

TESTIMONY OF
EDWARD H. COMER
Vice President and General Counsel
Edison Electric Institute
Before the Federal Energy Regulatory Commission on
Affiliate Abuse
January 28, 2005

I am Edward Comer, Vice President and General Counsel for the Edison Electric Institute. I am appearing before the Federal Energy Regulatory Commission (“FERC”) today on behalf of the Edison Electric Institute, a national trade association that represents shareholder-owned electric utilities, and our affiliated Alliance of Energy Suppliers, a division of EEI that represents unbundled, bundled and independent power suppliers (together “EEI”).

EEI members serve about 70 percent of all ultimate customers in the nation. The majority of our members are subject to both federal and state jurisdiction. EEI members also represent the largest segment of buyers and sellers in wholesale power markets. We therefore have a considerable interest in Commission policies as they relate to electricity sales for resale and affect procurement of power.

I am pleased to participate as the Commission reviews its use of the four-prong review process for assessing market power for purposes of granting market based rate authorization.

The purpose of my testimony today is to discuss how affiliate issues relating to market power concerns should be addressed by the Commission. I urge the Commission to recognize that an effective regulatory framework exists at the state level to prevent affiliate abuse relating both to asset and purchased power transactions. State regulation already plays an important role in guarding against the potential exercise of affiliate abuse relating to such transactions and this should figure prominently in the Commission’s deliberations. I continue to encourage the Commission to develop a state/federal dialog process to create the regulatory stability needed to address these issues in a manner that will attract capital for the facilities needed to serve our customers.

My statement incorporates the positions set forth in EEI's Framework for the Continuing Development of a Competitive Wholesale Market for the Benefit of Consumers. A copy of the Framework is attached. This Framework represents a consensus of our members from our January Board and CEO meeting.

The Framework strongly supports the development of competitive wholesale markets. EEI companies support pursuing more effective wholesale markets throughout the United States because properly structured competitive wholesale markets benefit consumers. Robust wholesale competition offers the potential of substantial benefits to consumers in terms of lower costs, greater efficiency in the use of generation and transmission resources, and enhanced reliability.

The benefits of robust wholesale competition can be achieved only if a strong, effective state-federal working relationship is established on all regulatory matters that provide the stability and certainty needed to attract investment. A recent survey of utility executives showed lack of regulatory certainty is one of their greatest concerns right now.

Without a strong effective working relationship among federal and state regulators, we will lack the stability and certainty needed to attract investment and best serve our customers. I have elaborated on these views in a recent article in the Electricity Journal, which is attached to my written statement.

Since current Commission concerns about affiliate abuse have focused on two areas – control of transmission and resource procurement options, including purchases or construction of generation, my statement will focus on these topics.

Transmission

With respect to transmission, FERC's open access rules, standards of conduct, behavioral rules and related rules have been effective in preventing affiliate abuse. However, we recognize that there are additional measures that can be implemented that could provide more certainty that such abuses can not occur in the future. Therefore, where RTOs are not formed, fair and non-discriminatory transmission access could be enhanced by state and FERC endorsed mechanisms, which might include independent transmission

administrators, transcos or similar organizations. Market monitors should also provide for oversight over matters such as the behavior of market participants and assurance of independence, transparency and fair open access.

Such measures should dispel any remaining concerns about affiliate abuse in transmission.

Resource Procurement Issues

When we look at resource procurement issues, we are facing a major challenge in the industry. There is widespread consensus among our members that there will soon be a need for substantial investment in new, large base load coal and nuclear generating plants to respond efficiently to growth, environmental needs and the expected limited availability and relatively high cost of natural gas. Public data bases identify there are currently 38 large scale (500 MW or more) coal projects totaling 30,197 MWs either announced or undergoing feasibility studies. They all have scheduled online dates between the years 2006-2013. 22 of the projects (or 18,247 MWs) have been "announced" while 16 of the projects (or 11,950 MWs) are undergoing feasibility studies. How will we finance and build such plants?

An effective competitive resource procurement process should be in place which explicitly recognizes both FERC's jurisdiction over wholesale sales transactions and state jurisdiction over retail service, planning, resource adequacy, fuel supply choices, environmental aspects of electric generation and retail cost-recovery issues. These regulatory policies must be compatible.

The most pressing issue in competitive markets today is to decide how to facilitate investments in new base load plants. EEI recommends that regional market structures should provide accurate price signals to promote efficient investment and ensure long-term resource adequacy. Provisions should be made for long-term resource adequacy that reflect the regulatory and market structures adopted by the states within a region. In competitive retail markets, this may require market mechanisms to ensure long-term resource adequacy.

The resource adequacy rules in most RTOs are in a state of flux. Many believe that three and even five year auctions are not likely to lead to major base load coal or nuclear generation investments. Moreover, the recent Edison Mission decision highlights the importance of wholesale market rules that do not unnecessarily curtail price levels where there is no market power.

We urge FERC, cooperating with the states, to devote more attention to making this critical aspect of the competitive market work. Unless there are effective market mechanisms to achieve long-term resource adequacy in competitive retail markets, new base load generation capacity may have to be built under traditional regulation.

Affiliates should be allowed to compete in competitive procurements conducted by regulated utilities to serve their own retail customers. Obviously, transactions with affiliates should be conducted in a fair and transparent manner to protect against bias and favor to the affiliate of such a regulated utility, a determination that State Commissions are well positioned to make.

As I testified last June in a similar proceeding before this Commission, when a utility chooses an affiliate over other competitors as a supplier, we recognize that there is heightened concern about the potential for self-dealing or unfairness in the selection process. However, the choice of an affiliate may be the best option in a given circumstance. Recently, several states, including California and Wisconsin, have approved affiliate transactions to support investments in new generation. Wisconsin acted under an innovative new utility financing law. This could be an important financing mechanism in the future for new base load plants. Many other states have excellent competitive solicitation processes in place, some of which result in the selection of affiliates.

State commissions have a direct interest in scrutinizing affiliate transactions to protect retail customers. Virtually all states have the authority to assure that such transactions are fair, do not result in cross-subsidization and do not harm customers. See the Fitch Rating's February 2004 Survey of State Public Service Commissions, a copy of which is attached to my written statement. State procedures are open to both competitors and customers to raise any concerns. States have a proven track record.

We agree with much in the FERC “guidelines” on competitive procurement as they apply to transactions involving affiliates which fall under FERC jurisdiction. The competitive solicitation process should be open and fair. Products sought should be precisely defined. Evaluation criteria should be standardized and applied equally to all.

However, the independence standard is too vague. It could be interpreted as an attempt to second-guess state decisions or to exclude state approval of an affiliate transaction as not “independent.”

We urge the Commission to confirm that state commissions qualify as an “independent” entity. Their decisions regarding affiliate transactions should satisfy the independence standard for many reasons. States have jurisdiction over retail service, planning, resource adequacy, fuel supply choices, environmental aspects of electric generation and retail cost-recovery issues. They also have jurisdiction over affiliate resource procurement transactions and have a strong interest in exercising that authority to benefit their consumers. They have been reviewing affiliate transaction for years and do it well. They offer due process to all interested parties.

There is no reason to conclude that every other so-called “independent” reviewer is better qualified, better able to assure due process and protect the interests of the retail consumers or, in the end, would do a better job.

If FERC has a concern that state commissions can do better in reviewing affiliate transactions, we urge you to work with NARUC to hold best practices workshops. But don’t disregard state commissions in favor of some unknown “independent” entity.

In addition, we agree with Commissioner Kelliher that the Commission’s action in the recent Conectiv Energy Supply proceeding raises the fundamental question whether these are really “guidelines” or mandatory standards. From a practical, federalism, and policy perspective, they should be applied as guidelines. With 50 different states and a variety of RTOs, ISOs, and regional-state organizations in place, there are going to be many different and fair ways to sell and solicit power supplies.

We urge the Commission to apply the Guidelines with flexibility. For example, short-term and spot market transactions are different from longer-term arrangements and may not require formal solicitations. In addition,

uncontested proceedings require a lower degree of scrutiny than contested ones. In competitive retail markets, the end-use customer will penalize any business that makes above-market purchases from affiliates

FERC has a legitimate interest in assuring that a utility does not exercise market power or improperly favor its affiliate in wholesale transactions. However, Edison Mission cautions it is wrong to regulate rates where there is no market power in competitive markets. It is just as wrong to restrict beneficial affiliate transactions when there has been no abuse.

Many, if not most, states believe that there is a role for the vertically integrated model and traditional regulation. If there is too much uncertainty or inconsistency between Federal and state regulation, many utilities and states will construct new large base load clean coal facilities in rate base. The Federal Power Act reserves these decisions to the states.

FERC has a responsibility to assure that wholesale sales are just and reasonable and do not reflect the exercise of market power if such sales were to be made under market-based rates. Given the need for new base load facilities, their high cost and their large environmental benefits, if FERC finds that market power may exist as a result of building a new facility, we urge that it apply flexible mitigation tools, like those it uses for load pockets within RTOs as Chairman Wood has recently suggested.

Much has been said about the safety-net theory. We agree with the ALJ in the Ameren proceeding that it is not valid. It presumes that state commissions are not doing the job Congress reserved for the states under the Federal Power Act. In addition, wholesale transactions from existing facilities within a corporate entity cannot increase market power under the tests FERC uses, because those tests already treat each utility and its affiliates as a single entity for market power analyses.

The proper way for FERC to address the concerns it has underlying the safety net theory is to assure that competitive markets provide appropriate price signals and sufficient certainty to stimulate the construction of needed new generation facilities. The challenge is to do so as effectively as would occur with construction financed through traditional retail rate regulation without imposing uncompensated costs on the balance sheets of purchasers signing long term contracts.

Let's make competitive markets work on their own without undermining traditional regulation in those states that continue to use it.

I welcome the opportunity to entertain your questions. Thank you.