UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Electricity Market Design and Structure   Docket No. RM01-12-000

(July 31, 2002)

Breathitt, Commissioner, concurring:

I am writing separately on the Notice of Proposed Rulemaking (NOPR) on Standard Market Design (SMD) to express some of my thoughts on certain of its provisions and design elements. We have been discussing the broad contours of the SMD NOPR with interested parties for months through the staff white paper, the options paper and technical conferences. Many of the NOPR's features have been welcomed and embraced by various entities, associations, company representatives and academics. Just as many participants have cautioned us to make sure that the procedures, protocols and standards that we wish to impose on the industry we regulate are practical in implementation, fair to consumers and respectful of state jurisdiction. They have also asked us to recognize that not all regions of the country are the same or have the same historical ways of providing electricity to retail and wholesale customers.

For example, the way the Northeast has evolved with their power pools is vastly different from how the Southeast and the Southwest has traded bulk power. The northwest has a heavy reliance on hydroelectric generated power. Even with these differences, all the regions have provided reliable and steady service especially in times of extreme weather conditions.

People will be pouring over this NOPR to see if it is practical and if it is doable. During the October SMD/RTO week we were advised to keep it simple. This is anything but simple. It is a comprehensive proposal and it's very complicated. Over time it will result in a sophisticated market. Parties are going to need time to understand its complexities and implement its many features. The Commission is going to need patience and flexibility. We have not assigned a cost to this proposal but we know that each FERC jurisdictional entity is required to hire an independent transmission provider (ITP) if they are not already in an RTO. The ITPs must set up locational marginal pricing (LMP), day-ahead and real time energy markets, as well as ancillary services markets.

In Order 2000 we paired a voluntary rule with very tight compliance deadlines, deadlines that I believe we all knew at the time would be difficult to meet. Today's proposed rule pairs many complicated and mandatory requirements with short implementation time lines. For example, the LMP system paired with energy and ancillary services markets has not been proven outside of the tight power pools in the Northeast. Also, allocation of initial Congestion Revenue Rights will be complicated, if not problematic for some areas of the country. But, I am pleased that today's order recognizes that not all areas of the country will be able to move ahead with all requirements of SMD at lightning speed. The Commission intends to be flexible in some compliance dates and while it is the objective to have SMD in place within two years of the effective date of the Final Rule, the Commission will consider requests to extend that date.

The fundamental goal of SMD requirements in conjunction with the standardized transmission service is to create "seamless" wholesale power markets that allow sellers to transact easily across transmission grid boundaries. Once the final rule is in place and implemented my hope is that the squabbling over which entities belong in what RTO will end. We should be able to put our magic markers away for good.

Today's NOPR puts forward a detailed vision of the roles that ITPs, this commission and states will play in planning for expansion of the transmission grid. I am pleased that the governors have requested a significant role in transmission planning through the formation of Multi State Entities (or MSEs). I am also pleased that we propose to give MSEs a role in both overseeing the plans developed by the ITPs and in developing a fair pricing methodology for these expansions. I feel very positive about the bottom up approach that is described in the planning section of this NOPR. This approach allows merchant transmission companies and utilities, as well as generators and demand resources, to bring economic solutions to the table to solve the problems of under-built infrastructure. These projects must be vetted by the ITP to determine their impact on the grid in terms of loop flows and other regional impacts, but the real tests will be the demand for the projects much as we see in gas pipeline certificates.

I do have concerns about the planning protocols that would be enacted by the ITP once it is determined that economic projects cannot fulfill all of the reliability requirements of the grid. My concern is that this "central planning" aspect may direct projects that are uneconomic with costs socialized to all users of the grid. It is hard to imagine gold plating of the transmission grid when we are in an era of under-built infrastructure, but I believe that once we get the incentives right for building needed infrastructure there will be no need for the ITP to direct the construction of possibly "uneconomic" projects.

Getting the incentives right in grid expansion has been on my top ten list through this NOPR process and in my tenure here at the Commission. To this end, I have continued to be a proponent of Independent Transmission Companies (ITCs) and continue to believe that ITCs show great promise to address grid problems through profit driven activities. I am pleased that the NOPR proposes to adopt a form of participant funding once independent transmission entities are in place. I am also pleased that the Commission is willing to consider proposals submitted by Regional State Advisory Committees for participant funding prior to nation-wide adoption. This order gives a push to state and regional entities that already have significant momentum and I hope to see the fruit of the Regional-State groups efforts in the form of actionable plans for cost allocation of expanded transmission. However, if these groups have difficulty getting organized and implemented, there is a default mechanism that would allocate the costs of expanded transmission locally if the facilities are below 138 kV and regionally if the facilities are above the 138 kV level. I urge the parties, especially the states, to carefully consider this section of the NOPR and comment on this. I still have some uncertainty whether we reached the right balance here.

Furthermore, the states have been asking for some time for certain responsibilities in RTOs, particularly in the area of reliability and planning. In SMD it is envisioned that they will play important roles in developing the resource adequacy standards and transmission expansion pricing methods. We will give deference to areas that are not as far along in standardizing markets, allowing states to manage the pace of the required changes. Additionally, the proposed rule, while it asserts jurisdiction over native load, does not abrogate either actual or implicit contracts. I am not so Pollyanna as to believe that everyone will be happy with our assertion of jurisdiction over native load, in fact this is likely to be a big bone of contention. But take a look at the rule, as I think states will find that it tries to be balanced and allows them significant say in determining outcomes.

Another area that I have focused on in this process is cost shifts. I agree that embedded costs charges for wheel through and export transactions should be eliminated or minimized while at the same time assuring recovery of the transmission owner's revenue requirement. My concern with respect to cost shifts resulting from this removal of inter-regional rates is two-fold.

First, I fear that areas with low-cost energy, such as my state of Kentucky, will see those resources flow to high-cost areas located several states or regions away. It is a mathematical fact that when costs are averaged that someone's costs will go up. This particular concern is in part alleviated by the ability for those in low-cost areas to lock up their low-cost power resources in long term contracts. I also note that these transactions which will flow over greater distances, now that they no longer face the fixed cost of the transmission system, will be subject to marginal losses and congestion charges. I believe that marginal losses in excess of actual losses should be credited back to the areas where the power originated.

My second concern with cost shifts relates to the determination of how these costs will be apportioned among different types of customers. Even if costs are allocated to import zones instead of to each ITP, one customer in the zone that relies solely on generation within the zone could subsidize a customer that imports all of its requirements. This is due to the fact that the embedded costs for imports would be spread across all load within the zone. My hope is that parties will comment on these and other costs shifts giving us concrete examples of the kind and level of shifts that may occur. I would also ask for recommendations on how best to address cost shifts, especially if they have a significant impact on retail customers.

In Order 888, Imbalance service was an ancillary service that could be provided by the transmission provider or it could be self-supplied. In staff's initial thinking on SMD as expressed in their concept paper, the markets for both real-time and day ahead energy would only require voluntary participation. As we worked through the details of SMD, this idea morphed a bit to now require imbalance service to be taken through the real-time energy market set up by the ITP. Participation in the day-ahead market is still left to the buyer's discretion and bilateral contracts are encouraged. But, the requirement for load to buy their imbalance service through the real-time market is a significant change. Loads will be subject to spot prices for that small portion of their load that varies from their load forecasts. I hope that parties will comment on this change to imbalance service.

I believe that one of the fundamental underpinnings of this rule is to give equal access to the transmission grid to all and I support that notion. However, I recognize that giving everyone equal access means that decisions will be made based on each party's willingness to pay. This means that the price certainty that we gave through Order 888 will disappear. But, this does not mean that all price certainty will disappear because SMD provides mechanisms for customers to use to hedge the volatility in transmission markets and in real-time markets. My concern is that both small players and less sophisticated players will have increased transaction costs and steep learning curves in finding their way through these markets and in hedging these price risks. I don't want this rule to result in two classes of SMD participants - those that know how to participate effectively and those that have difficulty and incur higher costs without competitive benefits.

Also, after consulting several economic textbooks, we have defined market power for the first time in an electric order as "the ability to raise price above the competitive level". We caveat that definition by stating that the determination of when to intervene in a market, i.e. when the price is significantly raised for a sustained period, will be incorporated into our triggers for intervention rather that the definition. I am not positive that we have the definition right and I hope that parties will let us know if they think we have used the right definition.

The three prongs of mitigation proposed in this NOPR, local market mitigation, a safety-net bid cap, and the resource adequacy requirement, along with the requirement for an active independent market monitor should protect these markets during what could be a rocky inception. My hope is that over time there will be less reliance on mitigation measures as the structural problems in these markets subside. Further, I believe this proposed rule holds promise for solving the disagreements that we have today on the ability to exercise market power under our current methods for granting market-based rates. With these stringent new mitigation measures in place the Commission should reassess its reliance on the Supply Margin Assessment test and study the need for the 206 refund obligation.

With respect to governance, I do not agree with the level of prescription that we are imposing on certain governance proposals. I don't think the Commission should be dictating with such specificity so many rules concerning the explicit makeup of stakeholder committees, who can sit on which committees, and exactly how boards should be selected. This could have the effect of disbanding boards of RTOs that are in the formative stages and boards that might have met our Order 2000 independence requirements.

And last, but definitely not least, I am pleased that today's proposed rule keeps the same provisions for reciprocity as that of the OATT. Entities that already have waivers of the reciprocity provision will not have to come in again and request additional waiver from the SMD provisions. Today's proposed rule also would allow reciprocal OATTs to be grandfathered and require no further changes to those tariffs to meet the new SMD requirements. This provides necessary relief to small transmission owners, including municipalities and cooperatives.

I urge my colleagues to carefully consider the comments and not be shy about considering changes to the proposal. We are asking over seventy-five questions which indicates that we still need industry's and the public's advice on a number of issues. I will be anxiously awaiting the comments and look forward to what parties have to say on these and other issues.

Linda K. Breathitt
Commissioner