

# ELCON REPORT

ELECTRICITY CONSUMERS RESOURCE COUNCIL

NUMBER TWO

2000

The 18th Annual ELCON Seminar  
co-sponsored by PGC

The  
New Energy Markets:  
From  
Transition to Competition

Hyatt Regency ■ Crystal City ■ Arlington, Virginia

October 12 and 13, 2000

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Agenda, registration form inside

## Ruling Upholding Order 888 Suggests FERC Can Push Harder for Competition

ELCON applauded the decision by the DC. Circuit Court of Appeals upholding Order 888 and urged the Federal Energy Regulatory Commission to take the ruling to heart as endorsement of its authority to encourage competition.

“Hopefully our friends at FERC will view this decision as a clear affirmation of their authority and get on with the task before them -- namely to help create the open, competitive interstate electricity market that Congress intended when it enacted the Energy Policy Act of 1992,” said ELCON Executive Director John Anderson.

The decision held that all electricity transmission is interstate commerce and thus under FERC’s authority. The court ruled that utilities must provide open access to transmission lines, rejecting arguments by investor-owned utilities challenging limitations on that requirement. This decision by the D.C. Circuit conflicts with an earlier ruling by the Eighth Circuit (in the Northern States

Continued on page 9

## FERC Reliability Effort Seen As Too Little

ELCON and allies told the Federal Energy Regulatory Commission they doubted the effectiveness of FERC’s interim procedures to ease concerns about reliability this summer. In addition, at least one of the initiatives -- allowing on-site generators to sell excess power during peak demand periods without prior wholesale rate approval -- would probably meet with utility resistance, they said. The industrials instead urged FERC to:

- put in place the electricity equivalent of the gas industry’s Order 636 as requested in a March 1998 petition,
- make RTOs mandatory as a condition for approving mergers under the Federal Power Act since the voluntary approach has not worked,
- update its interconnection policy to assure non-utility generation can enter the market,

Continued on page 5

## Performance-Based Rates Seen Failing As a Way to Motivate True Competition

Because regulators will never allow monopoly utilities to fail, a system of performance-based rates to create incentives for better operation will

not work, ELCON says in a new issue profile, *Performance-based Regulation*.

The penalties in a PBR system will never be applied with the same force as they would in a real competitive marketplace, which means that from the perspective of the regulated utility, “there is ultimately little downside risk under PBR,” the profile says. “PBR is just another venue for improper strategic gaming.”

Also, the complex statistical methodologies that underpin many PBR proposals

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## The Changing Job of an Energy Manager

In my position as an energy manager for Honeywell, I travel the globe and participate in markets in dozens of countries. And it is obvious that in almost every country the energy market is in transition to competition. Some are moving faster, some a little slower, but virtually everywhere that my company operates, we see that energy markets are becoming more competitive.

This transition to competition raises many questions. For those of us who value long-range planning, we are concerned not only with how energy markets look today but also about how they will

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Even in the last few months the increase in e-commerce both here and abroad is astonishing.

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look three years and five years from now.

A simple -- but very important -- question is whether we can count on the marketplace to fulfill customers' needs in the future. Both in the United States and abroad, we see some geographic areas experiencing tremendous growth in terms of population and industry. That is almost always accompanied by an increase in the demand for electricity. In the United States and elsewhere, non-utility generators, or merchant plants, are filling much of the demand for new electricity. These for-profit entrepreneurial undertakings hold much promise -- I strongly believe that facilities built to compete in the market are likely to be more efficient and produce lower-cost products than those built by monopolists and rewarded by regulators.

Similarly with new transmission, can construction and innovation keep pace with demand? How can we ensure that transmission is open on a non-discriminatory basis -- that the roads of commerce for electricity markets enhance and don't impede competition? And how can we ensure that sufficient transmission is built? Do we need special incentives, or perhaps we should open up new transmission opportunities to the forces of competition -- let's see who wants to build it and what kind of return on investment they expect in a competitive market.

Finally, and perhaps most important to me, is the question of how will we -- as energy purchasers for corporations and as energy purchasers for our own homes -- how will we buy our energy? Even in the last few months the increase in e-commerce both here and abroad is astonishing. There are more companies beating a path to my door -- or, more accurately, clogging my e-mail inbox -- than I would ever have thought imaginable.

As an energy purchaser for Honeywell, these are some of the questions that I face on a daily basis. And, not coincidentally, these are among the topics that will be addressed at the 18th Annual ELCON Seminar this October. I know that I am not unbiased, but I have found previous ELCON Seminars to be right "on target" in helping me understand the changing energy markets through the years. This year's event (which for the first time will be cosponsored by the Process Gas Consumers Group PGC) is titled "The New Energy Markets: From Transition to Competition" and looks like it will be very timely and very informative. I urge you to look at the preliminary agenda enclosed as part of this Report -- and I hope to see you in October.

*Gary Groner is director of Energy Supply and Policy for Honeywell, a large international company with facilities in more than 40 countries.*

*By Gary Groner,  
Chairman,  
ELCON*

## Stand-Alone Reliability Bill Is a Problem, Not a Solution

As stated elsewhere in this Report, the efforts in Congress to enact a comprehensive electricity restructuring bill now seem to be turning to next year. The most that Congress might do before it recesses in mid-October is pass what is commonly called a "stand-alone reliability" bill. At the outset, I want to emphasize that large industrial electricity consumers care a lot about reliability. Without a reliable supply of electricity, they quite simply cannot produce what they intend to produce.

*By ELCON  
Executive  
Director  
John  
Anderson*

But this "stand-alone reliability bill" is a misnomer. And it is bad public policy.

Now don't get me wrong. I am not so politically naïve as to think that every time Congress acts it does so in the name of good public policy. Congress most often acts due to crisis or consensus. But sometimes Congress acts simply to provide some political cover.

By way of background for those of you who don't follow Congress intimately, the Senate Energy Committee, after years of hearings and workshops, met in June to consider electricity legislation. Committee members by and large believed they had not reached a consensus on Chairman Frank Murkowski's (R-AK) comprehensive bill, so they decided not to consider it. They then turned to a stand-alone "reliability" bill authored by Sen. Slade Gorton (R-WA).

Now, who could vote against reliability? It passed the Committee with little debate and within days passed the full Senate by voice vote with even less discussion.

In reality, however, this bill is not a reliability bill. It will not help make the interstate electricity transmission system more reliable. It will only mandate by law the creation of a new Electricity Reliability Organization, meaning most likely it will recraft the present North American Electric Reliability Council

Continued on page 9

## Third Alliance RTO Filing Comes Closer to Addressing Key Concerns

After repeated efforts to comply with FERC's Order 2000 and create a regional transmission organization (RTO), companies in the Alliance organization submitted a plan that appeared to address key concerns of both the Federal Energy Regulatory Commission and interested consumers such as ELCON.

In December -- on the same day that it issued its Order 2000 on Regional Transmission Organizations (RTOs)--FERC granted conditional approval to the Alliance RTO, pending several significant modifications. When the companies came back with a subsequent compliance filing, FERC again found the application deficient in its conformance with Order 2000. In fact, Commissioner William Massey described the compliance filing as "woefully inadequate."

On its third go-round, the Alliance RTO made further adjustments to bring its policies regarding membership, fiduciary obligations, conflicts of interest, governance and other issues more into compliance. Among specific proposed changes:

- The companies will limit the active ownership interest of a class of market participants (including transmission owners) in the Alliance Transco to 15 percent. The earlier proposals had held out for a 25-percent cap. Order 2000 requires a 15-percent "class cap."

### ELCON People In the News

ELCON Director of Government and Public Affairs Marc Yacker was elected senior vice president of the National Energy Resources Organization, a non-partisan group dedicated to promoting dialogue on energy issues. Yacker also was one of eight people chosen by House Energy and Power Subcommittee Chairman, Joe Barton (R-TX), to brief Commerce Committee members on transmission issues. E

- New members to Alliance will be allowed to participate in the same fashion as the existing members do, and applicants denied membership for failing to be interconnected with the RTO can appeal the decision to FERC. Originally, no appeal was permitted.
- No passive owner of the Transco can singly exercise approval or veto rights over transco actions.
- Multiple transmission charges will be eliminated within the RTO. Consistent with the Commission's directive, the proposal will permit the recovery of quantifiable lost revenues in a nondiscriminatory manner during a reasonable transition period.
- The companies will continue to seek seams agreements with adjoining entities and will file those agreements (or, alternatively, their own proposal for a pro forma seams agreement) with the Commission.

FERC had identified the following problems in the initial compliance filing:

- Alliance proposed to give transmission owners approval/veto rights, after a transition period, over rates, terms and conditions proposed by the ISO. Order 2000 gives RTOs, not their owners, the exclusive right to set rates.
- The circumstances under which Alliance transmission owners would be able to remove the entire ISO Board for specific unauthorized acts were too broad.
- Alliance erred in proposing to permit the ISO board to deny admission to a transmission owner if the board found that admission would be inconsistent with the goal of forming an Alliance transco. FERC said that while it is reasonable to require new members to agree to conversion from ISO to transco, this can be accomplished without barring admission.
- The company failed to justify a proposal to limit new transco members to those physically interconnected

unless Alliance determined that admitting a member that is not interconnected would yield a net benefit.

While FERC earlier agreed that Alliance owners should have the ability to veto certain significant business events such as sale of assets, liquidation, dissolution, winding up or voluntary bankruptcy, it reserved judgment in other areas -- elimination of pancaked rates, rate design, development of congestion-management plans, interfacing with the Midwest ISO -- until specific proposals were filed.

Massey, in voicing his disappointment with the initial compliance filing, noted that Order 2000 is too weak on the need for large RTOs and seems to accept coordination among smaller-size RTOs as a substitute for RTOs of sufficient size and coordination.

In another new development in the case, Alliance member Consumers Energy filed an alternative proposed governance structure. "Structure B," as it is called, allows the transmission owners who have invested in the Alliance Transco, through conveyance of either ownership or functional control of their transmission facilities, to have direct involvement in choosing how the facilities of the Alliance Transco will be managed, while vesting majority control in disinterested parties. E

### ELCON Welcomes International Paper

ELCON is pleased to note that International Paper, by virtue of its purchase of Champion International, is ELCON's newest member. IP is the world's largest forest prod-



ucts company and the nation's largest private landowner, with 1999 sales of \$29.7 billion. It has operations in nearly 50 countries and employs more than 117,000 people. Norm Davis, Manager, Energy Purchasing Logistics, will be the member representative. While ELCON will miss the participation of Champion, it welcomes International Paper. E

## Performance-based rates

From Page 1

“clearly limit full accountability, and enable regulation to degenerate into a process of accommodation between the regulators and regulated.” The best regulatory paradigm is a process that is transparent to the public and policy makers.

The profile notes that the ongoing deregulation of generation and other potentially competitive services has increased interest in applying PBR to transmission and distribution (or “wires”) services that remain regulated. The intent is to create a “market-like” regulatory structure that might promote more efficient utility operation and planning.

ELCON believes that any such effort is structurally flawed. “PBR cannot simulate ‘market-like’ incentives in an industry that remains dominated by monopoly suppliers

and the existing regulatory mindset,” the profile notes. “Monopolies cannot be induced to respond to economic incentives in the same manner that business firms respond to market forces in real competitive markets. In part, that is why natural monopolies are regulated in the first place.”

ELCON makes two key recommendations about how to continue regulating transmission and distribution services:

1. Return to the unembellished first principle of traditional cost-of-service regulation -- i.e., allow the recovery of all prudently incurred costs plus a reasonable opportunity to earn a fair rate of return on all prudently incurred investments that remain used and useful.
2. Subject utilities to real market risks that hold them accountable for their behavior. This must be a precondition to eliminating the earnings cap for any utility. For example, utilities should no

longer be protected from technological competition, third-party developers or other owners of transmission or distribution should be allowed to build new or expanded capacity, and services that can be offered competitively should be unbundled.

The profile urges regulators not to forget that cost-of-service regulation provides economic incentives that are equal to or greater than pure market incentives -- namely, the opportunity to earn a virtually guaranteed rate of return with almost no downside risk, even for mediocre business performance.

The opportunity to serve a larger, growing market should be ample incentive to encourage new investment and to innovate. “Electric industry restructuring is not a zero-sum game as often portrayed by incumbent utilities whose traditional ‘markets’ are limited to their old franchise territory,” the profile says. E

## *Holding on to What Works in Traditional Regulation*

*Rather than switch to flawed performance-based rates, regulators of transmission and distribution services should keep the following in mind, ELCON says in its profile, Performance-based Regulation.*

- Cost-of-service regulation provides economic incentives that are equal to or greater than pure market incentives -- namely, the opportunity to earn a virtually guaranteed rate of return with almost no downside risk, even for mediocre business performance. There is no need to embellish any utility’s earnings as long as this guarantee applies.
- The rate-setting process should be transparent to the public and to policy makers. Regulation is subject to the public trust and should be fully accountable to public needs. It should never be a black box that inhibits public scrutiny and over-

sight. The complex statistical methodologies that underpin many PBR proposals clearly limit full accountability, and enable regulation to degenerate into a process of accommodation between the regulators and regulated. The best regulatory paradigm is a process that is always transparent to the public and policy makers.

- Regulation should acknowledge its limitations for simulating real competitive market outcomes. Regulation cannot make a monopolist behave as a real competitor. This is why any form of regulation is inherently imperfect and unsatisfying. Changing the regulatory paradigm does not change the underlying problem. The only way to minimize this problem is to structure the regulatory process in ways that minimize the potential for improper strategic behavior and gamesmanship that dis-

credit the integrity of the process. This requires that utilities be held fully accountable for their actions.

- Traditional cost-of-service regulation is not lacking in workable incentive mechanisms. Those mechanisms should be used.
- The use of real competitive market forces should be maximized within the regulatory context. Utilities will price their services more efficiently if there is a credible risk of new entrants into their market. Real market forces can be interjected into the regulatory process by removing the utility’s protection from technological competition; allowing third-party developers or other owners of transmission or distribution to build new or expanded capacity (i.e., franchise competition); and unbundling purely regulated services from any other service that can be offered on a com-

## ELCON Convenes Industrial Summit

More than 100 industrial representatives met in Rosemont, Ill., July 19 at a summit convened by ELCON to develop a common industrial-user position on transmission congestion management. The all-day meeting resulted in three proposed recommendations:

- All RTOs should adopt a congestion management methodology with minimum implementation costs that reflects the actual flows of electric power and allows market participants to arrange in advance for the supply and delivery of electricity based on the customer's pricing and reliability requirements;
- A congestion management methodology should provide the benefits of locational marginal pricing without the disadvantages; such prices should be discovered in bid/ask markets; and
- RTOs should ensure grid reliability with balanced schedules supplemented by RTO real-time balancing service to cover normal variations in supply and demand and any unexpected outages in transmission capability. E

## The Problems with LMP

*ELCON's technical brief, "Locational Marginal Pricing: A Computer Program Pretending to be a Market" (available at [www.elcon.org](http://www.elcon.org)) explains why LMP fails as a suitable methodology for a real market:*

- **Lack of pricing transparency.** LMP does not produce real prices. It is an accounting mechanism that produces a "rate" similar to a fuel adjustment charge. After-the-fact true-ups of costs contradict the most simplistic of basic economic models of market behavior.
- **High transaction costs.** LMP assigns "prices" on a nodal basis, and there can be thousands of nodes in even a relatively small electrical system such as the Pennsylvania-New Jersey-Maryland (PJM) Exchange. This produces high transaction costs, limiting market participation and entry.

- **Needless bundling.** Transmission (regulated service) and generation (unregulated service) are bundled together needlessly. Separate markets must exist for these services to prevent manipulation.
- **LMP is susceptible to market abuse.** LMP requires the establishment of a new monopoly -- the pool or exchange -- which will dominate the market. No other commodity is traded in such a pool or exchange. Bilateral transactions are handicapped by this structure.
- **LMP's risk allocation is old-fashioned.** Like traditional regulation, LMP places most of the risk on consumers. For example, requiring all successful bidders to receive the "clearing" price is extremely lucrative to suppliers at the expense of consumers.

petitive basis in the marketplace. In the long run, technological changes may eliminate many residual natural monopoly functions and the need of regulation itself.

- Existing disincentives to new investments should be removed. A "bright line" should be established between all transmission assets and those assets used exclusively for local distribution. This is to eliminate the potential for a "regulatory gap" that prevents any owner of transmission or distribution assets from recovering all its prudently incurred costs. Generation, transmission and distribution functions need to be "unbundled" for accounting purposes to eliminate the potential for cost shifting, over-recovery of costs, and gaming of the rate-setting process.

- The opportunity to serve a larger, growing market should be ample incentive to encourage new investment and to innovate. Electric industry restructuring is not a zero-sum game as often portrayed by incumbent utilities whose traditional "markets" are limited to their old franchise territory. The formation of large, independent regional transmission organizations (RTOs) will create large, regional markets without the impossible requirement or risk of private ownership of a huge transmission network. The opportunity to serve this larger, more dynamic market should be adequate incentive for any rational business -- perhaps even regulated transmission and distribution monopolies -- to efficiently operate and invest in that market.

## Reliability Effort

From Page 1

- revisit its capacity benefit margin policy, and
  - focus on bringing the demand side into the market.
- Other commenters suggested that FERC eliminate the capacity benefit margin altogether, require independent verification of the availability of some transmission capacity and independent security coordinators, and use onsite generation to "clip the peak" of a utility's load duration curve.
- FERC had earlier suggested state regulators could increase use of demand side management and market-mechanisms; eliminate regulatory disincentives to customers' integrating on-site supply and demand solutions; promote energy efficiency; and improve coordination for supply emergencies. E

**Wednesday, October 11, 2000**

**6:00 - 7:00 p.m.**

**Pre-registration and Reception**

**Brubaker and Associates will hold a competition symposium at the Hyatt Regency Crystal City Hotel on Wednesday October 11, 2000, the day before the Seminar. For more information please call 800/650-1239.**

**Thursday, October 12, 2000**

**8:30 - 10:00 a.m.**

**Opening Speakers**

**One Vision of the Future  
(The "New World" View)**

**Pam Strobel**

*Executive Vice President of Unicom Corporation and its chief subsidiary Commonwealth Edison Company (ComEd) Upon completion of merger will be President of Exelon Delivery Services Company*

**Another Vision  
(The "Old World" View)**

**Christopher Jones**

*The European Commission's Directorate-General XVII - Energy*

**10:00 - 10:30 a.m.**

**Break**

**10:30 - noon**

**Lessons From the Transition —  
The Good, the Bad, and  
the Ugly**

**Dr. William R. Huss**

*Senior Vice President and Project Manager for the Retail Energy Markets study conducted by XENERGY*

**Joel Gilbert**

*CEO, Apogee Interactive*

**Nora Mead Brownell**

*Commissioner, Pennsylvania Public Service Commission*

**Noon - 1:30 p.m.**

## Luncheon Speaker

Ed Cazalet

*CEO, Automated Power Exchange (APX)*

**1:30 - 2:45 p.m.**

## Can We Count on the Marketplace to Assure Customers' Electricity Needs in 2005?

Leonard Hyman

*Senior Industry Advisor, Salomon Smith Barney*

Dan Larcamp

*Director, Office of Markets, Tariffs and Rates, FERC*

An Independent Power Producer

**2:45 - 3:15 p.m.**

## Break

**3:15 - 4:15 p.m.**

## How Will Power be Delivered to Large End-users in 2005?

Phil O'Connor

*Senior Vice President, NewEnergy Midwest*

Jose Delgado

*CEO, American Transmission Company*

**4:15 - 5:15 p.m.**

## How Will End-use Consumers Shop for Power in 2005?

Terry Grant

*Principal, Energy Ventures Group*

Jim McGee

*Partner, Diamond Technology Partners, Inc.*

**6:00 - 8:00 p.m.**

## Reception

# Friday, October 13, 2000

**8:30 - 9:15 a.m.**

## Keynote Speaker

Oliver G. (Rick) Richard, III

*Chairman, President and CEO, Columbia Energy Group*

**9:15 - 10:30 a.m.**

## Selling and Buying Gas and Electricity Services After Order 637 in the New World of Convergence

Branko Terzic

*Energy/Utilities Services, Deloitte & Touche LLP*

Joseph T. Ewing

*Strategic Sourcing Manager, Energy-Global, The Procter & Gamble Company*

**10:30 - 10:45 a.m.**

## Break

**10:45 - 12:00 noon**

## Will the Gas Supplies and Infrastructure be Adequate to Meet the needs of the Gas and Electric Markets in 2005?

R. Skip Horvath

*President, Natural Gas Supply Association*

*Other speakers to be announced*

## Registration Fee:

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**Early bird by September 11 -- \$495.** After September 11 -- \$595. (A fee of \$95 is offered for regulatory commissioners and staff and "non-utility" government employees.) These fees include admission to the seminar, materials, a luncheon, refreshments throughout the program, two receptions and two continental breakfasts. We accept AMEX, Discover, Mastercard, VISA and Diners Club.

**Registration is available online at [www.elcon.org](http://www.elcon.org).** Alternatively, fax or email the information requested on the form below or mail the form with a check payable to ELCON, 1333 H Street, NW, The West Tower, 8th Floor, Washington, DC 20005. Tel.: 202/682-1390.

Fax: 202/289-6370. Email: [elcon@elcon.org](mailto:elcon@elcon.org).

## Register by September 11 and save \$100!

### Cancellation:

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Refund requests must be submitted to ELCON in writing prior to the Seminar. Refunds will be reduced a fee of \$50. Substitutions are welcomed and encouraged at no charge. Please contact the ELCON office to designate a substitute.

### Hotel Accommodations:

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Please make your reservations directly with the Hyatt Regency Crystal City, 2799 Jefferson Davis Highway, Arlington, VA 22202. Tel.: 703/418-1234 or 800/233-1234. Rates: Single/Double \$159.00. These rates are guaranteed only until September 18, 2000. Any reservations made after this date will be accepted on a space-availability basis and at current hotel rates.

## Registration Form

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## Federal Legislation Dies, But not Without Pain

The likelihood of Congress passing a comprehensive electricity restructuring bill fell to almost zero as both houses adjourned for the August recess, not returning until after Labor Day.

In the House there was a three-week flurry of activity as Commerce Committee Chairman Tom Bliley (R-VA) scheduled a July 13 mark-up of electricity legislation based on his proposal to place all transmission under federal regulatory authority. On the day of the scheduled markup, Chairman Bliley realized that his proposal did not enjoy sufficient support on the Commerce Committee, and he postponed the markup while he attempted to modify his language and garner more support.

ELCON then participated in a last-ditch effort to keep the issue alive when staff from Chairman Bliley invited a wide-ranging group of stakeholders -- including a few generally intransigent utilities -- to try to find agreement on the contentious transmission issues, including federal/state jurisdiction, RTO membership, and market power. Despite general agreement, the end of the congressional session and continuing dissent from the National Association of Regulatory Utility Commissioners (NARUC) and a few utilities precluded any final agreement.

The Senate Energy Committee earlier had passed a "reliability" bill giving statutory sanction to a new Electricity Reliability Organization that will replace the North American Electric Reliability Council (NERC) when it was clear that there was no consensus on the Committee to consider a comprehensive bill. The full Senate then passed the Committee-approved bill by unanimous voice vote shortly thereafter (see John Anderson's view, page 2).

Although Congress will be back in session for five or six weeks in September and October, most Congressional observers, as well as Members of Congress and staff, cannot envision a scenario in which comprehensive electricity

legislation can be considered by the full House. The press of other business, the necessity to consider appropriations bills and the overwhelming partisanship as the election approaches all work against such consideration. In fact, many lobbyists view the last-minute meetings held on the House side primarily as the first step toward building consensus in 2001. E

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### Stand-Alone Bill

From Page 2

(NERC) into a North American Electric Reliability Organization (NAERO). This new organization is charged with drafting and implementing the new "rules of the road" that will govern the interstate electricity transmission system.

That effort fails on two counts. First, ELCON and its members have been participating in NERC for several years now, since shortly after they opened their doors and stopped being a utility-only club. We can speak from experience that the mindset of most NERC participants is still steeped in the ways of the utility industry. The views of new players such as marketers, non-utility generators and consumers are secondary. The transmission network the utility club envisions is not one to encourage competition but to guarantee reliability regardless of the impact on the market. All too often, vertically integrated utilities hide behind the shibboleth of reliability when their intent is to hide their high-cost generation from competition. Such entities, often with nearly unlimited resources, have been able to dominate NERC in the past. We must be sure that the new organization, NAERO or whatever, has a different mindset. This requires dealing with the problems of vertical integration and market power. The bill as passed by the Senate does not address these at all.

Second, it puts the cart before the horse. Improved reliability will not be achieved simply by creating a new organization. Before we set up a governing body, we need to set up the rest of the system. For example, FERC Order 2000 is a good first step on RTOs, but we need more. We need to see how utilities comply with

Order 2000 and to be sure that RTOs are governed in an independent manner as that Order requires. We need clear legislative and judicial guidance that transmission lines are under federal, not state, regulatory authority, so we have one set of rules, not 50. We need a framework to prevent the abuse of market power.

Simply put, how can a reliability organization set any rules of the road when we don't yet know what the road looks like?

Luckily, the House of Representatives yielded to reason and took no action on this Senate-passed measure. No doubt, there will be pressure in the remaining weeks for the House to pass this bill or one similar to it because some in Congress want the political cover -- they want to be able to say they did something and, again, who can be against reliability?

As I said above, ELCON and its members are strong advocates of a reliable electric system. However, we are strongly opposed to bad public policy, no matter how it is disguised. Stand-alone reliability legislation would be a problem, not a solution. E

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### Order 888 Ruling

From Page 1

Power case) and in a practical sense largely overturns it.

ELCON's objective is the establishment of uniform rules for transmission of electricity just as there are uniform rules for the transportation of other goods. Allowing states to retain jurisdiction over some aspects of transmission in the name of states' rights "recalls the Articles of Confederation in which states could assess tariffs and impose unfair rules on out-of-state products," Anderson said. "This produced an inefficient market in the 1700s and would produce an inefficient market today."

The "dark lining" in the silver cloud of the court's ruling was its affirmation of Order 888's provisions on stranded costs, which "will not help competition," Anderson said. "It merely rewards each utility's prior mistakes and inefficiencies. Both as a FERC rule and as a precedent, this will be damaging." E

# ELCON Activities Before The Federal Energy Regulatory Commission

**F**ERC rejected a Regional Transmission Organization (RTO) proposed by the Southwest Power Pool (SPP) based on an “agency agreement” between members to schedule transactions and administer transmission service for member utilities (*Docket EL00-39*). In fact, FERC cited SPP’s failure to comply with many of the provisions that ELCON has long sought as criteria for independent RTOs. The board was to have a stakeholder structure of seven transmission-owning utilities, seven transmission concerning members, and seven independent directors which ELCON believes would not guarantee sufficient independence.

FERC said SPP’s “agency membership” approach is no substitute for separating out control of transmission service as Order 2000 requires, and it found that SPP’s congestion management plan failed to comply. SPP’s proposed governance structure could tilt the board so it was in fact controlled by stakeholders, FERC ruled. Most significantly, FERC found that SPP had inadequate scope and configuration. The fact that SPP is a regional security coordinator does not satisfy Order 2000 requirements.

## *AEP/CSW Merger Approved*

Over the objections of ELCON and other industrial users, the Federal Energy Regulatory Commission approved the merger of American Electric Power (AEP) and Central and Southwest (CSW), although the approval was conditioned on AEP/CSW making changes to address competitive concerns (*Docket EC98-40-000*). FERC said the companies’ application “failed to show that the proposed merger will not adversely affect competition as a result of combining their generation and transmission.”

The Commission imposed the following conditions:

- The companies are required to transfer operating control of their transmission facilities to a FERC-approved regional transmission organization (RTO) by Dec.15, 2001.
- Between the time the merger is approved and the date the RTO is approved, the companies must have their available transmission capacity (ATC) independently calculated and set up a means for independent monitoring of their market power. FERC said the measures (1) will address concerns raised by outside parties over possible manipulation of ATC and transmission denials, (2) can be performed by independent third parties and (3) can be implemented in a relatively short time frame.

If the two companies are unwilling to accept the interim measures, FERC said they would have to join an approved, fully functional RTO before consummating the merger. Fearing that they might gain a competitive advantage by retaining control over divested generation, FERC also conditioned the merger on the companies’ relinquishing their entire ownership interest in the facilities they plan to divest.

The two companies indicated they would accept FERC’s conditions.

## *ComEd/PECO Merger Approved*

Over ELCON objections, FERC unconditionally approved a merger between ComEd and PECO, finding that the two companies took adequate mitigation measures to prevent market abuse (*Docket EC00-26-000*). ELCON had argued strongly against the merger on the

*Following is the outline of the arrangement proposed by AEP to comply with terms set by FERC for approving its merger with CSW.*

- American Electric Power Service Corporation (AEPSC), a service company that provides various services for the AEP utility group, engaged Southwest Power Pool Inc. (SPP), an independent regional reliability council, security coordinator and tariff administrator, to calculate and post the availability of short-term and long-term transmission capacity and to process requests for transmission service.
- SPP will perform these functions until AEP transfers control of its transmission system to a FERC-approved RTO. Although SPP may

need to hire AEPSC employees with knowledge and expertise of the AEP transmission system, these employees will immediately sever their employment with AEPSC and divest all securities in any affiliate of AEPSC within six months. Employees of SPP working under the agreement will be treated as “transmission function employees” under Order 889’s Standards of Conduct.

- To address FERC’s order regarding a market-monitoring plan, AEPSC engaged an expert to perform the monitoring function, ensuring that “actions taken by AEP that affect constrained transmission facilities will be thoroughly reviewed by an independent and highly qualified monitoring team.”

basis that the two companies were essentially creating their own sub-regional transmission organization (RTO) within the Midwest Independent System Operator (MISO).

From ELCON's perspective, ComEd and PECO are trying to distance themselves from MISO and vest themselves with the most important congestion management and operational authorities, making MISO little more than Midwest security coordinator. The separatist initiative represents a fundamental violation of the tenet that all stakeholders should be involved in forming and defining an RTO, according to ELCON.

The mitigation measures that satisfied FERC included ComEd's commitment to turn over transmission system control to the proposed MISO transmission company (ITC) and PECO's participation in the Pennsylvania-New Jersey-Maryland (PJM) ISO. FERC also found that neither company had or would be able to exercise excessive power in the generation market.

But ELCON had argued that the participation of PECO and ComEd in an ISO through a transmission company does not lessen the need for FERC to insist on strict compliance with Order 2000. FERC's legal authority in reviewing and conditioning applications for merger approval is being tested and ELCON argued that FERC should not allow merger applicants to escape rigorous RTO compliance because they belong to ISOs and transcos that do not comply with Order 2000.

FERC concluded that although increased market concentration would occur in the ComEd market, it would not be profitable for the merged company to withhold output in an attempt to drive up market prices, partly because much of the company's generation is low-cost nuclear capacity.

Finally, FERC praised the newly merged company's ratepayer protection programs -- especially the hold-harmless provision not to pass merger related costs on to customers and their open season commitment to the Illinois cities.

#### *TECO Balancing Charges Approved*

Revisions in Tampa Electric Company's (TECO) proposed balancing

charges -- especially changing from a minute-based charge to an hourly charge -- won approval from the Federal Energy Regulatory Commission (*Docket ER00-801-000*). The balancing charges, which are penalties and credits set when a generator delivers less or more power than scheduled, will be used with independent generators in TECO's control area.

TECO's original plan to balance by the minute drew protests from ELCON and the Florida Industrial Cogeneration Association (FICA). FERC said TECO's revised proposal was consistent with generation balancing rates accepted in other cases. FERC said it believes that balancing promotes good operating practices.

ELCON and FICA opposed the revised plan as well as the earlier one and asked for a rehearing on the basis that FERC:

- acted arbitrarily in concluding that TECO's revised proposal did not constitute a new rate filing and that customers therefore already had notice of the filing;
- failed to give reasoned consideration to a contention made earlier by FICA that TECO's hourly service violates comparability of service principles;
- failed to give reasoned consideration to whether TECO's hourly service unreasonably limits competition or constitutes an unreasonable penalty;
- failed to address FICA's contention that acceptance of TECO's hourly service without modification was inconsistent with FERC's treatment of comparable circumstances in its regulation of natural gas pipelines; and
- erred in failing to consider FICA's request that it require TECO to credit imbalance penalty revenues to customers to prevent a windfall.

In comments, ELCON and FICA described problems that cogenerators would face from balancing charges, and FICA sought an exemption for cogenerators. FERC denied the exemption, saying that TECO's proposal to switch from minute-by-minute to hourly netting increases a generator's ability to meet its schedules. FERC has pressed the idea that generators meet their schedules with precision. FERC also denied a request for

a generic proceeding to standardize balancing service.

#### *Companies Seek Suspension of Rates*

At least two companies have sought a suspension of Entergy's right to charge market-based rates in the wake of a decision by FERC that Entergy discriminated against another utility by reserving all of its available transmission capacity for its own affiliated utilities (*Dockets EL98-36, ER91-569-009*). FERC ruled in the case, brought by Aquila Power, that a transmission provider is required to designate resources and loads on behalf of its native load customers under the same terms as it

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**ELCON has long been concerned about utilities "gaming" the system by manipulation of their transmission facilities.**

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does for its network customers, and Entergy failed to designate network resources as required by its open-access transmission tariff. However, FERC did not direct Entergy to make capacity available, instead leaving the issue to be resolved in a proceeding on Entergy's tariff amendment. ELCON has long been concerned about utilities "gaming" the system by manipulation of their transmission facilities.

Aquila Energy Marketing Corp. (AEMC) and Enron both sought the suspension of Entergy's rate-making authority. AEMC pointed to three probable anti-competitive practices: (1) Entergy's improper capacity reservations for anti-competitive purposes, (2) Entergy's control of regulated power plant sites that are candidates for new capacity development, and (3) Entergy's use of its interconnection policies to delay or frustrate new entry.

Enron analyzed information posted on Entergy's public information site which indicated that Entergy unreasonably altered information about its available transmission capacity at critical interfaces in a manner that benefited only its merchant function and its affiliates. E

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### *WHAT IS ELCON?*

- **DATE ORGANIZED:** January 15, 1976
- **WHO WE ARE:** ELCON is an association of large industrial consumers of electricity. Our members have facilities in most of the 50 states and in many foreign countries, producing a wide range of products, including aluminum, steel, paper products, petroleum, chemicals, industrial gases, glass, motor vehicles, electronics, textiles, tires, and food. Our member companies consume almost six percent of all the electricity in the US. These companies require an adequate and reliable supply of electricity at competitive prices.
- **2000 MEMBER COMPANIES:** A.E. Staley Manufacturing Company • Ag Processing, Inc. • Air Liquide • Alcan Aluminum Corporation • Anheuser-Busch Companies, Inc. • Bethlehem Steel Corporation • BP • Cargill/North Star Steel • Central Soya Company, Inc. • The Chevron Companies • Cleveland-Cliffs, Inc. • Corn Products International • Dow Chemical, U.S.A. • E.I. du Pont de Nemours & Co. • Eastman Chemical Company • Equilon Pipeline, L.L.C. • Ford Motor Company • GNB Technologies • General Motors Corporation • Honda • Honeywell • Intel Corporation • International Paper • LTV Steel Company • Motorola • Occidental Chemical • Owens-Corning • Praxair • Procter & Gamble Company • Rockwell Automation • Solutia, Inc. • Southdown, Inc. • Texaco • The Timken Company
- **FOR MORE INFORMATION CONTACT:** ELCON, 1333 H Street, NW, West Tower, 8th Floor, Washington, DC 20005, 202/682-1390, fax: 202/289-6370. E-mail: [ELCON@ELCON.ORG](mailto:ELCON@ELCON.ORG) or on the Internet: [WWW.ELCON.ORG](http://WWW.ELCON.ORG)

## **The Electricity Consumers Resource Council**

The West Tower  
1333 H Street, NW, 8th Floor  
Washington, DC 20005

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