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REC'D ENERGY
COMMISSION

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Entergy Services, Inc.

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Docket No. EL99-57-000

**ANSWER OF ENTERGY SERVICES, INC. TO PROTESTS, MOTIONS FOR
SUMMARY DISPOSITION, AND MOTIONS TO HOLD IN ABEYANCE.**

Entergy Services, Inc., on behalf of the Entergy Operating Companies, (together "Entergy") submits this Answer to the various protests and motions submitted by intervenors in response to Entergy's April 5, 1999 Petition for Declaratory Order Regarding Compliance of Transco Proposal With Applicable ISO Principles (the "Petition").¹ Entergy answers the Motions for Summary Disposition and Motions to Hold in Abeyance pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213. Entergy also seeks leave to respond to the protests. While answers to protests are not expressly authorized in the Commission's Rules, the Commission may accept such answers if, *inter alia*, the answer "is helpful to the Commission's resolution of the issues." *Entergy Services*,

¹By Entergy's court, 44 parties moved to intervene in this proceeding. Entergy does not oppose any of the motions to intervene. To the contrary, Entergy suggests that the Commission grant those motions so that it can have the benefit of a broad range of views in ruling on the Transco Petition.

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Inc., 85 FERC ¶ 61,356, at 62,381 (1998), or "assist[s] [the Commission's] understanding of the issues," *Atlantic City Electric Co.*, 86 FERC ¶ 61,318, at 62, 42 (1999). Entergy submits that its Answer meets this standard because in certain respects it clarifies the Petition in response to the protests and the recently-issued Notice of Proposed Rulemaking on Regional Transmission Organizations, Docket No. RM99-2-000 (May 13, 1999) ("RTO NOPR").

OVERVIEW AND CLARIFICATION OF REQUESTED RELIEF

Entergy continues to urge the Commission to act on the Transco Petition by the end of July. As noted in the Petition, the guidance the Commission can render with a declaratory order will greatly facilitate developing a truly regional RTO in Entergy's region. Without this guidance, Entergy to date has not been able to engage other transmission owners and stakeholders in meaningful RTO negotiations. Failure to give the requested guidance will essentially stop regional RTO developments in Entergy's region until a final RTO rule is established.² As explained below, in light of developments at the state level, Entergy does not have the luxury of time.

² Some regional stakeholders will not engage in meaningful negotiations because they are unwilling to commit resources to develop a Transco because of the uncertainty of what structure may ultimately be approved by the Commission. Still others will not participate in an RTO other than a not-for-profit ISO.

Entergy received forty-four responses to the Petition. Twenty-four of the responses protested some aspect of the Petition. The parties raising the protests (the "Protesters") challenged the Petition on both procedural and substantive grounds. On procedure, the Protesters argued that (1) declaratory relief should be denied because Entergy's Transco Proposal is too incomplete and subject to change; and (2) declaratory relief should be held in abeyance pending the Commission's ruling in the Notice of Proposed Rulemaking (NOPR) on regional transmission organizations (RTOs).⁵ Some Protesters specifically moved to summarily dismiss or hold the proceeding in abeyance for these reasons. On substance, the Protesters argued that several aspects of Entergy's Proposal ran afoul of the Commission's ISO principles, particularly Principle Nos. 1 and 2 involving independence and conflicts of interest.

Many Protesters contend that Entergy's Transco Proposal is too incomplete to support a Commission ruling that the Proposal complies with the Commission's ISO Principles. These Protesters observe – as Entergy frankly pointed out in its Petition – that Entergy has not identified any other members of the Transco nor submitted to the Commission the Transco's Open Access Transmission Tariff or

⁵ At the time of the protests, the Commission had not yet issued its RTO NOPR. The Commission subsequently issued the RTO NOPR on May 11, 1999.

any rules governing transmission pricing for the Transco. Absent this information, they contend, the Commission cannot properly determine whether Entergy's Transco Proposal complies with most of the ISO principles. The Protesters characterize Entergy's contentions regarding most of the principles as mere promises to comply in the future.

First, the commitments Entergy made in the Petition are not illusory. Entergy is committed to participating in a large, truly regional, independent RTO. However, Entergy cannot act unilaterally; it cannot commit any other transmission owners to any one specific RTO proposal; it cannot engage "ISO or nothing" stakeholders in meaningful negotiations. Thus, many Protesters would have the Commission put Entergy in a procedural catch-22. On the one hand, they contend that Entergy's proposal should be rejected because it does not reflect a regional collaborative process. On the other hand, they would deny Entergy the preliminary guidance necessary to initiate the regional collaborative process.

Second, the Protesters have misunderstood Entergy's request in this proceeding. Entergy is not at this time seeking the Commission's ultimate approval of the Transco Proposal under sections 203 and 205 of the Federal Power Act ("FPA"), 16 U.S.C. §§ 824b and 824d. Nor is Entergy asking the Commission to declare that the aspects of the Proposal that have not yet been crafted comply with

the ISO Principles. Rather, Entergy is seeking preliminary guidance from the Commission on whether the parts of the Proposal that have been presented to the Commission – including the governance, code of conduct, market monitor, and regional planning summit features – comply with the applicable ISO principles, particularly the independence and conflicts of interest principles. This preliminary guidance, while not binding on the Commission and while subject to change when the Proposal is completed and presented to the Commission under FPA sections 203 and 205, would help Entergy in jump-starting its stalled efforts to form a larger, regional independent transmission organization.

Entergy understands that certain language in its Petition may have led the Protesters to believe that Entergy was seeking more sweeping Commission approval for the Transco Proposal. To reiterate its position, the dominant focus of the Petition is to seek preliminary guidance that the Transco Proposal complies with ISO Principles No. 1 and 2, the principles involving independence and conflicts of interest.⁴ Because Entergy has not yet developed or proposed pricing principles that the Transco might adopt, Entergy was not requesting that the Commission approve a

⁴ In the RTO NOPR, the Commission stated that the ISO Principles continue to apply until the Commission issues the final rule. See RTO NOPR at 221. Moreover, ISO Principles No. 1 and 2 appear consistent with the independence characteristic described in the RTO NOPR. See RTO NOPR at 119-126; 18 C.F.R. §§ 35.34 (i)(1)(i)-(ii) (Proposed).

specific transmission pricing proposal on issues such as cost shifting or performance-based rates. Entergy was simply seeking general guidance on the Commission's willingness to consider alternative ratemaking approaches. The RTO NOPR is replete with statements that the Commission is willing to do so. Moreover, Entergy shares the Commission's concerns about the potential for cost-shifting.⁵ It is encouraged by various aspects of the RTO NOPR in this regard.

The Transco Proposal is sufficiently complete to support declaratory relief on compliance with ISO Principles No. 1 and 2. The Commission's ruling will primarily require examination of the governance provisions of the LLC Agreement, including the Code of Conduct. In fact, the tariff provisions and the rules governing pricing should have little impact on the issue of compliance with ISO Principles No. 1 and 2. Moreover, the protests themselves make clear that there is a concrete dispute regarding whether the Proposal, as submitted to the Commission, runs afoul of these principles. In light of the Commission's broad discretion to issue declaratory orders to resolve uncertainty, the Commission would be well within its legal authority to issue the requested declaratory relief.⁶

⁵ The RTO NOPR also strongly encourages regional pricing mechanisms that seek to manage and address congestion. Entergy agrees and hopes other regional stakeholders will agree during the collaborative process.

⁶ Indeed, the RTO NOPR endorsed the use of declaratory orders to resolve
(continued...)

Many Protesters also argue that Entergy's Petition should not be considered now, but should instead be considered as part of the RTO NOPR. Some Protesters even accuse Entergy of attempting to short-circuit the Commission's NOPR through its Petition. Their position is tantamount to "no good deed should go unpunished." Entergy has no intent to short-circuit the NOPR process. As Entergy made clear in its Petition, it will participate in that rulemaking and "will abide by the outcome of any final and non-appealable rulemaking order that might modify any relevant regional transmission organization related policies or principles." Petition, at 4 n.5.

Indeed, the Petition would achieve many of the same objectives the Commission seeks to achieve in the RTO NOPR. That is, the Transco Proposal seeks to establish a large, regional independent transmission organization that independently operates the transmission grid without any financial ties to market participants; that efficiently manages congestion; that effectively monitors the market; and that efficiently plans the expansion of the grid on a regional basis. Moreover, the Transco Proposal seeks to establish such an entity in a time schedule consistent with the time schedule provided by the Commission in the RTO NOPR.

⁶ (...continued)
uncertainty regarding RTO proposals. See RTO NOPR at 218. The Petition is fully consistent with this approach.

Entergy faces aggressive time lines in developing an independent, regional transmission organization in light of recently enacted and pending legislation in its retail jurisdictions. The Arkansas Legislature has already enacted a law requiring Entergy Arkansas, Inc. to turn operation of its transmission facilities over to an independent transmission entity approved by the Commission ninety days prior to the date of retail open access, which is targeted for January 1, 2002. See Act 1556, the Electric Consumer Choice Act of 1999. Similar legislation is pending in Texas. Simply put, unlike the Protesters, Entergy cannot delay moving forward pending a final RTO rule.⁷ It must have an RTO operational by January 1, 2002. Entergy needs preliminary guidance on the Proposal by July 1999 in order to meet these rigorous state-imposed deadlines.

Further, the preliminary guidance Entergy seeks in this proceeding will promote and start sooner the collaborative process of RTO formation that the Commission seeks to foster through the RTO NOPR. The Commission proposes a collaborative process to take place in the Spring of 2000 "building upon progress made to that date." RTO NOPR at 215. Uncertainty regarding the compliance of the Proposal with the independence and conflict of interest principles has been a major obstacle to convincing other transmission owners to join. timely guidance by the

⁷ Entergy cannot help but point out that delay gives negotiating leverage to those advocating solely for an ISO or for Entergy to move back to the SPP.

Commission on these principles – which do not appear to be significantly changed under the RTO NOPR – should help Entergy achieve significant progress in the collaborative process by the Spring of 2000. Unless the Commission wants to halt in its tracks RTO development and negotiations until after a RTO final rule is issued, including perhaps judicial review, it should move forward and act on Entergy's Petition.

ARGUMENT

I. THE PROCEDURAL CHALLENGES TO THE REQUESTED DECLARATORY RELIEF ARE WITHOUT MERIT.

Many Protesters urge the Commission to summarily reject the Petition on procedural grounds without reaching the merits. Those Protesters contend that it would be both impermissible and imprudent for the Commission to provide the requested preliminary guidance because (a) the Transco Proposal is too incomplete and tentative and (b) the Commission will address the appropriate criteria for RTOs in the RTO NOPR. These arguments should be rejected.

First, the Commission has broad discretion to issue declaratory relief to resolve uncertainty and provide guidance. The Transco Proposal provides ample detail to provide the requested declaratory relief, as clarified and revised in this Answer. Second, the requested relief would not be a waste of the Commission's decisional resources. To the contrary, it would provide valuable assistance in

moving forward a potential RTO. Third, the Commission should not postpone its guidance until after it issues the final rule in the RTO NOPR. As discussed earlier, guidance this summer is needed to allow Entergy to meet the time deadlines set by state legislation.

A. The Commission Has Broad Discretion to Provide the Requested Relief.

Section 5(e) of the Administrative Procedure Act provides that an administrative agency "in its sound discretion may issue a declaratory order to terminate a controversy or remove uncertainty." 5 U.S.C. § 554(c); *see also* 18 C.F.R. § 385.207(a)(2) (authorizing the Commission to issue declaratory orders "to terminate a controversy or remove uncertainty"). It is well settled that an agency possesses "extremely broad latitude" in determining whether or not to issue a declaratory order. *Tenneco, Inc. v. FERC*, 688 F.2d 1018,1023 (5th Cir. 1982); *see also Central Freight Lines v. ICC*, 899 F.2d 413,417 (5th Cir. 1990). The Commission has, accordingly, recognized that its authority to issue declaratory orders under Rule 207 is a matter "committed to our sound discretion." *El Paso Natural Gas Company*, 44 FERC ¶ 61,065, at 61,181 (1988).

Here, as the Protesters' pleadings amply demonstrate, there is significant and concrete disagreement regarding whether the Transco Proposal complies with the Commission's ISO principles involving independence and conflicts of

interest. This uncertainty is all but preventing Entergy from engaging in meaningful negotiations with other transmission-owning entities to join in forming a truly regional, independent transmission organization. The Commission is vested with broad discretion to remove that uncertainty and to issue an order declaring that the proposal is consistent with those ISO principles.

Protesters cite a number of cases in which the Commission has exercised its broad discretion and declined to issue a declaratory order where the controversy at issue was not sufficiently concrete or where the petitioner supplied insufficient information to support declaratory relief. *See, e.g., Dominion Resources, Inc.*, 85 FERC ¶ 61,069 (1998). However, those cases are inapposite for three reasons.

First, the Transco Proposal provides ample detail for the Commission to determine whether it complies with the independence and conflict of interest principles. The Petition and the LLC Agreement, including the Code of Conduct, explain in detail the Transco's proposed governance structure and the features which make the board independent of Entergy and all other market participants. It is true that some aspects of the Proposal await further development, notably the tariff provisions and the pricing structure. But these features pertain primarily to the other ISO Principles. They do not affect resolution of the issue of compliance with the

independence and conflict of interest principles.⁸ More important, if Entergy were to unilaterally propose a new tariff and pricing regime, it would have done so without the regional collaborative process that the Commission requires and proposes through the RTO NOPR. These parties are essentially criticizing Entergy for asking for Commission guidance that Entergy has demonstrated is crucial to start a regional collaborative process preparatory to final section 203 and 205 RTO filings.

Second, there currently exists a concrete controversy regarding whether the Transco Proposal complies with these provisions. The Protesters themselves have challenged the lawfulness of many features of the Proposal, including the procedures governing the election of the board, the use of the LLC structure, and the retention by Entergy of a passive ownership interest. This controversy is not hypothetical or unripe, but it has a present impact on Entergy and its ability to make its Transco a reality. Moreover, it is "well established" that the case or controversy requirement, upon which the Protesters rely, "does not restrict an agency's authority to issue declaratory orders." *Central Freight*, 899 F.2d at 416 (quoting *State of Texas v. U.S.*, 866 F.2d 1546,1551 (5th Cir. 1989)).

⁸ Further, even if facts presented in a declaratory order are subject to change, that does not remove the Commission's authority to issue a declaratory order. *See Central Freight*, 899 F.2d at 417-418 (An agency can issue a declaratory order "only in terms of the facts presented by [petitioner]," and that does not protect the petitioner "if facts were proved that were different from those supposed by the order.").

Third, even if the Commission had the discretion to deny the Petition, that does not mean that the Commission should exercise that discretion in this proceeding. Entergy does not deny that the Commission's discretion over declaratory orders is broad enough to support the denial of Entergy's Petition on the merits if the Commission determined that was the appropriate result. But by the same token, that discretion could also be exercised to grant the Petition if the Commission believed that granting the Petition would be valuable and justified under the circumstances. As discussed in the next section, under the circumstances, the Commission should exercise its discretion in this case to issue the requested declaratory relief.

B. The Commission Should Exercise its Discretion Under the Circumstances of This Case.

The Commission has stated that the portion of the grid operated by an RTO "should be as large as possible." *Midwest Independent Transmission System Operator*, 84 FERC ¶ 61,231 (1998) (quoting Order No. 388, FERC Stats. & Regs. at 31,731). In the RTO NOPR, the Commission "reiterate[d]" this conclusion, declaring that "many of the characteristics and functions for an RTO proposed in this section suggest that the regional configuration of a proposed RTO should be large in scope." RTO NOPR at 130 & n.199.

Entergy is, and has been for well over a year, attempting to convince other transmission-owning entities in the region to join the Transco so that the

Transco can become a sufficiently-sized RTO. However, uncertainty surrounding the Transco's compliance with the independence principle is a significant obstacle in the way of that goal. Even Protesters admit that uncertainty regarding independence is hampering Entergy's ability to convince other transmission-owning entities to join. *See, e.g., Motion to Intervene and Protest of the Transmission Dependent Utilities*, at 6 ("It is not hard to understand why" the independence issue has been a threshold obstacle.). If the Commission removes that uncertainty through a declaratory order, that action could help break the current logjam and advance the worthy goal of forming a large RTO in the region.

Some Protesters argue that the Commission should reject the Petition because Entergy's Proposal does not include other members of the Transco. Those Protesters are missing the point of the Petition. One reason why Entergy has not been able to attract any other members is because other transmission owners and stakeholders are not convinced that the Transco might be a viable option.⁹ Preliminary guidance from the Commission might make it possible for Entergy to present such a proposal to other transmission owners and stakeholders. If the Protesters really want Entergy to come forward with such a complete proposal, they should be supporting Entergy's request for a ruling.

⁹ The RTO NOPR contains ammunition for both sides of this debate.

C. The Commission Should Not Delay its Ruling Until Issuance of the Final Rule in the RTO NOPR.

Many Protesters argue that the Commission should delay its decision on the Petition until it issues its final rule in the RTO NOPR. Some Protesters even suggest that the Commission should not individually address Entergy's Petition, but should simply treat the Petition as comments to the NOPR. Those Protesters argue that any relief provided while the NOPR is pending would be preliminary and subject to change after the final rule is issued. The Protesters also argue that issuing declaratory relief while the Petition is pending might interfere with the Commission's final rule. These arguments should be rejected, and the Commission should not delay the requested declaratory relief until the final rule.

As discussed above, granting the requested declaratory relief would remove an obstacle to Entergy's efforts to convince other transmission-owning entities to join the Transco. It would allow other stakeholders to join in this process. Therefore, such relief would enhance, not diminish, the ability to timely develop and present to the Commission a sufficiently-sized RTO as contemplated by the RTO NOPR. In this manner, the preliminary declaratory relief would foster the collaborative process contemplated by the NOPR – and currently hampered by the uncertainty surrounding the Transco.

Moreover, there is no risk that the Commission's final rule might alter any preliminary guidance provided by the Commission. The proposed rules do not appear to alter the essential attributes of the independence principle - absence of financial interest or control by market participants. The Commission's ruling under ISO Principle Nos. 1 and 2 should provide sound preliminary guidance to the industry regarding compliance with the independence criterion in the RTO NOPR. Moreover, even if the final rule does alter the concept of independence, Entergy has committed to comply with any future pronouncements made by the Commission. See Petition at 4 n.5.

Finally, Entergy is under significant time pressure to form and join a RTO. One of Entergy's retail jurisdictions (Arkansas) has recently passed a law requiring Entergy Arkansas Inc. to turn operation of its transmission facilities over to an independent transmission entity approved by the Commission ninety days prior to the date of retail open access, which is targeted for January 1, 2002. See Act 1556, Electric Consumers Choice Act of 1999. Texas is considering, and expected to enact, legislation with a similar time line. Entergy needs guidance quickly if it is to put its Transeo in place to comply with those deadlines. That is why Entergy asked for a ruling by July 1999. In many respects, delaying the requested declaratory relief until after the final rule would be tantamount to denying relief.

II. THE COMMISSION SHOULD ISSUE THE REQUESTED DECLARATORY RELIEF.

Entergy's Petition seeks an order declaring that its Transco Proposal complies with ISO Principles No. 1 and 2 involving independence and conflicts of interest. Entergy described the governance structure of the proposed Transco, *see* Petition at 9-17, and set forth the authority demonstrating compliance with those principles, *id.* at 20-25.

The Protesters attack many aspects of Entergy's Proposal, arguing that those aspects fail to comply with ISO Principles No. 1 and 2. With respect to Principle No. 1, the Protesters argue, *inter alia*: (1) the board selection process gives too much authority to the LLC members; (2) the rights reserved by the LLC members give the members too much control over the Transco; and (3) the passive ownership interest of the LLC members defeats independence. With respect to Principle No. 2, the Protesters argue, *inter alia*: (1) the fiduciary duties owed by the board members of the LLC create an impermissible conflict of interest; and (2) the transfer of transmission owner employees to the Transco violates Principle No. 2.

Entergy has reviewed the protests, and, in response, is willing to revise its board selection process in two critical ways. First, Entergy will remove the provision that permitted LLC members to select the board from the slate chosen by the national search firm. Instead, Entergy will commit to the other option described

in its Petition – that board members be selected by a Stakeholder Committee from the slate chosen by the national search firm. Second, Entergy has removed the right of LLC members to select replacement members of the board in the event that over 50% of the interests of the LLC are held by non-transmission-owners. With these revisions, Entergy's Proposal addresses Protesters' concerns and is consistent with Principles No. 1 and 2 and indistinguishable from other ISO proposals approved by the Commission.

A. THE TRANSCO PROPOSAL COMPLIES WITH PRINCIPLE NO. 1, THE INDEPENDENCE PRINCIPLE.

1. The Board Selection Process Ensures Independence from Market Participants.

Under the Transco Proposal, the independent board of directors is responsible for the day-to-day operations and functions of the Transco. Therefore, the board selection process is crucial to compliance with the independence principle. Entergy has modeled the Transco's board selection process after the processes established in other ISOs approved by the Commission. The selection process is designed to ensure that the Transco board is independent from any market participant and is qualified to run a large electric transmission company.

The primary attacks on the board selection process were directed to the proposal that the Transco members, rather than a stakeholder committee, would

chose the board members and the provision that the LLC members (rather than the board itself) would appoint new board members if more than 50% of the interests were held by non-transmission-owning entities. As stated above, Entergy is willing to revise the Proposal to remove these provisions. With these revisions, the board selection process now consists of the following three steps:

- First, the members of the LLC select an independent search firm to chose candidates for the board. The search firm must be an established, nationally-recognized firm.
- Second, the independent search firm selects a slate of candidates for the board. The search firm must select a slate consisting of at least two candidates for each board position. The candidates must have the qualifications and expertise necessary to run an electric transmission company.
- Third, a committee of stakeholders that are representative of the users of the Transco transmission grid choose seven board members from the slate selected by the search firm.

Once the initial board is selected, the board will become self-perpetuating – *i.e.*, the existing board members choose the new board members. If for some reason the remaining board members cannot choose the candidates, then the new members will be chosen in the same manner as the initial members – by a stakeholder committee choosing candidates selected by the national search firm. This selection process is now indistinguishable from the selection processes adopted by other ISOs (notably the Midwest ISO) and approved by the Commission. *See Midwest Independent Transmission System Operator*, 84 FERC ¶ 61,231, at 62,147 (1998). Moreover, the

board will have the independence and authority to act (including filing amendments to the tariff) that the RTO NOPR states is essential to independence. *See* RTO NOPR at 126-128.

Besides challenging the right of the LLC members to select the board, other challenges to the board selection process involved (1) the right of the LLC members to choose the independent search firm; and (2) the right of the board to fill vacancies. Neither of these objections has merit as they have already been rejected in other Commission orders.

In the Midwest ISO order, the Commission expressly held that it was permissible for the transmission owners to initiate the board selection process by choosing the executive search firm. *See* 84 FERC at 62,148. The Commission found that the search firm "will provide a suitable slate of qualified candidates and will not be biased toward any stakeholder." *Id.* The Commission, thus, rejected arguments by stakeholders that they should have the right to participate in the decision to choose the search firm. The same result should obtain here.

Moreover, in both the NEPOOL and New York ISO Orders, the Commission approved ISO proposals that permitted the boards to be self-perpetuating. *See New England Power Pool*, 79 FERC ¶ 61,374, at 62,584 (1997); *Central Hudson Gas & Elec. Co.*, 83 FERC ¶ 61,357 (1998). When the board is independ-

ent, the selections made by the board should also be independent. Further, a self-perpetuating board has the benefit of streamlining the process for replacing board members as it avoids the cumbersome process of selecting the initial board members.¹⁰

2. The Limited Rights Reserved by the LLC Members Do Not Defeat Independence.

Under the proposed LLC Agreement, the LLC members have *passive* ownership rights to share in the Transco's income. Those members have very limited rights to participate in certain specific and enumerated decisions made by the Transco's board. However, many Protesters have challenged the limited rights given to the LLC members and argued that those rights defeat independence. For example, the Protesters have focused on Paragraph 5.11(b) of the LLC Agreement, which gives a Super Majority (over 75%) of the members the right to participate in certain fundamental corporate decisions including amendments to the LLC Agreement, the acquisition of capital stock or equity interests, the dissolution of the LLC, the sale of all or substantially all of the LLC assets, and merger or consolidation of the LLC.

¹⁰ The Arkansas PSC challenges Entergy's proposal for the board members to serve three-year terms. The Arkansas PSC argues that three-year terms are too short. However, in the PJM, NEPOOL, and Midwest ISOs, the board members serve 3-year terms. Nonetheless, during negotiations, Entergy would be willing to consider longer terms for board members.

Also, the Protesters have singled out Paragraph 5.8(b) of the LLC Agreement, which gives the LLC members the right, subject to FERC approval, to remove board members for cause.

The Protesters' challenges to these rights are without merit. These limited rights cannot defeat the independence of the Transco. The limited rights do not involve the day-to-day operations or essential functions of the Transco. They do not affect the key functions that the Commission has found in the RTO NOPR that the RTO must independently perform. Rather, they pertain to a limited number of fundamental corporate transactions regarding the LLC. It would be difficult to convince transmission owners to turn over control of their transmission assets without permitting them to retain these rights. Indeed, in all of the ISOs approved by the Commission, the transmission owners retained certain rights to participate in decisions regarding fundamental structural changes. If those rights do not preclude an ISO from being independent, then they should not preclude a transco from achieving independence. Nothing in the RTO NOPR changes this conclusion.

Moreover, to the extent that there is a risk that the LLC members might use these rights to somehow exercise undue control over the day-to-day decisions of the Transco, any such risk is all but eliminated by the requirement that the exercise of these rights are subject to FERC approval. Because these rights must

be exercised in the open and subjected to FERC scrutiny, the LLC members will not be able to abuse them to defeat independence.

3. The Passive Ownership Interest of the Market Participants Does Not Defeat Independence.

Under the Transco Proposal, the LLC members, including the existing Energy Operating Companies and the other transmission-owning entities, have a right to share in the income produced by the Transco. In this sense, the members have an "ownership" interest in the Transco. However, it is purely a passive ownership interest. The members have no control over the Transco, and no right to make day-to-day operational decisions or any of the other critical functions that the RTO NOPR requires the RTO to perform. Rather, all such authority is placed in the hands of the independent board.

Many Protesters have challenged the members' ownership interest. Those Protesters argue that the members' ownership of the Transco will give them effective control over its operations and will enable them to coerce the Transco to make operating decisions that favor their generating interests. These arguments should be rejected, and the Commission should declare that the LLC members' passive ownership interest does not defeat independence.

The Commission has made clear that market participants should not be able to control or influence the decisions of an ISO. Because ownership over an

entity generally bestows control, it is logical to expect that an owner of an ISO could control it. For this reason, the RTO NOPR proposes a safe harbor: any RTO with market participants having less than a *de minimis* (1%) ownership of a regional transmission organization would automatically comply with the NOPR's independence principle. See RTO NOPR at 122. The NOPR also seeks comments on whether this *de minimis* ownership standard should be adopted in lieu of other solutions to potential discrimination – including a performance based system that realigns economic interests to remove the motive for discrimination. See RTO NOPR at 220.

While ownership usually denotes control, that is not the case for the passive ownership interest held by the LLC members. Those members do not make any of the decisions that affect the operation of the transmission grid. Rather, the independent board makes all those decisions. The members do not control the board in any way. Moreover, they do not have the effective control rights that shareholders of a corporation have over the corporate board because they are not responsible for voting for the board or approving the board's action (except for the limited corporate exceptions discussed above). Thus, because the passive right to receive a share of the Transco's income does not give members any control over the Transco, it should

not be considered an ownership interest that prevents compliance with the independence principle. This is consistent with the RTO NOPR.¹¹

B. THE TRANSCO PROPOSAL COMPLIES WITH PRINCIPLE NO. 2, THE CONFLICT OF INTEREST PRINCIPLE.

The Petition also provided information sufficient to determine that the Transco Proposal complied with ISO Principle No. 2. Protesters contend that certain features of the Proposal run afoul of Principle No. 2. In particular, Protesters contend that the fiduciary duties owed by the board members to the members of the LLC create a conflict of interest that violates Principle No. 2. Protesters also argue that the transfer of Entergy's, and other transmission owners', employees to the Transco creates an impermissible conflict of interest. As discussed below, these arguments are without merit.

1. The Fiduciary Duties Owed by the Board to the Members Do Not Create an Impermissible Conflict of Interest.

¹¹ *If the RTO NOPR is read as prohibiting market participants from having any type of ownership interest – even a passive ownership interest – in the RTO or its facilities, then the NOPR would essentially be imposing an “ISO or divest” model on any transmission owner that had any other market activity. This would be contrary to longstanding corporate law and Commission orders that recognize the fact that the link between ownership and control can be severed. It would also be contrary to the Commission’s stated intent in the RTO NOPR to allow transmission structures to evolve. Indeed, the RTO NOPR states numerous times that the Commission is not “mandating” one particular corporate form or type of RTO. RTO NOPR at 163. The NOPR speaks often of “no mandates,” “flexibility,” and “open architecture.”*

Many Protesters contend that an LLC is an inappropriate structure for an independent transmission organization because, in an LLC, the board members owe a fiduciary duty to maximize the profits of the members of the LLC. Because some or all of those members may be integrated utility companies that also own generation resources, the Protesters argue that this fiduciary duty would cause the board to favor the generation interests of its members over those of other market participants.

This argument misconstrues the nature of the fiduciary duty owed by a board member. The Transco board would have a fiduciary duty to maximize the value of the members' interests only in the *transmission* resources held or controlled by the Transco. The board would have no duty to maximize the value of other interests – such as the *generating* interests – of the members. The board's duty to act independently of market participants is fully consistent with its fiduciary duty to maximize transmission value, which would be accomplished by maximizing throughput, minimizing congestion, and maintaining reliability.

Moreover, this argument also ignores the other ISO proposals approved by the Commission. ISOs also owe a fiduciary duty toward the transmis-

sion owners. *See* Order No. 888 at 31,731.¹² However, that duty has not been found to be inconsistent with the independence principle. Thus, in the Midwest ISO order, the Commission found that the ISO and the transmission owners were in a "custodial trust relationship," which included the "duty to maximize transmission service revenues." 84 FERC at 62,140. This is no different than the fiduciary duty the board would owe the LLC members. In fact, the PJM ISO is structured as an LLC under Delaware law. *See* §1 FERC at 62,234 n.1. But the fiduciary duty owed by the PJM ISO to the transmission owners was not found to be a violation of the independence principle.¹³

¹² *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services By Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,730-32 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, at 30,278-79 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

¹³ Some parties question why, if the fiduciary duties are the same as an ISO, Entergy expects the Transco to be more efficient than an ISO. The answer is that, unlike the ISO board and unlike the ISO employees, the Transco board and employees will have a financial incentive to maximize the value and use of the Transco and facilities it owns or controls. That financial interest will give the Transco the incentive to act efficiently and creatively. The regional planning summit and process -- which will consider all legitimate solutions to enhancing the regional market -- is a key component toward meeting this goal. Thus, the Transco will not have any incentive (or ability) to favor any market participant.

2. The Transfer of Member Employees Does Not Create an Impermissible Conflict of Interest.

Many Protesters also challenge the proposal to transfer the employees of Entergy and the other transmission owners to the Transco. Those parties contend that the employees would not be able to sever all their personal ties and allegiances to the utility's merchant employees and, therefore, might violate their duties and provide preferential treatment or information to the merchant employees.

These arguments should be rejected. The Commission has never recognized a prohibition against former employees of transmission providers working for an ISO, and none should be recognized here. To the contrary, ISO Principle No. 2 expressly contemplates that ISOs will hire former employees of the transmission owners. See Order No. 888 at 31,731. Moreover, the Commission has recognized that it is often important for ISOs to hire former employees of a transmission owner. See *Midwest Independent Transmission System Operator*, 85 FERC ¶ 61,250, at 62,036 (1998). Many of the current ISOs are staffed by former employees of a transmission owner. Indeed, the RTO NOPR expressly recognized that the independence principle "does not preclude past financial ties with market participants," RTO NOPR at 120, and that RTOs can have the flexibility to "convert some employees ... into RTO employees," RTO NOPR at 142.

The Commission's orders have indicated that any potential conflicts of interest between the employees and their former employer can be resolved through a strict code of conduct¹⁴ and a severing of all financial ties with their former owner. Here, the Transco Proposal fully complies with those directives. The proposal requires the employees to comply with a strict code of conduct, modeled after the code of conduct approved by the Commission in the Midwest ISO. The Proposal also requires the employees to sever all financial ties with their former employer. Those employees will be completely indifferent to the financial success of their former employer. Their only concern will be the financial success of their new employer, the Transco.

CONCLUSION

The Petition presents the Commission with an RTO that will have complete independence and operational control over the transmission facilities transferred to it. The Transco's board and employees will have no financial incentives toward any entity other than the Transco. The Transco will be able to unilater-

¹⁴ Entergy recognizes that the RTO NOPR appears to suggest that even strict codes of conduct may not be sufficient in all circumstances to ensure independence. Entergy's Proposal goes well beyond just strict codes of conduct. Under its proposal, it is a strict code of conduct, the severing of financial interests, the incentive to maximize the use of the Transco's assets, plus complete operational control of the grid that ensures the independence of the Transco from market participants.

ally file changes to its FERC-approved tariff. In light of this and all the other steps to ensure operational and financial independence outlined in its Petition, Entergy respectfully requests an order declaring that the Transco Proposal complies with ISO Principle Nos. 1 and 2, the independence and conflict of interest principles. Entergy also respectfully requests that the Commission issue the requested declaratory order by the end of July.

Respectfully Submitted,

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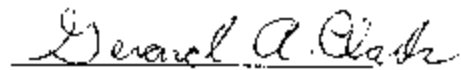
On behalf of Entergy Services, Inc.

Dated: May 20, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing Answer of Entergy Services, Inc. to Protests, Motions For Summary Disposition, and Motions to Hold in Abeyance to be served upon all parties listed on the official service list maintained by the Secretary of the Commission for these proceedings.

Dated this 20th day of May, 1999


Gerard A. Clark