

**Remarks of Commissioner Linda K. Breathitt  
Federal Energy Regulatory Commission**

**"The Gas and Electric Wholesale Markets - Regulatory Issues"**

**1st North American Energy Standards Board Annual Meeting**

**Marriot Hunt Valley Inn  
Hunt Valley, Maryland**

**September 24, 2002**

Good morning ladies and gentleman. Thank you for inviting me to address the 1st Annual Meeting of the North American Energy Standards Board. It is an honor to be here among such a distinguished group of people representing the electric and gas industries, federal and state regulators, and the financial community. I last spoke to many of you two years ago at the 6th Annual Gas Industry Standards Board Meeting in San Antonio. I am truly glad to be part of your first annual meeting as the North American Energy Standards Board as you embark on the important and challenging task of developing standards for the wholesale electric, retail electric, and retail gas markets.

I have been asked to share with you my perspectives on regulatory issues affecting the gas and electric wholesale markets. Obviously, the most important regulatory issue at FERC can be summed up in three letters: SMD. As you all know by now, Standard Market Design or SMD is the

Commission's initiative to create a common set of standards, rules and procedures for the interstate transmission of electricity. There are a number of major features of SMD. All transmission customers - wholesale, unbundled retail and bundled retail - will be under a single tariff and will receive the same flexible transmission service known as network access service.

Physical rights for transmission capacity would be replaced by financial rights for transmission capacity. Locational marginal pricing (LMP) would be the system for transmission congestion management and tradable financial rights - Congestion Revenue Rights - would be provided to transmission customers as a means to lock in a fixed price for transmission service.

Further, the independent transmission provider will administer three energy markets - the day ahead market, the real time market and the ancillary services market.

The resource adequacy requirement of the proposed SMD rule recognizes the need for more infrastructure and would establish procedures to assure, on a long term basis, that there are adequate transmission, generation and demand-side resources. State representatives would have input in this process through the Regional State Advisory Committees contemplated by the

NOPR. The proposed rule recognizes that the Regional State Advisory Committees appear to be similar to the Multi State Entities that the National Governors Association recommended be established to facilitate state coordination on transmission planning, certification, and siting at a regional level. The SMD NOPR also proposes market monitoring and mitigation procedures that are similar to those in operation in a number of existing ISOs.

As I have publicly stated, there is a lot to like about the proposed SMD rule that I voted for. But I also have some concerns with the NOPR. I am concerned about the level of complexity in the SMD NOPR as well as the cost of implementation. I stated in my concurring opinion that there appears to be the potential for cost shifts among regions of the countries. This is an issue where we have already gotten a great deal of feedback. Low cost energy states in the Southeast and the hydroelectric generating states in the Northwest are concerned that their cheaper power will be exported to higher cost regions. Finally, I indicated that I was concerned with the prescriptive nature of the proposals concerning governance of the boards of independent transmission providers. As I said, I do not think the Commission should be dictating with such specificity so many rules concerning the explicit makeup of

stakeholder committees, who can sit on which committees, and exactly how boards should be selected.

An important development that occurred in the SMD process was the Commission's issuance on September 10 of a notice revising the public comment schedule and announcing technical conferences in the SMD proceeding. Parties will now have until November 15, 2002 to file initial comments and until December 20, 2002 to file reply comments. In addition, the staff will convene a series of technical conferences to address several specific issues identified in the NOPR. An October 2, 2002 technical conference will address essential elements of a standard market monitoring plan. The next day, standard software to support electric grid and market operations under standard market design will be discussed. On December 11, 2002, the conference will address liability and indemnification provisions in the SMD tariff. The Commission will also reserve a week in January 2003 for any further technical conferences to explore remaining areas of concern identified during the Commission's outreach efforts and through the comment process. In addition, in the RTO West Stage 2 order issued last Wednesday

we stated that there will be additional technical conferences on resource adequacy and Northwest hydroelectric issues.

I believe that the extension of time and the technical conference process established by the September 10 notice can only benefit the Commission and all parties involved in the SMD process. Although many people would like to get to standard market design as quickly as possible, I believe it is more important to get it right than to do it fast. Standard market design will result in a fundamental change in the way business is done in the electric industry and it is the Commission's responsibility to ensure that the change will be just and reasonable and consistent with the public interest. I urge all of you to carefully consider every aspect of the SMD NOPR and give the Commission specific, detailed comments on where we have gotten it right as well as where we have gotten it wrong. This can be done at the technical conferences as well as in written comments. Developing as extensive an administrative record as possible will allow the Commission to fulfill its obligation of engaging in reasoned decision making and will ultimately allow the courts to decide the fate of standard market design. One might consider it pessimistic to talk about court review while we are still in the NOPR stage. However, I

consider it a realistic approach given the many legal and technical issues that will arise from a proposal of this magnitude.

It is quite appropriate that I talk about how seriously I view the comments in the SMD proceeding at this meeting given that there are a number of questions posed in the NOPR concerning the role NAESB may have in standard market design. The Commission proposed a process, similar to that used in the natural gas industry, that could be used for standardization of a wide array of business practices that SMD implementation will require. The Commission envisioned that the NAESB would produce business practice and electronic communication standards and would notify the Commission when it has adopted standards. The Commission would then use rulemaking proceedings to propose the incorporation of these standards by reference into the Commission's regulations.

The Commission identified three areas where business practice standardization may take place. First, as part of its regional resource adequacy requirement, the Commission proposed to establish standards for deliverability of generation, transmission, and demand response

resources. The Commission sought comment on whether NAESB should develop such standards. The Commission proposed standardization of various data and software that supports SMD and sought comment on who should establish such standards, including NAESB, the Electric Power Research Institute (EPRI), or another organization. The Commission also suggested a broad array of business-related standards for the handling of operational issues that support both the grid and markets. Some of the issues in this general area could include a) calculation of total transmission capacity, b) various practices to support resource adequacy requirements, c) various transactions-related business practices that include scheduling and checkout, OASIS, and billing and payment provisions, d) curtailments, and e) emergency planning and management.

I would now like to turn to NAESB itself. I applaud you all for undertaking the task of creating a forum for developing business practices for wholesale and retail electric markets, and for retail gas markets. An organization which seeks to develop standard business practices within an industry through a consensus building process provides a valuable service to all segments of the industry as well as to the regulatory community. Your

organization has been a great success in creating standards for the wholesale gas industry, which the Commission has adopted into its regulations through numerous rulemakings in the Order No. 587 series. Although it may be a long and difficult process in developing standards for the electric industry, I believe that the Wholesale Electric Quadrant of NAESB will one day share the success of the Wholesale Gas Quadrant.

I also want to commend both NAESB and the North American Electric Reliability Council (NERC) on their letter of intent in which they expressed the desire to work together to coordinate the development of business practice standards and electronic communication protocols by NAESB and the development of reliability standards by NERC. I believe it is very important that both organizations recognized business practice and reliability standards be harmonized, that all reasonable efforts be made to eliminate overlap and duplication of effort, and that each organization be able to move forward with its appropriate standards development activity while keeping the other fully informed as to its efforts. I look forward to seeing a memorandum of understanding between NAESB and NERC as the Wholesale Electric Quadrant becomes a fully functioning unit within NAESB. I believe that the

cooperative efforts expressed in the letter of intent is important for the future stability of the electric industry because it will ensure the reliability of the electric grid while recognizing the need for uniform practices to allow business to be easily transacted across the grid.

While electric issues have dominated the headlines, the Commission has also been busy on gas issues. The Commission has processed most of the initial Order No. 637 compliance filings and has even begun addressing rehearing issues. The Commission expects to complete the initial Order No. 637 filings by December 2002. In May, the Commission requested comments with respect to the issues remanded by the United States Court of Appeals for the District of Columbia Circuit to the Commission regarding Order No. 637. Specifically, the Commission requested comments on issues pertaining to (1) the right of first refusal (ROFR) term matching cap, (2) the relationship of the ROFR to tariff provisions, (3) backhauls and forwardhauls to the same point, and (4) the waiver of posting and bidding for prearranged releases. As many of you know, I dissented in Order No. 637-B and in individual compliance proceedings on the issue of forwardhauls and backhauls to the same point. I believed that when the total amount at a delivery point exceeds the contract

demand, shippers are receiving service in excess of that for which they are paying. I feel that my dissents were worthwhile since the court remanded the issue to the Commission for further explanation.

The Commission also recently addressed the issue of creditworthiness standards in a number of orders that should be of particular interest to this gathering. The Commission accepted and suspended for five months a number of pipelines' revisions to their creditworthiness standards. The Commission established technical conferences to address the issues presented. More importantly, in response to a number of parties, the Commission agreed that it could be valuable to develop a generic standard for creditworthiness since shippers would be able to provide the same documents to every pipeline to obtain capacity, and there appears to be value in establishing standards for when a pipeline must provide service to a shipper. The Commission encouraged parties to initiate the standards development process at NAESB to see whether a consensus standard can be developed for credit worthiness. By June 1, 2003, NAESB, and other parties, were directed to file a report with the Commission indicating whether standards have been adopted, or if consensus cannot be reached, an account of its deliberations,

including an outline of the standards considered, the voting records, and the reasons for the inability to reach consensus, to enable the Commission to determine whether further action is necessary. I believe that creditworthiness standards are precisely the type of issue that NAESB should be addressing. I hope that you can achieve the proper balance of recognizing the pipelines' need for ensuring the financial stability of its shippers while on the other hand also recognizing the need of shippers of all types - LDC, marketers, producers, electric generators, municipals, etc. - to be able to easily transact business across the interstate pipeline grid.

I thank you again for inviting me here.