's systems," contradicts the Commission's "exclusive and independent" RTO requirement. The proposal to share Section 205 filing rights effectively removes the ratemaking decision from the SPP RTO with respect to transmission facilities located within the Transco control area.

Entergy claims the right to "propose rate or rate structure changes for transmission charges to load within the Transco grid and to make filings at FERC to implement new transmission services that are not contained in the SPP tariff." Rather than requiring oversight or approval of the Transcos rate charges by the SPP RTO, Entergy violates Order 2000 by only providing for notice to be given the RTO that such a filing will be made.

In Docket RM99-2, FERC considered Entergy's comments that transmission owners should retain Section 205 filing rights but ultimately determined that RTOs must have the right to make Section 205 filings. No court has stayed or vacated Order 2000 and thus Entergy is bound by FERC's determination.

Operational Authority. Entergy's unilateral control over the transmission facilities in its control area is inconsistent with Order 2000 and promotes the continued balkanization of the Southwest. Entergy's Transco should be permitted no more operational control or planning authority than any other transmission owner participating in the RTO.

Entergy has designed the Transco such that it exercises complete operational control over its transmission facilities, allowing the Transco to supersede final RTO authority over the operations of its transmission facilities. This directly contradicts the requirements of Order No. 2000.

Transmission Planning. Under Order 2000, an RTO has the “ultimate responsibility for both transmission planning and expansion within its region that will enable it to provide efficient, reliable and non-discriminatory service and coordinate such efforts with the appropriate state authorities.”<sup>4</sup> Entergy’s proposal to permit the Transco to “develop its own transmission plan and then submit this plan to the SPP for its region” “for review and inclusion in an RTO-wide plan” will remove control over regional planning and expansion from the RTO.

Efficient utilization of the transmission grid within the region will only be accomplished based upon region-wide planning.

#### INDUSTRIAL CONSUMERS COMMENTS ON ENTERGY’S SPECIFIC PROPOSALS

##### A. Enhanced Return On Equity For Certain Economic Projects

Entergy has provided no justification for seeking a generic 3% premium on regional expansion projects. The Federal Power Act does not impose an “obligation to serve” on Transmission Providers, thus there can be no claim of exclusive franchise rights. Industrial Consumers urge that proposed projects be subject to competitive bids to see if another developer will build it with a lower or no incentive. If there are no bids, one would have to question the merits of building the project. If these projects are rate based in a FERC jurisdictional rate base, they must be subject to a prudence review before any enhanced ROE becomes applicable.

##### B. Transco Incentive for Participant-Funded Expansion

These projects (which might more accurately be called “merchant transmission facilities”) should be encouraged and some form of incentive may have merit on an after-the-fact

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<sup>4</sup> Order No. 2000, 65 Fed. Reg. at 907.

basis. As defined, these projects will not be operated as regulated, common-carrier facilities. Third-party users will only be allowed if the participants' transmission rights are released in the secondary market. Since only private capital is at risk (i.e., the investments are not rate-based) the projects need not be subject to a prudence review. It is appropriate for the Commission to treat these projects with light-handed regulation. The project participants (owners or investors) should negotiate with the developer some form of performance contract with milestones and, if applicable, incentives (rewards and penalties). This should be a private decision of the owners. The owners might decide to offer a more substantial reward than the amount proposed by Entergy, or they may feel that no reward or incentive is necessary. Ideally, the owners should be allowed to put the project development responsibility up for bid at their own discretion. However, Entergy is assuming that its Transco will conceive these projects and solicit participants to fund them. The Transco may also be a funding participant. The participants (other than the Transco) should not be precluded from deciding that the incumbent transmission owner (the Transco) is best suited for enhancing an existing facility. It is their choice if only their capital is at risk.

### C. Performance Based Regulation

The PBR should be rejected unless the Transco is exposed to real business risk and made fully accountable for those risks. Entergy's PBR proposal trivializes the rate-setting process. The EDI and VPI are, at best, crude and simplistic approximations of any meaningful performance review. Performance can only be truly measured by customers, not by arbitrary indices.

Significantly, Entergy's EDI does not include TLRs called by Southwest Security Coordinators, which could account for many of the outages. There is no incentive under this proposal for Entergy (or its Transco) to work within NERC to improve the TLR situation. Hence, customers will not see much overall improvement in reliability but will pay higher rates to the Transco.

1. Industrial Consumers' Concerns With PBR

Rates under PBR are usually adjudicated in the same manner as rates under cost-of-service regulation. But unlike cost-of-service regulation, which is based on accounting data, most PBR methods rely on the design and use of statistical models in the form of indices, benchmarks, and regression analysis. These methodologies add a new dimension of technical complexity and uncertainty to the adjudicatory process.

The establishment of an accurate baseline revenue requirement is absolutely critical to the success of PBR. Unfortunately, the adjudicatory process under PBR may be no better than under cost-of-service regulation in that the regulator faces the same problems of gamesmanship, incomplete information and cost revelation. From a consumer (ratepayer) perspective, the problem with any baseline revenue requirement determination is the high probability that the baseline will be overestimated. This results from the fact that the process will almost always make a new baseline estimate reflect the utility's inflated historical costs and not start with a "clean" set of books from which cross-class subsidies and other, often arbitrary, past accommodations and adjustments are removed. The subsequent application of sophisticated statistical methods will only memorialize this skewed outcome and defeat any attempt to sever the link between rates and costs.

The adjudication of the quality control mechanism requires a determination of what measures of quality to include in the PBR, setting the right threshold for each quality parameter, and assessing penalties for any breach of a standard. For example, a measure of system reliability may be “average number of customer interruption minutes,” a common industry standard. Customer service is often measured with periodic customer surveys (usually designed and conducted by the utility itself), and safety can be measured with different types of “accident rates.” In this proceeding Entergy has selected two such measures, EDI and VPI.

While quality parameters are easy to design and measure, they are difficult if not impossible to value (in dollar terms), and therefore the process for setting thresholds and assessing penalties becomes wholly speculative or arbitrary. This valuation problem is one more theoretical contradiction of incentive regulation. For example, how do customers value a given level of reduction in service reliability? And what is the right penalty for a reduction in reliability?

PBR, as an alternative regulatory paradigm to traditional cost-of-service regulation, will not produce the intended benefits because it suffers from the same inherent flaws of cost-of-service regulation, namely, the strategic behavior of regulated utilities with an advantage in asymmetric information. Under PBR, regulators face the same problems of gamesmanship, incomplete information, and cost revelation that they face under traditional cost-of-service regulation. In fact, PBR may encourage even greater inefficiencies because it imposes on the rate-setting process methodologies that are more complex and data intensive. Decades of experience by industrial intervenors in state and federal rate-setting proceedings has demonstrated that it is very difficult to prove that the failure to undertake a cost-saving action—

such as a decision to make, or not to make, a new investment—is responsible for creating unreasonable costs. PBR is even less transparent than conventional rulemaking.

## 2. How To Do PBR Right

A pre-condition to the elimination of any earnings cap for any utility is the requirement that the utilities be subject to real market risk that holds them accountable for their behavior.

Utilities will tend to price their services more efficiently only if there is a credible risk of new entrants into their market by alternative suppliers of new technologies, and they are fully accountable for the consequences.

At a minimum, real “market-like” incentives can be interjected into the regulatory process by (1) removing the utility’s protection from technological competition; and (2) allowing franchise competition.

Technological Competition. If the objective of public policy is to encourage cost reductions and innovations, transmission providers should be forced to compete with generation, and distribution providers should be forced to compete with distributed generation, and neither “wires” provider should be guaranteed the recovery of stranded costs if it is unable to meet the competition. Neither form of direct competition involves the duplication of the utility’s “essential” facilities.

Franchise Competition. Incumbent providers of transmission and distribution services should be allowed to be the only supplier of such services in any geographical region or

traditional franchise area. The right to finance or construct new or expanded facilities, including merchant facilities, should be subject to open competition.

D. Three-Year Exact Recovery Mechanism

The glaring flaw of Entergy Transco's proposal for assurance of three years of cost-plus recovery is that Entergy would thereby establish an inflated baseline since during the three-year period, Entergy Transco would have no incentive to contain costs. The proposal should be rejected outright.

Entergy Transco's "true up" proposal is not categorized as an "innovative rate treatment" or "incentive" by Entergy but it has an important bearing on how Entergy's attitude on risk and reward should be interpreted. After all the rhetoric about the wonders of profit-making Transcos, why does Entergy have so little confidence in its "Transco" proposal such that it must operate on a "cost-plus" basis for three years? There is no justification for offering monopoly transmission providers risk-free guaranteed cost plus recovery. We are surprised that Entergy would make such a proposal in their filing.

CONCLUSION

For the foregoing reasons, Industrial Consumers' Motion to Intervene should be granted.

Respectfully submitted,

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Dated: January 29, 2001

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Motion to Intervene and Protest of Industrial Consumers were today mailed to parties on the service list of this proceeding by U.S. mail, postage prepaid.

Dated at Washington, D.C., this 29<sup>th</sup> day of January, 2001.

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