FERC Faces Challenge

By Stephen Barlas


FERC Chairman Joe Kelliher

COMMISSIONERS AND STAFF at the Federal Energy Regulatory Commission have already stuffed their 2006 desk calendars with meetings as the agency faces one of its heaviest—and for the electric utility industry, most significant—workloads since the FERC's predecessor agency, the Federal Power Agency, was created in 1930.

FERC Chairman Joe Kelliher enters his first full calendar year as chairman having to make do with just two commissioners as colleagues — and two vacancies on the commission. They face an agenda as deep as a mine shaft, clogged with active dockets initiated in response to last summer's Energy Policy Act and by Kelliher's own reform agenda, highlighted by his signature initiative: revision of the Open Access Transmission Tariff (OATT) designed as part of Order 888.

Kelliher faces the new year with an unenviable, and in many ways, conflicting task. Natural gas prices were running amok in some parts of the country, sending electric rates higher even before the supply disruptions from Katrina and Rita. With state public utility commissions jumping in to cap electric prices, FERC must show that it, too, is acting to defuse exploding electricity rates. On the other hand, the commission has to offer generators and transmission providers effective rate incentives to add capacity in the long term, which means offering more attractive rates.

"That is a fair question," says Tom Welch, vice president of external affairs for regional transmission organization PJM Interconnection, responding to a question about whether Kelliher and FERC face an impossible dilemma. PJM is the RTO operating in 13 eastern states and the District of Columbia. "At what point do you know if what you build is enough, too much or too little?" asks Welch.

PJM raised the stakes for Kelliher when it submitted a request to FERC in August, asking for access to a reliability pricing model, which a FERC official says "is already generating controversy."

In addition to the PJM request, FERC has to decide whether to modify its previous approval of ISO New England's request to use Locational Installed Capacity Plan (LICAP) pricing as a means of encouraging Dominion, PSEG, FPL and other power providers to increase generation capacity. Massachusetts and Connecticut state officials oppose LICAP, arguing it will jack up electric costs by $13 billion in the region over the next five years while failing to guarantee that power plants will be built. Power companies say they can't build new facilities until new transmission lines are built.

Nearly everyone agrees, however, that Kelliher's commitment to make changes in Order 888 and its OATT will be controversial. Order 888, which became final in 1998, allows market-based rates if a wholesaler does not have market power. But there is all kinds of latitude for determining those rates. Kelliher says power suppliers use 13 to 17 different methods for calculating Available Transfer Capability (ATC) — a key factor in the rate equation. "That makes it hard for the commission to identify violations," Kelliher notes. "There needs to be more consistency there."

Significant changes in the OATT are a threat to vertically integrated utilities in the South and West, most prominently, but not exclusively, Entergy, Southern and Duke. Larry Bruneel, vice president of federal affairs for the International Transmission Company, which serves customers in 13 southeast Michigan counties, says reform of the OATT will be Kelliher's "keystone" initiative. Bruneel contrasts Kelliher's approach to remedying discriminatory rates with that of former Chairman Pat Wood, Jr., who tried to impose a Standard Market Design (SMD), which he was forced to abandon — in part because of political opposition by Entergy, Southern, Duke and others, who brought pressure to bear in Congress.

Bruneel thinks Kelliher will be better able to bring off OATT reform not only because it is a more conservative, legal, narrow approach than SMD, but also because Kelliher is better suited to artfully deflect political pressure in a way that Wood could not. His theory is based on his background as a

BPL COVERAGE

The broadband over power line sector will be covered by Market Central.

Development of BPL has been heralded by top regulators at the Federal Energy Regulatory Commission and Federal Communications commission.

Analyst James P. Morgan, of Market Central, said, "Investors might be well served to follow very closely the industry and the companies that provide it."

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House staffer and close ties to House Energy and Commerce Chairman Rep. Joe Barton (R-Texas). "Anything Kelliher does will have very solid legal underpinnings," Bruneel adds.

Kelliher's go-slow, legalistic approach will also be felt in FERC's implementation of its new merger review authority granted by the new energy act. Kelliher implied at a press briefing in September that he wished FERC would have been able to take a look at Duke Energy's divestiture of its entire 5,000 megawatts of merchant capacity in the Southeast to KGen Partners in 2004. FERC approval was not required then. But the new energy act gives FERC authority to examine sales of generation assets for the first time.

As he moves forward on these issues, Kelliher will be working with Democrat Suedeen Kelly and Republican Nora Mead Brownell with whom Kelliher has very good relations. He says he "has no idea" when the two vacant seats on the commission will be filled. The Bush administration has yet to announce any nominations. "But in the meantime, we will be fully functional," Kelliher states. "There are very few matters we can't dispose of."

In fact, in the past five years, the FERC has had a full complement of five commissioners for only three months. Complementing those collegial relations is Kelliher's command of a like-minded top staff, which he already has begun to mold. His first appointment to a "political position"—i.e. one that commissioners can fill with whomever they want (no Senate confirmation required)—was John Moot to be general counsel, a pivotal position. Bruneel describes Moot, who had worked in the Washington office of law firm Skadden, Arps, Slate, Meagher & Flom LLP since 1992, as "an incredibly good lawyer."

Industry observers almost unanimously agree Kelliher will lead his staff and commissioners down a careful, thoughtful path in 2006. "There will be much more solid legal underpinnings to anything the commission does," Bruneel maintains.

RELIABILITY INITIATIVE

- FERC's establishment of an Electric Reliability Organization (ERO) means utility companies in the distribution chain will have to tune up their operations and maintenance procedures or pay a stiff price for failing to do so, both financially and in terms of public relations.

- "If we end up with an ERO as strong as INPO, we'll all be better off," said Kelliher at a September press briefing.

- The Institute of Nuclear Power Operations (INPO) was formed after the 1979 Three Mile Island accident to promote excellence in nuclear power plant operations. Terry Young, a spokesman for INPO, says the group inspects nuclear plants every two years, and submits a report to the utility. Those reports are never made public. INPO has never taken any enforcement action against a utility for violation of standards.

- The Energy Policy Act, which mandated that FERC oversee an ERO that establishes mandatory reliability standards, also gives the ERO power to levy enforcement actions and penalties — subject to FERC approval — and allows FERC to do the same on its own.

- Brian Lee, the FERC spokesman, says Kelliher used the INPO example in the sense that the nuclear industry was forced by pressure from the Nuclear Regulatory Commission to set up a self-policing organization. Lee adds that a better parallel, at least in terms of an ERO's policing of the electric utility industry, is the relationship between the Securities and Exchange Commission and the New York Stock Exchange, where the SEC fines companies who violate NYSE rules.

- But enforcement of mandatory reliability standards - if in fact that happens - remains a ways off. FERC must designate the rules for ERO operation by Feb. 15. It won't be able to select an ERO until sometime after that date. It is almost a foregone conclusion that FERC will designate the North American Electric Reliability Council (NERC) as the ERO. "It is our expectation that we will become the ERO," says Joanne Callahan, manager, editorial services for NERC.

- The electric industry established NERC in the aftermath of the 1965 blackout in the northeast United States. Since its inception, NERC has developed Operating Policies and Planning Standards that provide voluntary guidelines for operating and planning the North American bulk-power system. In April 2005, NERC adopted "Version 0" reliability standards. The new ERO will have to develop mandatory standards, which may or may not mimic Version 0 and must then be approved by FERC.

- Stephen A. Stolze, managing director for Enterprise Management Solutions, a Black & Veatch company, says, "At the start, FERC will try to get an idea of who is going to play and who is not going to play. But it won't come out with axes swinging."

- Because FERC will have the power to issue fines, I think you'll see more transmission investment," Stolze explains. "For example, there could be more installation of new technologies such as superconductors, and then rate activity around recouping those costs."

- He notes that the ERO will operate differently than NERC has. Whereas NERC and its regional affiliates have depended heavily on utility industry technical talent, who are assigned by their companies to develop and vet proposed standards, the ERO will have a paid technical staff and will also seek input on standards from all market participants. Moreover, end-users will fund the ERO, and will want a voice in its operation - meaning manufacturing industries will for the first time have a say in how their power suppliers operate.