

UNINTENDED CONSEQUENCES OF DELAYING FERC'S STANDARD MARKET DESIGN

By Elizabeth Anne Moler¹
Executive Vice President
Government and Environmental Affairs & Public Policy
Exelon Corporation

As conferees on the energy bill race to complete action on the legislation, they will be faced with a proposal from the Senate to prohibit the Federal Energy Regulatory Commission (FERC) from implementing its July 2002 Standard Market Design rulemaking proposal (SMD).² Prohibiting FERC from implementing SMD is one of those things that “sounds good if you say it fast.” But a close look at the proposed SMD rule, and FERC’s April 2003 Wholesale Market Platform White Paper, clearly shows that delaying SMD will have numerous unintended consequences. The conferees should oppose the SMD delay proposal.

Those advocating SMD delay have proposed to prohibit FERC from issuing any “final rule pursuant to the proposed rulemaking, including any rule or order of general applicability within the scope of the proposed rulemaking” until December 31, 2006. Prohibiting FERC from issuing any rule or order that applies to more than a single utility, pertaining to any issue “within the scope” of the SMD notice of proposed rulemaking (NOPR), will have unintended consequences that even the opponents of SMD don’t want.

RTOs and SMD are Intertwined

Those advocating for Congress to “delay SMD” argue that FERC should be stopped from implementing SMD, but should continue to encourage voluntary RTO formation. Frankly, it is not clear to me how Congress can “delay SMD” and “encourage RTOs” at the same time.

¹ Ms. Moler served as a Commissioner (1988-1993) and then as the Chair (1993-1997) of the Federal Energy Regulatory Commission and as Deputy Secretary of the United States Department of Energy from 1997-1998.

² Neither the House-passed nor the Senate-passed version of H.R. 6 contains an SMD delay provision. However, Chairman Domenici and his staff have stated publicly that he made a commitment to Senator Shelby to support a provision to prohibit FERC from issuing its final rule in the SMD docket, or any related rule or order of general applicability, until December 31, 2006 in order to secure consent to pass the energy bill. According to press reports, Vice President Cheney supported the SMD delay provision in a telephone call to an unknown group of Senators just prior to final passage of the energy bill in the Senate in order to secure their commitment not to object to passage of the bill. The agreement is modeled after Section 1121 of S. 14, as reported by the Committee on Energy and Natural Resources, with the delay extended from July 1, 2005 to December 31, 2006.

How can an RTO do its job if it does not plan the transmission system, and address generation needs, on a regional basis? How can an RTO do its job if it does not manage congestion on its system and does not redispatch generation to avoid problems on its system? How can an RTO do its job if FERC is prohibited from acting to deal with market problems that develop, as in California?

A close look at issues “within the scope of the proposed rulemaking” shows how harmful the unintended consequences of the broadly worded delay would be. Many initiatives included in the SMD NOPR have wide support, but FERC could not finalize or implement them broadly if the SMD NOPR is put on hold. If FERC’s hands are tied by the SMD delay provision, these consequences will follow:

1. FERC will not be able to respond to the August 14 blackout by requiring better coordination among regional transmission organizations (RTOs) and individual public utilities that are not in RTOs.

The U.S. Department of Energy, Natural Resources Canada and the North American Electric Reliability Council are still working to complete their analysis of what caused the August 14 blackout. If the Senate SMD delay proposal were adopted, FERC would be powerless to address any RTO coordination issues, information sharing requirements, and the like until 2007. Nor would FERC have authority to issue a general rule requiring utilities that are not yet in RTOs to coordinate, share information, or take other appropriate steps to try to avoid another blackout. Thus, FERC would be sidelined with its shoelaces tied together, prohibited by Congress from adopting changes that DOE and NERC conclude are necessary to avoid a repeat of the blackout. Even so-called “mandatory reliability rules” would leave FERC very limited in its authority to develop solutions to whatever caused the blackout. Simply put, that is not an appropriate way for the Congress to respond to the blackout.

2. FERC will not be able to approve voluntary RTO development or proposals to improve the operational efficiency and reliability of existing RTOs.

Many state regulators, public utilities, and other stakeholders are advocating that RTO development should be “voluntary.” Numerous utilities are actively engaged in discussions they hope will lead to voluntary RTO filings to form RTOs, perhaps even later this year. And the existing RTOs are constantly striving to improve their performance and advance their market design. Prohibiting FERC from issuing an order addressing RTO development would thwart even voluntary RTOs.

3. FERC will not be able to eliminate transmission rate pancaking and adopt transmission rate reform, including so-called “participant funding.”

In the SMD NOPR, and the White Paper, FERC proposes to eliminate transmission rate “pancakes” across an RTO (that is, charging multiple rates to wheel electricity across multiple utilities); incentives for construction of new transmission facilities; and authority for RTOs to require “participant funding” of transmission upgrades (requiring those who cause utilities to incur costs to expand their transmission system to pay the cost of the expansion).

Putting SMD on hold would prohibit FERC from adopting any final rule that would codify these much-needed transmission rate design reforms. Ironically, some of the most vociferous opponents of SMD are touting the need for incentive pricing to encourage investment in our transmission system and participant funding so that their native load customers do not pay for system upgrades needed by generators locating in their service territory who propose to export their power outside the region.³ Putting these important initiatives on hold for three years is a bad idea.

4. FERC will not be able to issue rules governing how market monitors can ensure that generation owners do not game the markets, as happened in California, and adopt mitigation measures, such as bid caps, to address market power or gaming.

One of FERC’s most important proposals in the SMD NOPR is to codify use of independent “market monitors” in existing RTOs and other regional markets to actively monitor markets and mitigate market power abuses and gaming, as in California. The SMD delay provision would eviscerate FERC’s use of market monitors by prohibiting FERC from requiring RTOs to have market monitors, bid caps, and other initiatives to address Enron-style gaming practices. FERC must also be able to enforce orders requiring a utility to join an RTO to mitigate its market power, particularly market power resulting from a merger.

5. Regulatory uncertainty will be perpetuated that is dampening investors’ interest in building new transmission needed to avoid future blackouts.

The SMD rulemaking proposal was issued in July 2002. FERC received an avalanche of public comments and Congressional inquiries. In response, FERC issued its April 2003 White Paper, changing the proposed rule significantly. It recognized the need for regional variations among RTOs, proposed to give State officials a formal role in the RTO process by forming Regional State Committees, and pledged that FERC would not assert jurisdiction over the rate component of transmission used to provide retail service to native load customers. SMD delay would prolong an already lengthy period of the regulatory uncertainty that is

³ See Testimony of H. Allen Franklin, Chairman, President and CEO of Southern Company, on behalf of the Edison Electric Institute before the Committee on Energy and Natural Resources, United States Senate, March 27, 2003, in which he endorses participant funding.

chilling investment in transmission. The August blackout made crystal clear that we need robust investment now.

6. FERC will not be able to require RTOs and utilities to do “regional planning” in order to address the need for new facilities (both transmission and generation) on a regional basis.

The SMD NOPR includes an initiative to foster a regional approach to planning transmission expansion and addressing the need for additional generation. If SMD is delayed, utilities would not be required to collaborate in the planning process. Capacity additions and transmission expansion would continue on a utility-specific or generator initiated basis, rather on a regional basis. Putting this initiative “on hold” for three years is a bad idea.

7. FERC will not be able to address transmission congestion and adopt congestion management rules.

The SMD NOPR proposes to mandate that RTOs adopt locational marginal pricing (LMP) to address congestion on transmission lines. PJM, ISO-New England, and the New York ISO use the LMP model. Even the most ardent opponents of SMD have endorsed the LMP initiative.⁴ The White Paper nonetheless backs off mandating LMP and proposes to defer to regional needs for congestion management systems. Both the LMP congestion management initiative and the White Paper’s endorsement of regionally based congestion management initiatives would be victims of SMD delay. Congestion on transmission lines is a nationally recognized problem that must be addressed to enhance the reliability of the transmission grid. Putting congestion management initiatives “on hold” for 3+ years is another bad idea.

8. FERC will not be able to adopt the North American Electric Reliability Council’s (NERC) cybersecurity standards.

The North American Electric Reliability Council (NERC) has adopted a proposed industry cyber-security standard. It is self-evident that such a standard is necessary in the era of cyber terrorists and dependence on the Internet and other forms of electronic commerce. The SMD NOPR proposes to codify cyber security standards and FERC has indicated that security measures to protect critical information systems, like the Internet, would be a condition of market-based tariffs. Because the cyber security standards were a part of the SMD NOPR, an SMD delay would have the unintended consequence of prohibiting FERC from codifying the cyber-security standard.

9. FERC will not be able to adopt market rules developed by the North American Energy Standard Board (NAESB).

⁴ The Alan Franklin testimony, cited previously, also endorses LMP.

The SMD NOPR proposed to incorporate business practice standards for the industry developed by the North American Energy Standards Board. An SMD delay would prohibit FERC from doing so.

10. Finally, an SMD delay would invite litigation over the scope of FERC's authority to do its job.

The SMD delay provision is poorly drafted with undefined terms and untold consequences. It is a litigator's dream, virtually inviting lawsuits about what Congress allowed FERC to do and what Congress prohibited FERC from doing.

Conclusion

These potential unintended consequences of tying FERC's hands with the Senate's deal to delay SMD should make clear that Congress should not legislate an administrative process. These issues should be left to the established regulatory process where market participants, state regulators and consumers can participate in reaching acceptable compromises. The SMD delay provision is a law of unintended consequences. It would hamstring FERC at the very moment that we need better reliability and better coordination in wholesale energy markets. It should not be included in the final version of the energy bill.