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FEDERAL ENERGY REGULATORY COMMISSION

Before the
FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C.

Entergy Services, Inc.)

EL99-57-001)

**REQUEST FOR REHEARING OF
ARKANSAS ELECTRIC ENERGY CONSUMERS**

Arkansas Electric Energy Consumers (AEEC) respectfully requests rehearing of the Commission's July 30, 1999 Declaratory Order in the captioned docket. *Entergy Services, Inc.*, 88 FERC 61, 149 (1999) (Declaratory Order). The Declaratory Order comes at a critical juncture in the evolution of the Commission's regulatory framework for RTOs. After the parties filed their protests in this matter, the Commission issued its Notice of Proposed Rulemaking regarding Regional Transmission Organizations, 87 FERC ¶ 61,173 (May 13, 1999) (*RTO NOPR*). Without even receiving the comments on the *RTO NOPR*, the Declaratory Order appears to decide core independence issues addressed in the *RTO NOPR* and does so inconsistently with the *RTO NOPR*.

Therefore, the Commission should grant rehearing and address at least the following deficiencies in its Declaratory Order:

- The Order concludes that Entergy can own 100% of the proposed Transco and still "could comply with the independence requirements of the ISO principles" despite the Commission's proposal in the *RTO NOPR* that no market participant can have more than a *de minimis* - 1% - ownership interest in an RTO. Decl. Order, Slip Op. at 9; *RTO NOPR*, 87 FERC ¶ 61,173, reported in 64 Fed. Reg. 31,390, 31,414 (1999).¹

¹ AEEC recognizes that the Declaratory Order provides that Entergy's proposal will need to meet "all applicable requirements in the final [RTO] rule." Decl. Order, Slip Op. at 8. Although this is an appropriate qualification, it appears that the Commission is using the Declaratory Order, in the words of Commissioner Massey, to "send a signal . . . that this Commission has made a policy call that will have applicability under the RTO Rule." Decl. Order, Slip Op. at 3. (Massey, C., dissenting)

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- The Order finds, without any analysis or reasoning, that certain aspects of Entergy's proposed Transco comply with the Commission's ISO governance and independence principles.
- The Order does not even address the Transco's other important deficiencies under the ISO principles, contrary to the Commission's prior ISO decisions.

Absent rehearing on these issues, Entergy will commence forming a Transco that cannot be approved under the Commission's RTO standards. This pointless exercise would delay, rather than speed, the development of a competitive market in Entergy's service territory. The Commission should foster the development of competition by rejecting Entergy's request for a declaratory ruling.

BACKGROUND

Entergy petitioned the Commission for a ruling that its proposed Transco complies with certain of the Commission's principles for evaluating ISOs. *See generally* Petition of Entergy Services, Inc. for Declaratory Order Regarding Compliance of Transco Proposal with Applicable ISO Standards ("Petition"). Entergy's Petition was expressly preliminary in nature and was silent with respect to numerous important details typically addressed in applications to form ISOs. *See* Petition at 2-4; *see also* May 5, 1999 Motions To Intervene And Protest Of Arkansas Electric Energy Consumers ("AEEC Protest") at 4-5. For example, Entergy failed to address important issues relating to operation and governance, such as congestion management, pricing for transmission service, and the Board selection process. *See generally* AEEC Protest at 4-5, 8-15. Nevertheless, Entergy sought an order from the Commission that its proposal satisfied the independence and governance principles established by the Commission in Order No. 888 and applied in its subsequent ISO decisions. *See* Petition at 2.

On May 5, 1999, AEEC protested Entergy's Petition, joining the many parties that criticized Entergy's proposal.³ AEEC demonstrated in its Protest that Entergy's proposal is insufficiently detailed to enable the Commission to render a reasoned decision on independence issues. AEEC also demonstrated that, of the details Entergy provided regarding the Transco, many did not satisfy the existing ISO standards. Accordingly, AEEC requested that the Commission deny Entergy's Petition as both incomplete and inconsistent with the Commission's ISO principles.

One week after the parties filed their protests, the Commission issued its *RTO NOPR*. In the *RTO NOPR*, the Commission proposed various requirements for the formation of RTOs many of which conflict with Entergy's Transco proposals. Despite the pending rulemaking's inevitable impact on Entergy's Petition, the Commission issued a Declaratory Order on July 30, 1999, conditionally granting Entergy's Petition. The Commission did not wait until it received comments on the *RTO NOPR* before ruling on Entergy's proposed Transco. Instead, the Commission prejudged – and abandoned – the proposals in the *RTO NOPR*. The Commission should grant rehearing of its Declaratory Order because it conflicts with prior ISO precedent and because it conflicts with the *RTO NOPR*.

³ AEEC is an association of industrial and agricultural electric power consumers located in the State of Arkansas. AEEC members purchase electric power from Entergy Arkansas, a subsidiary of Entergy Corporation. AEEC members include customers of Entergy that Commissioner Massey noted have spoken "with almost a single voice about the fact that Entergy has not involved them in the development of its proposal." Decl. Order, Slip Op. at 4 (Massey, C., dissenting)

1. The Commission's Declaratory Order Improperly Concludes That Passive Ownership Of A Transmission Company May Satisfy ISO Principles.

The most glaring error in the Commission's Declaratory Order is that it approves Entergy's proposal to allow market participants to own "passively" 100% of an "independent" transmission owning entity.⁴ Entergy's proposed ownership structure is neither "passive" nor "independent," and therefore raises considerable anticompetitive concerns. Moreover, the FERC's approval of this structure in its Declaratory Order is arbitrary and capricious because (1) the decision represents a departure from established FERC precedent and policy without adequate reasoning, (2) the decision improperly preempted the ongoing RTO rulemaking process, thus undermining the purpose of the notice and comment requirements of the Administrative Procedure Act (APA), and (3) the decision does not meet the minimum requirements of reasoned decision making for agency action.

A. The Commission departed from established precedent and policy without sufficient reasoning in approving Entergy's proposed passive ownership structure for the Transco.

In the Declaratory Order, the Commission decided the "central issue" of passive ownership, ruling that Entergy's proposal "could comply with the independence requirements of the ISO principles" Decl. Order, Slip Op. at 9. This decision is contrary to established Commission precedent and policy, and was made with virtually no analysis or reasoning of how "passive" the ownership must be. Accordingly, the decision "represents an unexplained departure from

⁴ Entergy's proposal provides that the Member Companies (all of which are currently Entergy entities) would own the Transco. See Petition at 5 & 9. Accordingly, under Entergy's proposal, 100% of the Transco could be owned by a single generation-owning company.

Commission precedent, and thus constitutes arbitrary decision making under the Administrative Procedure Act.” *Transcanada Pipelines Ltd v. FERC*, 24 F.3d 305, 308 (D.C. Cir. 1994) (citing 5 U.S.C. § 706(2)(A)).

The Commission has an obligation to explain adequately a change in course or policy or a departure from past precedent. See, e.g., *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) (“[A]n agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored”); *Louisiana Pub. Serv. Comm’n v. FERC*, 1999 WL 587041, *5 (D.C. Cir. Aug. 5, 1999) (“For the agency to reverse its position in the face of a precedent it has not persuasively distinguished is quintessentially arbitrary and capricious.” (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 57 (1983))); *Telecommunications Research and Action Ctr. v. FCC*, 800 F.2d 1181, 1184 (D.C. Cir. 1986) (“When an agency undertakes to change or depart from existing policies, it must set forth and articulate a reasoned explanation for its departure from prior norms.”). In this case, the Commission departed from prior policy regarding RTOs by approving a “passive” RTO ownership structure unlike any it has ever approved before. Specifically, the Commission’s decision indicates that a single generation-owning company may own 100% of a for-profit transmission company. Such an ownership structure – even if allegedly “passive” – raises serious concerns about the independence of the RTO. And, as the Commission has made clear, the “principle of independence is the bedrock upon which the ISO must be built.” *Atlantic City Elec. Co.*, 77 FERC ¶ 61,148, 61,574 (1996).

Despite the novel position taken in the Declaratory Order, the Commission does not explain its decision. Other than cursorily stating the conclusion that Entergy's Petition, if modified in certain yet-to-be-defined ways, can satisfy the Commission's independence principles, the Commission does not address the topic of passive ownership further in the Order. This dearth of reasoning regarding an important change in RTO policy renders the decision arbitrary and capricious.

Not only is the Declaratory Order contrary to prior precedent, the Order is contrary to Commission policy because the Commission proposed a dramatically different standard less than two months before in the *RTO NOPR* – a standard that Entergy's proposal would fail. In the *RTO NOPR*, the Commission proposed that, in order to ensure that an RTO is independent of control by any market participant, no single market participant may have more than “a de minimis (one percent) ownership interest in the RTO.” *RTO NOPR*, 64 Fed. Reg. at 31,414. The Commission ignored its proposed standard in approving Entergy's proposal and concluded that a Transco owned by a *single* market participant would satisfy the Commission's ISO standards. Decl. Order, Slip Op. at 14 (“Passive ownership of a transmission company by one or more power market participants is acceptable . . .”).

The Commission does not attempt to explain in the Declaratory Order its disregard for its own policy choice to limit ownership in the Transco as announced in the *RTO NOPR*. The Commission does not even acknowledge the contrary *RTO NOPR* standard. The Declaratory Order also fails to reference any factors that the Commission may have considered in reaching a conclusion directly contrary to the *RTO NOPR* proposal. These deficiencies run afoul of the Commission's obligation to provide a reasoned explanation for changes in policy. See *Greater*

Boston, 444 F.2d at 852.⁴ And the complete lack of reasoning in the Declaratory Order stands in stark contrast to the express reasoning in the *NOPR* for implementing the *de minimis* ownership rule.

The Commission explained in the *RTO NOPR* that the *de minimis* ownership requirement was important to ensure the independence of the RTO. Specifically, the Commission noted that the *de minimis* ownership rule would minimize the distrust of market participants that the owners could exercise influence over the RTO. *RTO NOPR*, 64 Fed. Reg. at 31,415 (stating that companies with more than *de minimis* ownership will not be trusted by market participants even if safeguards are put in place because “we [the Commission] believe that market participants are likely to suspect that the safeguards will be gamed”). In addition, the Commission noted that a different rule would “continue the regulatory need for detailed and hard to enforce codes of conduct.” *Id.* Given these express concerns that more than a *de minimis* ownership level would compromise the independence of the RTO, the Commission proposed the 1% *de minimis* standard and sought comment on this issue during the rulemaking process. Given the express reasons the Commission gave for this rule in the *NOPR*, the Commission was obligated to explain why it would disregard this standard in the Declaratory Order. However, the Commission provided no reasoning or analysis to explain why it approved 100% ownership by a single company in the Declaratory Order.

This change in policy, without adequate reasoning, is arbitrary and capricious and should be reheard by the Commission.

⁴ It is not sufficient for the Commission to rely on its statement in the Declaratory Order that Entergy’s Petition was evaluated only under established ISO principles and not the *RTO NOPR*. See Decl. Order, Slip Op. at 8. The Commission is still required to explain its approval of the ownership structure in light of the fact that no prior FERC decision had approved such a structure. And, in light of the proposed rulemaking, it is illogical and improper for the Commission to legislate a different rule regarding ownership without a reasoned explanation.

B. The Commission's decision is arbitrary and capricious because it preempts the purpose and requirements of the rulemaking process.

The Declaratory Order is also arbitrary and capricious because it violates the notice and comment requirements of the APA. "The APA guarantees the public an opportunity to comment on proposed rules. That opportunity is meaningless unless the agency responds to significant points raised by the public."²⁹ *Action on Smoking and Health v. Civil Aeronautics Bd.*, 699 F.2d 1209, 1217 (D.C. Cir. 1983) (quoting *Alabama Power Co. v. Castle*, 636 F.2d 323, 384 (D.C. Cir. 1979)). In this case, the Commission has interfered with the public's right to comment on the proposed rules by apparently deciding RTO ownership policy before even obtaining comments or input from the public. The Commission should not have expressed any opinion on the issue of passive ownership at this juncture due to the pending rulemaking on the proposed 1% *de minimis* ownership standard. Nevertheless, the Commission eviscerated the proposed standard in the Declaratory Order by allowing a full 100% ownership by market participants. This decision was premature and short-circuited the rulemaking process. The court in *Action* stated that in "order to uphold the agency's action, it must be shown that the Board rationally considered the relevant evidence." *Action*, 699 F.2d at 1217. The Commission's decision on RTO passive ownership in the Declaratory Order cannot be upheld under that standard because the FERC had not even *received* the relevant evidence – the comments from the public – at the time the Declaratory Order was issued.

The Commission also has an obligation to explain how a final rule evolves from a proposed one when the final rule differs significantly from the proposal. See *Formula v. Heckler*, 779 F.2d 743, 760-61 (D.C. Cir. 1985) (addressing differences between final and proposed rule and stating that the "agency, to be sure, is still obliged to provide a rational explanation as to how it

conceived and fashioned the new version of the rule"). If the Commission's true intent here is to preempt the notice and comment procedures of the APA and create a new rule that is contrary to the one proposed in the *RTO NOPR*, the Commission should state that this is its intent and provide a rationale for its new standard. In that case, although the public will still be deprived of the notice and comment process, at least the record will be complete.

Because the Commission's decision on the passive ownership issue is premature, preempts the comments elicited in the *RTO NOPR* on this issue, and creates a new *de facto* rule, it should be revised.

C. The Declaratory Order is arbitrary and capricious because it does not meet the minimum standards for a reasoned agency decision.

Finally, the Commission's conclusion on Entergy's proposed ownership structure is arbitrary and capricious because it is not sufficiently reasoned. The APA requires that "an agency must provide a reasoned explanation for its actions and articulate with some clarity the standards that governed its decision." *Moon v. United States Dep't of Labor*, 727 F.2d 1315, 1318 (D.C. Cir. 1984); *Public Media Cir. v. FCC*, 587 F.2d 1322, 1331-32 (D.C. Cir. 1978) ("As this court has repeatedly emphasized, 'the failure of an administrative agency to articulate the reasons for a particular decision makes meaningful review of that decision impossible.'" (quoting *American Smelting & Refining Co. v. FTC*, 494 F.2d 925, 945 (D.C. Cir.), *cert. denied*, 419 U.S. 882 (1974))). Aside from the fact that sufficient reasoning is required to depart from past policy and precedent, some minimum explanation is required of any agency decision. The Declaratory Order lacks even a basic explanation—the Commission has simply stated in blanket and conclusory form that Entergy's

proposal may satisfy the Commission's standards. This is inadequate as a matter of law; accordingly, the Declaratory Order should be revised.

II. The Commission Should Not Have Approved Any Aspect of Entergy's Proposal Because It Is Insufficiently Detailed To Permit A Reasoned Decision.

Aside from the Commission's "passive" ownership decision, the Commission also purported to approve certain other aspects of Entergy's proposal. The Commission should not have rendered any decision on the proposal. As noted by AEEC in its Protest and even acknowledged by Entergy itself, the Petition is preliminary in nature and lacks sufficient detail to provide a meaningful basis upon which the Commission could make a decision. Nevertheless, the Commission determined that certain "limited issues" were defined "well enough" to support "informed guidance." Decl. Order, Slip Op. at 8.

As noted above, the APA requires the Commission to articulate a reasoned decision. Moreover, it is axiomatic that the Commission must act consistently with its statutory mandate and in keeping with its prior Orders and decisions. Nevertheless, in its Declaratory Order, the Commission approved certain aspects of Entergy's Petition without providing any underlying reasoning or clarifying what further information must be provided.

For example, the Commission found "acceptable" Entergy's proposal to use a stakeholder committee for the Board Selection process. Decl. Order, Slip Op. at 10. However, Entergy did not include many essential details of that process in its proposal. In prior FERC decisions analyzing ISO proposals, the Commission has scrutinized the composition of the Board, the voting system for selection of the Board members, Board member qualifications, and other aspects of Board

membership and operation. See, e.g., *Midwest Indep. Transmission Sys. Operator*, 84 FERC ¶ 61,231, 62,148-49, *order on reconsideration*, 85 FERC ¶ 61,250, *order on reh'g*, 85 FERC ¶ 61,372 (1998), *order conditionally accepting compliance filing*, 87 FERC ¶ 61,085 (1999); *New England Power Pool*, 79 FERC ¶ 61,374, 62,585 (1997), *order on reh'g*, 85 FERC ¶ 61,242 (1998); *Atlantic City Elec. Co.*, 77 FERC ¶ 61,148, 61,574 (1996). The Commission addressed none of these issues in the Declaratory Order. In fact, the Commission itself indicates that the “ultimate application filed by Entergy must include a more complete description of how the stakeholder committee will be selected and will operate, how adequate representation of all stakeholders is assured, and how voting will be conducted.” Decl. Order, Slip Op. at 10. Given the lack of detail in Entergy’s Petition, the Commission erred in approving Entergy’s proposal. Accordingly, this matter should be reheard.

The Commission glossed over other serious deficiencies in Entergy’s Petition. For example, Entergy’s Petition recognizes that the proposed Transco’s Board Members will have a fiduciary duty to protect the shareholders’ (Entergy’s) interests under Delaware law. See Petition at 24. This legal obligation of the Board Members to safeguard the interests of Entergy compromises the Transco’s independence. Nevertheless, the Commission – without reasoning – did not reject this aspect of the Transco and instead only indicated that Entergy would have to address it in a future application. Decl. Order, Slip Op. at 11.

Such a hands-off approach to an issue that has a direct impact on the Transco’s independence is inconsistent with the Commission’s prior decisions. As noted above, the Commission has stated on numerous occasions that the “principle of independence is the bedrock upon which the ISO must be built if stakeholders are to have confidence that it will function in a manner consistent

with th[e] Commission's pro-competitive goals." *Atlantic City Elec. Co.*, 77 FERC at 61,574. The Commission erred in finding that Entergy's proposal is consistent with the established ISO principles.

The Commission also departed from its prior precedent with respect to the requirement that contracting functions of the Transco be subject to open and competitive bidding. In the past, the Commission has appeared to require an open bidding process if an ISO will contract with ISO members. *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257, 62,268 (1997), *clarified*, 82 FERC ¶ 61,068 (1998), *reh'g pending*. In fact, Entergy admitted in its Petition that its Transco "may" violate this principle to some extent. See Petition at 32 n.25. In the Declaratory Order, the Commission recognized that Entergy's proposal would allow the Transco to contract with the companies that own it. This creates a significant concern of bias in the Transco's operations. However, the Commission did not require the Transco to submit its contracts to open and competitive bidding. Instead it provided a general admonition to Entergy to ensure that no "undue" favoritism occurs. This admonition is toothless and constitutes another way in which the Declaratory Order serves to erode the Commission's established RTO principles.

In light of the various conclusions drawn by the Commission regarding Entergy's proposal that are insufficiently reasoned, based on inadequate information from Entergy and contrary to past ISO cases, the Commission should grant rehearing of the Declaratory Order.

III. The Commission Failed To Address Or Resolve Numerous Deficiencies In Entergy's Petition In The Declaratory Order.

Nearly as alarming as what the Commission did say in the Declaratory Order is what it did not. Although the Commission actually granted Entergy's Petition for an order seeking

approval of its proposed Transco, it failed to address several important issues raised by the parties' protests. The Commission should have addressed these issues in the Declaratory Order, as similar issues have been evaluated in detail by the Commission in earlier ISO decisions that determined a proposal's level of compliance with the eleven ISO principles from Order No. 888.

For example, AEEC noted that Entergy proposes that transmission owners can lease their facilities to the Transco, rather than transfer ownership in fee. This method of asset transfer would create an unacceptable relationship between the Transco and the transmission owner because a lessor retains reversionary interests in the leased property, which typically restricts the manner in which the property is used. Although this issue could have been subsumed into the Commission's blanket approval of the passive ownership structure, it should have been addressed separately by the Commission. In addition, AEEC raised numerous problems with the Transco's governance, such as problems with Board selection, membership and removal. Some of these were addressed by the Commission in the Declaratory Order, but most were deferred without discussion until a later filing. If the Commission intends to provide any meaningful guidance – not just to Entergy but to all market participants – it must address these issues on rehearing.

IV. The Commission Should Adopt More Stringent Independence Standards For Transcos.

As AEEC explained in its Protest, there are significant problems when a profit-maximizing entity such as Entergy's proposed Transco operates the transmission grid. Such problems are exacerbated when market participants own a significant interest – even an allegedly passive one – in the Transco. Therefore, the Commission should adopt strict standards for market participants to have any ownership interest in a Transco.

The FERC is not the first agency to face this problem. It was this exact concern about the adequacy of insulation of allegedly passive ownership interests that led the Federal Communications Commission (FCC) to adopt more stringent standards. In the mid-1980s, the FCC addressed the question of whether limited partnership interests were sufficiently insulated to avoid attribution of ownership of radio stations and other FCC-regulated entities for purposes of assuring adequate competition. Initially, the Commission decided to rely upon the Uniform Limited Partnership Act as sufficient insulation. On reconsideration, however, the Commission concluded that more stringent guidelines were needed to ensure that "passive" limited partners could not influence regulated entities. "Contrary to our initial finding, we now believe that the mere fact that a limited partnership conforms to the provisions of the RULPA does not provide meaningful assurance that the limited partner will lack the ability to significantly influence or control partnership affairs." *Corporate Ownership Reporting and Disclosure by Broadcast Licensees*, 58 Rad. Reg. 2d. 604, 616 (1985)⁵

Under the FCC's guidelines, a limited partner may not: (1) act as an employee of the FCC-regulated entity; (2) serve as an independent contractor to the FCC-regulated entity; (3) communicate with the general partner about the FCC-regulated entity or with the FCC-regulated entity itself; (4) prevent the general partner from vetoing the admission of new general partners; (5) vote on the removal of general partner unless an independent third party determines that the general partner has engaged in malfeasance; (6) provide services to the FCC-regulated entity; and (7) be involved in the management or operation of the FCC-regulated entity. *In re Amendment of the*

⁵ The FCC later extended this ruling to Limited Liability Corporations such as the one proposed by Entergy. *In re Applications of Quincy D. Jones, et al.*, 11 FCCR 2481 (1995).

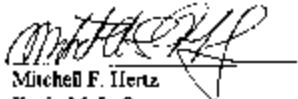
Comm'n's Rules to Establish New Personal Communications Servs., 10 FCCR 7893, 7896 (1995).

If the Commission allows market participants to have any ownership interest in a Transco, it should adopt standards at least as stringent as those proposed by the FCC.

Conclusion

Entergy's proposal to form a Transco is underdeveloped and inconsistent with prior FERC precedent and the pending *RIO NOPR*. Therefore, the Commission's Declaratory Order approving aspects of the proposal is premature and represents a departure from previous Commission precedent and policy. Because there is a dearth of reasoning in the Order on the issues it purports to decide and because it also fails to decide many pertinent issues raised by AEEC and the other intervenors, the Commission should grant rehearing in this matter.

Respectfully submitted,



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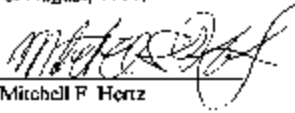
Counsel for
Arkansas Electric Energy Consumers

Dated: August 30, 1999

CERTIFICATE OF SERVICE

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

Dated at Washington, D.C. this 30th day of August, 1999.

By 
Mitchell F. Hertz