

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Market-Based Rates for Wholesales Of
Electric Energy, Capacity and
Ancillary Services By Public Utilities

RM04-7-007

**RESPONSE OF THE TRANSMISSION ACCESS
POLICY STUDY GROUP IN OPPOSITION TO THE
COMPLIANCE WORKING GROUP'S AMENDED
REQUEST FOR CLARIFICATION**

Pursuant to Rules 211, 212 and 213 of the Commission's Rules of Practice and Procedure¹, and the Commission's October 30, 2009 Notice, the Transmission Access Policy Study Group² ("TAPS") files its comments in opposition to the Compliance Working Group's ("CWG") October 28, 2009 Amended Request for Clarification ("CWG Request"). Although styled a Request for Clarification, the CWG ask FERC to modify fundamentally the current MBR protections against affiliate abuse by "interpret[ing] the Affiliate Restrictions to permit sharing of employees who are not 'transmission function employees' or 'marketing function employees' – the same sharing that is now permitted under the Standards of Conduct." CWG Request at 2. The functional effect, if that request were granted, would be to permit closer and problematic

¹ 18 CFR §§ 385.211, 212 and 213. Functionally, the CWG have moved the Commission to revise fundamentally the MBR Affiliate Restrictions, and TAPS should be able to answer in opposition as a matter of right.

² TAPS is chaired by Roy Thilly, CEO of Wisconsin Public Power, Inc. ("WPPI"). Current members of the TAPS Executive Committee include, in addition to WPPI, representatives of: American Municipal Power-Ohio; Blue Ridge Power Agency; Clarksdale, Mississippi; ElectriCities of North Carolina, Inc.; Florida Municipal Power Agency; Illinois Municipal Electric Agency; Indiana Municipal Power Agency; Madison Gas & Electric Co.; Missouri River Energy Services; Municipal Energy Agency of Nebraska; Northern California Power Agency; and Southern Minnesota Municipal Power Agency.

ties between those involved in marketing power under MBR authority, and those involved in marketing power to captive customers.

The CWG ask FERC to replace the MBR affiliate restrictions with the transmission Standards of Conduct affiliate restrictions. The Standards of Conduct restrictions are designed to protect against the particular problem of affiliate transmission abuses. FERC's MBR affiliate restrictions are intended to achieve different purposes. The MBR affiliate restrictions are intended to protect against "transferring captive customer benefits to stockholders through a company's non-regulated power sales business." Order 697, P 544.³ As explained more fully below, it makes no sense to replace the MBR affiliate restrictions with Standards of Conduct intended to protect against the very different problem of affiliate transmission abuse. The requested CWG relief would largely gut the existing MBR Affiliate Restrictions and leave no meaningful protections in their place. TAPS has been concerned in the past about the abuse of market power associated with MBR rate authority, and opposes CWG's proposed radical revision of the Commission's current MBR Affiliate Restrictions.

³ Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), [2006-2007 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,252 ("Order 697"), *clarified*, 72 Fed. Reg. 72,239 (Dec. 20, 2007), 121 F.E.R.C. ¶ 61,260 (2007), *on reh'g*, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), III F.E.R.C. Stat. & Regs. ¶ 31,268, *clarified*, 124 F.E.R.C. ¶ 61,055 (2008), *on reh'g*, Order No. 697-B, 73 Fed. Reg. 79,610 (Dec. 30, 2008), III F.E.R.C. Stat. & Regs. ¶ 31,285, *on reh'g and clarification*, Order No. 697-C, 74 Fed. Reg. 30,924 (June 29, 2009), III F.E.R.C. Stat. & Regs. ¶ 31,291, *corrected*, 128 F.E.R.C. ¶ 61,014 (2009), *petition for review filed sub nom. Mont. Consumer Counsel v. FERC*, No. 08-71827 (9th Cir. filed May 1, 2008).

I. INTRODUCTION AND BACKGROUND

A. *Order 717 and the Adoption of an Employee Functional Approach as Opposed to the Prior Corporate Separation Approach for Purposes of the Transmission Standards of Conduct*

In Order 717, Standards of Conduct for Transmission Providers,⁴ FERC adopted a new approach for protecting against affiliate transmission abuse. Under its prior Standards of Conduct FERC required a separation of employees based upon their corporate affiliation, as distinguished from their job function, and described this as a “corporate separation approach.” Order 717, P 129. Under the pre-Order 717 Standards of Conduct “any employee of a marketing or energy affiliate [was] prohibited from interacting with transmission function employees.” Order 717 P 34. This absolute prohibition was considered by some to be unworkable and thus FERC modified its approach to permit the sharing of a substantial number of individuals between the marketing affiliate and the transmission affiliate, such as directors, officers, attorneys, certain consultants and engineers, etc., provided that those individuals did not serve as an impermissible conduit of transmission information that could advantage merchant sales.

FERC replaced the corporate separation approach with the employee functional approach. The new “Standards restrict[] the category of employees who must function independently from transmission function employees to those who actively and personally engage in marketing function.” *Id.* This new approach eliminates the concept of excepted shared employees. Every affiliated corporate employee (or officer, director

⁴ Standards of Conduct for Transmission Providers, Order No. 717, 73 Fed. Reg. 63,796 (Oct. 27, 2008), III F.E.R.C. Stat. & Regs. ¶ 31,280 (“Order 717”), *on reh'g*, Order No. 717-A, 74 Fed. Reg. 54,463 (Oct. 22, 2009), III F.E.R.C. Stat. & Regs. ¶ 31,297, *clarified*, Order No. 717-B, 74 Fed. Reg. 60,153 (Nov. 20, 2009), 129 F.E.R.C. ¶ 61,123 (2009).

or consultant) is free to interact with every other employee, except transmission function employees must be kept independent from merchant function employees.⁵ In addition, under the “No Conduit Rule,” “[a] transmission provider is prohibited from using anyone as a conduit for the disclosure of non-public transmission function information to its marketing function employee.” 18 C.F.R. § 358.6(a).

Not surprisingly, although the Commission replaced the corporation affiliation rule with the independent functioning rule, it adopted an independent functioning rule intended to protect against the same root problem. The Commission believes that the new transmission Standards of Conduct approach “preserves protection against affiliate abuse, as it is those employees who are making wholesale *sales* of electricity ... who can improperly benefit from transmission function information obtained from the affiliated transmission provider.” Order 717, P 77.

B. The Current MBR Affiliate Restrictions

The current MBR affiliate restrictions, like the prior Standards of Conduct affiliate restrictions, employ a corporate separation approach. Importantly, and regardless of approach, the MBR affiliate restrictions are intended to effectuate a very different separation of employees and for very different purposes as compared to the transmission provider Standards of Conduct. The MBR affiliate restrictions are intended to protect against “transferring captive customer benefits to stockholders through a

⁵ The definition of marketing function is quite specific, and in many respects quite narrow.

[I]n the case of public utilities and their affiliates, the sale for resale in interstate commerce, or the submission of offers to sell in interstate commerce, of electric energy or capacity, demand response, virtual transactions, or financial or physical transmission rights, all as subject to an exclusion for bundled retail sales, including sales of electric energy made by providers of last resort (POLRs) acting in their POLR capacity....

18 C.F.R. § 358.3(c)(1).

company's non-regulated power sales business." Order 697, P 544. An example of such affiliate abuse is collusion between a market-regulated power sales affiliate and a franchised public utility intended to steer a particular sale to the benefit of the MBR seller as opposed to the affiliate public utility for the benefit of parent company stockholders and at the expense of the public utility's captive customers. Order 697, P 596. This kind of collusion, and indeed most if not all of the affiliate abuses targeted by the MBR affiliate restrictions have nothing to do with undue preferences relating to transmission. In order to protect against MBR affiliate abuses, the Commission requires that "the employees of a market-regulated power sales affiliate must operate separately from the employees of any affiliated franchised public utility with captive customers." 18 C.F.R. § 35.39(c)(2).

Unlike the Standards of Conduct, which are intended to prevent the improper sharing of "marketing function information" and "transmission functioning information," the affiliate restrictions are intended to prevent the improper sharing of "market information." Market information is defined functionally, and expansively:

Therefore, we clarify that, as a general matter, the definition of "market information" includes information that, if shared between a franchised public utility and a market-regulated affiliate, may result in a detriment to the franchised public utility's captive customers. Therefore, market information includes, but is not limited to, information concerning sales and purchases that will not be made such as in circumstances where parties have discussed a potential contract but no agreement has been reached.

Order 697, P 593. *See* 18 C.F.R. § 35.36(a)(8) (definition of market information including illustrative and non-exhaustive examples). The definition of MBR-related "market information" does not encompass transmission information because the

Standards of Conduct already protect against the improper sharing of affiliate transmission information.

[T]he definition does not prohibit the sharing of transmission information. The standards of conduct already prevent improper disclosures of non-public transmission information by a transmission provider to its marketing and energy affiliates, which would include both the franchised public utility with captive customers and the market-regulated power sales affiliate.

Order 697, P 592.

There was, however, one intended area of overlap between the MBR affiliate restrictions and the transmission provider Standards of Conduct. In Order 697 (at P 564) the Commission clarified:

that the types of permissibly shared support employees under the standards of conduct are the types of permissibly shared support employees that will be allowed under the [Standards of Conduct] affiliate restrictions in § 35.39(c)(2)(c). Such employees include those in legal, accounting, human resources, travel and information technology.

The CWG argue that because FERC has eliminated the concept of shared employees under the Standards of Conduct “[t]here is now a ‘void’ or ‘null set’ in the [MBR] Affiliate Restrictions.” CWG Request at 2. While it is true that FERC can longer rely upon the contemplated “affiliate restrictions in § 35.39(c)(2)(c)” to identify specifically the permitted shared employees under MBR affiliate restrictions, there is somewhat less of a substantive void than meets the eye given FERC’s elucidation of the kinds of permitted shared support individuals. A specific elucidation of permitted shared support employees may be desirable, but this would appear to be a defined and limited issue that the Commission can readily address without the kind of massive and problematic revisions sought by the CWG.

II. THE COMMISSION SHOULD REJECT THE CWG'S PROPOSED REVISIONS OF THE MBR AFFILIATE RESTRICTIONS BECAUSE THE CWG APPROACH, IF ADOPTED, WOULD RENDER THE MBR AFFILIATE RESTRICTIONS INEFFECTIVE

Rather than propose a tailored solution for filling the modest void in the MBR Affiliate Restrictions, the CWG seek to use this supposed "inconsistency" (CWG Request at 2) as a springboard for radically rewriting the MBR affiliate restrictions. The CWG want FERC to abolish the existing MBR affiliate restriction and instead rely upon the transmission provider Standards of Conduct independent functioning rule combined with the "no conduit rule" against the sharing of market information.

Under the interpretation we request, a franchised public utility with captive ratepayers could not share transmission function employees or marketing function employees with a market-regulated power sales affiliate, and no one (under the no-conduit rule) could share the franchised utility's market information with the marketing function employees or transmission function employees of a market-regulated power sales affiliate.

CWG Request at 15 (footnotes omitted).

The CWG nowhere address or explain, why the Commission should abolish the core safeguard of corporate separation, *i.e.*, that "to the maximum extent practical, the employees of a non-regulated power sales affiliate will operate separately from the employees of any affiliated franchised public utility." Order 697, P 553. The Standards of Conduct require the very different separation of individuals involved in transmission functions from those involved in marketing functions. If the CWG proposal were adopted, nothing would prevent, *e.g.*, the same individual from managing both a franchised utility's standard offer service (SOS) auction bidding and also managing the market-regulated power sales affiliate's SOS offers. But this would be the very kind of

affiliate abuse, and disadvantaging of captive customers, that the MBR Affiliate Restrictions are intended to protect against.

The MBR Affiliate Restriction “no conduit” rule does not remedy the shortcomings of the CWG proposal. The “no conduit rule” is intended to prevent a “circumvent[ing of] the affiliate restrictions.” 18 C.F.R. § 35.39(g). It is unclear what would remain of the no conduit rule if the Commission were to abolish the core restriction of corporate separation. The CWG contend that “no one (under the no-conduit rule) could share the franchised utility’s market information with the marketing function employees or transmission function employees of a market-regulated power sales affiliate.” CWG Request at 15 (footnote omitted). However, as noted above, under the CWG proposal the same individual could *perform* marketing functions for both a franchised utility and a market-regulated power sales affiliate. The CWG might argue that this is a violation of the “no conduit rule,” but this would require the tortuous interpretation that a particular individual was operating as an improper conduit to himself: one part of his brain impermissibly knew things that another side of his brain was forbidden from knowing. FERC has not seen fit to rely upon the “no conduit rule” as an adequate safeguard, in and of itself, either with respect to the MBR Affiliate Restrictions or the transmission Standards of Conduct. As regards the MBR Affiliate Restrictions, the Commission has deliberately chosen to require the general prohibition against employee sharing, subject to certain excepted employees (and officers and directors), who in turn are required to abide by the no conduit rule. The prohibition against employee sharing is a primary measure of protection against MBR affiliate abuse and there is no good reason to abandon it. FERC did not abandon the concept of

employee separation under the transmission provider Standards of Conduct, it simply changed its approach for identifying the employees who must be separated.

III. TO THE EXTENT THE COMMISSION SEEKS TO FILL THE SHARED EMPLOYEE “GAP” OR TO ADOPT AN EMPLOYEE FUNCTIONAL APPROACH TAILORED TO PROTECTING AGAINST MBR AFFILIATE ABUSES IT SHOULD DO SO BY MEANS OF A SEPARATE NEW NOTICE AND COMMENT RULEMAKING

To the extent FERC needs to address the MBR affiliate restrictions and fill-in the hole in the definition of permitted shared support employees it can do so by means of a very narrow NOPR. Alternatively, FERC could choose to propose a new functional employee test tailored to the MBR affiliate abuse issue and issue a NOPR to that effect. The Commission should not adopt the CWG’s proposal and abandon a regulation governing the treatment of MBR oranges and replace it with a regulation governing affiliate-transmission apples.

CONCLUSION

For all of the foregoing reasons, the Commission should deny the CWG’s amended request for clarification.

- 10 -

Respectfully submitted,

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Document Content(s)

Rulemaking.PDF.....1-10