UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Remedying Undue Discrimination
through Open Access Transmission Service
and Standard Electricity Market Design Docket No. RM01-12-000

NOTICE OF CONFERENCES AND REVISIONS TO PUBLIC COMMENT SCHEDULE

(October 2, 2002)

1. In the nine weeks since the Commission issued its Notice of Proposed Rulemaking (NOPR) in the above-captioned docket, Commission members and staff have participated in numerous meetings and conferences throughout the country to discuss the proposed rule. These meetings have been a valuable source of information about the response of the general public, and specifically the electric utility industry, to the proposed Standard Market Design rule and the issues that the Commission must address going forward.

2. Commission staff has identified areas of public concern about the proposed rule and recommended that the Commission hold meetings that will address and attempt to resolve these issues. A copy of the staff memorandum that makes these recommendations is attached to this notice.

3. Standard Market Design is an important initiative that will bring the public significant benefits, but the rule must be formulated properly in order to work as the Commission envisions. We understand the public concerns, and we want to work through them individually and in detail. As a first step, the Commission will hold a series of public meetings to discuss specific items of concern.

4. The public meetings will be held as follows. Unless otherwise noted, these meetings are open to the public, and registration is not required; however, in-person attendees are asked to notify the Commission of their intent to attend by sending an e-mail message to customer@ferc.gov. Members of the Commission may attend and participate in the discussions. Further details about each Commission conference will be provided in supplemental notices.

- November 4, 2002: (Portland, Oregon) This conference will address the unique operating characteristics of Western bulk power markets. It will also attempt to identify aspects of the proposed Standard Market Design for which regional flexibility may be appropriate for the West, and corresponding degrees of flexibility.

- November 6, 2002: (Washington, D.C.) This conference will focus on pricing proposals for network upgrades and expansions. In particular, the discussions will attempt to clarify the definition of "participant funding" and seek consensus on the types of facilities that should be eligible for participant funding.

- November 10-13, 2002: (Chicago, Illinois) Commissioners and staff propose to participate in the National Association of Regulatory Utilities Commissioners Annual Convention. The Commission will make a presentation on the morning of Wednesday, November 13, and the Chairman will deliver a keynote address.

  Registration is required for this conference. You may obtain a copy of the registration form and information about fees at http://www.naruc.org/Meetings/annualconv/2002/index.html, under the Registration" link.

- November 19, 2002: (Washington, D.C.) This conference will focus on aspects of the resource adequacy requirement proposed in the NOPR, specifically: (1) the sufficiency of proposed penalties; (2) the function of the resource adequacy requirement in areas that have retail access; and (3) how to accommodate regional variations in proposals to satisfy the resource adequacy requirement without interfering with state jurisdiction.

- December 3, 2002: (Washington, D.C.) This conference will discuss specific issues related to the transition to congestion revenue rights (CRRs), such as: (1) ensuring that native load and load serving entities receive sufficient CRRs; (2) guarding against the use of CRRs to exercise market power; and (3) the possibility of regional variation on how rights are allocated to load.

5. Each Washington, D.C. conference will be held from approximately 9:30 a.m. to 5:00 p.m. at the offices of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. Transcripts of the conferences will be immediately available from Ace Reporting Company (202-347-3700 or 1-800-336-6646), for a fee. They will

be available for the public on the Commission's FERRIS system two weeks after the conference. Additionally, Capitol Connection offers the opportunity for remote listening and viewing of the conference. It is available for a fee, live over the Internet, via C-Band Satellite. Persons interested in receiving the broadcast, or who need information on making arrangements should contact David Reininger or Julia Morelli at the Capitol Connection (703-993-3100) as soon as possible or visit the Capitol Connection website at http://www.capitolconnection.gmu.edu and click on "FERC."

6. The Commission will extend to January 10, 2003, the deadline for submission of comments that address the following issues: (1) market design for the Western Interconnection; (2) transmission planning and pricing, including participant funding; (3) Regional State Advisory Committees and state participation; (4) resource adequacy; and (5) CRRs and transition issues. The deadline for submission of all other comments remains November 15, 2002.

7. The Commission will extend the deadline for all reply comments to February 17, 2003. All initial and reply comments should include an executive summary that should not exceed ten pages.

By direction of the Commission.

Magalie R. Salas,
Secretary.

Memo to Members of the Federal Energy Regulatory Commission Regarding Industry Outreach on Standard Market Design

September 30, 2002

To: Pat Wood, III, Chairman
William L. Massey, Commissioner
Linda K. Breathitt, Commissioner
Nora M. Brownell, Commissioner

From: FERC SMD Outreach Team

Re: Report on SMD Outreach activities, summary of issues raised, and staff recommendations.

On July 31, 2002 the Federal Energy Regulatory Commission issued its Notice of Proposed Rulemaking on Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design (SMD NOPR). Since that date, the staff of the Commission (Staff) has engaged in extensive outreach, both to state regulatory commissions, industry trade groups and the industry at large. Specifically, we have held six SMD briefings exclusively for state commissions and staff, three SMD briefings for state commissions and the industry at large, and ten meetings with groups representing different sectors of the industry. In addition, Staff has attended dozens of industry meetings, both in Washington, DC, and across the country. Our contacts have now included several thousand industry representatives, covering a wide spectrum of interests.

Identified Areas of Concern

Several broad areas of concern have been identified as a result of this outreach effort. Most of these areas are ones that were not addressed in great detail in the NOPR because the details were to be worked out on a regional basis. However, because of the lack of detail, parties are interpreting the proposals in different ways and sometimes interpreting them based on their worst fears. Clarifying that the Commission intends to permit additional regional flexibility would satisfy many of the concerns. Staff recommends that the Commission obtain further input from states and the industry before comments are due, so that it can provide greater clarification on these issues and identify areas where regional flexibility would be allowed. Discussed below are brief summaries of these areas and a proposed process for addressing these concerns.

1. The Unique Operational Characteristics of the Western Interchange

State regulators and industry representatives have pointed out that the Western North American market has unique characteristics that may not readily lend itself to the Standard Market Design proposed by the Commission. Specifically, they are concerned that a market design that has evolved over a long period of time in the Eastern U.S. cannot be readily adapted to the West. Many participants believe that the Commission does not have a grasp of the inherent differences, which include:

- the complexities of hydroelectric production, based on agreements and international treaties negotiated over several decades, and which include the accommodation of many regional concerns, including agricultural uses, fishing and recreational requirements, and environmental constraints.
- the major role of public power in the West, and the difficulties that might be encountered if public power chooses not to join an ITP/RTO.
- changes in transmission prices for long-distance purchases, which would create hardship for some customers, as well as operational anomalies brought about by distance-related issues, including large loop flow patterns.

Some Western regulators have requested that the Commission consider a separate market design for the West. They are also concerned about the amount of flexibility that the Commission would consider to accommodate their concerns, including flexibility in designing and allocating Congestion Revenue Rights (CRRs), and operational issues related to hydro and other intermittent generator resources.[1]

To resolve these issues, there needs to be a process to identify the specific issues where there are concerns and start developing solutions in these areas. Staff recommends doing this through a two stage process. First, we recommend that the Commission schedule a staff-level technical meeting to discuss specific technical concerns and potential solutions. Second, the commissioners should also hold a conference to discuss the specific concerns that have been raised by the West. At this conference the Commission could explore the level and areas where flexibility would be appropriate. Staff recommends that both of these meetings be held in the West.

2. Planning and Pricing Transmission Expansions, including Participant Funding.

In the SMD NOPR the Commission expressed a preference for participant funding and noted that it would consider participant funding for proposed transmission facilities that

[1] The Commission has already expressed its willingness to offer regional flexibility in its order on RTO West, Docket Nos. RT01-35-005 and RT01-35-007, issued September 18, 2002.

are included in a regional planning process conducted by an independent entity. The Commission also indicated that it would look favorably on a pricing proposal, whether it is roll-in, an assignment to beneficiaries, or some combination of the two, by a Regional State Advisory Committee (RSAC) if it is consistent with the FPA. However, it did not attempt to clearly define the types of network upgrades that would be priced through "participant funding" and those that would be priced through rolled-in pricing.

There has been considerable reaction to this proposal in the outreach sessions. Southern state commissioners and southern utilities have been supportive of the use of participant funding. One rationale used is that participant funding would protect native load customers from paying for network upgrades constructed to export power to other regions. However, transmission owners in other areas, public power, and industrial customers are concerned that if participant funding is the main vehicle for pricing network upgrades, there will be inadequate investment to relieve transmission congestion and thus limit wholesale competition. While their positions differ in some areas, they all argue for the ability to roll-in at least some upgrades that relieve constraints and thus increase competition. This will be an important issue in the Commission's approval of SeTrans, which is expected to be considered in the near future.

Staff believes that the Commission's proposal needs to be clarified. During the outreach, it has become clear that there is not a consistent definition of participant funding. It could be defined to include only upgrades that a market participant volunteers to pay for, or it could be defined as upgrades that the beneficiaries would pay for, either on a voluntary or cost-allocation basis. If load benefits from the upgrades, the costs could be rolled-in to the access charge paid by the load that benefits. That load would receive CRRs. If a generator benefits, then the generator would pay for the upgrades, and receive CRRs. Many observers assume that construction to relieve transmission constraints could not be rolled-in to the access charge under a participant funding scenario. In that case, there would be little construction to relieve transmission congestion. Staff believes that this issue could be clarified through a technical conference that discusses this pricing issue.

A related issue is the requirement for regional planning. Transmission owners in particular are concerned that the process is reminiscent of central planning and that it could be used to slow construction of necessary upgrades, including construction to relieve congestion. Additionally, state commissioners and others are concerned that the use of four large regions will unnecessarily delay the planning process. This concern is especially strong in the Midwest and the Mid-Atlantic, which was identified as one of the four regions. There is support for having the planning process done within the territory covered by each RTO or ISO. RTOs could then coordinate the regional plans in each Interconnection.

Staff believes the Commission needs to further define how the regional planning process will work. Also, the Commission may want to explore the size of the regions used in the planning process. Staff believes these topics could be addressed at the same technical conference as participant funding.

3. State Concerns and Regulatory Participation in Regional State Advisory Committees

State commissions were particularly concerned about their ability to protect native load from cost shifting, particularly in those states that have not chosen electric restructuring. They were concerned that the rule might have an impact on their ability to continue regulating vertically integrated utilities under traditional cost-of-service ratemaking and bundled rates that these states continue to favor.

Commissioners from low-cost states were also concerned that the new market envisioned by the Commission might result in low-cost power being exported from their states, to the detriment of local ratepayers. They also want assurances that their native load will be protected from paying the cost of new transmission that would serve customers in other states or regions. They also seek clarification that CRRs will fully protect ratepayers as well as they are protected today.

States are also concerned about their role in establishing resource adequacy, whether the Commission's plan conflicts with ongoing state efforts to set reserve margins, and the extent to which states will be able to ensure future supplies.

Commissioners in all regions of the country expressed concern about the organization of "Regional State Advisory Committees" and what that would represent. They want to know who will become members of such an organization, how it would be funded, what its duties would encompass, how large a region it would serve and whether commissioners would be required to belong to more than one RSAC. Most importantly, state commissioners want to know the exact nature of the organization and what its responsibilities would include, and whether that conflicts with existing state law or with existing regional cooperative efforts. Finally, many state commissioners also would like to create a new name for these committees that does not use the word "advisory".

Staff recommends that the Commission use the NARUC meeting scheduled for November to develop a process for resolving these types of concerns and coming to a common understanding of the role of state commissions in the RSACs and how SMD might affect retail rates. Staff and state commission staff in the various regions could also hold a series of meetings to work on a common understanding and potential solutions.

4. Resource Adequacy.

While there has been general support for load to meet some form of resource adequacy requirement, there has been a good deal of criticism of the proposal in the NOPR. Generators are concerned that the types of penalties proposed are insufficient and unworkable. Specifically, they are concerned that penalties may not be sufficient to keep load from "leaning on the system" in real time. State commissioners, ISOs and many market participants in the Northeast and Mid-Atlantic states also believe it is unworkable in areas that have retail access. They want to have a form of capacity obligation for load to ensure resource adequacy. State commissions in areas where there has been little or no divestiture see the requirement for a 12% reserve margin as intruding on their authority to review the purchasing decisions of utilities.

Staff believes this issue would benefit from a full discussion at a public conference. At the conference, the commissioners could explore how much regional flexibility there should be for satisfying the resource adequacy requirement. For example, could regions with retail access use a capacity obligation? In regions without retail access, could state commissions require vertically integrated utilities to satisfy a minimum reserve requirement? If so, would there be any additional requirements needed to satisfy the requirements of SMD?

5. Transition Issues and Congestion Revenue Rights.

Many industry participants are concerned that they will not have adequate protection from congestion costs when they move from the current system to SMD. Transmission dependent utilities and industrial customers are concerned that they will not receive sufficient CRRs through the initial allocation process and will be vulnerable to the exercise of market power by vertically integrated utilities. They also raised market power concerns, particularly if generators held CRRs in load pocket areas. They also are concerned that they will not be adequately protected if the CRRs are auctioned and they receive the auction revenues. They believe they have better protection if CRRs are allocated to load. They also believe it is necessary to retain the allocated CRRs on a long-term basis.

State commissions have raised similar issues regarding protecting native load. There also is concern about load growth and how load serving entities would be able to get CRRs for increased needs, or how the use of CRRs would impact construction of new transmission capacity. Finally, there is a concern that CRRs need to be available for resources used to satisfy the resource adequacy requirement. The SMD NOPR left the regions a great deal of discretion in designing the transition process. There seems to be a desire among load in some industry segments for additional guidance on how the transition process will work.

Staff believes a public conference would be a good forum for airing and developing these issues and perhaps additional principles to be used in the transition process. Staff will prepare a paper providing more details on how CRR allocation would work. Additionally, the Commission could explore whether there should be eventual auction of CRRs or if a region could decide that an allocation process should be used for the foreseeable future.

6. Timing of Industry Responses.

There are two areas of concern on timing. First, SMD contains a multiplicity of details and getting the details right is very important to ensure customer protection. Load and state commissions in areas that have not previously used an LMP system have expressed concern that they do not have sufficient time to fully work through and understand all of the details of the proposal and how they work together. They are unwilling to support concepts in SMD unless they fully understand how they can protect themselves. Second, many have expressed concern that the implementation timeline (SMD in place by 2004) is too ambitious. They believe it will take more time to make the changes.

Based on the concerns we have heard, Staff believes that the timetable for issuing a Final Rule and for full implementation of SMD should be revised. Staff anticipates that a Final Rule could be issued in summer 2003. We also anticipate that the Commission may not see full implementation of SMD in all regions of the country at the same time. Certain aspects of the Final Rule should move forward at a faster pace than others. Formation of RSACs, for example, could begin soon after the Final Rule is issued. Staff recommends that the Commission communicate these revised expectations on timelines to the industry in the near future.

Staff Recommendations

Based on the feedback gathered by Staff, we are recommending additional meetings and public conferences with state commissions and the industry at large. The following is a proposed schedule of activities that would help address and resolve the major issues identified to date.

Staff-to-Staff Meeting with Southern Commissions
Suggested Date: Week of October 13, 2002
Suggested Site: Atlanta, Georgia
[Note: FERC staff would confer with Southern Commissions to determine the exact date and location.] This non-public meeting would consist of staff members of the Commission and state regulatory agencies. It would focus on identifying specific issues for southern states, including the ability to protect native load customers from cost shifts, assigning costs for transmission expansions, how public power would operate under SMD, the allocation of CRRs and other issues of concern.

Staff-to-Staff Meeting on Western Operations
Suggested Date: October 22, 2002
Suggested Site: Denver, Colorado
This non-public meeting, attended by senior FERC staff with technical staff from the industry, would identify major operational concerns by Western operators, including the unique characteristics of the Western hydro and public power systems.

Policy Meeting on Western Issues
Suggested Date: November 4, 2002
Suggested Site: Portland, Oregon
This meeting would be open to the public and attended by FERC commissioners and staff. It would address policy issues related to the West, proposals for flexibility in certain areas of the NOPR, and differences in market design within the Western Interconnection.

Working Group Meeting on Participant Funding
Suggested Date: November 6, 2002
Suggested Site: FERC Headquarters, Washington, DC
This meeting would be open to the public and would address the concerns outlined above in the memo.

Discussion of RSACs and State Issues
Suggested Dates: November 10-13, 2002
Suggested Site: NARUC Annual Conference in Chicago, Illinois
This event would include participation in the NARUC Annual Conference by FERC commissioners and members of the FERC staff, a major presentation by FERC on Wednesday morning, November 13, and a keynote address by FERC Chairman Pat Wood.

Working Group Meeting on Resource Adequacy
Suggested Date: November 19, 2002
Suggested Site: FERC Headquarters, Washington, DC
This meeting would be open to the public and would address the concerns outlined above in the memo.

Working Group Meeting on CRRs and Transition Issues
Suggested Date: December 3, 2002
Suggested Site: FERC Headquarters, Washington, DC
This meeting would be open to the public and would address the concerns outlined above in the memo.

Recommendations on Extension of Time for Comments

Because of the extensive outreach and discussion that FERC staff is recommending, we believe the Commission should consider extending the deadline for comments on this proposed rulemaking.

1. The Commission would retain the November 15 deadline for comments covering most issues raised in the proposed rulemaking, but would establish a January 10, 2003 deadline for initial comments on the following topics:

    - Market Design for the Western Interconnection
    - Transmission Planning and Pricing, including Participant Funding
    - RSACs and State Participation
    - Resource Adequacy
    - CRRs and Transition Issues

2. Staff recommends retaining a single deadline for reply comments, but rescheduling it for February 17, 2003 for the entire series of comments.