Technical Conference on Seams Issues for RTOs and ISOs in the Eastern Interconnection

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Before the Federal Energy Regulatory Commission

Good Morning. My name is Mike Beer, and I am Vice President for Federal Regulation and Policy at E.ON U.S. I would like to thank the Commission for this opportunity to inform the Commission regarding cost allocation issues among RTOs, their members, and non-member border utilities.

Through the experiences of its public utility subsidiaries, Louisville Gas & Electric Company ("LG&E") and Kentucky Utilities Company ("KU"), E.ON U.S. has a unique perspective on the issue of cost allocation among RTOs and non-member border utilities. On October 7, 2005, LG&E and KU filed an application before this Commission for permission to withdraw from the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO"). At that time, LG&E and KU had been Midwest ISO Day 2 market participants for over six months. The Commission approved E ON U.S.'s withdrawal from the Midwest ISO on March 17, 2006. On September 1, 2006, LG&E and KU transferred its Midwest ISO status from Transmission Owning member of the Midwest ISO to external market participant.

Let me emphasize that E.ON U.S.' withdrawal from the Midwest ISO should not be viewed as indictment of the entire RTO construct. Based upon an analysis that included examination of those Midwest ISO services for which E.ON U.S. paid, but believed to be neither required nor operationally desired, E.ON U.S. made a business decision. E.ON U.S. determined that ongoing membership in the Midwest ISO as a transmission owner would not be the most cost effective means to continue providing the high levels of service our customers have come to expect. E.ON U.S.' continued membership in the Midwest ISO did not provide our utility ratepayers with benefits sufficient to offset the increased costs of Midwest ISO membership. The company’s decision was confirmed in approvals received from this Commission, as well as the Kentucky Public Service Commission. E.ON U.S. fully understands how other utilities operating in other jurisdictions with their own unique integrated resource portfolios can arrive at a different business decision, and E.ON U.S. appreciates how the RTOs may be seen to be providing value in excess of costs to entities that elect to remain within an RTO footprint.

Since September 1, 2006, E.ON U.S. has delegated certain tasks to a Commission-approved Independent Transmission Organization (“ITO”) and Reliability Coordinator. These roles are fulfilled by Southwest Power Pool, Inc. (“SPP”) and the Tennessee Valley Authority (“TVA”), respectively, and ensure that the E.ON U.S. transmission system is operated in an open, non-discriminatory, and reliable manner.

Due to having operated as both an RTO transmission-owning member and an external market participant, E.ON U.S. has perhaps a unique vantage point from which to discuss the RTO/non-RTO seams issues on today’s agenda.

Current Costs: We Have Paid, We Do Pay, We Will Continue to Pay

In the withdrawal proceeding, the issue was raised that E.ON U.S. may become a “free rider” on the Midwest ISO system. The allegation was that E.ON U.S. would receive “positive externality benefits” by virtue of being “on the border of” the Midwest ISO, without providing financial support for the alleged benefits received. Some have suggested that border utilities such as E.ON U.S. should be required to compensate the Midwest ISO for these alleged benefits. E.ON U.S. firmly rejects the notion that border utilities receive any special services for which the Midwest ISO is entitled to recover costs.

E.ON U.S. does not understand how it is receiving a free ride on the Midwest ISO system as a border utility. To the contrary, if E.ON U.S. or any other non-member wishes to sell to or purchase energy from a Midwest ISO member, each and every transaction is subject to Midwest ISO charges. The transmission rates paid for such transactions in every instance include recovery of the Midwest ISO's various administrative costs. Transmission rates are also based on the Midwest ISO's revenue requirements and provide the Midwest ISO transmission-owning members a return on transmission facilities dedicated to the Midwest ISO. For example, any such non-RTO member must pay the so-called "through and out" rate to purchase power from the MISO Day 2 market. The through and out rate is set well above the cost of service and has been the subject of much debate. RTOs now appear to argue for additional costs to border entities above and beyond this non-cost-based rate. Through these transmission rates, border utilities such as E.ON U.S., pay for all of the services provided to them by the Midwest ISO, to the extent they transact in the Midwest ISO.

Border utilities that receive transmission service from RTOs pay for that service through their transmission rates. To date, RTOs have not identified any special services provided to border utilities beyond those for which transmission customers are already being charged. Until such services are identified and supported by a Section 205 filing before this Commission, and the Commission accepts such rates for filing as just and reasonable, the threat of additional RTO costs on border utilities should be removed. In fact, E.ON U.S. remains concerned that if the Commission, in the absence of specific factual evidence to support vague RTO assertions, does not definitively put this issue to rest, RTOs may conclude that they have justification to unduly discriminate against border utilities with regard to operations and services. Although E.ON U.S. has no specific examples to provide to the Commission at present, the company is concerned that a permissive atmosphere with respect to this perceived "issue" could lead to such behavior in the future.

Notably, even if the Midwest ISO is able to demonstrate that it provides uncompensated non-reciprocal benefits and services to border utilities, E.ON U.S. should nonetheless be exempt from paying any increased rates. E.ON U.S. paid the Midwest ISO an exit fee of almost $34 million. This fee represents the present value of past and future costs of Midwest ISO programs that were completed or planned for prior to E.ON U.S.' withdrawal. Even if the Midwest ISO attempts to levy a charge on border utilities to recoup some costs, E.ON U.S. should be exempt from those charges to the extent that it has already paid such costs.

Specific Operational and Commercial Seams Issues

As I mentioned earlier, TVA acts as the Reliability Coordinator for the E.ON U.S. transmission system. TVA is a signatory to the Joint Reliability Coordination Agreement ("JRCA"), along with the Midwest ISO and PJM Interconnection, LLC ("PJM"). The purpose of the JRCA is to allow information exchange between and among the parties, and to establish congestion management protocols for common flowgates among the parties. Under Section 2.3.5 of the JRCA, "[e]ach Party will perform this Agreement with respect to each Control Area for which the Party serves as transmission provider, and with respect to each Control Area *for which it serves as Reliability Coordinator* . . . ." (Emphasis added.) In other words, because TVA is E.ON U.S.' Reliability Coordinator, the E.ON U.S. transmission system is subject to the information exchange and congestion management protocols of the JRCA.

During the withdrawal proceeding, it was suggested that E.ON U.S. should have to compensate the Midwest ISO and/or PJM for the commercial value of the information and operational assistance provided by the Midwest ISO and/or PJM under the JRCA. However, the JRCA clearly states in Section 4.2 that "[e]ach Party shall bear its own cost of providing the data and information to the other Parties as required . . . under this Agreement." The parties are also required to bear their own costs of compliance with the Congestion Management Protocol or reciprocal coordination of flowgates under the JRCA (Article 6), or costs of compliance with the Emergency Procedures under the JRCA (Article 9). Both PJM and the Midwest ISO act as the Reliability Coordinator for entities other than their RTO members. If PJM and the Midwest ISO propose to charge E.ON U.S. for providing "services" under the JRCA, then TVA should be allowed the same opportunity to charge PJM and the Midwest ISO's reliability clients for all reciprocal services. To proceed otherwise and charge only E.ON U.S. for such information and coordinated congestion management provided by the RTOs would be unduly discriminatory. Given the reciprocal nature of these services, however, it is entirely appropriate that PJM and the Midwest ISO recover these costs from their own reliability clients, just as TVA recovers them through the fees charged to E.ON U.S.

Importantly, although PJM and the Midwest ISO appear to be the moving complainants regarding border issues, it is E.ON U.S.' flowgates that are now at the mercy of the Midwest ISO/PJM's scheduling under the auspices of the JRCA. Under the JRCA, the Midwest ISO and PJM submit their day-ahead schedules, and TVA and SPP must then use that information to calculate the Available Transfer Capability ("ATC") on E.ON U.S.' transmission system. It is not known until real-time operations commence whether any transmission capacity will be available for third parties to use on the E.ON U.S. transmission system. If anything, operating under the JRCA has worked to E.ON U.S.' detriment, not benefit.

The PJM/Midwest ISO scheduling practices I just mentioned continue to have the unfortunate impact of limiting the ability of E.ON U.S. and other border entities to participate in the Day-Ahead market. The Midwest ISO has to commit more units on a post Day-Ahead basis as a result. This inflates the amount of Midwest ISO's revenue sufficiency guarantee ("RSG") uplift required by Midwest ISO to pay to committed generation. Furthermore, the uplift amount cannot be estimated until a week after the fact when the Midwest ISO issues the first round of settlement statements, thus masking the true value of real-time energy. The locational marginal prices under this system thus fail to communicate value to real-time market participants – not only within Midwest ISO, but in neighboring non-RTO wholesale markets. The fact that as of March 15, 2007 Midwest ISO began assessing RSG uplifts to all imports, including those that can be scheduled prior to Midwest ISO's unit commitment decision, further exacerbates this problem.

I raise these specific seams issues not to complain about the consequences of our business decision, which we still believe to be entirely correct, or to advocate here on matters more appropriately addressed in different dockets. Rather, my point is that if the Commission looks at the alleged positive externalities of RTO markets and decides to compensate the benefactors, it must also examine the negative externalities of such markets as well, and concomitantly compensate burdened parties.

Conclusion

The issues I have addressed here are just a few of those currently facing utilities that border RTOs. On the horizon, E.ON U.S. is concerned that RTOs may use the context of "regional planning," under Order No. 890 as a means to impose additional costs on border utilities without providing any additional services. For now, however, E.ON U.S. believes that it has compensated, and is compensating, the Midwest ISO appropriately for those services that E.ON U.S. receives from the Midwest ISO. Only if a clearly-defined service can be identified and its costs supported under a Section 205 rate filing, should the Midwest ISO be entitled to additional compensation from border utilities. If these costs are not included in the transmission owners' revenue requirement, then all users of the system should have to pay their pro rata share of the cost – members and non-members. Pointedly, E.ON U.S. does not believe that it is receiving, or will receive at any time, such services that would warrant additional charges.

Thank you, and I am happy to entertain any questions you may have.