

BEFORE THE
LOUISIANA PUBLIC SERVICE COMMISSION

ORDER NO. U-25965-A

(CORRECTED)

DOCKET NO. U-25965 - LOUISIANA PUBLIC SERVICE COMMISSION V. CLECO POWER LLC, ENTERGY GULF STATES, INC., ENTERGY LOUISIANA, INC., SOUTHWESTERN ELECTRIC POWER COMPANY AND LOUISIANA GENERATING LLC - IN RE: RULE TO SHOW CAUSE WHY LOUISIANA TRANSMISSION-OWNING ENTITIES SHOULD NOT BE ENJOINED FROM TRANSFERRING THEIR BULK TRANSMISSION ASSETS TO A TRANSCO AND RELATED ISSUES

(Decided at the Business & Executive Session dated 2/27/2002)

This proceeding involves the Rule to Show Cause issued by the Louisiana Public Service Commission ("LPSC") on September 21, 2001, in response to a series of orders promulgated by the Federal Energy Regulatory Commission ("FERC"). These orders sought to mandate participation by Louisiana utilities in a Southeast regional transmission organization ("RTO") and purported to compel all transmission-owning entities, by December 15, 2001, to commit to join an RTO. The Rule to Show Cause was issued to gain the information needed to determine, in advance of the FERC deadline, whether the transfer of ownership or control of the utilities' transmission assets to an RTO is in the public interest and to investigate the potential structure of the RTO, including the form of participation in the RTO. Based on the evidence presented, the Commission finds that the transfer of ownership or control of transmission assets to a for-profit transmission entity ("Transco") presumptively is not in the public interest; that Louisiana utilities be directed not to join any RTO without performing certain analyses; and, that the Staff proceed to analyze congestion management methods and develop, as necessary, ratepayer protection mechanisms to deal with potential adverse consequences of the "financial rights" model for congestion management.

I. OVERVIEW AND PROCEDURAL HISTORY

A. The Louisiana Proceeding

This matter is before the Louisiana Public Service Commission on a Rule to Show Cause issued by the Commission at its September 21, 2001 Business and Executive Session and by written Order dated September 27, 2001. The Order directed Cleco Power LLP ("CLECO"), Entergy Gulf States, Inc. ("EGSI"), Entergy Louisiana, Inc. ("ELI"), Southwestern Electric

Power Company ("SWEPCO"), and Louisiana Generating LLC ("Louisiana Generating") (sometimes collectively referred as "Transmission-Owning Entities")¹ to demonstrate the following:

1. Why they should not be enjoined from transferring ownership or control of their bulk transmission assets, paid for by jurisdictional ratepayers, to a TRANSCO or any similar organization?
2. Why they should not be enjoined from joining a Southeast Regional Transmission Organization as opposed to an SPP RTO or other regional transmission organization?
3. Why the Louisiana Public Service Commission should not declare that the pricing and cost transfers required by the recommendation of the Administrative Law Judge, in FERC Docket RT01-100-000, conflict with the public interest?

The Transmission-Owning Entities were directed to respond to this Order by October 9 and to provide responses to ten questions attached to the Order. These questions were designed to provide information regarding the Transmission-Owning Entities' plans to join an RTO; the available RTO options; the preferred form of participation in an RTO; when the RTO is expected to be functional; whether transferring ownership of transmission assets into a Transco would be in the public interest; the cost impact of joining an RTO, including the effect on wholesale sales and purchases; and, the effect of joining an RTO on the LPSC's regulatory oversight. On October 9, CLECO, SWEPCO, and Louisiana Generating responded to the Show Cause Order and accompanying questions. EGSI and ELI provided responses on October 31, 2001.

When the Commission Order was issued, the FERC had in effect an order requiring all transmission-owning utilities to join a regional transmission organization ("RTO") by December 15, 2001. That deadline has now been extended, but the FERC's resolve to establish a large RTO in the Southeast portion of the United States apparently has not diminished.

A hearing examiner was appointed in this matter, and a procedural schedule was established. Initial Testimony was due on November 9, 2001 and Reply Testimony on

¹ Each of these companies is a vertically-integrated utility, except Louisiana Generating.

November 19, 2001. In accordance with the procedural schedule, the Commission Staff submitted the "Direct Testimony and Exhibit of Stephen J. Baron" and the "Direct Testimony of Matthew I. Kahal." CLECO submitted the "Direct Testimony and Exhibits of David W. Brammer." SWEPCO submitted the "Testimony of Michael Desselle" and, subsequently, the "Reply Testimony of Michael Desselle." The Louisiana Environmental Action Network ("LEAN"), Alliance for Affordable Energy ("Alliance"), and Mike Thibodeaux filed a joint position paper.

Despite owning extensive transmission assets in Louisiana, EGSI and ELI failed to file direct testimony, and instead submitted a "Joint Position Paper on Behalf of Entergy Gulf States, Inc. and Entergy Louisiana, Inc. in Response to Rule to Show Cause Why Transmission-Owning Entities Should Not be Enjoined from Transferring Their Bulk Transmission Assets to a Transco and Related Issues." This paper challenged the Commission's jurisdiction to conduct the current proceeding and stated, with little explanation, the Companies' intention to proceed with the Transco structure. On November 19, 2001, EGSI and ELI submitted the "Reply Testimony of Frank F. Gallaher." By failing to submit Initial Testimony, EGSI and ELI undermined the ability of the parties in this proceeding to conduct discovery regarding their positions. The Reply Testimony was submitted the Wednesday before the Thanksgiving holiday, with the hearings scheduled to begin five days later. Indeed, the only date on which Entergy made its witness available for deposition was the Saturday after Thanksgiving, two days before the hearings began.

Hearings were held on November 26 and 27, 2001 and December 17, 2001, before the Honorable Vanessa Caston Lafleur, Hearing Examiner. At the hearings, all parties were given the opportunity to present evidence and to cross-examine all witnesses.

B. Summary of the Staff Recommendation

Based on the prefiled testimony and evidence presented at the hearings, the Commission finds that the transfer of ownership or control by the Transmission-Owning Entities

of their bulk transmission assets to a for-profit Transco or independent transmission company² presumably is not in the public interest at this time, whether that transfer is to a stand-alone Transco or a Transco participating in an RTO. Any attempt by the Transmission-Owning Entities to establish, join, or transfer transmission assets or operations to a Transco shall be declared presumptively imprudent.

In addition, the Commission will require the Transmission-Owning Entities to examine, fully and systematically, all reasonably feasible RTO options, including all options available in the Southeast Region, the Midwest Region and the Southwest Power Pool Region. Those analyses should include the economic impacts of these various options and must be performed prior to committing to join any such organization. The economic impact on native load customers should be a primary consideration in selecting an appropriate RTO option. The Transmission-Owning Entities also should analyze what the effects of a large RTO configuration, such as the FERC proposed Southeast Region, will have on transmission service, as compared to a smaller geographic configuration, such as the SPP/Entergy Region. Until these analyses are complete, the Transmission-Owning Entities are precluded from joining a particular RTO.

Finally, based on its preliminary analysis of this issue, the Staff recommended that the Commission order an extensive examination of transmission congestion pricing issues, including the relative impacts of physical transmission congestion rights versus the various options for financial rights. The Commission adopts this recommendation. The tool apparently preferred by the utilities for congestion pricing is a methodology known as "locational marginal pricing" or "LMP." LMP appears to provide only limited incentives to remediate congestion while, at the same time, places upward pressure on the pricing of generation and transmission, especially in congested areas. The supposed mechanism to protect retail customers against these costs is undeveloped, and it is not clear that ratepayers will be insulated from the congestion

² For purposes of this discussion, the term "Transco" also refers to an "Independent Transmission Company" or "ITC." These terms, although having somewhat different meanings, are generally used interchangeably. (Brammer, Dir., p. 4.)

charges and pricing provided for by LMP. These issues need to be addressed in much greater detail, and we direct the Staff to proceed with this analysis and, as necessary, propose ratepayer protection methods to address the potential harmful impacts of congestion management pricing.

II. FERC EFFORTS TO COMPEL UTILITIES INTO MEMBERSHIP IN REGIONAL RTOS

A. Order 2000

On December 20, 1999, the FERC issued Order No. 2000, which, after much input from affected parties, established rules for the minimum characteristics, functions and standards for RTOs. (*See* Regional Transmission Organizations, 65 Fed. Reg. ¶ 810 (Jan. 6, 2000) (hereinafter "Order 2000").) In Order 2000, the FERC strongly encouraged participation by transmission-owning utilities in the RTO process but did not mandate utilities to join RTOs. (*Id.* at p. 834.)

The FERC stated in Order 2000 that large RTOs are necessary to achieve the FERC's goal of competition in the wholesale electricity market. (*Id.* at pp. 811-813.) According to the FERC, an RTO of adequate size and scope (and meeting FERC standards for independence and function) would provide the platform and structure for wholesale market development. Order 2000 required all jurisdictional transmission owners to file their RTO plans or proposals, or an explanation for not having a proposal, by October 2001.

Although the FERC did not mandate participation in RTOs, the FERC indicated that it might attempt this step if the voluntary process did not succeed. The FERC suggested that it could condition its approval of mergers on RTO participation or require RTO participation to alleviate "undue discrimination or anti-competitive effects." (Order 2000, 65 Fed. Reg. at p. 834). The FERC also suggested that the ability of utilities to sell wholesale power at market-based prices was dependent upon a showing that transmission market prices have been mitigated. (*Id.*) Although the FERC stated in Order 2000 that it would not deny market-based rate authority as a penalty for failing to join an RTO, the FERC recently did just that to the Entergy companies, SWEPCO, and Southern Company. (*Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy*, Docket Nos.

ER96-2495-015, et al., (November 20, 2001).)³ Regardless of its jurisdiction, it is clear that the FERC will utilize every means possible to force utilities into RTOs.

After the issuance of Order No. 2000, most utilities throughout the country, including those in Louisiana and adjoining states, began voluntary efforts to create RTOs in varying forms. The Southwest Power Pool ("SPP") made a filing with the FERC to create an RTO. Entergy, in partnership with the Southwest Power Pool, sought FERC approval for the formation of a for-profit Transco, which was to be a partner in the SPP RTO. Proposals to operate a Grid Florida RTO and a Gridsouth RTO among utilities in the Southeast also were presented for FERC approval. Many thousands of hours were spent in negotiations and discussions to develop these RTO proposals. In addition, many millions of dollars were spent in developing these RTOs. These proposed RTOs received varying levels of preliminary approval by the FERC.

The LPSC was kept informed of negotiations regarding the proposed formation of the SPP RTO. Entergy filed for approval of its Transco and joint RTO with the SPP, and some discovery occurred in that Docket before it was stayed. (*See* Docket No. U-25460.) Although supporting the concept that broader transmission coordination and planning are needed to create better access for customers to wholesale markets, the Commission expressed to the FERC various concerns, particularly regarding the Entergy Transco proposal.

³ In this order, the FERC developed a new test to determine whether utilities possessed market power and found, under the new test, that the Entergy companies, SWEPCO, and Southern Company possessed such power. The test was developed and applied with *no* evidence, *no* hearing, and *no* input from the affected companies, and the order is rife with procedural and substantive infirmities. In her dissent, Commissioner Breathitt chastises the FERC, stating that:

I disagree with using the threat of market-based rates as the "stick."
If forming RTOs is the goal here, then we should be straightforward about that and establish a rulemaking to mandate them--going through the front door, not the backdoor. (*Id.*, slip op. at p. 3.)

Perhaps recognizing the legal concerns regarding the order, the FERC recently stayed implementation of the more problematic market power mitigation measures contained in the order. (*Notice Delaying Effective Date of Mitigation and Announcing Technical Conference*, Docket Nos. ER96-2495-016, et al. (December 20, 2001).)

B. The July 12 Orders

Without the benefit of hearings or the presentation of evidence, in a series of orders issued on July 12, 2001, the FERC determined that four regional RTOs should be created to handle transmission over the entire nation.⁴ FERC mandated that the single RTO for the Southeast region⁵ be developed through a fast-track mediation process. The July 12 orders required the formation of RTOs in a predetermined size and shape, in violation of the FERC's statutory authority and the principles established in Order 2000 and without input from the States or any hearings on the issues.

The FERC also rejected the filings of Entergy and the SPP to form a joint RTO, stating that "the proposed RTO fails to satisfy the scope and regional configuration requirements set forth in Order No. 2000." (Order, FERC Docket RT01-34-000, slip op. at p. 2 (July 12, 2001).) The FERC failed to explain or provide any basis for this conclusion. The FERC directed that Entergy should consider joining the Southeast RTO, even if the remainder of the SPP group joins a different RTO. Although the FERC recognized that Entergy's historical trading market was within the SPP, the FERC suggested that this market "may" change without the current pancaking of transmission rates and once retail competition occurs. (*Id.* at 11.) The FERC required that parties to the Entergy, Gridsouth, Southern Company and SPP RTO proceedings participate in the mediation.

The FERC set an expedited 45-day mediation process devoted to establishing a Southeast RTO. (*Order Initiating Mediation*, Docket RT01-100-000 (July 12, 2001).) The

⁴ RTOs are to be established in the Southeast, Northeast, Midwest, and Western regions of the United States. Only Florida and Texas were exempted from involuntary participation in these RTOs. See *Order Initiating Mediation*, 96 FERC ¶ 61,065 (July 12, 2001) and accompanying orders in FERC Docket Nos. RT01-2-000, RT01-98-000, RT01-10-000, RT01-95-000, RT01-86-000, and RT01-94-000 regarding the Northeast region; *Order Initiating Mediation*, 96 FERC ¶ 61,066 (July 12, 2001) and accompanying orders in FERC Docket Nos. RT01-74-002 and -003, RT01-77-000, RT01-34-000 and -002, and RT01-75-000 and -003 regarding the Southeast region. See also *Order on RTO Filing*, 96 FERC ¶ 61,052 (July 12, 2001) addressing the proposed Alliance RTO and coordination required with the Midwest Independent System Operator, which relate to the development of the Midwest RTO.

⁵ The single RTO for the Southeast is to include the following states: North Carolina, South Carolina, Tennessee, Georgia, Alabama, Mississippi, Louisiana, parts (if not all) of Florida, and at least part (if not all) of Arkansas.

FERC required that parties to the Entergy, Gridsouth, Southern Company and SPP RTO proceedings participate in the mediation. (*Id.*) Entergy, CLECO, and SWEPCO participated in the mediation. The LPSC was not a party to the mediation but did participate informally in discussions with the mediator. The FERC Administrative Law Judge serving as the mediator was directed to issue a report within ten days from the close of the mediation that would, among other things, include an outline of the proposal to create a single RTO for the Southeast region of the United States.

The July 12 FERC orders were issued without notice, without statutorily required input from the States and other interested parties, and without complying with due process requirements. The orders violated federal laws requiring notice to and input from the affected States before any change in transmission coordination districts may be implemented. (Federal Power Act § 202(a), 16 U.S.C. § 824a(a).) The orders mandated results that likely would strip the States of authority over transmission matters and result in cost increases for retail electric consumers.

The FERC orders represent sweeping changes in the manner that the FERC and industry previously attempted to organize the national transmission grid. Prior to the July 12 orders, the FERC appropriately recognized its shared jurisdiction with State commissions and sought voluntary participation in RTOs. The July 12 orders *mandated* the formation of RTOs of specific size and scope, with no alternative configurations to be considered.

In her dissent, Commissioner Breathitt criticized the FERC for its "dramatic departure" from the voluntary, open, and collaborative approach pursued in Order 2000. (96 FERC ¶ 61,062 at p. 61,253.) She noted that "the Magic Markers have come out, and the boundaries are being drawn with little regard to the status and timing of RTO formation efforts in various regions of the country." (*Id.*) Commissioner Breathitt also was troubled by the failure to include the State commissions in the development of these super-regional RTOs and suggested that if the Commission wished to depart from the "basic philosophies" in Order 2000, the FERC should open a rulemaking "so that we [can] make a reasoned decision informed by the views of the stakeholders in this process – state commissions, chief among others." (*Id.*)

C. The Mediation

Despite the serious legal infirmities in the FERC's July 12 orders, the FERC proceeded with the expedited mediation for the Southeast RTO. In September, 2001, the mediator issued a report endorsing a model for the Southeast RTO, referred to as the "Collaborative Governance Model" or "CGM." (*Mediation Report for the Southeast RTO*, 96 FERC ¶ 63,036.) The mediator rejected the "SeTrans" model proposal by Southern Company, finding the CGM to be "better developed and more clearly in compliance with the requirements of Order 2000." (*Id.*, slip op. at p. 8.) The Entergy companies and CLECO endorsed the CGM model.⁶

The CGM endorsed by the mediator suffers from a number of infirmities. First, there is no evidence to support the formation of a single RTO through the model proposed by the FERC mediator, who proposed the model through unilateral and largely undisclosed analysis. The CGM does not even represent a consensus result from the mediation. Second, the CGM provides for the ownership of transmission assets by a Transco, a structure that effectively will strip the LPSC of its jurisdiction over retail transmission rates, lead to higher costs for Louisiana ratepayers, and seriously erode the LPSC's ability to address local transmission issues. Third, the use of a single rolled-in revenue requirement for the entire Southeast RTO could lead to substantial costs shifts that would be borne by retail customers of the affected utilities. Fourth, the CGM relies on a methodology for congestion pricing that is theoretical and unproven in its ability to achieve the effective management of congestion.

The FERC has not yet ruled on the report presented by the mediator. The FERC has, however, made informal comments supportive of a Southeast RTO (in some form), and it has continued to engage in vigorous efforts to force utilities into RTOs. (*See Order on Triennial Market Power*, Docket Nos. ER96-2495-015, *et al.* (November 20, 2001).) At the same time, the FERC has expressed skepticism over the RTO-Transco structure. (*See Inside FERC*, October 29, 2001, "Interests of Robust Market, Stand-Alone Transco May Not Coincide," p. 1.) Thus, there

⁶ Early in the mediation, the mediator announced that the SPP model would be rejected, claiming that Entergy and the SPP had irreconcilable differences. This conclusion is unsupported and appears incorrect.

is considerable uncertainty regarding the model and configuration of the RTOs that ultimately will emerge in the Southeastern United States.

Adding to this uncertainty is Entergy's recent decision to break from the CGM and join with Southern Company to file a proposal for an alternative RTO. On November 20, 2001, Entergy, Southern Company, and several smaller companies filed a Supplemental Status Report advising the FERC that they intended to pursue an RTO alternative to the CGM model endorsed by the mediator.⁷ (ELI/EGS Exh. 2). This RTO is based on the SeTrans model sponsored by Southern Company during the mediation, with some modifications to encompass Entergy's particular RTO requirements. The FERC has not ruled on this proposal.

D. FERC Developments Post-Mediation

In mid-October, the FERC conducted "RTO Week," in which a series of panels were held addressing various RTO issues. During RTO Week, the FERC was severely criticized by multiple state commissions for its handling of RTOs, particularly the July 12 orders and resulting mediations. The state commissions criticized the FERC for its unilateral decision to implement four regional RTOs and disregard for the jurisdiction vested in state commissions.

Perhaps in response to these criticisms, on November 9, 2001, the FERC announced its intent to establish regional panels with the state commissions to address RTO issues. (*Order Announcing the Establishment of State-Federal Regional Panels to Address RTO Issues, Modifying Application of Rule 2201 in the Captioned Dockets, and Clarifying Order No. 607*, 97 FERC ¶ 61,182 (2001).) It remains to be seen whether these panels will provide a meaningful opportunity for a collaborative process between the FERC and state commissions.

⁷ This is the fifth RTO model proposed by Entergy. The Company first proposed to form a single Transco/RTO that consisted solely, at least initially, of Entergy transmission assets. Next, Entergy sought to join its Transco into an RTO with the SPP. This proposal was filed with the LPSC in Docket No. U-25460. In July, 2001, the FERC rejected the Entergy/SPP RTO, and Entergy later withdrew the remainder of its filing. (Order, Docket No. RT01-34-000); Notice of Filing, Docket No. RT01-75-001.) Entergy then joined in a proposal with Grid Florida and Grid South to form an RTO. This proposal was the foundation for the CGM model sponsored by the FERC mediator and eventually endorsed by Entergy. Now, Entergy is leaving the CGM to support the SeTrans proposal. Entergy's shifts in its RTO proposals add to the uncertainty associated with the FERC RTO process.

The FERC also issued an order stating that the December 15 deadline for RTO selection is not feasible. (*Order Providing Guidance on Continued Processing of RTO Filings*, Docket No. RM01-12-000.) Although the FERC was careful not to suggest it was slowing the process of RTO development, it does appear that the agency at least recognizes the need for additional work before compelling (or attempting to compel) RTO membership.

Finally, the FERC is developing a rulemaking on standard market designs. (FERC Docket No. RM01-12-000.) This rulemaking is intended to promote market efficiency, appropriate cost allocation, and mitigation of "seams" issues. Accompanying this rulemaking will be the development of wholesale business practices and communication standards. The FERC has directed that the participants in the electric wholesale market agree on a single organization to develop standards or, alternatively, accept a FERC-selected organization or standards to be developed by the FERC. (*Order Providing Guidance on the Formation of a Standards Development Organization for the Wholesale Electric Industry*, 97 FERC ¶ 61,289 (December 19, 2001).)

III. CLARIFICATION OF FERC AND LPSC JURISDICTION

The Louisiana Public Service Commission is a constitutionally-created body vested with plenary authority over the rates and services of Louisiana utilities. (La. Const. Art. IV, § 21.) The Commission was created for the purpose of exercising regulatory police power over all common carriers and public utilities and compelling the performance of these public duties for the benefit of the State and its citizens. (*Morehouse Natural Gas Co. v. La. Pub. Serv. Comm'n*, 242 La. 985, 140 So. 2d 646 (1962); *Southern Bell Telephone & Telegraph Co. v. La. Pub. Serv. Comm'n*, 187 La. 137, 174 So. 180 (1937).) The Louisiana Supreme Court has recognized that the plenary authority granted to the Commission includes the authority to review transfers of ownership and control of the assets owned by Louisiana utilities. (*Bowie v. La. Pub. Serv. Comm'n*, 627 So. 2d 164 (La. 1993).) The Commission has in place a General Order addressing requirements for approval of a change in ownership or control of the assets of a Louisiana utility. (General Order, *In Re: Commission Approval Required of Sales, Leases, Mergers, Consolidations, Stock Transfers, and All Other Changes of Ownership or Control of*

Public Utilities Subject to Commission Jurisdiction (March 18, 1994).) The Order encompasses every form of a change in control or ownership of more than one percent of a utility's assets.

The Louisiana Commission has jurisdiction over bundled retail rates, including the transmission component of those bundled rates. The participation of a jurisdictional utility in an RTO will not cause the Commission to lose that jurisdiction, if that participation does not take the form of a Transco or Independent Transmission Company ("ITC"). The Commission's jurisdiction also extends to the approval of any transfer of control or ownership of any transmission assets that could be required for RTO participation.

The Federal Power Act preserves the states' jurisdiction over retail ratemaking issues. Congress has not sought to occupy state jurisdiction over ratemaking, expressly or otherwise. The FERC has jurisdiction over the sale of electric energy at wholesale in interstate commerce. (16 U.S.C. § 824.) "[S]ale of electric energy at wholesale in interstate commerce" is defined as "a sale of electric energy to any person for resale." (16 U.S.C.A. § 824(d).) However, the Federal Power Act limits federal regulation of electric utilities engaged in interstate commerce "to those matters which are not subject to regulation by the states." (16 U.S.C.A. § 824(a).) Thus, the exclusive source of the FERC's authority specifically excludes from that authority matters that are subject to regulation by the States.

The U.S. Supreme Court confirmed this limited preemptive effect of the FPA. It held that the FPA "had no purpose or effect to cut down state power. On the contrary, "perhaps its primary purpose was to aid in making state regulation effective." (*Panhandle Eastern Pipe Line Co. v. Public Service Comm'n of Indiana*, 332 U.S. 507, 517, 68 S. Ct. 190, 195, 92 L.Ed. 128 (1947).) The Fifth Circuit similarly held that it must be assumed that state police powers were not to be superseded by Federal Power Act in the absence of clear and manifest congressional purpose. (*New Orleans Public Service, Inc., v. Council of City of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990), *rehearing denied, certiorari granted* 111 S. Ct. 1617, 499 U.S. 974, *certiorari dismissed* 112 S. Ct. 411, 502 U.S. 954.)

The Commission's jurisdiction to set bundled retail transmission rates and to approve any RTO participation also is not preempted by the Federal Power Act. "The critical

question in any preemption analysis is always whether Congress intended that federal regulation suspend state law." (*Louisiana Public Service Comm'n v. Federal Communication Comm'n*, 476 U.S. 355, 369, 106 S. Ct. 1890, 1899 (1986).) The Federal Power Act was never intended to remove this authority from the states.

When Part II of the Federal Power Act was enacted in 1935, the states were regulating all aspects of retail transmission. These revisions to the Act were intended only to provide the Federal Power Commission (now the FERC) with the power to regulate wholesale electric rates in interstate commerce, which the states could not regulate. It was intended to preserve, not override, the existing state authority. (*Connecticut Light & Power Co. v. Federal Power Comm'n.*, 324 U.S. 515, 525-530 (1945).) The legislative history of the Federal Power Act confirms that Congress intended to reserve to the states regulation over those areas that states traditionally had regulated, and that regulation included transmission. (H.R. No. 74-1318 (1935); Hearing on H.R. 5423 Before the House Comm. On Interstate and Foreign Commerce, 74th Cong. (1935).)

The FERC itself has not asserted any jurisdiction that would preempt state regulation over bundled retail rates. In Order 888, the FERC interpreted Section 201 of the Federal Power Act as preserving the states' historical jurisdiction over bundled retail service. (*Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities*, 61 Fed. Reg. 21,540 (hereinafter, "Order 888").) It did, however, assert jurisdiction over *unbundled* retail transmission rates. Its authority to assert this jurisdiction was recently affirmed by the United States Supreme Court. (*State of New York v. Federal Energy Regulatory Comm'n*, Nos. 00-568 and 00-809.)

The Commission is not preempted, and we have full authority to approve any transfer of ownership or control of transmission assets that may be required for RTO participation. The FERC does not have the authority to mandate participation in RTOs absent this approval. Neither the FERC, nor any court, has ever determined that the FERC may mandate participation in RTOs.

Sections 205 and 206 of the Federal Power Act ("FPA") give the FERC some power to remedy discriminatory practices, but those Sections do not give the FERC the authority to require all utilities to transfer control of their transmission assets or to transfer system operating responsibilities to an RTO. Sections 205 and 206 of the FPA only allow the FERC to remedy undue discrimination "with respect to any transmission or sale subject to the jurisdiction of the FERC." (16 U.S.C. § 824(b)(1).) This does not carry with it the power to mandate, for the entire electric industry, participation in RTOs.

Section 202(a) of the Federal Power Act provides for the creation of regional districts for the "voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy . . ." (16 U.S.C. § 824a(a).) However, this provision does not allow the FERC unilaterally to configure and mandate participation in RTOs. Section 202(a) requires that:

Before establishing any such district and fixing or modifying the boundaries thereof the Commission shall give notice to the State commission of each State situated wholly or in part within such district and shall afford each such State commission reasonable opportunity to present its views and recommendations, and shall receive and consider such views and recommendations.

(16 U.S.C. § 824a(a).)

This *requires* state participation and in no manner preempts State jurisdiction over any transfer of ownership or control that could impact retail rates and service.

In Order 2000, the FERC itself determined only to "pursue a voluntary approach to participation in RTO's." (Order 2000, FERC Stats & Regs ¶ 31,089 at p. 31,033.) The Commission recognized that the voluntary approach would allow the development of "mutually agreeable arrangements." (*Id.* at 31,358.) The FERC stated, "[w]e are convinced that the transmission owners, market participants, and *regulators* in a particular region have a better understanding of the dynamics of the transmission system in that region." (*Id.* at 31,079 (emphasis added).)

Both the Indiana and Florida Commissions recently recognized that states possess the ultimate authority over RTO participation. Recent orders have denied the requests for participation in the Alliance RTO by Indiana Michigan Power Company and have denied the

participation in the Southeast RTO by Florida Power & Light Company, Florida Power Company and Tampa Electric Company. (Order, Cause No. 42032, Indiana Utility Regulatory Commission (December 17, 2001); Order No. PSC-01-2489-FOF-EI (Fla. P.S.C. December 20, 2002.)

The Louisiana Commission possesses exclusive jurisdiction over the retail rates of vertically-integrated utilities operating in Louisiana. Neither the Federal Power Act nor any decision interpreting that statute suggests that the FERC may preempt state jurisdiction over bundled retail rates. Moreover, we have full authority to approve any transfer of ownership or control of transmission assets that may be required for RTO participation. The FERC lacks the statutory authority to mandate industry-wide RTOs, and the FERC cannot preempt our authority in this area.

IV. PROHIBITION AGAINST THE TRANSCO STRUCTURE

In each of its proposals, and in the CGM endorsed by the mediator, Entergy has proposed to transfer ownership and/or control of its assets to a Transco. (Gallaher Cross.) Entergy has identified a Transco as one of the essential components of any RTO it will join. (*Id.*) CLECO and SWEPCO also generally support the option of a Transco, although neither company currently anticipates transferring ownership or control of its assets to a Transco. (Brammer Cross; Desselle Cross.) Louisiana Generating presented no evidence at the hearing, but the Company endorsed the CGM. Thus, it is reasonable to assume that Louisiana Generating at least supports the option of a Transco. Given the positions of the utilities, it is important that the Commission give guidance regarding the likelihood of approving a transfer of assets to a Transco.

A Transco is an independent, for-profit transmission company that would own the current and future transmission assets otherwise owned by a regulated electric utility. An RTO may be established in the form of a Transco, in which case the RTO both owns and operates transmission assets. This is known as the "Transco-on-top" model and is the model proposed in the CGM. A Transco also may be a participant in an RTO, in which case the Transco owns, but does not operate, transmission assets. The operation of the assets is vested in the RTO. This is known as a "binary" structure and is the model proposed by Entergy in the recent SeTrans filing.

Under any Transco structure, the utility will transfer ownership and/or control of its transmission assets to the Transco, in exchange for a passive ownership interest in the Transco. (Baron Dir., p. 10.) To meet the independence requirements of Order 2000, the utility may hold only a passive ownership interest in the Transco and may not participate in governance or hold voting rights. (*Id.*) This structure is intended to make the Transco independent of the original owner of the transmission assets and, in theory, facilitate an unbiased opportunity for all participants in the wholesale market to attain transmission service. (*Id.*) These independence requirements are not unique to a Transco but apply equally to any form of participation in an RTO.

There are a number of problems inherent in the structure of a Transco. First, the LPSC would effectively lose ratemaking authority over transmission costs. (Baron Dir., pp 11-12.). Second, related to the loss of jurisdiction, the use of a Transco likely will cause adverse rate impacts for Louisiana retail customers. (*Id.*) Third, a Transco structure would reduce beneficial local utility and LPSC influences on transmission planning, maintenance, and investment decisions. (*Id.*, pp. 12, 28.) Finally, the prospect of rolled-in revenue requirements associated with a Transco may lead to higher retail transmission rates.

A. Loss of LPSC Jurisdiction Over Retail Transmission Costs

If a utility transfers its transmission assets to a Transco, there are two means by which the LPSC may lose jurisdiction of retail transmission rates. First, a *de facto* transfer of jurisdiction will occur because the utility will lose the right to receive revenues that currently offset FERC-imposed costs in determining the utility's retail revenue requirement. (*Id.*, p. 11.) Second, as a matter of law, the unbundling of the utility's transmission assets may cause even retail ratemaking for transmission to become FERC-jurisdictional.⁸ (*Id.*, p. 12.) Although this legal issue is far from settled (and we would dispute the loss of jurisdiction), it is a possible

⁸ This concern was considered by the Florida Public Service Commission recently in its decision to permit its utilities to participate in the GridFlorida ISO but requiring that the utilities maintain ownership of their transmission assets. (Order No. PSC-01-2489-FOF-EI (FPSC, December 20, 2001).)

consequence of a Transco and is a factor to be considered. Under either scenario, the loss of jurisdiction will adversely affect the rates of Louisiana customers. (*Id.*, pp. 11-14.)

Under the current shared jurisdiction between the States and the FERC, the FERC sets the utility's wholesale transmission rate while the States, including the LPSC, set the utility's bundled retail rate, which includes transmission. To the extent that the utility takes wholesale transmission service for its retail load under its FERC-approved rate, the costs associated with this service are offset by the revenues received by the utility under its FERC tariffs. When the LPSC sets the transmission component of a utility's retail rates, the FERC-approved costs and revenues essentially cancel one another, and it is only the LPSC-approved rate that is passed through to retail customers.

If a utility transfers its transmission assets to a Transco, it will lose the right to receive revenues under FERC-approved tariffs. (Baron Dir., p. 11.) This occurs because the Transco, not the utility, will own the transmission assets.⁹ (*Id.*) Thus, the utility will pay FERC-approved rates for transmission service needed to serve its retail customers, but the utility will not receive any revenues to offset these costs. (*Id.*) As a result, the utility will pay the FERC rate for transmission service. If the FERC rate exceeds the rate that the LPSC would approve, this higher rate is paid by ratepayers. As Mr. Baron explained in his Direct Testimony:

If the FERC authorizes the utility to collect revenues higher than those authorized by the LPSC, the FERC decision would lead to higher retail rates. The higher revenues would go to the Transco and would not be credited to the retail revenue requirement.

(*Id.*)

At the hearing, EGSI/ELI attempted to test this conclusion. The Companies prepared two charts that compared a utility's hypothetical revenue requirement under the Transco model to the revenue requirement when the utility retains ownership of its transmission assets

⁹ As Mr. Desselle acknowledged, the transfer of jurisdiction does not occur if the utility retains ownership of its transmission assets and transfers only operational control to the RTO. (Desselle Dir., pp. 4-5.)

and transfers only operational control to an RTO. However, these charts confirm Mr. Baron's conclusion that the utility's revenue requirement increases under the Transco model.¹⁰

The first chart reflects a scenario in which the utility transfers its assets to a Transco, and (1) the FERC authorizes a rate of return on transmission investment of 12%, while the LPSC authorizes only 11%; and (2) the utility has a rate base of \$10 million, with \$1 million of that rate base constituting the transmission investment. Under this scenario, the utility's transmission revenue requirement is \$120,000, and the overall revenue requirement is \$1,110,000. This contrasts with the example illustrated in the second chart, in which ownership of the transmission assets remains with the utility, and only operational control is transferred to the RTO. Under this "no-Transco" scenario, the utility's transmission revenue requirement is \$110,000, and the overall revenue requirement is \$1,100,000. The \$10,000 difference in the revenue requirement is due to the ownership by the Transco of the utility's transmission assets and the higher return permitted by the FERC.

Apparently recognizing that rates will increase under the Transco model, Entergy witness Mr. Gallaher suggested that this increase will occur regardless of whether the assets are transferred to a Transco because "the transfer of control of those assets to an RTO, regardless of its location or form is what FERC has determined causes the loss of jurisdiction." (Gallaher Reply, p. 7.) Mr. Gallaher conceded, however, that his position was based solely on the advice of counsel, and he was unable to point to any references in FERC orders or federal legislation that support his conclusion. (Gallaher Cross.)

Moreover, nothing in FERC Orders 2000, 2000-A, or any of the decisions applying these orders supports Mr. Gallaher's position. In support of its position, Entergy apparently relies on orders issued by the FERC indicating that native load customers must take transmission service from the RTO.¹¹ As Mr. Baron explained, however, the fact that

¹⁰ Messrs. Brammer and Desselle, the witnesses for CLECO and SWEPCO, acknowledged the correctness of Mr. Baron's conclusion. (Brammer Cross; Desselle Cross.)

¹¹ Examples of such orders include *Order on Petition for Declaratory Order*, 94 FERC ¶ 61,271 (March 14, 2001) (involving Southern Company Services, Inc.); *Order Denying Rehearing and Clarification*, 97 FERC ¶ 61,178 (November 9, 2001) (involving the Midwest Independent Transmission System Operator); and, *Order Denying Rehearing* (continued on next page)

transmission service for native load customers is taken from the RTO does not determine what retail customers will pay for transmission service or displace state regulation of the retail transmission rate. (Baron Cross.) Rather, both the costs approved by the FERC *and* the revenues obtained from the utility's FERC tariffs will be used in determining the retail transmission revenue requirement. (*Id.*) These costs and revenues tend to cancel one another, and only what is left -- *i.e.*, the revenue requirement set by the state commission, determines the rate paid by retail ratepayers. Nothing in the FERC's orders suggests that the state commission must pass through the FERC-approved costs without also taking into account FERC-approved revenues.

Further, the FERC does not interpret its jurisdiction as extending to the pricing of the transmission component of retail bundled sales. Indeed, the FERC has been careful to state that requiring the RTO to act as the sole provider of transmission service will not interfere with the pricing of retail bundled power sales, "which is a decision for appropriate state authorities." (*Southern Co.*, 94 FERC ¶ 61,271, 2001 FERC LEXIS 570, pp. *9-10.) In *Carolina Power & Light Co.*, the FERC clarified that taking service from the RTO will not preempt the jurisdiction of state commissions to set bundled retail rates:

We disagree, however, that paying Grid South for the transmission needed to serve bundled retail customers makes the Applicants' retail rates subject to our jurisdiction As we stated in the March 14 order, we are willing to accommodate the Applicants paying Grid South a transmission rate equal to the transmission component of their bundled retail rates, as long as the price is clearly stated, is reduced to writing in contracts with Grid South, and is not accomplished by omission.

(*Carolina Power & Light Co.*, 95 FERC ¶ 61,282, 2001 FERC LEXIS 1211 at *19.)

(*See also Midwest Independent*, 97 FERC ¶ 61,178 at p. 61,827 (the FERC interprets its jurisdiction as extending only to unbundled retail sales, not bundled retail sales.)

In Order 888, which was the precursor to Order 2000, the FERC explored the limits of its jurisdiction. (Order No. 888, 61 Fed. Reg. 21,540 (1996).) The Federal Power Act

and Granting, In Part, Clarification, 95 FERC ¶ 61,282 (May 30, 2001) (involving the GridSouth Transco).

gives the FERC authority to regulate transmission and the wholesale sale of electricity in interstate carriers. (16 U.S.C. § 824(b).) In Order 888, the FERC interpreted the Federal Power Act as preserving the States' historical jurisdiction over traditional monopoly arrangements under which retail customers buy electric energy, transmission service, and local distribution service from a single supplier at a regulated rate. (Order 888, 61 Fed. Reg. at pp. 21,625-27.) The FERC re-affirmed this position in Order 888-A, stating that "the Commission does not have jurisdiction over the transmission of purchased power to the bundled retail customers. . . ." (Order 888-A, FERC Stats. and Regs. ¶ 31,048 at p. 30,217." Nothing in Orders 2000 or 2000-A suggest that the FERC has shifted from this position.

Neither the Federal Power Act nor any order issued by the FERC supports the assertion of ELI/EGSI that the LPSC may not account for FERC revenues when passing through FERC costs. If the utility retains ownership of these assets, the LPSC may account for both FERC-approved costs and revenues in setting the utility's bundled rate. It is only the transfer of assets to a Transco that may cause the LPSC to lose jurisdiction over the retail rate and lead to higher rates for Louisiana customers. For this reason, a Transco is not in the public interest.

Mr. Desselle, SWEPCO's witness, argued that the loss of revenues at the retail level should not be a significant issue because these same revenues will be considered by the FERC as an offset to costs when setting rates at the FERC level. (Desselle Reply, pp. 4-5.) While correct, this testimony misses the point of Mr. Baron's concern, with which we agree. Mr. Baron recognizes that the FERC, in setting rates for the Transco, will consider all of the Transco's revenues. However, the problem with FERC ratemaking is that the FERC may grant significantly higher rates than the LPSC currently authorizes. The only way in which Louisiana ratepayers can avoid these increases is if the utility receives the transmission revenues at the retail level necessary to offset the FERC costs. Without this process, retail ratepayers will be forced to pay the higher rate set by the FERC.

ELI/EGS also suggested in cross-examination that Order 2000 does not permit a utility to own both transmission and generation assets and, therefore, EGSI is required to transfer its transmission assets to a Transco. As Staff witness Mr. Kahal explained, this assertion

misconstrues Order 2000, which requires only that an *RTO* not own generation and transmission. (Kahal Cross; Order 2000, 65 Fed. Reg. at p. 842.) Nothing in Orders 2000 or 2000-A suggests that a utility transferring operational control of its transmission assets to an RTO may not continue to own these assets. Indeed, the FERC recently approved an RTO that is a non-profit independent system operator owning no transmission assets and in which a number of vertically-integrated utilities are participants. (*Order Granting RTO Status and Accepting Supplemental Filings*, Docket No. RT01-87-000, et al. (December 20, 2001).) Obviously, the FERC would not approve an RTO structure prohibited by Order 2000. Entergy's argument is simply incorrect.

The Florida Public Service Commission recently determined that the Transco structure was not in the public interest. (*Order Finding Proactive Formation of GridFlorida Prudent and Requiring the Filing of a Modified GridFlorida Proposal*, Docket Nos. 00824-EI, et al. (December 20, 2001).) In its order, the Florida Commission approved the formation of an RTO for peninsular Florida but required the utilities to eliminate the Transco from the model. (*Id.*, slip. op. at p. 11.) The Florida Commission found that the Transco was "not in the best interests of Florida's retail ratepayers at this time" and that the benefits of the Transco structure could be achieved equally with an independent system operator ("ISO") serving as the RTO.¹² (*Id.*)

In reaching its decision, the Florida Commission rejected arguments similar to those advanced by the Louisiana utilities. Specifically, the Commission rejected the argument that the Transco will provide the best incentive for efficient operation. (*Id.*, p. 12.) The Commission found that the ISO structure can provide the same operational, planning, and congestion management benefits of an RTO. (*Id.*) The Commission also noted that an ISO may avoid the potential inability to meet the FERC's independence requirements inherent in a Transco. (*Id.*) Finally, the Florida Commission noted that, once the transfer occurs, the assets

¹² An ISO is a non-profit entity that operates the transmission assets of its members. The FERC recently approved an ISO as an RTO in the midwestern region of the United States. (*Order Granting RTO Status and Accepting Supplemental Filings*, Docket Nos. RT0-87-000, et al. (December 20, 2001).)

cannot be reacquired, and the market is too undeveloped to permit a permanent transfer at this time. (*Id.*, p. 13.)

Like the Florida Commission, we find the Transco structure, at this time, to be inconsistent with the best interests of ratepayers. If a utility transfers its assets to a Transco, this will cause the LPSC to lose regulatory control over the retail transmission rates of that utility. This loss of jurisdiction results from the Transco's ownership of the assets, and consequently, retention of all transmission revenues. In the absence of a Transco, there is no reason that the LPSC cannot account both for FERC-approved costs and revenues when setting retail rates. The loss of jurisdiction is a significant concern and is one reason we find Transcos presumptively inconsistent with the public interest.

B. Adverse Rate Impacts

Relating to the loss of jurisdiction, there are likely to be adverse rate consequences caused by the transfer of transmission assets to a Transco. First, to the extent that FERC ratemaking treatments on issues such as return on equity, proforma adjustments, and other matters differ from LPSC ratemaking treatments of these issues, Louisiana ratepayers may be adversely affected. (Baron Dir., p. 12.) Second, a Transco model may encourage over-investment in transmission, relative to current transmission ratemaking under the shared jurisdiction between the LPSC and FERC. (Baron, Dr., p. 16.) Third, a conflict of interest will arise between the profit motive of the utility, which is the passive owner of the Transco, and the obligation of the utility to obtain the lowest reasonable rates for its ratepayers. (Baron Dir., pp. 19-20.) Finally, the use of a rolled-in revenue requirement may result in cost-shifting with adverse consequences to certain retail customers. (Baron Dir., p. 14.) Each of these matters raises the specter of increased costs to be paid by Louisiana customers and supports our finding that a Transco is contrary to the public interest.

1. FERC Ratemaking Treatments

As a result of differences between FERC and LPSC ratemaking, the transfer of jurisdiction to the FERC likely will result in adverse rate consequences to Louisiana ratepayers. (Baron Dir., pp. 12-13.) The FERC has indicated a willingness to authorize higher returns on transmission investment than those currently authorized by this Commission. (Order 2000, 65

Fed. Reg. at pp. 922, 924-27.) Indeed, Entergy has assumed that the FERC will allow a 13% return on transmission investment, compared to the approximately 11% return currently authorized by the LPSC. (Gallaher Cross.)

The FERC also has indicated that it will utilize incentive rates to encourage investment in new transmission. (Order 2000, 65 Fed. Reg. at pp. 922, 924-27; Baron Dir., p. 14.) As Mr. Gallaher acknowledged, this could result in an additional return of 200 basis points on any new transmission assets. (Gallaher Cross.) Using Entergy's assumptions, this would result in a return of 15% on new investment, a return significantly higher than we are likely to approve. (Gallaher Cross.)

The FERC also currently employs automatic adjustment mechanisms for the entirety of the revenue requirement in many transmission tariffs. (Baron Dir., p. 12.) As Mr. Baron testified, assuming net growth in transmission plant, the use of an automatic adjustment mechanism would render FERC transmission rates higher than retail rates that are based on historic test year rate proceedings. (*Id.*) Further, our ability to review the reasonableness of the Transco's rate requests at the FERC will be severely diminished. (*Id.*, pp. 12-13.) Once a formula rate is approved, we may be required to file a complaint at the FERC to challenge the Transco's revenue requirement.¹³ (*Id.*, p. 13.)

At the hearing, counsel for ELI/EGS suggested that Entergy requires a Transco in order to take advantage of the incentive rates and other ratemaking treatments authorized by the FERC. Without these advantageous rates, Entergy suggests it will lack the incentive necessary to comply with the FERC's goal of encouraging investment in new transmission. (Baron Cross.) As Mr. Baron noted, in the absence of a Transco, it is only native load customers from which the utility will be unable to obtain the benefit of these higher rates. (Baron Cross.) The utility *will* reap the benefit of higher rates from service to customers other than native load customers. (*Id.*) In addition, if the LPSC continues to authorize just and reasonable rates, then the utility

¹³ As Mr. Baron noted, the LPSC's experience at the FERC is that such complaints may take as long as five years to be heard, assuming the complaint is not rejected prior to a hearing. (*Id.*, p. 13, n.1.)

possesses the appropriate incentive to invest in new transmission because it will earn a reasonable return on this investment and must act consistently with its obligation to provide safe and reliable service. (*Id.*) The absence of additional rate benefits should not diminish the utility's incentive to make reasonable and prudent investments in transmission.¹⁴ Indeed, as discussed below, what the FERC incentive rates may well do is cause Transcos to over-invest in transmission in order to generate the higher returns.

Finally, ELI/EGS suggested that because transmission forms a relatively small component of a utility's overall cost of service, even a large increase in transmission costs will have only a fairly small impact on the overall rate. To the contrary, regardless of size, if the costs causing the increase are unreasonable, the increase should not be permitted.

2. Encouragement of Over-Investment in Transmission

The Transco structure has the potential for encouraging over-investment in transmission assets, relative to continued LPSC/FERC transmission ratemaking. (Baron Dir., p. 16.) The Transco, as a profit-making company, has the incentive to over-invest in order to take advantage of the incentive rates of return the FERC intends to authorize to further its goal of investment in new transmission. (*Id.* at 17.) At this point, it is impossible to predict whether this investment will be in the best interests of Louisiana customers, but it is clear that retail customers ultimately will be asked to pay the costs associated with implementing the FERC policy. (*Id.*)

Mr. Baron also noted that a Transco could result in a loss in local Louisiana utility control over transmission expenditures, with a concomitant increase in such expenditures. (*Id.* at 17.) We agree with this concern, which results from the fact that the incremental cost of a single expenditure for one member of an RTO will be relatively small and, therefore, more likely to be incurred and approved without much scrutiny. (*Id.*, pp. 17-18.) When these incremental expenditures are combined, however, they may result in a material increase in the revenue requirement paid by all customers. (*Id.*)

¹⁴ A number of commentators argued to the FERC that there are sufficient incentives in place to ensure that an RTO makes needed investment in transmission structure and that permitting an increased return on such investment is "a bribe for utilities to provide service they are statutorily required to provide." (Order 2000, 65 Fed. Reg. at p. 926.)

3. Conflicts of Interest

The third general concern with a Transco is the existence of conflicts between the interests of the utility as the owner of the Transco and the obligation of a utility to provide service to its customers at the lowest reasonable cost. These conflicts arise from several sources.

As Mr. Baron testified, under most Transco models, there is an expectation for a future initial public offering ("IPO") associated with the Transco shares owned by the original utility investors. (*Id.*, p. 19.) The greater the size and profitability of the Transco, the greater the premium above book value that may be earned by the utility through the IPO. (*Id.*) To increase this premium, the utility owners of the Transco have the incentive to over-invest in transmission, at the expense of retail ratepayers who will pay the revenue requirements associated with this investment. (*Id.*)

In addition, even without the IPO, the utility owners of the Transco are vested with the incentive to increase the profitability of the Transco through higher rates, at the expense of their retail ratepayers. Mr. Baron explained that:

The current income and ultimate value of these LLC [Transco] shares is a direct function of the profitability of the Transco. . . . To the extent that the Transco receives higher rates for transmission service, the profitability and value of the LLC shares increases. At the same time, the incumbent utility, which retains the LLC shares on a passive basis, has a responsibility to retail ratepayers to ensure that it achieves the lowest possible rates, consistent with reliable service. . . . If the profits were earned by a Transco owned by the utility's parent, higher rates would increase the parent's overall profit. This would appear to unduly increase the natural conflict between the profit motive and prudence under the Transco framework.

(*Id.*, pp. 19-20.)

This conflict creates little incentive for the utility owners to negotiate with the Transco for lower rates because their economic incentive as owners of the Transco is to charge the highest rates possible. (*Id.* at 20.) The result of this conflict will be higher rates for retail customers.

4. Loss of Economies of Scope

With the transfer of transmission assets to a Transco, there may be a loss of economies of scope existing in the current integrated structure of Louisiana utilities. (Baron Dir., p. 21.) Corporate overheads currently are allocated to the functions of transmission,

generation, and distribution. If a Transco is created, these costs will be allocated only to the generation and distribution functions. (*Id.*) If these overheads are not reduced proportionately when the transmission assets are transferred, the overall overhead costs will increase, because there will be a greater allocation to the generation and distribution functions. (*Id.*) At the same time, the costs of these lost services will be incurred independently by the Transco and charged to retail ratepayers. This also is true of certain engineering and operational efficiencies and planning and maintenance functions. (*Id.*) Again, unless these costs are reduced proportionately, the overall costs will increase.

None of the Louisiana utilities has performed a study of the cost impact on rates because of the possible lost economies of scope and possible duplicative administrative structures. (Gallaher Cross; Brammer Cross; Desselle Cross.) Although Mr. Gallaher believes the cost impact will be small, there is no study to verify this assertion. If the utility retains ownership of its transmission assets, however, this issue is moot because the transmission assets will continue to be counted in determining the utility's share of overhead allocations, and the utility will retain the administrative efficiencies existing in an integrated company.

In his Reply Testimony, Mr. Desselle suggested that the LPSC should not rule out the possibility of Louisiana utilities participating as non-divesting members in a for-profit RTO. (Desselle Reply, p. 3.) Under this scenario, while the RTO may be a for-profit company, the utilities would transfer only operational control of their transmission assets. Mr. Desselle believes that a for-profit RTO, independent of the question of owning assets, may bring benefits in the form of efficiency and good management to further its economic incentives. (*Id.*, p. 4.)

At this point, we will not rule out the possibility of a for-profit RTO. Any such proposal would have to be reviewed carefully, however, to determine whether the benefits of the proposal outweighed the incentive created by the upward pressure on rates caused by the RTO's profit motive.

Whether this RTO should be permitted to own transmission assets, however, is a separate issue. Mr. Desselle suggested that the potential for ownership of any assets (even if not those belonging to the Louisiana utilities) would cause the RTO to act prudently. (Desselle

Reply, p. 4.) However, as Mr. Gallaher noted, there may be a conflict within the RTO that causes it to favor its own assets over those of its non-divesting members. (Gallaher Cross.) This conflict is avoided if the RTO does not own assets. Again, we must review closely any proposal for a profit-based RTO.

C. Loss of Control over Local Transmission Matters

In addition to the potential adverse rate impacts, the potential loss of LPSC jurisdictional authority under a Transco also will erode the LPSC's ability to regulate quality of service, reliability, and transmission adequacy. (Baron Dir., p. 22.) Today, the LPSC provides the oversight necessary to ensure reliable and adequate transmission service to Louisiana customers. (*Id.*) If the LPSC's jurisdictional authority is lost through the Transco, the Commission no longer will be able to ensure that local concerns are addressed, which may lead to a decline in local service. (*Id.* at 23.) Instead, the LPSC will have to make requests through the RTO, and possibly through complaint filings at the FERC. (*Id.*, p. 22.) The loss of the authority to order a utility to address transmission issues represents a serious diminution in the authority currently held by the LPSC.

As the utilities note, most of the RTO and Transco proposals include stakeholder committees and other mechanisms in which the LPSC may be able to voice its concerns. (*Id.*) The ability to voice concerns, however, is not nearly the equivalent of our current authority to require that local transmission needs be addressed.

The Transco structure provides the LPSC with little or no opportunity to ensure that Louisiana retail ratepayers are protected through needed investment in the transmission system. (*Id.*, p. 23.) If needed investment is not made, local reliability will decline. (*Id.*) The stakeholder process affords only a greatly diminished means to address local concerns, and jurisdiction over such issues may shift to the FERC. This loss of local control over local reliability is an unacceptable result.

D. Cost-Shifting Under a Transco or RTO

Any Transco that consists of the assets of more than one company -- as is the case with the Transco proposed by Entergy -- may result in permanent cost-shifting relative to the costs that would have been borne by a utility's customers without the Transco. This cost-shifting

results from using a rolled-in revenue requirement for a Transco that consists of the transmission assets of more than one utility. (Baron Dir., p. 14.) Although cost-shifting may be mitigated for some period of time by not utilizing a single rate, the FERC goal of single rates for RTOs eventually will overrun any short-term mitigation.

As Mr. Baron explained, if a Transco consists of the assets of more than one utility, cost-shifting occurs simply because the transmission revenue requirements of the individual utility members are not identical. (*Id.*, pp. 14-15.) When these multiple revenue requirements are merged into a single revenue requirement and rate for the Transco, this rate may be higher or lower for different customers than the rate that each individual utility's revenue requirement would produce. (*Id.*) The greater the size of the Transco, the greater the likelihood that cost-shifting will occur.

The problem of cost-shifting exists under any RTO structure that employs a single revenue requirement and rate. (Baron Dir., pp. 24-25.) This is because certain charges are expected to be established on an RTO-wide basis. (*Id.*, p. 24.) For example, under the CGM proposed by the FERC mediator, there will be RTO-wide charges for incremental bulk transmission investments, regardless of where these investments are made. (*Id.*) The cost-shifting problem is discussed in greater detail in Section VI, below.

E. Summary

We find that the transfer of ownership or control of transmission assets to a Transco presumptively is not in the public interest. The Transco structure effectively strips this Commission of its authority to set the transmission component of the utility's bundled retail rate. This loss of jurisdiction likely will lead to higher rates for Louisiana customers because of differing FERC ratemaking treatments, the incentive to over-invest in transmission, and the conflict of interest between the utility's economic interest as owner of the Transco and its obligations to obtain the lowest reasonable rates for its customers. Higher rates also may result through the cost shifting inherent in a Transco that owns assets from more than one company. The Transco structure also is likely to reduce the LPSC's authority to regulate service quality and reliability at the local level.

V. ANALYSIS REQUIRED TO DEMONSTRATE THAT RTO PARTICIPATION IS IN THE PUBLIC INTEREST

The selection of an appropriate RTO structure is vitally important to the public interest. The RTO structure that is finally adopted for Louisiana utilities will have a major impact on reliability, competition, efficiency, and cost of service, and rates in Louisiana. (Kahal Dir., p. 8.) No Louisiana utility will be allowed to join an RTO until the implications of the RTO on these public interest factors are fully analyzed and presented to us for review.

Although there are several proposed RTO models ostensibly available to the LPSC-jurisdictional utilities, the public interest implications have not been analyzed for any of these models. The potentially available options include the SeTrans RTO and the CGM RTO in the Southeast, and the SPP-MISO RTO in the Midwest. Although Entergy has now expressed an apparent commitment to the proposed SeTrans RTO, it has not provided the Commission with any evidence that this RTO, as opposed to any other RTO structure, would be in the public interest. In fact, the evidence before the Commission indicates that the SPP-MISO RTO may be the preferred RTO for Louisiana utilities.

Moreover, neither Entergy nor any of the other utilities has prepared a study of the costs and benefits associated with any of the various RTO proposals. Thus, the public interest implications of these models are unknown. There is too much at stake for Louisiana's ratepayers to allow the RTO selection process to proceed without eliminating this uncertainty. By June 17, 2002, the Louisiana utilities will be required to conduct a systematic and comprehensive analysis of the costs and benefits associated with each reasonably feasible RTO option, including the SPP-MISO RTO, the SeTrans RTO, and the CGM RTO. Until these analyses are completed and presented to the Commission, the utilities are precluded from joining or participating in any RTO.

A. There Are Several RTO Options Potentially Available To Louisiana Utilities

There are several proposed RTO structures that are potential options for Louisiana utilities. In the southeastern region, there is the Collaborative Governance Model recommended by the FERC Administrative Law Judge who presided over the Southeast RTO mediation. The CGM is described in the ALJ's Mediation Report for the Southeast RTO that was presented to

the FERC on September 10, 2001. (Mediation Report for the Southeast RTO, 9/10/01 (attached to EGSI/ELI Response to Ex. A Q6).) The CGM model contemplates a single "Southeast Power Grid" that would include North Carolina, South Carolina, Tennessee, Georgia, Alabama, Mississippi, parts (if not all) of Florida, Louisiana, and Arkansas. Under the CGM model, the RTO would consist of a single "Independent Transco" working in conjunction with an "Independent Market Administrator." (*Id.* at p. 9.) Transmission owning entities would have the option of participating in the CGM RTO either by transferring the ownership of their transmission assets to the Independent Transco, transferring the operation of their transmission assets to the RTO pursuant to an operating agreement, or transferring operation of their transmission assets to an independent transmission company ("ITC") (equivalent to a Transco) that, in turn, would enter into an operating agreement with the Independent Transco. (*Id.* at pp. 9-12.) The CGM model envisions a single RTO-wide transmission rate and RTO-wide charges for incremental bulk transmission investments made anywhere in the RTO. (Baron Dir. pp. 24-25.)

A second potential Southeast RTO option surfaced only days before the hearing in this matter when Entergy withdrew its support of the CGM model and joined with Southern Company and several smaller transmission owners to resurrect the SeTrans RTO proposal that was rejected during the FERC mediation. On November 20, 2000, the SeTrans proponents filed a status report with the FERC advising the FERC that they intended to pursue the development of the SeTrans model. (ELI/EGSI Ex. 2.) That model retains the original SeTrans model, including a for-profit, independent third-party operator to serve as the RTO. The SeTrans model has been revised, however, to incorporate Entergy's particular RTO requirements, including Entergy's desire to participate as an ITC, LMP congestion management, and participant funding. (Gallaher Cross.) The proposed SeTrans RTO would extend over portions of Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, South Carolina, and Texas and include 73,000 MWs of generation. (ELI/EGSI Ex. 2.)

A third potentially viable option for Louisiana utilities is the SPP-MISO RTO formed by the recent merger agreement of the SPP and the Midwest ISO ("MISO"). (Kahal Dir.,

p. 16.) The SPP and the MISO announced the merger on October 19, 2001, with expectations of completing the merger in the early part of this year. (*Id.* at p. 19.) The FERC approved the SPP-MISO RTO in December, 2001. (*Order Granting RTO Status and Accepting Supplemental Filings*, Docket Nos. RTOI-87-000 (December 20, 2001).) The combined SPP-MISO RTO will cover 20 states stretching from Canada to New Mexico, with over 120,000 MW of generating capacity. (Kahal Dir., p. 16.) The SPP-MISO RTO is expected to be operational some time this year. (*Id.* at p. 19.)

The FERC also rejected the Alliance Companies' proposal to form a separate RTO and ordered the Alliance Companies to explore joining the SPP-MISO RTO. (*Order on Requests for Rehearing*, 97 FERC ¶ 61,327 (December 20, 2001).) The FERC stated that the Alliance RTO lacked sufficient scope and that the public interest would be best served if Alliance joined MISO. (*Id.*) This is significant because SWEPSCO is a wholly-owned subsidiary of AEP, and several of AEP's operating companies were part of the Alliance.

The SPP had previously partnered with Entergy and proposed to the FERC an Entergy-SPP RTO that would encompass all of Louisiana and the SPP region. (Kahal Dir., p. 9; FERC Docket No. RT01-34-000.) This proposal was made after three years of intensive negotiation and development work by the participating utilities in an effort to comply with Order 2000. (*Id.*) The FERC rejected the Entergy-SPP RTO filing in its July 12, 2001 order for the stated reason that "the proposed RTO fails to satisfy the scope and regional configuration requirements set forth in Order No. 2000." (Order, FERC Docket No. RT01-34-000 at 2 (July 12, 2001).) The FERC, however, acknowledged the validity of the supporting market analysis demonstrating that Entergy-SPP "encompasses a natural wholesale market." (Kahal Dir., p. 10.) The FERC ultimately declined to accept that analysis because it was based on historical data, and the FERC "look[ed] beyond sales under today's conditions" to take into account possible changes in trading patterns. (*Id.*) In that order, the FERC expressed a desire for a larger Southeast RTO that may include Entergy but not necessarily the SPP.

The FERC has neither ordered the Louisiana utilities to join a specific RTO nor precluded them from joining any RTO. The FERC has not acted on either the ALJ's Southeast

Mediation Report or the SeTrans filing. The FERC has not directed Louisiana utilities to participate in the Southeast region as opposed to the Midwest or SPP regions. Although the FERC has expressed support for a Southeast RTO and has suggested that this may include Entergy, it has not precluded Entergy from joining the Midwest or SPP regions and has not presented any analysis or evidence that the geographic area that would ostensibly comprise the Southeast RTO is a "natural market" in which Louisiana utilities would be expected to operate. (Kahal Dir. p. 11.) Thus, the Southeast proposals, as well as the SPP-MISO RTO, are potential options for Louisiana utilities.

B. The Utilities Have Not Demonstrated That Their Participation In A Southeast RTO Under the CGM Or SeTrans Models, As Opposed To The SPP-MISO RTO, Would Be In The Public Interest

As part of the Commission's Rule to Show Cause, the utilities were asked to identify which RTO they intend to join. (Rule to Show Cause, Ex. A, Q1 (a).) Entergy responded that it intends to participate in the Southeast RTO. (EGSI/ELI Response to Ex. A, Q1(a).) Entergy also stated that it intends to join the Southeast RTO by transferring its transmission assets to an ITC that would operate within the RTO. (*Id.*) SWEPCO, currently a member of SPP, indicated that it has not yet decided which RTO it will join, but that it is evaluating the Alliance RTO (which is apparently no longer viable under the FERC's recent decision), the SPP-MISO RTO, and the Southeast RTO. (SWEPCO Response to Ex. A, Q1(a).) CLECO responded that it has made no definitive decision regarding which RTO it will join, but that it will comply with FERC directives.¹⁵ (CLECO Response to Ex. A, Q1(a).)

The utilities also were asked to describe the public interest advantages, including benefits to Louisiana native load customers, of joining a Southeast RTO over joining the SPP-MISO RTO. (Rule to Show Cause, Ex. A, Q4.) As part of this description, the utilities were asked to address any "legal, institutional and technical impediments" that would prevent the companies from joining the SPP-MISO RTO. (*Id.*) None of the utilities identified any

¹⁵ CLECO indicated that in selecting an RTO, it will have to consider that it is dependent on Entergy for transmission service to serve its customers and that the vast majority of its interconnections are with Entergy. Because of these factors, CLECO stated that it may have to participate in the same RTO as Entergy. (CLECO Response to Ex. A Q4). The Staff did not dispute this conclusion. (Kahal Dir. p. 6.)

legitimate public interest benefits that their participation in the Southeast RTO would have over the SPP-MISO RTO. Nor did the utilities identify any impediments to joining the SPP-MISO RTO.¹⁶ In fact, the utilities' witnesses admitted on cross examination that they have performed no cost-benefit analysis of the various RTO options to allow them to identify the public interest advantages or disadvantages of the Southeast RTO as opposed to the SPP-MISO RTO. SWEPCO's witness, Michael Desselle, testified that SWEPCO has not performed a cost-benefit analysis of the various RTO options or of the Transco structure. (Desselle Cross.) Mr. Desselle further admitted that making a complete cost-benefit analysis is important and should be done prior to SWEPCO's participation in an RTO or divestiture of its assets to a Transco. (*Id.*) CLECO's witness, David Brammer, likewise admitted that CLECO has not performed a cost-benefit analysis or otherwise assessed the impacts of the RTO proposals on native load customers. (Brammer Cross.)

Entergy's witness, Frank Gallaher, testified that Entergy has not made any study of the costs and benefits of one RTO structure over another RTO structure or of a Transco-based RTO as opposed to a non-Transco-based RTO. (Gallaher Cross.) Entergy has established that the transmission revenue requirement will increase with a Transco structure, and Entergy has known for years that there would be an impact on retail ratepayers from Entergy's transfer of its transmission assets to a Transco. (*Id.*) Despite this, Entergy has not studied those impacts on native load customers. (*Id.*) Further, Entergy has not studied the duplicative costs that may result from a two-tiered RTO structure that includes a Transco. (*Id.*) Nor has Entergy studied the lost economies of scope that may result from a transfer of transmission assets. (*Id.*) Mr. Gallaher stated that Entergy had, however, performed a profitability study of the Transco model, a study that has not yet been filed with the Commission. (*Id.*)

The evidence thus shows that Entergy has been motivated in its selection of RTO structure and region not by public interest concerns or an attempt to reduce costs and improve

¹⁶ In fact, Entergy admitted that there are not "any legal impediments to prevent [the Entergy Companies] from joining the SPP-MISO RTO." (EGSI/ELI Response to Ex. A Q4.)

service for Louisiana customers, but by the RTO's willingness to accept an Entergy Transco, an option that Entergy has analyzed and determined to be profitable for the Company. On each of its five RTO proposals, Entergy has maintained the Transco structure.

In its first proposal, Entergy sought its own RTO-Transco, consisting solely of Entergy's transmission assets, but inviting others to participate. (Gallaher Cross.) When Entergy could find few other transmission owners willing to join its Transco, Entergy agreed to join with SPP on the condition that it be allowed to participate in the SPP RTO through its Transco. (*Id.*) Entergy spent millions of dollars and several years developing the SPP-Entergy RTO. (*Id.*) That RTO was rejected by the FERC due to inadequate geographic scope.¹⁷ The SPP-Entergy model also was rejected by the ALJ and removed as an option in the early stages of the mediation, for the stated reason that "the relationship between SPP and Entergy had failed to stabilize to the degree necessary to support a viable model for the Southeast RTO." (Mediation Report for the Southeast RTO, 9/10/01 p. 6 (attached to EGSI/ELI Response to Ex. A Q6).)

Entergy then joined with another set of proponents participating in the Southeast mediation, Grid South and Grid Florida (the "Grids"), when they agreed to "accommodate Entergy's business needs" for a Transco. (*Id.*) The model jointly proposed by Entergy and the Grids ultimately became the Collaborative Governance Model recommended by the ALJ. (*Id.*)

The CGM is based on a "Transco-on-top" structure. Entergy recently withdrew its support of the CGM model and declared its intent to develop a Southeast RTO based on the SeTrans model proposed in the mediation and to join that RTO as a Transco. (Gallaher Cross.) Entergy's support of the SeTrans model was contingent on its acceptance of a division of responsibilities within the RTO structure that would allow for the Entergy Transco. (*Id.*)

There is no evidence that Entergy's various RTO affiliations were concocted to promote the public interest in reducing costs and improving service for its native load customers. As admitted by Mr. Gallaher, in all of these actions, Entergy's primary concern has been to obtain an Entergy Transco. (*Id.*) The Entergy Transco has been a consistent feature throughout

¹⁷ Any alleged deficiency due to inadequate geographic scope is clearly cured by the SPP's merger with the MISO.

all of Entergy's proposals. (*Id.*) Moreover, Entergy has never undertaken an analysis of the costs and benefits to ratepayers in connection with its RTO proposals. (*Id.*) It is inappropriate for Entergy to make affirmative commitments to develop and join RTOs without an analysis of the impact of the structure of the RTOs, and Entergy's Transco, on its native load customers. Entergy's RTO decisions should be driven by the goal of promoting the public interest and reducing the cost of wholesale transactions in its service area.

It is thus improper for Entergy to have decided to participate in a Southeast RTO under either the SeTrans or CGM models without an analysis of the public interest implications of that decision. Entergy identified several purported "public interest advantages" to joining the Southeast RTO over the SPP-MISO RTO: (1) Entergy prefers a congestion management system based on locational marginal pricing ("LMP"), which Entergy claims is supported by market participants in the Southeast; (2) Entergy favors participant funding for transmission upgrades, which Entergy claims is supported by a number of Southeast transmission owners; (3) Entergy asserts that its "natural market" is the to the east, rather than the west; (4) Entergy claims membership in the Southeast RTO will enable Entergy to address a parallel flow problem with Southern Companies. (ELI/EGSI Response to Ex. A Q4.) Entergy's public interest justification for joining the Southeast RTO is unsatisfactory.

First, while the Southeast may favor LMP, so does the SPP-MISO RTO. Entergy presented no comparison of the Southeast and SPP-MISO congestion management methods. Moreover, Order 2000 requires all RTOs to implement a market-based method of congestion management, such as LMP. (Kahal Dir., p. 18.) Second, both LMP and participant funding for upgrades are likely to be addressed generically by the FERC in its rulemaking in Docket No. RM01-12-000 or elsewhere. (*Id.*) Absent additional evidence or analysis, these are insufficient reasons for preferring the Southeast RTO over SPP-MISO.

Third, Entergy's "natural market" assertion is not supported by the evidence. Entergy is a very large purchaser of economy energy and capacity products. (*Id.*) Entergy's own simulation modeling conducted pursuant to MSS-7 indicates that most of Entergy's purchases come from sources in the SPP and/or Midwest regions. (*Id.* at pp. 18-19; Schedule MIK-1.)

With the exception of TVA, no source to the east of the Entergy System is of any significance. (*Id.*) Although TVA is an important source for Entergy, it is not certain that TVA will join the Southeast RTO or, indeed, any RTO. Entergy has produced no evidence to show that the simulation modeling assumptions are incorrect or are unrepresentative of current trading patterns. Thus, the only evidence before the Commission shows that Entergy's sources to the north and west are of greater importance than those to the east. (*Id.*)

Moreover, until recently, Entergy strongly supported the SPP RTO, not the Southeast RTO. Entergy spent significant resources in the development of the SPP RTO. There have been no changes to the SPP RTO except for its planned merger with MISO, a change that should not make the SPP RTO any less attractive to Entergy. No evidence has been presented that would justify Entergy's abandonment of the SPP-MISO RTO in favor of the Southeast RTO at this point.

C. The Utilities Will Be Required To Perform A Cost-Benefit Analysis Of All Reasonably Feasible RTO Options, Including the SPP-MISO RTO

Although the Louisiana utilities have been actively involved in the discussion and development of RTOs, and Entergy has made multiple commitments to join particular RTOs, the utilities have not assessed the impact of these RTOs on their native load customers. The selection of an RTO structure will have a profound impact on the reliability, efficiency, and cost of service provided to retail customers. The public interest implications of the various RTO proposals must be analyzed in order for the utilities, the FERC, and this Commission to make an informed RTO decision. The utilities will be required to assess the costs and benefits of all reasonably available RTO structures and regional configurations to ensure the formation and selection of an RTO that benefits, and does not harm, Louisiana ratepayers. That cost-benefit analysis should be done before any irretrievable commitment is made to any particular RTO structure or region. The study should be done now, while the RTO process is still evolving, so that the study can have a meaningful impact on RTO selection and will not serve as a mere after-the-fact justification for a pre-ordained decision.

The utilities should perform a cost-benefit analysis of the Southeast RTO under both the CGM and SeTrans proposals, as well as the SPP-MISO RTO. The SPP-MISO RTO

clearly is a viable option for Louisiana utilities. The FERC has not precluded Entergy or any other Louisiana utility from joining the SPP-MISO RTO. Further, the evidence suggests that the SPP-MISO RTO may be the preferred option for Louisiana's utilities. The Southeast RTO under the CGM will be controlled by a Transco, which, as even Entergy acknowledges, creates an internal conflict of interest. (Gallaher Cross.) As discussed in Section III above, there are serious problems with the Transco structure that likely would increase costs to Louisiana ratepayers. The CGM's use of a single rolled-in revenue requirement could lead to substantial cost shifts that also would increase costs to Louisiana ratepayers.

The evidence also shows that Entergy's and SWEPCO's wholesale power markets (except for TVA) are in the SPP and Midwest regions. (Kahal Dir., pp. 18-19; Schedule MIK-1; Desselle Cross.) If the utilities were to participate in the same RTO as their power suppliers – the SPP-MISO RTO – the costs of economy and capacity purchases may decrease with the elimination of seams and pancaked rates. Conversely, if the utilities participate in a different RTO than their power suppliers, then the costs of these transactions may increase. Thus, the SPP-MISO RTO may achieve lower costs for energy purchases and may be more desirable for Louisiana ratepayers.

For the same reasons, it would be preferable for all Louisiana utilities to participate in the same market and in the same RTO. (Kahal Dir., p. 20.) SWEPCO, as a wholly owned subsidiary of AEP, is included in the recent FERC order directing the Alliance to negotiate for membership in the MISO and is in fact considering the SPP-MISO RTO as an option. This same option should be explored by all Louisiana utilities.

In addition, there is far more certainty associated with the SPP-MISO RTO than the Southeast RTO. (Kahal Dir. p. 19.) The FERC has approved the SPP-MISO RTO, and it is reasonably expected to be functional this year. (*Id.*) By contrast, the Southeast RTO does not exist – not even as a concrete proposal – and it has not yet received support from state commissions in the Southeast. (*Id.*) Given its current embryonic status and lack of state regulator support, the future of the Southeast RTO is very much in doubt, and even if it does succeed, it may be years before it is operational. (*Id.*)

Thus, we will require the utilities to perform an analysis of the costs and benefits associated with the Southeast RTO under both the CGM and SeTrans models, and the SPP-MISO RTO. The study is to analyze the advantages and disadvantages of each RTO structure, taking into account the effect of any asset-owning Transco that is contemplated and the RTO's proposed regional configuration. The analysis must consider, at a minimum, the impact of each RTO proposal on (1) reliability and efficiency of transmission service to Louisiana retail customers; (2) costs of transmission service to retail customers, including an evaluation of the possibility of cost-shifting and an excessive allocation of costs to Louisiana customers; (3) wholesale competition; (4) power flows; (5) costs of economy sales and purchases; and (6) transmission costs across seams. If necessary, the Staff will provide further guidance on the parameters of the cost-benefit analyses.

VI. COST TRANSFER AND PRICING ISSUES

The Show Cause Order requires that the transmission-owning utilities demonstrate why the pricing and cost transfer recommendations in the ALJ's Mediation Report do not conflict with the public interest. The utilities did not address these issues in depth, apparently viewing them as premature in light of the FERC's decision to delay the formation of an RTO and Entergy's proposal to join and support the SeTrans proposal. These issues were pursued, however, in an attempt to develop an understanding of the utilities' positions and to determine the steps necessary to protect ratepayer interests as RTO formation proceeds.

A. Cost Transfers

Both of the proposed RTO models in the FERC mediation contain ratemaking approaches that will result in cost transfers among jurisdictions. The proponents proposed measures to mitigate or delay the effect of the cost transfers, but not to eliminate them. Whether the transfers would increase or decrease the costs of the Louisiana utilities is unclear, because some of the tariffing issues have not been resolved, the RTO configuration is unclear, and relevant cost data has not been compiled by the utilities.

The potential causes of cost transfers include the following:

1. Rolling-in Transmission Costs from Different Areas in Fashioning a Single RTO Rate

Currently, transmission rates for different utility systems are based on the costs incurred by that system to provide transmission. Depending on the amount of transmission plant required, the undepreciated cost of the plant, and the required operation and maintenance expense, the overall costs and rates may vary significantly. Rolling in all the costs from the different areas into a single RTO transmission tariff necessarily will raise the rate in some areas and lower it in others.

Recognizing this problem, RTO proponents have proposed various mitigation measures, including a phase-in of the change to rolled-in pricing, at least for embedded transmission plant. At best, however, the phase-in only will delay the cost transfers. Further, as to new transmission projects, the costs likely will be rolled into the regional tariff even if a project is needed only to serve a particular area. To the extent new construction occurs disproportionately throughout the region, the averaging of costs will shift some costs among utilities and ratepayers.

The use of rolled-in charges may be reasonable when the investment benefits all RTO customers. (Baron Dir., p. 25.) However, this is not likely to be the case for all RTO costs or investments, and the impact on specific retail customers is unknown and could be adverse. (*Id.*) Additionally, the FERC appears committed to developing a single RTO rate for all customers. (*Id.*) This will only exacerbate the cost-shifting problem.

It is difficult to quantify the effect of rolled-in pricing at the RTO level, especially for super-regional RTOs. (*Id.*, p. 26.) The geographically different growth rates for transmission investment in a large regional RTO may have a detrimental impact on Louisiana customers. (*Id.*, pp. 26-27.) For example, if transmission grew substantially more in North Carolina than in Louisiana, but all customers paid the same rate to the RTO, Louisiana customers may end up subsidizing the North Carolina transmission users. (*Id.* at 27.) Of course, the reverse also could be true. The problem, as noted by Mr. Baron, is that the issue has not been addressed. (*Id.*)

Finally, the use of rolled-in pricing, whether at the Transco or RTO level, may lead to over-investment because the costs are spread among all customers. (*Id.*, pp. 25-26.) Due to the large geographic scope of the proposed RTOs, there potentially would be significant incremental investments throughout the RTO. (*Id.*, p. 26.) Thus, RTO-wide pricing could provide an incentive to over-invest in transmission plant with a resulting detrimental impact on transmission users, particularly captive retail ratepayers that continue to take bundled service. (*Id.*)

2. Uniform and Expanded Rules for Recognition of "Transmission" Assets

Utilities in different areas currently functionalize assets to transmission based on different criteria. Thus, transmission rates may reflect the costs of different types of plant. Plant not included as "transmission" generally is functionalized to distribution and collected in retail rates as part of the costs of distribution. Requiring a uniform functionalization of transmission, and averaging the costs across the regions, necessarily will change the transmission cost level in some areas as compared to the situation that now exists. A uniform approach would not be inequitable and may be desirable, but it likely would produce rate changes for some utilities.

3. Changes in Transmission Revenues

Utilities obtain revenues for providing transmission service from third party users based on their transmission costs and rates. The revenues can be used as a cost offset in setting retail rates. If a uniform transmission rate is adopted, there will be changes in the amount of transmission revenue available to each utility. Moreover, to the extent "pancaking" of transmission costs is eliminated, overall transmission revenues will decrease. Thus, there likely will be revenue requirement changes from moving to an RTO, and the changes will vary depending on the size and configuration of the RTO.

At the hearing, the utilities' witnesses professed to have no information from which to estimate the impact of cost transfers resulting from joining particular RTOs. These parties apparently have pursued various RTO options without studying the impact of potential cost transfers on their ratepayers. The utilities appear satisfied to study these issues after they have joined an RTO and have no other option.

The Commission will require each transmission-owing utility to study the likely cost impact of joining a Southeast RTO, the Midwest RTO or retaining the original SPP-Entergy RTO structure. The studies necessarily will produce only estimates, but the estimates will provide some basis for reasonable planning. The utilities should study the potential impact under the cost arrangements currently being proposed at the FERC, using information available from FERC Form 1 filings, utility databases and similar sources. The studies should be completed and submitted to the Commission no later than June 17, 2002.¹⁸ The Staff is instructed to work with each utility to ensure that the studies are performed in a reasonable and comprehensive fashion.

B. Congestion Management and Pricing Issues

One of the primary issues under discussion in connection with the FERC's pursuit of RTOs is the question of how to "manage" congestion on the transmission system. Stated simply, "congestion" occurs when loads on the system cannot be served from the cheapest available generators because transmission capacity is inadequate. The FERC ALJ and the Louisiana utilities appear to favor a "financial rights" method to resolve congestion issues, using "locational marginal price" ("LMP") as the basis for pricing generation and eliminating the price advantages of purchasing across congested lines to, in turn, eliminate congestion.

The working of the LMP approach to congestion management is complex and to some extent unclear. The witnesses at the hearing described the LMP approach differently, contradicting each other as to its breadth. Technical conferences were held to acquire a working understanding of LMP, primarily for the purpose of anticipating problems and ensuring adequate protections for ratepayers, but the concept has proven elusive. The approach essentially has been implemented in some regions that have adopted retail access, but its basis nevertheless appears somewhat theoretical.

¹⁸ The Staff originally recommended that the deadline to complete the studies be March 31, 2002. The utilities commented that this did not provide adequate time for the analysis. The Commission agrees that the deadline should be extended and will establish June 17, 2002 as the deadline to complete the studies.

It appears that the basic framework of LMP congestion management, as proposed by Entergy, and perhaps endorsed by the other Louisiana utilities, includes the following components:

1. Determination of LMP at Points of Delivery

At any point of delivery on the System, the System Operator will determine the "locational marginal price," or LMP. The LMP is the price to deliver an incremental megawatt-hour ("MWH"), beyond that already being consumed, at the delivery point. The determination of LMP is based on generators' bids to sell electricity into the market. The LMP may be the price of generation at the delivery point or the price of generation that can be delivered through the transmission network to that point. Under Entergy's proposal, all generators delivering power at that point receive the LMP, even if their bids to sell the power to the system operator are lower. Thus, this method equalizes the price paid to all suppliers at the highest accepted bid.

2. Elimination of Price Advantage to Buy Over Congested Lines

When generation is available on the System at a cheaper price than the LMP at a point of delivery, a buyer (and the System Operator) ordinarily would seek to purchase the electricity. But if the demand exceeds the transmission capability of the System, "congestion" prevents the delivery of all the cheaper power. LMP "solves" this congestion problem by pricing the entire supply at the LMP at the point of delivery, thus eliminating the price advantage that might be realized by purchasing electricity from elsewhere on the System. The buyer pays this higher price for all electricity purchased at the delivery point, even if some of the lower-priced energy could have been transmitted to the delivery point. Because the buyer now obtains no advantage by purchasing across congestion, the congestion by definition disappears. The difference between the LMP at one point and that at another is the "cost of congestion," which assertedly will be collected by the System Operator and redistributed to entities that hold financial hedges against congestion costs. Entergy asserts that these financial hedges can and will be used to protect captive ratepayers from assessments for congestion.

Because the electric transmission system is comprised of many lines, offsetting flows and multidirectional flows, a System Operator may consider multiple generating units in deciding how to serve a delivery point over congested lines. A generator with the lowest bid

may not be used to supply the load when its energy, in combination with energy from other units that could supply the load over congested lines, produces an overall cost greater than that produced from some different combination of generating units.

C. Financial Transmission Rights ("FTRs") or "Hedges"

Because the LMP method equalizes costs by eliminating potential savings from cheaper generation, there will be price differences between the price paid the generator (LMP at point of supply) and the price collected from the buyer (LMP at point of delivery). This difference is collected by the System Operator for redistribution to someone. Under Entergy's proposal, holders of financial transmission rights would receive distributions to offset the costs of congestion. Entergy asserts that these rights will protect ratepayers from the cost effects of congestion. This protection is only conceptual, however, as the mechanics of an FTR system have not been developed. It has not been determined how the FTRs will be distributed, what retail loads they will protect, whether they will cover new retail loads, whether and how they might be traded in FTR markets. Nor have other mechanics of the hedging system been assessed.

These three basic elements of the LMP congestion management system generally would apply to forward purchases as well as real time markets. The System Operator would add the cost of congestion to the contracted price when congestion exists. If the buyer holds an FTR for the purchase, this amount would be distributed to the buyer by the System Operator.

The LMP System has theoretical appeal as a means to deal with congestion. If there is no advantage to using a congested line, the congestion over the line undoubtedly should disappear. This methodology has many troubling attributes, however, and may threaten much higher electricity costs for ratepayers. Further, the purported incentive for transmission development in the LMP approach may not produce the desired transmission investment or promote sufficient generation siting needed to alleviate the congestion. We have the following concerns with the LMP method:

1. LMP Pricing

The System, because it pays the highest marginal price at each delivery or injection point to generators, may increase overall prices. In a perfectly competitive market, the

market dictates price, and all sellers receive the same price, but in perfect competition, price also moves toward the most efficient seller's cost. The market for electric sales is not perfectly competitive and likely never could be. The costs associated with different types of generators vary, sometimes widely, so bid prices may differ substantially. Paying all sellers the highest bid price that is accepted necessarily will increase prices relative to a system in which sellers receive what they bid. Utilities still would recover only their cost for regulated generating units, as (presumably) price increments would offset added costs, but for purchases made by the utility, the overall impact of LMP could be substantial. It is not clear how ratepayers would, or could, be protected from these impacts.

2. Price Awareness

The LMP method contemplates price "transparency," in which sellers will know the LMPs at all locations very soon after transactions occur. To the extent supply is short relative to demand, these sellers may use the information to coordinate prices, which would drive up prices and perhaps change the price differentials for transmission congestion. Even in the absence of supply shortages, the price awareness may promote coordination and supra-normal prices. Again, to the extent ratepayers depend on purchases for supply, the adverse impact could be significant.

3. FTR Uncertainties

The FTR system is supposed to protect ratepayers from added costs imposed for transmission congestion. Yet the utilities appear to argue for the adoption of LMP first, after which interested parties may work out the FTR system. This approach leaves ratepayers vulnerable to the danger that the ratepayer protections will be inadequate or nonexistent. Further, the distribution of congestion costs to FTR holders may lead to significant cost transfers.

4. Potential that "Incentives" Are Imaginary

A key objective of LMP is to produce incentives to expand transmission and place generators in geographic areas that will relieve congestion, but the ability of this pricing scheme to produce the desired effects is unproven. If the added cost of transmission is offset by FTRs, it is unclear how those costs will promote desirable conduct. Generators may be disinclined to locate where LMP is high but other diseconomies exist because of the fear that LMP will change.

Transmission siting problems may make expansion to cure congestion impossible. The theoretical benefits of LMP are potentially illusory.

LMP and the associated FTRs do provide a means to reward merchants for financing the expansion of the transmission system. To that extent, the method may serve the useful purpose of promoting "participant funding" rather than ratepayer funding of improvements that benefit the participants. This benefit may not outweigh the potential costs, however, of this pricing system.

Given the uncertainties associated with LMP congestion management and the potential for ratepayer harm, we will order an intensive examination of this issue and the steps necessary to protect consumers. This examination will evaluate alternatives to LMP, assess the likelihood that LMP will be adopted, and determine how an FTR system will operate. If necessary, the Commission may oppose the adoption of LMP or participation in an RTO that uses LMP. Alternatively, the Commission will consider safeguards to protect ratepayers from adverse consequences of LMP.

VII. PROVISIONAL EXEMPTION OF LOUISIANA GENERATING

The Staff recommended that this Commission provisionally exempt Louisiana Generating from this Order. The Staff based its recommendation on the extremely limited nature of Louisiana Generating's assets; the absence of any existing plans by Louisiana Generating to join an RTO; and, the fact that Louisiana Generating does not serve retail customers but, instead, makes only sales at the wholesale level.

Louisiana Generating provides wholesale electric service to the distribution cooperatives in Louisiana. Its transmission assets are limited to those necessary to make wholesale sales to its customers and do not constitute an integrated transmission network. As documented by public records filed at the FERC, Louisiana Generating's transmission assets consist of two switchyards at the Big Cajun Stations; equipment at 115 points at which Louisiana Generating delivers power to the cooperatives; and, a single 26 mile 138 KV transmission line, with a substation at either end, running inside the service territory of Jefferson Davis Electric

Cooperative, Inc. ("Jeff Davis"), which line is used exclusively to serve Jeff Davis.¹⁹ Based on its review, the FERC determined that Louisiana Generating would be exempt from the provisions of Order 888 (requiring the filing of an open access transmission tariff) because its facilities did not form an integrated transmission grid but were, instead, limited and discrete transmission facilities.²⁰

Although participating in this Docket, Louisiana Generating has questioned our jurisdiction over its transmission assets. However, Louisiana Generating also has stated that it currently has no plans to join an RTO because of its limited transmission assets. Given this, we will exempt Louisiana Generating, provisionally, from this Order. We will, however, reserve our position and rights regarding the scope of our jurisdiction over Louisiana Generating. Louisiana Generating's position and rights likewise are reserved. Louisiana Generating has agreed to the mutual reservation and to advise this Commission if it decides to join an RTO.

VIII. CONCLUSION

Upon motion of Commissioner Field, seconded by Commissioner Owen, and unanimously approved, after considering the Report of Special Counsel, briefs filed by the utilities and intervenors, oral argument, and the record in this proceeding, the Commission hereby orders the following:

1. The Commission finds that the Transco structure presumptively is not in the public interest. This finding applies whether the Transco will be the actual RTO (as in the CGM model) or simply a participant in an RTO (as in the Entergy SeTrans proposal). The utilities should explore RTO participation that does not require the transfer of their transmission assets to an RTO or Transco.
2. By June 17, 2002, the utilities shall prepare and submit a study of the costs and benefits of each of the reasonably feasible RTO options, including the Southeast RTO under both the CGM and SeTrans models, and the SPP-MISO RTO. The studies must analyze the advantages and disadvantages of each RTO structure, taking into account the effect of any asset-owning Transco that is contemplated and the RTO's proposed regional configuration. The analyses shall consider, at a minimum, the impact of each RTO proposal on (1) reliability and efficiency of transmission service to Louisiana retail customers; (2) costs of transmission service to retail customers, including an evaluation of the possibility of cost-shifting and

¹⁹ See Application for Determination of Exempt Wholesale Generator Status (FERC Docket No. EG00-89-000).

²⁰ See FERC letter dated March 29, 2000, 90 FERC ¶ 61,307.

an excessive allocation of costs to Louisiana customers; (3) wholesale competition; (4) power flows; (5) costs of economy sales and purchases; and (6) transmission costs across seams. If necessary, the Staff can provide further guidance on the parameters of the cost-benefit analyses, and the Staff is instructed to work with each utility to ensure that the studies are performed in a reasonable and comprehensive manner.

3. The Commission orders an intensive examination by the Staff of LMP congestion management and the potential for ratepayer harm and the steps necessary to protect carriers. This analysis shall include an evaluation of alternatives to LMP, an assessment of the likelihood that LMP will be adopted, and a determination of how the system will operate for financial transmission rights. The analysis also should focus on safeguards to protect ratepayers from adverse consequences of LMP, and the Staff is to propose ratepayer protection methods to address the potential harmful impacts of congestion management pricing. The Commission also may oppose the adoption of LMP or participation in an RTO that uses LMP.
4. Louisiana Generating will be exempted, provisionally, from this Order. Louisiana Generating will advise this Commission if it decides to join an RTO. Both this Commission and Louisiana Generating reserve their positions and rights regarding the scope of this Commission's jurisdiction to review any transfer by Louisiana Generating of the operations or ownership of its transmission assets to an RTO.
5. The parties are directed to take all further action consistent with this Order.

This Order will be effective upon its issuance.

IT IS ORDERED.

**BY ORDER OF THE COMMISSION
BATON ROUGE, LOUISIANA
March 19, 2002**

/S/ JACK "JAY" A. BLOSSMAN
DISTRICT I
CHAIRMAN JACK "JAY" A. BLOSSMAN

/S/ DON OWEN
DISTRICT V
VICE-CHAIRMAN DON OWEN

/S/ IRMA MUSE DIXON
DISTRICT III
COMMISSIONER IRMA MUSE DIXON

/S/ C. DALE SITTIG
DISTRICT IV
COMMISSIONER C. DALE SITTIG

SECRETARY

/S/ JAMES M. FIELD
DISTRICT II
COMMISSIONER JAMES M. FIELD

