

117 FERC ¶ 61, 021
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
and Jon Wellingshoff.

Southern Company Services, Inc.	Docket Nos. EL05-102-000
Alabama Power Company	EL05-104-000
Georgia Power Company	ER03-713-000
Gulf Power Company	
Mississippi Power Company	
Savannah Electric and Power Company	
Southern Power Company	

ORDER ON SETTLEMENT

(Issued October 5, 2006)

1. In this order, the Commission accepts in part and rejects in part an Offer of Settlement (Settlement) submitted by Southern Company Services, Inc. (Southern Services) acting for itself and as agent for Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, Savannah Electric and Power Company and Southern Power Company (Southern Power) (collectively, Southern Operating Companies), Calpine Corporation (Calpine), Coral Power, L.L.C. (Coral), and the Board of Water, Light and Sinking Fund Commissioners of the City of Dalton (Dalton) (collectively, Settling Parties).

2. The Settling Parties request that the Commission unconditionally accept the Settlement. We cannot do so, however, because the Settlement does not adequately protect against affiliate abuse. We have an independent duty to protect consumers from affiliate abuse. We therefore order significant changes to the Settlement, which we find severely deficient in several respects.

3. First, we require that the Southern Operating Companies adopt a clear separation of functions, including restrictions on information sharing, and a separation of personnel, for all transactions undertaken for the benefit of Southern Power's shareholders. Similarly, we require the Southern Operating Companies to make clear that Southern Power is to be treated as an Energy Affiliate under the Standards of Conduct and therefore cannot receive any nonpublic transmission information. Second, we modify the Settlement to ensure that Southern Power cannot receive preferential access to transmission information or otherwise receive transmission service on terms not available

to third parties. Finally, we require that all similarly situated merchant generators have access to back up power from the Southern Operating Companies. The Southern Operating Companies have fifteen (15) days to determine whether to accept these and the other changes specified herein. If not, we will reinstate the hearing in this case.¹

4. These modifications will provide immediate benefits to consumers and competitors in the Southern region. To ensure that these important protections are implemented properly, we will direct the Office of Enforcement to conduct an audit of Southern Power and its regulated Operating Company affiliates. This audit should address whether the Southern Operating Companies are fully complying with all the conditions set forth in this order. The audit should also address whether the conditions imposed herein are sufficient to address any remaining opportunities for affiliate abuse as it relates to Southern Power under the Intercompany Interchange Contract (IIC).² The audit report should be completed within fifteen (15) months. We will then notice the report for public comment and, after considering the comments on it, determine what further action is appropriate. If affiliate abuse concerns remain, we will either set such concerns for hearing or require further changes immediately. We will therefore keep this section 206 investigation open until receiving the audit, any public comments on it, and determining what further action is appropriate in this docket.

¹ Article X of the proposed Settlement provides that any Settling Party that is adversely affected by a Commission order modifying the Settlement may terminate the Settlement or, alternatively, indicate that it accepts such modifications.

² For example, the audit should examine whether any of the pooling arrangements (*e.g.*, relating to joint dispatch, opportunity sales, and reserve sharing) can operate in practice to provide an undue preference to any Operating Company, including Southern Power. The audit should also address whether Southern Power is entering into wholesale sales that are not supported by the capacity of its own generating resources, relying instead on the generating capacity of the regulated Southern Operating Companies. We note that section 7.1 of the IIC provides that each Southern Operating Company “is expected to have adequate resources to reliably serve its obligations,” and that any “deficit” with respect to those obligations should only be “temporary.” The audit shall also address whether the Generation Support Service Tariff is adequately addressing the potential for undue discrimination against third parties in the provision of back-up power.

I. Background

5. On May 5, 2005, the Commission instituted an investigation in Docket No. EL05-102-000 to determine whether the role of Southern Power in the Southern Operating Companies' generation "pool" continued to be appropriate and consistent with the Commission's regulations and precedents regarding affiliate abuse.³ Specifically, we set for hearing the following issues: (1) the justness and reasonableness of the IIC, including the justness and reasonableness of Southern Power's continued inclusion in the Southern Operating Companies' pool and whether that inclusion involves undue preference and undue discrimination that adversely affect wholesale competition and wholesale customers in the southeast; (2) whether any of the Southern Companies, including Southern Power, have violated or are violating (either on their own or through their agent, Southern Services) the standards of conduct under Part 358 of the Commission's regulations; and (3) whether the Southern Operating Companies' Code of Conduct is just and reasonable and whether the Code of Conduct should continue to define Southern Power as a "system company."⁴

6. The Chief Judge issued an order which, as modified, established a procedural schedule and set the hearing to begin on June 5, 2006.⁵ On November 18, 2005, after a joint motion was filed by the Southern Operating Companies, Calpine, Coral and Trial Staff, the Chief Judge suspended the procedural schedule for 90 days in order to facilitate a settlement of the case. After 90 days had elapsed, the Chief Judge reinstated the procedural schedule, which included an amended hearing date of September 5, 2006.⁶

7. On March 27, 2006, after reaching a settlement in principle, Southern Services, acting as agent for the Southern Operating Companies, and Coral filed a motion to

³ *Southern Company Services, Inc.*, 111 FERC ¶ 61,146 (Hearing Order), *clarified*, 112 FERC ¶ 61,015 (2005).

⁴ Additionally, the Commission instituted a second hearing in Docket No. EL05-104-000, which is being held in abeyance pending the outcome of Docket No. EL05-102-000, regarding whether the Southern Operating Companies satisfy Parts 2, 3 and 4 of the Commission's market-based rate analysis. *Southern Companies Energy Marketing, Inc.*, 111 FERC ¶ 61,144 (2005).

⁵ *Southern Company Services, Inc.* (July 5, 2005).

⁶ *Southern Company Services, Inc.* (February 16, 2006).

suspend the procedural schedule. The Chief Judge, once again, suspended the procedural schedule to allow the parties time to file a settlement.⁷ On April 11, 2006, the parties to this proceeding filed the Settlement and Explanatory Statement.

8. Article I of the Settlement restricts Southern Power from entering into sales contracts of one year or longer with the other Southern Operating Companies. However, if the affiliate has selected Southern Power as a supplier through the RFP process in compliance with the Commission's guidelines set out in *Allegheny Energy Supply Company, L.L.C.*,⁸ or Southern Power has requested and received relief from this restriction from the Commission, Southern Power may enter into these sales contracts. Additionally, Article I provides that Southern Power can engage in short-term transactions of less than a year with other Southern Operating Companies only within the context of the IIC, which provides that only the Southern Operating Companies collectively, not individual operating companies, can engage in certain off-system opportunity sales.

9. Article II revises the IIC to clarify that only capacity added by a Southern Operating Company as part of the coordinated planning process for the entire Southern Operating Companies' system will be eligible for reserve sharing, thus excluding any capacity that is unilaterally added by a company. Under the IIC reserve sharing system, the Southern Operating Companies receive or make payments related to reserve sharing to the other Southern Operating Companies pursuant to a formula set out in the IIC.⁹

10. Article III revises the IIC to clarify that the Southern Operating Committee (composed of representatives from each of the Southern Operating Companies and Southern Services) has oversight responsibility over generation and has no responsibility over transmission or transmission reliability. Further, Article II adds language to the IIC stating that it is not to operate as a means to share transmission information in violation of the Commission's Standards of Conduct. If the Southern Operating Companies share prohibited information, Article II requires that they immediately post that information on their Open Access Same-Time Information System.

⁷ *Southern Company Services, Inc.* (March 28, 2006).

⁸ 108 FERC ¶ 61,082 at P22-35 (2004) (*Allegheny*).

⁹ Offer of Settlement, Exhibit A, Original Sheet Nos. 28-38.

11. Article IV provides for a revision to the IIC requiring that the transmission service provided to bundled and grandfathered native load customers be comparable to network service provided under the Open Access Transmission Tariff (OATT) and that all transmission service provided to the Southern Operating Companies, other than service to native load, is subject to the OATT.

12. Article V establishes a protocol that restricts communications between Southern Power and the other Southern Operating Companies with regards to planning inputs involving forecasts for fuel, emissions allowances, load, and projected unit operating characteristics. Second, Article V provides that Southern Power shall develop its plan to meet system target reserve levels separate and apart from the other Southern Operating Companies. The Southern Operating Companies will then combine the Southern Power plan with the aggregate plan of all the other companies into a single system plan. Third, Article V revises the IIC to prohibit Southern Power from participating in the review and recommendation of the overall coordinated system plan by the Southern Operating Companies.

13. Article VI revises the IIC to eliminate a portion of the discretion that the Southern Operating Companies have concerning costs and other data inputs into the IIC formula rate. In cases where the Southern Operating Companies retain discretion, they must provide informational filings to the Commission which summarize the decisions that involve the exercise of discretion.

14. Article VII proposes to revise the IIC and the procedure manual to clarify a number of practices. Among those revisions would be the timing of informational filings for changes to the formula rate, procedures for billing adjustments in the event of missing or erroneous data, and the updating of marginal replacement costs for natural gas and oil.

15. Article VIII explains the Generator Support Agreements that the Southern Operating Companies have or will enter into with the merchant generator intervenors, Calpine and Coral. According to the agreements, Southern Companies will provide non-firm energy, not to exceed an aggregate of 500 MW, in the event of a forced outage at

specific facilities owned or controlled by Calpine and Coral.¹⁰ However, service to the Southern Operating Companies' native load, firm wholesale transactions and existing non-firm transactions will have priority over these sales. The merchant generators have the responsibility of arranging the transmission service for this energy.

16. Article IX addresses the implementation of the Settlement.

17. Article X sets out a number of miscellaneous provisions. Specifically, Article X establishes a three-year moratorium on Calpine, Coral and Dalton on asserting claims in Docket Nos. EL05-102-000 and ER03-713-000, and overlapping claims in Docket No. EL05-104-000. Further, Article X provides for the termination of further action in Docket No. EL05-104-000, by any entity, to the extent that the proceeding encompasses the same claims.

18. Trial Staff filed initial comments on May 1, 2006 that do not support or oppose the Settlement, but rather raise two concerns. The first concern relates to the scope of the access to a Generator Support service provided under Article VIII of the Settlement. Trial Staff argues that this service should not be available only to Calpine and Coral, but rather to all other similarly situated generators in the Southern Operating Companies' control area.

19. Trial Staff's second concern with the Settlement relates to the scope of the issues settled by Article X.¹¹ In Trial Staff's opinion, the language of Article X is too broad and therefore has the effect of extinguishing claims beyond those issues set for hearing in Docket No. EL05-102-000. It is Trial Staff's view that, as it is currently written, Article X will impair the rights of parties and non-parties to Docket No. EL05-102-000 to pursue allegations of affiliate abuse and market power in Docket No. EL05-104-000, and the Commission should not permit the parties to restrict the rights of non-parties.

¹⁰ Trial Staff assumes that the "Southern Companies will make these wholesale sales at market-based rates and include them in their Electric Quarterly Reports filed with the Commission," citing Revised Public Utility Filing Requirements, Order No. 2001, 67 Fed. Reg. 31,043, FERC Stats. & Regs. ¶ 31,127 at P 12-21, *reh'g denied*, Order No. 2001-A, 100 FERC ¶ 61,074, *reconsideration and clarification denied*, Order No. 2001-B, 100 FERC ¶ 61,342, *order directing filings*, Order No. 2001-C, 101 FERC ¶ 61,314 (2002). See Trial Staff Initial Comments on Offer of Settlement at n.24.

¹¹ Trial Staff Initial Comments on Offer of Settlement at 11-16.

20. Sawnee Electric Membership Corporation and Coweta-Fayette Electric Membership Corporation (collectively, Sawnee), both parties to the proceeding, filed initial comments on May 1, 2006, that conditionally support the offer of settlement based on a reliance that the settlement does not affect the rights of any party currently contracting with the Southern Operating Companies.

21. Dalton, a party to the Settlement, filed initial comments on April 26, 2006, that conditionally support the Settlement based on a reliance that the Settlement does not affect the rights of any party currently contracting with the Southern Operating Companies.

22. Four non-party individuals, Richard W. Heidorn, a Commission employee and former member of Trial Staff in Docket Nos. EL05-102-000 and ER03-713-000, Ms. Carina Nejsun, Mr. Colin Schroeder and Mr. Andy Weiskoff, separately filed initial comments in opposition to the Settlement.

23. Trial Staff filed reply comments on May 11, 2006, reiterating that it neither supports nor opposes the Settlement. Dalton filed reply comments on May 11, 2006, arguing that Article X does not unreasonably circumscribe the issues in Docket No. EL05-104-000. Southern Operating Companies filed reply comments on May 11, 2006, stating that all parties and participants to the Settlement have either joined in the Settlement, do not oppose the Settlement, or have waived their right to oppose the Settlement by declining to file timely comments. The Southern Operating Companies acknowledge that four individuals have filed comments opposing the Settlement, but declare that, as non-parties, they lack the requisite standing to contest a settlement under Rule 602(g) of the Commission's Rules of Practice and Procedure.¹²

24. On May 23, 2006, the Electric Power Supply Association filed a motion for leave to file reply comments out of time. The Presiding Judge rejected this motion as untimely.¹³

25. On May 24, 2006, the Presiding Judge held oral arguments on the Settlement. By order dated May 30, 2006, the Presiding Judge certified the Settlement as contested. The Presiding Judge recommended that the Settlement be accepted, subject to: (i) generator

¹² 18 C.F.R. § 385.602(g) (2006).

¹³ Order Denying Leave to File Reply Comments Out of Time (May 24, 2006).

support service being made available to all similarly situated generators, and (ii) the Settlement being deemed to resolve only those issues in Docket No. EL05-104-000 that are common to the issues in this case.

II. Discussion

A. Modifications to the Proposed Settlement

26. Southern Power is a competitive generation provider that does not have a franchised obligation to serve; by contrast, the other Southern Operating Companies in the pool are vertically integrated utilities with a franchised obligation to serve at retail. In *Southern Company Services, Inc.*,¹⁴ we granted Southern Power's request to become a member of the Southern Operating Companies' pool. We therefore allowed all the Southern Operating Companies' generating assets, both regulated and competitive, to be operated on an integrated basis. In the Hearing Order, we instituted an investigation into whether this arrangement continued to be just, reasonable and not unduly discriminatory, particularly given the growth of Southern Power as a major competitive supplier in the Southeast.¹⁵

27. Although the Settling Parties attempted to address our concerns regarding affiliate abuse, the Settlement is severely deficient in several respects. Based on the growth of Southern Power, in conjunction with the affiliate concerns discussed below, we are concerned that the IIC arrangement, even as modified by the Settlement, may no longer be just, reasonable or not unduly discriminatory. Accordingly, we will order further modifications necessary to protect against affiliate abuse.

28. We first evaluate the provisions relevant to the potential for affiliate abuse in the sale of power at wholesale, and then turn to those provisions relevant to the potential for affiliate abuse in the provision of transmission service.

¹⁴ 91 FERC ¶ 61,259 (2000).

¹⁵ For example, Southern Power's 2005 annual report indicates that Southern Power owns approximately 5,403 MW of generation assets and had wholesale power sales revenues in 2005 in excess of \$743 million. Southern Power Company, 2005 Annual Report at 2-3.

1. **The Potential for Affiliate Abuse in the Sale of Wholesale Power**

29. Our analysis of the proposed Settlement, as it relates to wholesale power sales, is organized as follows. We first consider whether Southern Power should continue to be classified as a “system company” under the Code of Conduct. Second, we consider the protections necessary when Southern Power makes wholesale sales to the other Southern Operating Companies. Third, we consider the protections necessary when the regulated Southern Operating Companies make wholesale sales to Southern Power. Fourth, we consider the protections necessary when Southern Power makes wholesale sales to third parties. Fifth, we consider the conditions under which the Southern Operating Companies are obligated to provide back up power to nonaffiliated generators.

a. **Southern Power's Role as a System Company under the Code of Conduct**

30. In most holding company power pools, the regulated operating affiliates have traditionally pooled their loads and resources for the benefit of all system customers. Through the joint dispatch of generation and sharing of reserves, these holding company pools have minimized the cost of serving their captive customers. However, we nonetheless have a responsibility to ensure that, when the affiliates in these pools exchange power at wholesale, no affiliate receives an undue preference. We therefore typically require that the affiliates submit a pooling agreement that shares the costs and revenues of these integrated operations on an equitable, cost-of-service basis.¹⁶

31. When a regulated pool adds a competitive affiliate, however, our precedents typically require a separation between regulated and unregulated functions because of the competing interests involved. The wholesale sales of the competitive affiliate are typically undertaken solely for the benefit of the competitive affiliate (and its shareholders), whereas the wholesale sales of regulated affiliates are typically undertaken to reduce the costs borne by native load customers. However, where an affiliation exists between competitive and regulated entities, an incentive exists for the regulated affiliates to subsidize the sales of the competitive affiliate to benefit their mutual shareholders. We therefore impose certain requirements, including a separation of functions and prior approval of any affiliate sales, to ensure that the parent company does not favor the sales of the competitive affiliate over those of the regulated affiliates.

¹⁶ See, e.g., *Louisiana Pub. Serv. Comm'n v. Entergy Serv., Inc.*, Opinion No. 480-A, 113 FERC ¶ 61,282 at P 8 (2005).

32. Specifically, our precedents require that entities with market based rate authority adopt a Code of Conduct that, *inter alia*, requires the separation of competitive and regulated affiliates. In this case, however, because the Commission approved the integration of Southern Power into the Southern Operating Companies' pool, the relevant Code of Conduct treats Southern Power as a "system company" and, hence, allows it to coordinate and communicate as appropriate with the other Southern Operating Companies (also designated as "system companies"). In the Hearing Order, we set for hearing whether this arrangement remained appropriate and, specifically, whether it could lead to affiliate abuse.

33. The proposed Settlement continues to treat Southern Power as a "system company" because it continues to provide for the integration of Southern Power into the Southern Operating Companies' generation pool. However, the Settlement includes one new restriction on the exchange of information. It prohibits the exchange of retail generation planning data between the regulated Southern Operating Companies and Southern Power. This restriction is embodied in a new Communications Protocol.¹⁷

34. We find the Settlement severely deficient in this respect. Retail generation planning is not the only area for potential affiliate abuse. Our precedents require that, where a competitive affiliate enters into transactions for its own benefit, it must separate its functions from those of its regulated affiliates.¹⁸ This separation of functions obligation includes, *inter alia*, a requirement to maintain separate staffs to perform the

¹⁷ Further, the IIC has been amended to reflect the requirements of that Protocol by providing that Southern Power "will not participate in reviewing and recommending generation expansion plans of the other [Southern] Operating Companies or the system, nor will the Southern Power Company representative have access to materials developed in conjunction with the formulation of such generation expansion plans." IIC, section 4.3.

¹⁸ *See, e.g., Montana-Dakota Utilities Co.*, 85 FERC ¶ 61,062 at 61,202 (1998) (a code of conduct must "require that, to the maximum extent practical, the personnel of [the public utility] and affiliated entities operate separately"); *Heartland Energy Services Inc.*, 68 FERC ¶ 61.233 at 62,062 (1994) ("Affiliate abuse takes place when the affiliated public utility and the affiliated power marketer transact in ways that result in a transfer of benefits from the affiliated public utility (and its ratepayers) to the affiliated power marketer (and its shareholders)") (*Heartland*).

sales functions and a restriction on the sharing of any market information.¹⁹ These protections ensure that the parent corporation cannot favor sales by the competitive affiliate over those of the regulated affiliates.

35. We cannot exempt Southern Power from this requirement. Consequently, the Communications Protocol and Code of Conduct must be revised to provide a separation of functions and information sharing protections for *any* function that is undertaken for the benefit of Southern Power's shareholders, *i.e.*, any function except joint economic dispatch and reserve sharing under the IIC.²⁰ The Settlement permits Southern Power to retain the profits for all sales transactions of longer than one week.²¹ Therefore, in its compliance filing, Southern Power must separate this sales function, *i.e.*, maintain a separate staff to perform these sales and adopt a prohibition on the transfer of market

¹⁹ See, e.g., *New England Power Co.*, 91 FERC ¶ 61,013 at 61,053-54(2000); *Long Beach Generation, LLC*, 82 FERC ¶ 61,295 at 62,154 (1998); *Millenium Power Partners, L.P.*, 82 FERC ¶ 61,024 at 61,074 (1998); see also *Heartland*, 68 FERC at 62,064.

²⁰ With respect to the joint dispatch function, Southern Power may have access to information regarding the operation of its own plants; however, it should not have access to information regarding the operation of plants owned by the regulated Southern Operating Companies. Such information (*e.g.*, a nuclear plant outage) could give Southern Power an advantage in making sales in the wholesale market.

²¹ Settlement, Article I; IIC, Sheet No. 62; IIC, section 9.4.2. By contrast, the IIC, as revised by the Settlement, provides that Southern Power will *not* make hourly, daily or weekly energy sales for its own account; rather, all such sales will be made collectively by the Southern Operating Companies, with the resulting revenues being shared among *all* the Southern Operating Companies on a load ratio basis. Settlement, Article I; IIC, Sheet No. 62; IIC, section 9.4.2. This provision protects native load customers because, when Southern Power's generating assets are used to support such sales, the native load customers of the regulated Southern Operating Companies will receive revenue credits they would not otherwise receive without this level of integration under the IIC. The revised IIC also protects native load customers when Southern Power's generating facilities are made available for economic dispatch. When Southern Power assets are used for that purpose, Southern Power recovers only the variable cost of its energy, not a market price. IIC, section 8.2.

information from the regulated Operating Companies to the Southern Power sales personnel.²² We cannot ensure that customers are protected against affiliate abuse without such a requirement.

36. We also find that the Code of Conduct and the Communications Protocol are deficient regarding the role of “employees” subject to their information sharing restrictions. The Protocol prohibits employees having access to retail generation planning information from sharing that information with “employees of Competitive Generation.” “Competitive Generation” is defined, in turn, as “the Competitive Generation organization of the Southern Company Generation, including (but not limited to) Southern Power Company.”

37. These definitions are ambiguous and must be clarified. In particular, the Southern Operating Companies must explain and clarify the role of any “shared” employees of Southern Services. For example, if certain employees of Southern Services perform a “planning” function for *both* the Southern Operating Companies and Southern Power, then a fundamental purpose of the Code of Conduct and the Communications Protocol – to restrict the flow of certain information from the regulated function to the competitive function – cannot be achieved. For any function covered by the Communications Protocol (planning and any transactions undertaken solely for the benefit of Southern Power and its shareholders, as discussed above), *separate* staffs must perform those functions for Southern Power, on the one hand, and the other Southern Operating Companies, on the other. We therefore direct the Southern Operating Companies to revise the Code of Conduct, Communications Protocol, and associated provisions of the IIC, accordingly.

b. Power Sales from Southern Power to the Other Southern Operating Companies

38. Sales between affiliates require prior approval under section 205 to ensure that a competitive affiliate is not granted an undue preference.²³ When the competitive affiliate

²² This prohibition on information sharing includes any participation by Southern Power in the Operating Committee. Therefore, section 4.3 of the IIC should be revised to provide that Southern Power cannot receive market information from the regulated Southern Operating Companies through its participation in the Operating Committee.

²³ See *Aquila, Inc.*, 101 ¶ 61,331 at P12 (2002); *Boston Edison Company Re: Edgar Electric Energy Company*, 55 FERC ¶ 61,382 at 62,167-69 (1991); *Allegheny*, 108 FERC ¶ 61,082 at P 18.

is making a sale to a regulated affiliate, our principal concern is that the price is set too high – *i.e.*, above the price of other available alternatives – because of the incentive to favor profits to shareholders of the competitive affiliate over the interests of the native load ratepayers of the regulated affiliate.

39. The proposed Settlement contains two provisions relevant to this issue. First, the Settlement provides that “Southern Power may enter into new long-term (one-year or longer) sales transactions with the other [Southern] Operating Companies only when it has been selected pursuant to a formal [RFP] process conducted in a manner that complies with the four guidelines described by the Commission in [*Allegheny*].”²⁴

40. Second, the Settlement provides that no Southern Operating Company can receive payment for “capacity” resources if those resources were not jointly planned by all the companies.²⁵ This provision is particularly relevant to Southern Power, which will not, as described, conduct joint generation planning with the other Southern Operating Companies. Therefore, under the Settlement and revised IIC, Southern Power cannot “unilaterally undertake to build or otherwise procure new capacity resources, automatically include them in the IIC reserve sharing mechanism, and receive reserve sharing payments from the other [Southern] Operating Companies.”²⁶

41. These two restrictions provide safeguards against affiliate abuse and we therefore approve them.

42. However, we note that the Settlement and IIC are unclear regarding the treatment of sales that are shorter than one year but longer than the transactions that occur pursuant to joint economic dispatch.²⁷ We are concerned that Southern Power may make negotiated sales to the other Southern Operating Companies at rates that have not been approved by the Commission and that may constitute an undue preference. We will

²⁴ Settlement, Article I.

²⁵ Settlement, Article II.

²⁶ *Id.*

²⁷ When Southern Power sells energy to the other Southern Operating Companies through the process of joint economic dispatch, Southern Power is paid only its variable operating costs, not the market price for energy. IIC, section 8.2. This protects the native load customers of the regulated Operating Companies from excessive charges.

therefore require that the IIC be modified to add an explicit requirement for pre-approval of any such sale. The same is true, as discussed below, for any such sale from a regulated Southern Operating Company to Southern Power.

c. **Power Sales from the regulated Southern Operating Companies to Southern Power**

43. In contrast to the concerns that arise when a competitive affiliate sells to a regulated affiliate, when a regulated affiliate sells to a competitive affiliate our principal concern is that the price is set *too low* – *i.e.*, below the market price of power – thereby allowing the competitive affiliate to resell the power at market prices to the benefit of its shareholders.

44. The IIC contains two provisions relevant to this issue. First, as explained above, energy that is provided from one Southern Operating Company to another through joint economic dispatch (including energy provided to Southern Power) is priced at the variable cost of that energy. This provision is appropriate because it treats all the Southern Operating Companies, including Southern Power, the same and is consistent with the traditional pricing of energy under integrated pooling arrangements.

45. Second, the IIC requires that energy provided by one Southern Operating Company to another to support its “opportunity sales” is provided at variable cost.²⁸ This provision also is nondiscriminatory because it treats all Southern Operating Companies the same – *i.e.*, Southern Power is paid only its variable costs if its generation supports opportunity sales by the regulated affiliates, and vice versa.

46. Finally, as discussed in the previous section, the IIC is unclear as to whether sales between the Southern Operating Companies can occur other than through the process of joint economic dispatch. To ensure that no such sales can be made without prior Commission approval, we will require that the IIC be modified to add an explicit requirement that any sales between the Southern Operating Companies outside the process of joint economic dispatch be submitted to the Commission for prior approval under section 205.

²⁸ IIC, section 8.1-8.2; Rate Computation Manual, section 3.3.

d. Power Sales to Third Parties

47. The Commission's principal concern related to sales to third parties is that the regulated Southern Operating Companies continue to compete for such sales and thereby earn potential revenue credits to reduce the rates of native load customers. Put another way, the IIC must not allow the Southern Operating Companies to favor sales by Southern Power (where profits accrue to shareholders) over sales by the regulated Southern Operating Companies.

48. As discussed above, the Settlement is severely deficient in this respect. It fails to establish a separation of functions for sales made by Southern Power for the benefit of its shareholders. The Southern Operating Companies therefore have the incentive and ability to favor Southern Power in making such sales. To remedy this, we will, as discussed above, require that, for any sales that are not undertaken for the benefit of the entire pool, the Southern Operating Companies must adopt a separation of functions – *i.e.*, the personnel engaging in such sales for Southern Power must be separated from the regulated operations and not have access to market information from the regulated Operating Companies.

49. We also will require one clarification regarding short-term sales. The Addendum to the IIC²⁹ requires that all hourly, daily and weekly opportunity sales will be made by the Southern Operating Companies collectively through the pool, rather than by the individual Southern Operating Companies.³⁰ It is not clear, however, that this provision has been adequately reflected in the body of the IIC. Specifically, section 9.4.2, which governs “Pool Sales of Capacity and Energy,” has not been amended to reflect this requirement. It is necessary that section 9.4.2 specifically incorporate this commitment because section 9.4.2 provides the mechanism by which the profits from such sales are shared among all the Southern Operating Companies on a load ratio basis. We will therefore require that section 9.4.2 be modified to reflect the commitment set forth in the Addendum.

²⁹ Revised Sheet 62 n.2.

³⁰ The Presiding Judge summarized Article I as follows: “Article I provides that Southern can engage in short-term transactions of less than a year with other Southern [O]perating [C]ompanies only within the context of the IIC which provides that only Southern collectively, not individual operating companies, can engage in off-system opportunity sales.” We do not read the Settlement as requiring all opportunity sales to be made only by the Southern Operating Companies collectively; rather, that commitment is specifically limited to sales of one week or less.

e. **Sales of Back up Power to Competing Generators**

50. Article VIII of the proposed Settlement requires the Southern Operating Companies to offer a “Generator Support service” to Coral and Calpine, the two unaffiliated merchant generators that are signatories to the Settlement. Trial Staff filed comments arguing that this service should be made available to all similarly situated generators. The Presiding Judge agreed, finding that “[a]ny interested merchant generator in the Southern control area may request the same backup service being offered to Calpine and Coral under the same skeletal outline set forth in Article VIII of the offer of settlement.” The Presiding Judge also found that “[t]he rates for all should be comparable, market-based,” and “reflected in Southern’s EQR reports.” The Commission agrees and therefore directs that the Settlement be modified accordingly. Specifically, the Southern Operating Companies shall file a Generation Support Service Tariff that sets forth the terms and conditions of the service, including, but not limited to, the firmness of the service and the procedures for requesting the service. In addition, the Tariff should specify the procedures that would apply if the parties cannot agree on a “comparable, market-based rate.”

2. **The Potential for Affiliate Abuse in the Provision of Transmission Service**

51. The IIC we approved in 2000 does not exempt the Southern Operating Companies from complying with Order Nos. 888 and 2004 – the rules requiring that transmission service be provided under an OATT and that transmission and merchant personnel be separated under a Standards of Conduct. Nevertheless, we became concerned that the level of integration associated with the Southern Operating Companies’ pool was creating the potential for violations of the Standards of Conduct, and hence the obligation to provide transmission service on a nondiscriminatory basis, and therefore set that issue for hearing.

52. The Settlement contains two provisions that address the potential for affiliate abuse in the provision of transmission service. First, Article IV of the Settlement provides that “the [Southern] Operating Companies must obtain all necessary transmission service in a manner consistent with the requirements of Order No. 888 and its progeny.” Specifically, with respect to Southern Power, the Settlement provides that “all transmission service provided to Southern Power . . . is subject to the OATT in all respects, including adherence to the same rates, terms and conditions applicable to other market participants in connection with such service.”

53. Second, the Settlement provides certain commitments regarding compliance with our Standards of Conduct adopted in Order No. 2004. As a general matter, the Settlement seeks to ensure that membership in the Southern Operating Companies' generation pool pursuant to the IIC will not provide a means for Southern Power to obtain preferential access to transmission information. Specifically, Article III provides that the Operating Committee, the entity responsible for providing guidance and direction under the IIC, "has no transmission-related duties or responsibilities (including transmission reliability)." Article III also provides that "the IIC (including, but not limited to, Operating Committee membership) is not to serve as a means whereby transmission information is shared in a manner contrary to the Commission's Standards of Conduct."

54. We will require certain revisions to the Settlement to ensure that Southern Power cannot receive an undue preference as it relates to transmission service. Not all the protections embodied in the Settlement have been incorporated into the IIC and therefore we will require certain corresponding modifications to the IIC. First, as indicated, Article IV of the Settlement provides that "all transmission service provided to Southern Power. . . is subject to the OATT in all respects, including adherence to the same rates, terms and conditions applicable to other market participants in connection with such service." However, the relevant section of the IIC, section 11.2, does not include this commitment. We therefore require that section 11.2 be modified to include the commitment ensuring that Southern Power takes all its transmission service under the OATT. This commitment is important because Southern Power has no bundled retail load or grandfathered agreements that could be served outside the OATT.

55. Second, as indicated, Article III provides that nothing in the IIC shall "serve as a means whereby transmission information is shared in a manner contrary to the Commission's Standards of Conduct." However, the relevant section of the IIC, section 4.4, does not include this specific commitment. We will therefore require that section 4.4 be revised to state, as reflected in the Settlement, that "the IIC (including, but not limited to, Operating Committee membership) is not to serve as a means whereby transmission information is shared in a manner contrary to the Commission's Standards of Conduct." Further, we will require that section 4.4 be revised to make clear that Southern Power is treated as an Energy Affiliate under the Standards of Conduct and therefore cannot receive any nonpublic transmission information.

56. With these modifications, it is now clear that *all* transmission service to Southern Power will be provided pursuant to the OATT and *nothing* in the IIC will permit the sharing of transmission information contrary to the Standards of Conduct. This will ensure that Southern Power does not receive an undue preference in the provision of transmission service.

B. Relationship to Docket No. EL05-104-000

57. On the same day that the Commission instituted an investigation in this case, the Commission initiated an investigation under section 206 to determine whether the Southern Operating Companies satisfy Parts 2, 3 and 4 of the Commission's test for granting market based rates relating to transmission market power, barriers to entry, and affiliate abuse, respectively. However, because many of the same issues would be considered in this docket, the Commission held the investigation in EL05-104-000 in abeyance pending the outcome of this case.

58. Article X of the Settlement provides that the Settlement “extinguishes any and all claims in Docket No. EL05-102 and ER03-713, and the overlapping claims in Docket No. EL05-104, concerning the ability of Southern Companies or any Southern Operating Company to afford an undue preference to Southern Power through the IIC, through the entities' corporate structure, through affiliate transactions, and/or through access to competitively sensitive information.” Trial Staff asserted that this provision was too broad and would inappropriately limit the issues that could be considered in Docket No. EL05-104. The Presiding Judge agreed and, based on certain representations by the Southern Operating Companies, found that “the language in Article X of the offer of settlement must reflect that the issues in Docket No. EL05-104-000 which are impacted by this Offer of Settlement are only those which are common to Docket No. EL05-102-000.”

59. The Commission generally agrees with the Presiding Judge, but clarifies that recommendation. This case concerns whether the corporate structure and affiliate transactions permitted by the IIC are just, reasonable and not unduly discriminatory. In this Order, we undertake a comprehensive review of the proposed Settlement, including making significant modifications and ordering an audit of any remaining opportunities for affiliate abuse under the IIC. Therefore, we intend that the issues resolved by this order should not be relitigated in Docket No. EL05-104. However, to the extent that there are affiliate issues unrelated to matters decided herein, and are relevant to the investigation commenced in Docket No. EL05-104, those claims may be addressed in Docket No. EL05-104, along with any remaining issues in that docket. To determine the appropriate scope of that proceeding, the Commission intends to issue a subsequent order in Docket No. EL05-104 within 90 days seeking comment on the issues that may remain appropriate for investigation in that docket, as well as the proper procedures for addressing those issues.

C. Audit

60. The proposed Settlement, with the significant modifications ordered herein, will provide immediate benefits to consumers and competitors in the Southern region. To ensure that these important protections are implemented properly, we will direct the Office of Enforcement to conduct an audit of Southern Power and its regulated Operating Company affiliates. This audit should address whether the Southern Operating Companies are fully complying with all the conditions set forth in this order.³¹ The audit should also address whether the conditions imposed herein are sufficient to address any remaining opportunities for affiliate abuse under the IIC as it relates to Southern Power. The audit report should be completed within fifteen (15) months. We will then notice the report for public comment and, after considering the comments on it, determine what further action is appropriate. If affiliate abuse concerns remain, we will either set such concerns for hearing or require further changes immediately. We will therefore keep this section 206 investigation open until receiving the audit, any public comments on it, and determining what further action is appropriate in this docket.

The Commission orders:

(A) The Settlement is accepted in part, and modified as discussed in the body of this Order.

(B) The Southern Operating Companies shall inform the Commission whether they accept these modifications within fifteen (15) days of this Order.

³¹ As noted earlier, the audit should examine, for example, whether any of the pooling arrangements (*e.g.*, relating to joint dispatch, opportunity sales, and reserve sharing) can operate in practice to provide an undue preference to any Operating Company, including Southern Power. The audit should also address whether Southern Power is entering into wholesale sales that are not supported by the capacity of its own generating resources, relying instead on the generating capacity of the regulated Southern Operating Companies. We note that section 7.1 of the IIC provides that each Southern Operating Company “is expected to have adequate resources to reliably serve its obligations,” and that any “deficit” with respect to those obligations should only be “temporary.” The audit shall also address whether the Generation Support Service Tariff is adequately addressing the potential for undue discrimination against third parties in the provision of back-up power.

(C) If the modifications are accepted, the Southern Operating Companies shall submit a compliance filing within thirty (30) days of this Order making such modifications to the IIC and related documents as necessary to reflect the findings in this Order.

(D) If the modifications are accepted, the Office of Enforcement shall conduct an audit as described in this Order.

(E) If the Southern Operating Companies do not accept these modifications, the Presiding Judge shall set an appropriate procedural schedule for continuing the hearing in this case.

By the Commission. Commissioner Kelly concurring with a separate statement attached.
Commissioner Moeller not participating.

(S E A L)

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Southern Company Services, Inc.
Alabama Power Company
Georgia Power Company
Gulf Power Company
Mississippi Power Company
Savannah Electric and Power Company
Southern Power Company

Docket Nos. EL05-102-000
EL05-104-000
ER03-713-000

(Issued October 5, 2006)

KELLY, Commissioner, *concurring*:

It is well-known that the process leading up to the filing of this settlement was highly unusual and caused great controversy. As stated by the Presiding Judge, while addressing a member of the Commission's Trial Staff during the Oral Argument established in this proceeding: "[Y]ou and I will admit that this is a most unusual circumstance. . . . I've been here almost 15 years, and I've never been involved in a case in which somebody representing the Commission, other than trial counsel, negotiated a settlement. And so I think your position is unique and maybe even dangerous, and I recognize that, and I want to acknowledge that for the record."¹

I think it is important to note that this Order does not condone or endorse that questionable process.

Suedeem G. Kelly

¹ See Transcript of Oral Argument, *Southern Company Services, Inc.*, Docket No. EL05-102-000 (May 24, 2006), at 66.