108 FERC ¶ 61,082
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Allegheny Energy Supply Company, LLC Docket No. ER04-730-000

ORDER GRANTING AUTHORIZATION TO MAKE AFFILIATE SALES

(Issued July 29, 2004)

1. In this order, we grant an application under section 205 of the Federal Power Act[1] by Allegheny Energy Supply Company, LLC (AE Supply) requesting Commission authorization to make market-based rate sales to its affiliate, The Potomac Edison Company (Potomac). AE Supply will make these sales pursuant to a master Full Requirements Service Agreement (FSA) and three transaction confirmations resulting from a Maryland Public Service Commission (Maryland Commission) supervised request for proposal (RFP) process. This order concludes that this competitive solicitation, as described below, satisfies the Commission's concerns regarding affiliate abuse. This order benefits customers by providing further guidance as to the Commission's standards by which it reviews market-based rate affiliate sales resulting from RFP processes.

Background

2. On April 13, 2004, AE Supply filed the instant application stating that as part of a RFP process supervised by the Maryland Commission, AE Supply had been selected to supply Potomac with full requirements service to fulfill some of Potomac's standard offer service obligations. For this reason, AE Supply seeks Commission authorization to make wholesale power sales to its affiliate, Potomac. AE Supply also requests waiver of the 120-day prior notice of filing requirement to allow an effective date of January 1, 2005.

3. AE Supply and Potomac are both wholly-owned subsidiaries of Allegheny Energy, Inc. AE Supply owns and operates generating facilities and markets energy and energy products at market-based rates. Potomac is a franchised electric utility that has transferred functional control of its transmission system to PJM Interconnection, L.L.C. Potomac is required to provide standard offer service to any customer that does not choose an alternate supplier under Maryland's retail choice program.

4. On April 29, 2003, the Maryland Commission approved a consensus settlement agreement between twenty parties, including Potomac, setting forth a plan that

[1] 16 U.S.C. § 824d (2000).

established the framework for a competitive solicitation process to procure standard offer service supplies in Maryland after utility rate caps expire.[2]

5. On September 30, 2003, the Maryland Commission approved another settlement agreement that defined the specific requirements and processes necessary to implement the competitive solicitation. The settling parties collaborated to design a uniform, state-wide RFP process whereby Maryland's franchised electric utilities procured supplies to provide standard offer service to their retail customers.[3]

6. Subsequently, Potomac issued its RFP, soliciting bids for the provision of standard offer service supplies for several different customer classes. AE Supply responded to Potomac's request for proposals in the first, second, and fourth rounds of a four-round process. AE Supply won bids to provide Potomac a total of 187.6 MW for its commercial/small industrial customer class and a total of 227.2 MW for its large commercial/industrial customer class.[4] AE Supply bid to provide these services beginning January 1, 2005 for a 5-month and a 12-month term respectively. AE Supply lost its bids to provide Potomac with supplies for its small commercial customer class. AE Supply states that, as a result of the competitive solicitation, it will serve about half of Potomac's 2005 energy obligation.

7. AE Supply states that the Maryland Commission is deemed to have approved the results of Potomac's RFP because it issued no order to the contrary within two business days of receiving the results, as required by the settlement it had previously approved.

<u>Notice of Filing and Pleadings</u>

---

[2] Maryland Commission Order No. 78400 at 5.

[3] Maryland Commission Order No. 78710 at 1-3.

[4] AE Supply won three bids in total. AE Supply will provide 94.6 MW for Potomac's commercial/small industrial class at $41.90/MWh for summer energy, $565.00/MW-month for summer demand, $52.00/Mwh for non-summer energy, and $550.00/MW-month for non-summer demand. Under its second bid, AE Supply will provide 93 MW for Potomac's commercial/small industrial class at $42.25/MWh for summer energy, $565.00/MW-month for summer demand, $52.80/Mwh for non-summer energy, and $550.00/MW-month for non-summer demand. Lastly, AE Supply will provide 227.2 MW for Potomac's large commercial/industrial class at $50.10/MWh for summer energy, $1025.00/MW-month for summer demand, $50.85/Mwh for non-summer energy, and $510.00/MW-month for non-summer demand.

8. Notice of AE Supply's filing was published in the *Federal Register*, 69 Fed. Reg. 22,783 (2004), with protests and motions to intervene due on or before May 4, 2004. None was filed.

Discussion

9. As noted, AE Supply asks the Commission to accept a master FSA and three transaction confirmations allowing AE Supply to make sales to its franchised electric utility affiliate, Potomac. In order to meet the Commission's requirements for sales between affiliates, AE Supply offers evidence that these transactions are the result of direct head-to-head competition between itself and competing unaffiliated suppliers. More specifically, AE Supply offers evidence that the Maryland Commission-supervised RFP process satisfies the Commission's concerns regarding sales between affiliates.

10. As discussed above, this RFP was designed through settlement agreements between many diverse and interested parties. As stated in the Maryland Commission's order accepting the second settlement agreement, the settlement "reflects the outcome of extensive and exhaustive negotiations between informed parties of diverse and traditionally adverse interests."[5]

11. Each of Maryland's four electric utilities, including Potomac, issued RFPs through their websites. First-round bids were due more than three months after this posting, giving interested parties sufficient time to respond.

12. To qualify to submit bids, potential suppliers, whether affiliated or not, were required to submit: a signed confidentiality agreement; documentation that the potential supplier is a member of PJM and a qualified market buyer and market seller in good standing; documentation that the potential seller is authorized at the federal level to make wholesale sales of energy, capacity, and ancillary services at market-based rates; submission of a credit application and associated financial information to the relevant utility; and provision of liquid bid collateral to assure the commitment of the bidder.[6] By qualifying potential suppliers before they submitted bids, the RFP-issuing utilities guaranteed that all submitted bids met a minimum standard for certain non-price factors. An entity that did not qualify was given an opportunity to correct any problems, resubmit for qualification, and, if then qualified, submit bids.

13. Bids were submitted to each franchised electric utility in standardized spreadsheets. For each bid submitted to Potomac, potential suppliers were allowed to

[5] Maryland Commission Order No. 78710 at 3.

[6] *Id*. at 10.

input a volume (in bid blocks of approximately 50 MW each), a price for summer energy (in $/MWh), a price for non-summer energy (in $/MWh), a price for summer demand (in $/MW-month), and a price for non-summer demand (in $/MW-month). Bidders were only able to choose the volume and price of their bids. For certain customer classes, Potomac solicited bids for different, set contract lengths. Potential suppliers were able to submit bids for any of the set contract lengths and could submit as many different bids as they chose. Bidders were not allowed to submit bids with terms other than those set by Potomac in the RFP.

14. Winning bids were selected on the basis of a single, calculated price for each individual bid. This number, specific to the Maryland RFP process, is called Discounted Average Term Price (DATP). The calculation to determine DATP involved creating a weighted average of different period prices for energy and demand, as well as discounting prices based on contract term and discount factors set by the RFP issuing utility. This calculation was applied using the same weighting method and discount factors for each bid regardless of affiliation. The only changes in this calculation from bid to bid were the values entered by the bidders (*i.e.*, volume and prices). Winning bids were then selected based on DATP alone.

15. Bids submitted in the Maryland RFPs were binding. Winning bidders received the actual price in their offers for each year of the term of their supply contract. Bidders were required to accept the terms of a master FSA. Winning bidders were not permitted to revise prices or any other terms and conditions of their supply contracts.

16. Potomac's RFP was monitored by an independent consultant. The Maryland Commission determined the consultant selection qualifications and evaluated potential candidates. The Maryland Commission then directed Potomac as to which candidate to hire and as to the terms and conditions under which the consultant was to be hired. The consultant was selected by, took direction from, and reported to the Maryland Commission. Its duties included monitoring the bid evaluation under the criteria set forth in the settlement agreements approved by the Maryland Commission.

17. In an effort to eliminate the need for bidders to incorporate a risk premium in their bid prices, the Maryland Commission approved a volumetric risk mechanism in the RFPs. To implement this volumetric risk mechanism, Potomac is required to trace standard offer service load served on a daily basis. An increment is triggered when standard offer service load increases more than 5 MW per bid block above the contracted load, while a decrement is triggered when this load decreases more than 3 MW below the contracted amount. In the case of an increment, the wholesale supplier will be paid the PJM spot market price for energy, capacity, and ancillary services plus $3 per MWh. In the case of a decrement, a new base load is established, and the wholesale supplier is released from its obligation to supply the decrement load at the original contract price.

This mechanism allows bidders to make offers without considering the risk of standard-offer service demand shifts.

18. The Commission has stated that, in cases where affiliates are entering into market-based rate sales agreements, it is essential that ratepayers be protected and that transactions be above suspicion in order to ensure that the market is not distorted.[7] The Commission has approved affiliate sales resulting from competitive bidding processes after the Commission has determined that, based on the evidence, the proposed sale was a result of direct head-to-head competition between affiliated and competing unaffiliated suppliers.[8] When an entity presents this kind of evidence, the Commission has required assurance that: (1) a competitive solicitation process was designed and implemented without undue preference for an affiliate; (2) the analysis of bids did not favor affiliates, particularly with respect to nonprice factors; and (3) the affiliate was selected based on some reasonable combination of price and non-price factors.[9]

19. We believe Potomac's RFP meets the *Edgar* standards. Designing Potomac's RFP (and the RFP's of Maryland's other franchised electric utilities) through a Maryland Commission proceeding increased the transparency of this process by keeping the design process public. Further, Potomac's RFP was part of the Maryland Commission's public record before it was issued, which allowed easier access to information such as the details of the bid selection process and potential supplier qualification criteria. Potomac was not allowed to change the terms of its RFP during the implementation phase, meaning that relevant information was available to potential bidders before the issuance of the RFP.

20. We believe the collaboration of parties with diverse interests helped ensure that affiliates of Maryland's franchised electric utilities were not given undue preference in the design phase of this competitive solicitation. Posting the RFPs publicly and providing ample response time helped ensure that affiliates of the franchised electric utility issuing the RFP did not receive undue preference during the bid submission phase of the RFP. Further, by pre-qualifying bidders using publicly available criteria, the franchised electric utilities eliminated the need to evaluate bids on certain non-price

[7] *See* Boston Edison Co. Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382 at 62,167 (1991) (*Edgar*).

[8] *See* Connecticut Light & Power Company and Western Massachusetts Electric Company, 90 FERC ¶61,195 at 61,633-34 (2000); Aquila Energy Marketing Corp., 87 FERC ¶61,217 at 61,857-58 (1999); MEP Pleasant Hill, LLC, 88 FERC ¶61,027 at 61,059-60 (1999); *Edgar*, 55 FERC ¶61,382 at 62,167-69.

[9] *Edgar*, 55 FERC ¶61,382 at 62,168.

factors, thereby allowing bid selection based on price alone. Selecting bids based on only price ensured that affiliates were not given preferential treatment during the selection phase of the process.

21. Accordingly, we conclude that the Maryland Commission competitive bid process described by AE Supply satisfies the Commission's concerns regarding affiliate abuse. Therefore, we will grant AE Supply's request for authorization to make sales to its affiliate Potomac as part of its participation in this Maryland Commission-approved RFP process.

22. We also provide here guidance as to the standards the Commission will use in the future to evaluate whether an RFP such as the one in the instant filing meets the *Edgar* criteria. The underlying principle when evaluating an RFP under the *Edgar* criteria is that no affiliate should receive undue preference during any stage of the RFP. The following four guidelines will help the Commission determine if an RFP satisfies that underlying principle.[10]

a. Transparency: the competitive solicitation process should be open and fair.

b. Definition: the product or products sought through the competitive solicitation should be precisely defined.

c. Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders.

d. Oversight: an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection.

Transparency principle

23. Transparency is the free flow of information to all parties. No party, particularly the affiliate, should have an informational advantage in any part of the solicitation process. The RFP and all relevant information about it should be released to all potential bidders at the same time. Instead of individually inviting specific bidders, the utility should allow all interested parties to bid on the RFP. All aspects of the competitive solicitation should be widely publicized. For example, the issuer can post the RFP on its website and issue a press release to that effect and/or advertise in the trade press. To compete effectively, bidders should have equal access to data relevant to the RFP. Any

[10] Concurrently, the Commission is issuing an order that sets out the Commission's new guidelines for evaluating affiliate transactions under section 203 of the FPA. *See* Ameren Energy Generating Company and Union Electric Company, d/b/a AmerenUE, 108 FERC ¶ 61,081 (2004).

communication between RFP issuer and bidder that are not part of the bid should be made available to all other bidders. For example, the answers to clarifying questions should be released to all other bidders, but proprietary bid information should not be released.

24. These principles enhance the fairness and transparency of the entire process. Specific steps in the solicitation process may require more guidance to achieve optimal transparency. Two such examples are when a collaborative design is used or when post-bidding negotiation occurs.

25. If the RFP is to be designed through a collaborative process, the entire process should be widely publicized and open. An independent third party can ensure meaningful participation by nonaffiliates and eliminate characteristics that improperly give an advantage to the affiliate, *e.g.*, the only acceptable interconnection point for a new nonaffiliate plant is at an affiliate's existing plant.

26. Negotiation may occur after the bidding; for example, when a shortlist has been compiled or a winner has been selected. If the affiliate is on the shortlist or wins, it is important to ensure that the affiliate has no undue advantage resulting from its affiliate relationship. One way to prevent such an advantage from occurring is for the independent third party to be the RFP issuer's agent in the negotiation with the affiliate.

<u>Definition principle</u>

27. The product or products sought through the RFP should be defined in a manner that is clear and nondiscriminatory. The RFP should state all relevant aspects of the product or products sought. At a minimum, these aspects include capacity and term, but other characteristics are usually necessary, among them fuel type, plant technology (*e.g.*, simple cycle gas turbine), and transmission requirements. If there are changes in the product specification, rebids should be allowed.

28. An RFP should not be written to exclude products that can appropriately fill the issuing company's objectives. This is particularly important if such exclusions tend to favor affiliates.

<u>Evaluation principle</u>

29. To fulfill the evaluation principle, RFPs should clearly specify the price and non-price criteria under which the bids are evaluated. Price criteria should specify the relative importance of each item as well as the discount rate to be used in the evaluation. Non-price criteria should also specify the relative importance of items such as firm transmission reservation requirements, including acceptable delivery points; credit evaluation criteria, such as the bond rating; the plant technology if more than one

technology is listed in the RFP; plant performance requirements, such as availability; and the anticipated in-service date if the plant needs to be constructed.

30. Naturally, these criteria are not meant to be exhaustive; they are merely illustrative. Keeping in mind that affiliates should have no informational advantage, all criteria should be specific and detailed so that all bidders can effectively respond to the RFP. Clear evaluation criteria will ensure that the RFP does not give an advantage to the affiliate.

31. RFP issuer and bidders will usually need to divulge commercially sensitive information in the solicitation process. Confidentiality agreements between the issuer and bidders can be signed to address this concern.

Oversight principle

32. Effective oversight of competitive solicitations can be accomplished by using an independent third party in the design, administration, and evaluation stages of the competitive solicitation process. Ensuring that the third party is independent and granting it at the outset the responsibility of ensuring that these guidelines are followed throughout the process will also minimize perceptions of affiliate abuse. Minimum standards for assuring independence and the scope of the third party's role are set forth below.

33. A minimum criterion for independence is that the third party has no financial interest in any of the potential bidders, including the affiliate, or in the outcome of the process.[11] Preferably, the independence criterion would be the same as that of an ISO or RTO.[12] In this context, "independence" means that the third party's decision-making process is independent of the affiliate and all bidders.[13] Without such independence, the

[11] Conference on Solicitation Processes for Electric Utilities, Docket No. PL04-6-000, June 10, 2004 (PL04-6 Conference), Comments of Maine Public Service Commission Chairman Welch, Tr. 78.

[12] PL04-6 Conference, Comments of John Hilke, Federal Trade Commission, Tr. 4.

[13] Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (2000), FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000 ¶ 31,089 at 31,061 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12, 088 (2000), FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000 ¶ 31,092 (2000), *affirmed sub nom*. Public Utility District No. 1 of Snohomish County, Washington, *et al*. v FERC, 272 F. 3d 607 (D.C. Cir. 2001).

third party could be biased towards the affiliate in order to enhance its financial position. Obviously, a similar concern could arise regarding an actual or potential financial interest link between the third party and any potential bidder. Independence can also be satisfied if the state commission has approved the selection of a third party on the basis of established independence criteria. In addition, the third party should not own or operate facilities that participate in the market affected by the RFP.

34. The independent third party should be able to make a determination that the RFP process is transparent and fair and that the RFP issuer's decision is not influenced by any affiliate relationships. For example, if the RFP issuer wishes to use a collaborative RFP design process, the independent third party should be the clearinghouse for comments by potential bidders on a draft RFP and should evaluate those comments as possible revisions to the RFP. The independent third party's role as the sole link for transmitting information between potential bidders and the RFP issuer would also help to ensure that the RFP design will not favor any particular bidder, particularly an affiliate. The independent third party should continue to be a conduit of information between utility and bidders in determining which of the original bid responses are qualified bids or may be included in a short list.

35. At the evaluation stage of the RFP process, the third party should be able to credibly assess all bids based on both price and non-price factors. It should be able to consider both generation asset bids and power purchase agreements. Also, it should be able to independently verify transmission characteristics that may limit the suitability of certain alternatives. The third party should have access to the same information that the RFP issuer uses in its evaluation and should be able to independently verify its correctness. The third party should also be able to evaluate non-price traits of various alternatives.

Potomac's RFP

36. Potomac's RFP process is an example of an RFP process that would meet the foregoing guidelines. We believe that the design, administration, and bid evaluation phases of Potomac's RFP were transparent. Potomac achieved transparency in the design phase through a collaborative process involving informed parties with diverse interests and an on-the-record, public Maryland Commission proceeding. Potomac was not allowed to change the terms of its RFP during its administration, meaning that relevant information was available to potential bidders before its issuance. Further, Potomac's RFP was part of the Maryland Commission's public record before it was issued, which allowed easier access to information such as the details of the bid selection process and potential supplier qualification criteria.

37. We believe that Potomac's RFP was clearly defined. By including information such as bidder qualification criteria and bid evaluation method in the RFP, Potomac helped ensure that the parameters of the RFP were clearly defined prior to the solicitation of bids. Bidders had knowledge of the process through which they could bid and through which their bids would be evaluated before they were called upon to submit them. We believe that Potomac's RFP was clearly defined.

38. We believe Potomac evaluated bids based on standardized criteria and applied that criteria equally to all bids regardless of affiliation. By setting a minimum standard for non-price factors, Potomac was able to select bids based on price alone. Further, all bidders were required to accept the terms of the master FSA. Selecting bids based only on price ensured that affiliates were not given preferential treatment during the selection phase of the process. Potomac applied the above mentioned DATP calculation to each bid in the same manner and evaluated the bids based on the resulting discounted price. We believe Potomac applied its evaluation criteria to all bids equally.

39. We believe Potomac's RFP had sufficient independent oversight. As described above, Potomac's RFP was monitored by an independent consultant. The fact that this consultant was selected by the Maryland Commission and that the consultant's compensation was determined by the Maryland Commission before the issuance of the RFP helped ensure the consultant's lack of financial interest in the outcome of the RFP. This consultant reported its findings directly to the Maryland Commission. We believe the presence of this independent third party, as well as the involvement of the Maryland Commission, provided sufficient independent third-party oversight of the design, administration, and bid evaluation stages of Potomac's RFP.

40. Finally, we note that AE Supply is in an RTO. Part of the concern about affiliate transactions is that competitors can be foreclosed from the market. In regions with an RTO-operated market, there is less of a risk of foreclosure if all parties have the option of selling into that market. Therefore, we take added comfort here from the fact that this transaction takes place in a region with an RTO-operated market.

<u>The Commission orders:</u>

AE Supply's application for authorization to make sales to its affiliate, Potomac, pursuant to the master Full Requirements Service Agreement included in the instant filing is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.