State of California **Public Utilities Commission**
San Francisco

M E M O R A N D U M

Date : May 8, 2008

To : The Commission
(Meeting of May 15, 2008)

From : Laurence G. Chaset, Legal Division
Bishu Chatterjee, Energy Division

Subject : FERC Docket No. RM07-1-000 -- Standards of Conduct for Transmission Providers

INTRODUCTION

On March 21, 2008, Federal Energy Regulatory Commission (FERC) released a Notice of Proposed Rulemaking (NOPR) proposing to revise its Standards of Conduct for transmission providers to make them clearer and to refocus the rules on areas where there is the greatest potential for affiliate abuse. FERC also proposes to facilitate compliance with, and the enforcement of, these standards. Staff seeks the Commission's authorization to file comments in response to this NOPR.

BACKGROUND

On January 18, 2007, FERC had issued an earlier NOPR in this Docket. In that earlier NOPR, FERC had proposed to adopt permanent regulations regarding the standards of conduct consistent with the decision of the United States Court of Appeals of the District of Columbia in National Fuel Gas Supply Corporation v. FERC, 468 F.3d 831 (2006), regarding natural gas pipelines. On January 9, 2007, FERC had issued an interim rule regarding the Standards of Conduct in response to the court's decision, and the NOPR solicited comments regarding whether or not the interim rule should be made permanent, and, specifically, whether or not these revised Standards of Conduct should govern the relationship between electric utility transmission providers and their energy affiliates.

Of particular importance, in that earlier NOPR, FERC acknowledged concerns that a number of state utility commissions had brought to its attention to the effect that

the existing Standards of Conduct restricted the ability of utilities to conduct thorough integrated resource planning. To address these concerns, FERC proposed to create a category of employees under the standards of conduct, namely, "planning employees," who would be permitted to engage in all aspects of integrated resource planning for bundled retail load, including to receive non-public transmission information, as well as to interact with transmission function employees, provided that integrated resource planning is conducted pursuant to a state mandate.

Based on its review of the initial comments on that earlier NOPR that various entities (primarily, NARUC and other state commissions) had filed, Legal Division filed substantive Reply Comments that reflected existing Commission policy. Specifically, our Reply Comments noted that FERC's proposal to allow for interaction between utility planning employees and transmission function employees would promote improved coordination as well as more meaningful, useful and accurate integrated resource planning. This proposal was especially important for California where the CPUC had already adopted comprehensive planning and procurement requirements, including the adoption of a regulatory framework for long-term planning and procurement of energy resources, the adoption by the CPUC and the California Energy Commission of the Energy Action Plan establishing a preferred loading order for the resources to be acquired by the state's utilities in order to meet demand, and where the State had adopted an ambitious Renewable Portfolio Standard (RPS) whereby 20% of the state's electric energy is to be provided by renewable energy sources by 2010.

Our Reply Comments also pointed out that given the locationally constrained nature of many renewable energy sources, it will be absolutely necessary for new transmission to be developed in order to access the additional renewable resources that will be necessary to achieve the State's very ambitious RPS goal. Thus, in the absence of FERC's proposed modification to the standards of conduct, there could be a significant potential for internal conflict, redundancy and inefficiency in connection with the efforts of California's utilities to engage in the sophisticated, coordinated resource and transmission planning that will be essential in order to meet both their long-term procurement objectives, and even more critically, the State's RPS goal, in a "least cost best fit" manner.

Finally, our Reply Comments noted that California's energy resource procurement efforts are structured in such a manner as to affirmatively prevent both undue discrimination and affiliate abuse, in that the utilities' long-term procurement plans are subject to CPUC approval and that under the guidance of the CPUC, each utility has established a Procurement Review Group, consisting of various representatives of ratepayer advocate and other non-profit customer groups, which have the right to review the details of the utility's procurement strategy, as well as all longer-term (5 years or longer) procurement contracts that the utility intends to submit for CPUC approval.

However, after giving consideration to the comments submitted in response to the initial NOPR, FERC considered that it was necessary and appropriate to modify the approach proposed in the initial NOPR. Hence, on March 21, 2008, FERC issued a new NOPR, proposing regulations that would modify FERC's long-standing Standards of Conduct rules set forth in 18 CFR Part 358. FERC's basic reasons for these proposed changes were predicated, in substantial part, by FERC's new civil penalty authority (bestowed by the Energy Policy Act of 2005), which leads FERC to be mindful of the fact that its regulations must be as clear as possible, and also to strengthen enforcement of the Standards by proposing additional transparency to aid in the detection of affiliate abuse.

DISCUSSION

Under current rules, planning and procurement personnel (designated as "Energy Affiliates") cannot have access to non-public transmission information necessary for integrated resource planning or procurement purposes. The new NOPR attempts to facilitate resource planning and competitive solicitation activities by eliminating the Energy Affiliate designation. To replace this definition, FERC proposes new definitions of "marketing function" and "transmission function" employees, who must function independently from each other. Of particular relevance, the new definition of "marketing function" refers to the "sale for resale" of power or the "submission of offers or bids" to buy or sell power or other products.

Although this new definition of "marketing function" provides for an exemption for "bundled retail sales" it does not explicitly exempt employees engaged in purchases necessary to serve bundled retail load, nor does it provide an exemption for state-mandated purchases, such as capacity purchases made to serve area-wide load or purchases necessary to meet state-imposed RPS goals. Therefore, it is not clear under the proposed definition of "marketing function" whether employees engaged in procurement/competitive solicitation activities for retail load or for other state-mandated programs are permitted to receive transmission information.

In addition, the new definition of "transmission function" includes "planning" as well as transmission system operations. This could have the effect of isolating transmission planners within the transmission function and, absent other changes in the rules, forestall the sort of effective "integrated" resource planning that is expected to occur in connection with the implementation of California's Renewable Energy Transmission Initiative, which this Commission has strongly supported, and the California ISO's Generator Interconnection Process Reform initiative, in which Commission staff and representatives of the CPUC-jurisdictional electric utilities have taken a leading role.

In order for California's utilities to make informed choices to meet their state obligations consistent with the principle of "least-cost, best-fit," FERC's revised Standards of Conduct rules should exempt employees engaged in purchases necessary to meet retail load and other state-mandated programs, such as the RPS, as well as all employees engaged in the integrated planning of transmission from rules that would require such employees to make decisions without full access to all relevant available information. However, FERC's rules need to continue not to exempt any employees working for a utility's unregulated affiliates.

ACTION REQUESTED

Legal Division and Energy Division request authorization to submit comments on FERC's proposed Standards of Conduct for Transmission Providers that are consistent with the foregoing discussion.

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