

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

Standards of Conduct for)	
Transmission Providers)	Docket No. RM07-1-000
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**Comments of the
National Association of Regulatory Utility Commissioners**

The National Association of Regulatory Utility Commissioners (“NARUC”) appreciates the opportunity to provide comments to the Federal Energy Regulatory Commission (“FERC or the “Commission”) in response to its March 21, 2008 Notice of Proposed Rulemaking (“NOPR”) in the *Standards of Conduct for Transmission Providers* proceeding (Docket No. RM07-1-000).

COMMUNICATIONS

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BASIS FOR NARUC’S INTEREST

NARUC is the national organization of the State commissions responsible for economic and safety regulation of the retail operations of utilities. Specifically, NARUC’s members have the obligation under State law to ensure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, as well as ensuring that

such services are provided at just and reasonable rates. NARUC's members include the government agencies in the fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands charged with regulating the rates and terms and conditions of service associated with the intrastate operations of electric, natural gas, water, and telephone utilities. Both Congress¹ and the Federal courts² have long recognized NARUC as the proper party to represent the collective interest of State regulatory commissions.

DISCUSSION

NARUC's comments follow the organizational scheme of the NOPR, which focuses on four topics: (1) The Need for Reform; (2) The Independent Functioning Rule; (3) The No Conduit Rule; and (4) The Transparency Rule.

The Commission is proposing to reform its Standards of Conduct for Transmission Providers ("SoC") Rules by refocusing on the areas where there is the greatest potential for affiliate abuse. FERC expects the new rules to both (1) comply with the decision in National Fuel Gas Supply Corp. v. FERC, 468 F.3d 831 (D.C. Cir. 2006) ("National Fuel"), and (2) combine the best elements of the SoC Rules adopted in Order Nos. 497³, 889⁴ and 2004⁵.

¹ See 47 U.S.C. § 410(c) (1971) (Congress designated NARUC to nominate members of Federal-State Joint Boards to consider issues of concern to both the Federal Communications Commission and State regulators with respect to universal service, separations, and related concerns); Cf., 47 U.S.C. § 254 (1996) (describing functions of the Joint Federal-State Board on Universal Service). Cf. *NARUC, et al. v. ICC*, 41 F.3d 721 (D.C. Cir. 1994) (where the Court explains "...Carriers, to get the cards, applied to...[NARUC], an interstate umbrella organization that, as envisioned by Congress, played a role in drafting the [rules] the ICC issued to create the "bingo card" system).

² See *United States v. Southern Motor Carrier Rate Conference, Inc.*, 467 F. Supp. 471 (N.D. Ga. 1979), aff'd 672 F.2d 469 (5th Cir. 1982), aff'd en banc on reh'g, 702 F.2d 532 (5th Cir. 1983), rev'd on other grounds, 471 U.S. 48 (1985).

³ Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines, Order No. 497, 53 FR 22139 (1988), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,820 (1988); Order No. 497-A, order on reh'g, 54 FR 52781 (1989), FERC Stats & Regs., Regulations Preambles 1986-1990 ¶ 30,868 (1989); Order No. 497-B, order extending sunset date, 55 FR 53291 (1990), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,908 (1990); Order No. 497-C, order extending sunset date, 57 FR 9 (1992), FERC Stats. & Regs., Regulations Preambles 1991-1996 ¶ 30,934 (1991), reh'g denied, 57 FR 5815 (1992), 58 FERC ¶ 61,139 (1992); aff'd in part and remanded in part sub nom. Tenneco Gas v. FERC, 969 F.2d 1187 (D.C. Cir. 1992) (collectively, Order No. 497).

Order Nos. 497 and 889 established a functional separation between transmission and merchant personnel for natural gas and electric transmission providers that was relatively clear and worked well. Order No. 2004 significantly expanded the scope of the SoC Rules to include Energy Affiliates beyond pipelines' relationships with their *marketing* affiliates to govern also pipelines' relationships with numerous *non-marketing* affiliates—processors, gatherers, producers, local distribution companies, and traders - and adopted a revised corporate separation approach to accommodate the addition of these affiliates. Order No. 2004 also specified a single set of standards applicable to both natural gas and electric industries. Based on no record evidence of the targeted abuses, the National Fuel court rejected expansion of the SoC to reach non-marketing energy affiliates in the natural gas industry. It did not address FERC's efforts to specify a single set of standards for both the gas and electric industries.

FERC continues to believe that (1) a single SoC should apply to both industries, although the proposed regulations do account for differences in discrete areas, and (2) these standards should be patterned on the functional separation of marketing and transmission personnel that was adopted in Order Nos. 497 & 889. FERC will not attempt to rehabilitate the “corporate separation” approach rejected by the decision in National Fuel because it never proved workable in practice.

⁴ Open Access Same-Time Information System (Formerly Real-Time Information Network) and Standards of Conduct, Order No. 889, 61 FR 21737 (May 10, 1996), FERC Stats. & Regs., Regulations Preambles Jan. 1991-June 1996 ¶ 31,035 (Apr. 24, 1996); Order No. 889-A, order on reh'g, 62 FR 12484 (Mar. 14, 1997), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,049 (Mar. 4, 1997); Order No. 889-B, reh'g denied, 62 FR 64715 (Dec. 9, 1997), 81 FERC ¶ 61,253 (Nov. 25, 1997) (collectively, Order No. 889).

⁵ Standards of Conduct for Transmission Providers, Order No. 2004, FERC Stats. & Regs., Regulations Preambles 2001-2005 ¶ 31,155 (2003), order on reh'g, Order No. 2004-A, FERC Stats. & Regs., Regulations Preambles 2001-2005 ¶ 31,161 (2004), order on reh'g, Order No. 2004-B, FERC Stats. & Regs., Regulations Preambles 2001-2005 ¶ 31,166 (2004), order on reh'g, Order No. 2004-C, FERC Stats. & Regs., Regulations Preambles 2001-2005 ¶ 31,172 (2004), order on reh'g, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), vacated and remanded as it applies to natural gas pipelines sub nom. Nat'l Fuel Gas Supply Corporation v. FERC, 468 F.3d 831 (D.C. Cir. 2006); *Standards of Conduct for Transmission Providers*, Order No. 690, 72 Fed. Reg. 2,427 (Jan 19, 2007), FERC Stats. & Regs ¶ 31,237, order on reh'g, Order No. 690-A, 72 Fed. Reg. 14235 (Mar. 27, 2007), FERC Stats. & Regs. ¶ 31,243 (2007); see also *Standards of Conduct for Transmission Providers*, Notice of Proposed Rulemaking, 72 Fed. Reg. 3,958 (Jan. 29, 2007), FERC Stats. & Regs. ¶ 32,611 (2007).

(1) THE NEED FOR REFORM

Simplifying and streamlining the Standards of Conduct can only facilitate compliance and enhance enforcement.

Broad reforms to clarify the Rules are necessary given FERC's enhanced civil penalty authority granted by the Energy Policy Act of 2005 for non-compliance. The complexity of the existing Rules can frustrate both company compliance and FERC efforts to enforce the rules. As acknowledged in the NOPR, FERC has received numerous comments from the regulated community that the existing Rules contain so many ambiguities that they impede good faith efforts to comply – leaving companies, in spite of their best efforts, exposed to significant civil penalties. Those same ambiguities can also frustrate FERC enforcement efforts, lead to inconsistent and uneven applications of the rules, or waste FERC resources on wavier proceedings.

FERC should require filed compliance plans, regular audits and reports.

Clarification of the SoC Rules can only improve FERC's ability to rectify and sanction violations.⁶ If clear auditing and reporting standards are not specified with SoC Rules then compliance is very difficult, if not impossible to enforce.⁷ FERC can profit from NARUC members' experiences. Many State SoC Rules include provisions that require a compliance plan

⁶ The purposes of SoC Rules include: preventing preferential treatment, especially to affiliates; aiding in the development of competitive markets; ensuring that utility ratepayers do not subsidize unregulated utility affiliates; removing the uncertainty for both utilities and their competitors; creating barriers to self-dealing; and addressing how an incumbent utility shall conduct business with an affiliate to promote fair competition and a level playing field among all participants. The existing rules deter undue preference by: (i) separating a transmission provider's employees engaged in transmission services from those engaged in its marketing services, and (ii) requiring that all transmission customers, affiliated and non-affiliated, be treated on a non-discriminatory basis. *Resolution Accepting White Paper on Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions* (November 2000).

⁷ *Resolution Accepting White Paper on Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions* (November 2000).

to be filed with the responsible regulatory agency.⁸ Frequently, these plans include requirements for periodic independent audits that provide an opinion on the utility's compliance, and reporting requirements that assist the responsible agency's monitoring of compliance with mandated standards.⁹

(2) THE INDEPENDENT FUNCTIONING RULE

The Functional Separation Approach clarifies what is prohibited conduct and facilitates compliance.

For all of the reasons outlined by the NOPR, FERC should rescind the corporate separation approach adopted in Order No. 2004 in favor of the functional separation approach used in Order Nos. 497 and 889.¹⁰ The NOPR concedes this corporate separation approach has (1) proven so difficult to implement that it has generated scores of waiver requests, (2) frustrated compliance by diverting the industry's focus from the purpose of the SoC Rules – the conflict of interest between the functions of transmission and merchant activities, and (3) impeded legitimate integrated resource planning (“IRP”) and competitive solicitations.

⁸ Id.

⁹ Id.

¹⁰ A fundamental consideration in developing SoC Rules is the question of the extent to which a utility's competitive activities should be separated from the regulated side of the business. While there are no industry-wide definitions, generally speaking, functional separation allows competitive activities to be operated from within the utility, its divisions or departments, and structural separation suggests that competitive business activities are operated by separate legal or corporate entities. Functional separation may be less difficult to establish and allows the utility to retain some economies of scope for both its regulated and competitive endeavors. However, it may allow more opportunity for information sharing, discrimination, and cross-subsidization. Structural separation is perhaps more difficult to accomplish and some of the economies of scope are lost. However, it presents less opportunity for cross-subsidization and inappropriate sharing of information. *Resolution Accepting White Paper on Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions* (November 2000).

The distinction between corporate and functional separation gains importance in a competitive market.¹¹ Corporate separation will tend to draw all activities of a firm into regulatory control, even activities that may be well outside the scope of the utility service. Indeed, as the NOPR points out, this approach has led to the proliferation of requests for waivers to carve out employees not involved in core activities that may result in undue preference. These waivers made it difficult to know with which persons an employee may or may not interact. Where waivers weren't granted, this approach also undermined the legitimacy of the Rules as employees may find a prohibition against interacting with employees who have nothing to do with sensitive marketing or transmission information nonsensical.

The proposed employee functional approach accomplishes FERC's goal *directly* by identifying which employees may not interact with one another. The prohibition depends on the job function of the employee, not the company or division where the employee works. Because this practice has been well-established for almost twenty years, both pipelines and public utilities understand the general concept of independent functioning. Regulation based on function will tend to ignore outside activities unless they impinge on the regulated activity in some way.¹² This approach makes the purpose of the prohibition clearer and makes it easier for employees to comply because job function will be apparent.

¹¹ It is useful to consider SoC Rules within a framework of techniques for mitigating market power. There are two primary approaches to handling market power: structural and behavioral. A behavioral approach involves the establishment of rules governing the relationship between the utilities and their marketing affiliates rather than changing the structure of the market. The incentive to discriminate, cross-subsidize, or otherwise abuse market power is not changed. However, while they are easier to implement, behavioral remedies require ongoing oversight and enforcement to ensure compliance. SoC Rules are one of the most common types of behavioral remedy. *Resolution Accepting White Paper on Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions* (November 2000).

¹² *Resolution Accepting White Paper on Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions* (November 2000).

(A) TRANSMISSION FUNCTION EMPLOYEE

The proposed exemption for planning purposes should include activities to meet State polices and programs.

In an earlier proceeding, NARUC supported the creation of two new categories of exempt employees – the Planning Employee and the Competition Solicitation Employee¹³ - as proposed in the initial NOPR. NARUC still supports exempting employees performing these functions from categorization as either *transmission* or *marketing* function employees.

For example, FERC proposes that a person who performs a planning function, and is not “engaged in” making wholesale offers, bids or sales, does not fall within the prohibited category of a *Marketing Function Employee*. This employee is free to discuss system planning, including State-mandated IRP, with *Transmission Function Employees*. NARUC supports this exception.

However, *FERC should specify that employees engaged in competitive resource procurement, including purchases necessary to meet retail load and other State-mandated programs, such as capacity purchases necessary to meet State Renewable Portfolio Standards, as well as all employees engaged in the integrated planning of transmission do not fall under the definition of Marketing Function Employee.*

Allowing an exemption from the SoC Rules for planning communications between resource and transmission planners will facilitate more effective coordination of State, subregional, and regional efforts. The rationale behind the Rules is to prohibit *preferential* non-public information sharing between transmission providers and market affiliates, not to prohibit all information disclosures *per se*.¹⁴ Indeed, the current application of the existing Rules to the

¹³ See NARUC comments in the initial NOPR.

¹⁴ The concerns include the potential for transmission providers: (1) to provide market affiliates with transmission information not available to other market participants and (2) to make use of private information to provide market affiliates with unduly superior service.

planning process for utilities serving bundled retail load is unnecessary and undesirable. For example, in States requiring long-term IRPs, there is potential for internal conflict, redundancy, and inefficiency when there are two sets of transmission planners (one on the resource side and another on the transmission side).¹⁵

To be fully integrated, IRPs must consider the full range of resource choices *as well as* the transmission system characteristics needed to integrate those resources and move power supplied by those resources to retail load. Generation resources, including those procured through the use of competitive solicitation efforts, are unable to serve bundled retail load if they are not connected by transmission to the load the utility is obligated to serve. Similarly, transmission resources are of little use for meeting a utility's service obligations if they are not integrated with the generation resources the utility uses to serve its retail load. A utility serving bundled retail load cannot identify the lowest cost and lowest environmental impact resources for serving its load if it cannot consider all potential combinations of generation and transmission as a joint product.

While some information of this type is available publicly through the utility's Open Access Same-time Information System ("OASIS"), the proscription on non-public communication between utility transmission and generation functions prevents a utility from thoroughly exploring scenarios to combine and optimize its transmission and generation options. Permitting employees engaged in long-term planning and resource acquisition, including employees involved in competitive resource solicitation efforts for the purpose of serving

¹⁵ The Commission's previous outreach efforts confirmed that the Rules restrict the ability of public utilities to conduct IRP. The reasons cited in support of this assertion were that the Rules restrict access to non-public transmission information and restrict transmission function employees from interacting with employees conducting IRP.

bundled retail load, to interact with transmission function employees will improve the quality and reliability of long-term resource plans.

FERC also proposes an exemption to the Independent Functioning Rule for the exchange of information necessary to maintain or restore operation of the transmission system. FERC allows these exchanges only to the same extent that a transmission provider would exchange information with similarly situated marketing function employees of a non-affiliated entity. It requires a contemporaneous record of exchanges made pursuant to this exception.

NARUC supports this exemption to the extent it covers interactions regarding reliability functions. The NOPR acknowledges that several reliability standards require an electric transmission provider to coordinate operations with entities that may include market affiliates and marketing functions employees. At the same time, it deems it “the first order of business on the part of a transmission provider to ensure reliability of operations.” NARUC has consistently supported legislation to provide FERC authority to enforce mandatory reliability standards for the bulk electric system applicable to all market participants. The public interest in a reliable and cost-efficient transmission system requires that the level of reliability to be achieved, and the standards and criteria to be complied with, be established with public input and oversight.

(B) MARKETING FUNCTION EMPLOYEE

The proposed exemptions for bundled retail sales and transmission providers acting as POLRs facilitate State goals.

FERC has previously exempted “bundled retail sales” from the definition of marketing. NARUC supports the proposal to carry forward this exemption for the reasons described in the planning section *supra*. FERC also proposes that the general exemption for bundled retail sales should also apply to transmission providers acting as providers of last resort (“POLRs”) –

transmission providers charged with serving retail customers when the customers choose not to purchase from other suppliers. As FERC acknowledged in the NOPR, those opposing the exemption could only present *theoretical* instances of abuse. We agree that, in the absence of actual evidence of abuse, the general exemption of bundled retail sales should apply to POLRs as well.

(C) PERMITTED INTERACTIONS

FERC should continue monitoring for abuse of these exceptions.

The Commission proposes an exception to the Independent Functioning Rule for communications for reliability situations as described *supra* and also in instances where the transmission function employees must communicate with the marketing function employees. NARUC supports the exception for reliability situation communications for the reasons described *supra*. We also support the exception for communications between transmission function employees and marketing function employees where it is essential that the employees who supervise the operation of the generating plants be able to discuss the plants' operational status with transmission function employees, as such information will affect flows and availability on the company's transmission system."¹⁶ At the same time, FERC should continue to verify that the communications properly fall under the exception. NARUC also supports the proposals to prevent and monitor for potential abuse of these exceptions, subject to our suggested enhancements to FERC enforcement as discussed *supra*.

¹⁶ See NOPR at Para. 47.

(3) THE NO CONDUIT RULE

The No Conduit Rule proposals should continue to strengthen proscriptions against the exchange of prohibited information.

The Commission advances various proposals, including prohibiting marketing function employees from receiving non-public transmission function information from any source; and prohibiting both an employee of a transmission provider and an employee of an affiliate engaged in marketing functions from disclosing non-public transmission function information to marketing function employees. *NARUC supports these proposals so long as they are designed to reach all sources of a prohibited informational exchange.*

FERC also proposes a “safety valve” by including an exemption to the no conduit rule that parallels the exemption to the independent functioning rule discussed *supra*. NARUC supports this exemption for the same reasons we support the parallel independent functioning exemption as discussed *supra*.

Finally, FERC discusses various measures to facilitate compliance with the proscriptions, including designating a Chief Compliance Office and certified training requirements. NARUC has already provided specific improvements to FERC’s compliance activities *supra*.

(4) THE TRANSPARENCY RULE

The Transparency Rule proposals should facilitate the goal to prevent undue discrimination and undue preference.

In this section of the NOPR, FERC proposes the retention of certain existing regulations and exceptions, and modification to other regulations. NARUC generally supports these proposals so long as they facilitate the No Conduit Rule’s prohibitions on receipt and disclosure

of information to prevent undue discrimination and undue preference by a transmission provider towards its marketing affiliate or division. We support methods to comply with the prohibitions, including making the prohibited information public on the transmission provider's OASIS or the natural gas industry's Internet.

CONCLUSION

NARUC respectfully requests that Commission incorporate the foregoing proposals in its final rule.

Respectfully submitted,

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May 12, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list via electronic mail compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 12th day of May, 2008.

By: _____/s/_____
Grace D. Soderberg