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May 4, 1999

VIA FEDERAL EXPRESS

David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

RE: Entergy Services, Inc.
Docket No. EL99-57-000

Dear Mr. Boergers:

Please find enclosed the original and fifteen copies of Texas Industrial Energy Consumers' Motion to Intervene and Notice of Protest. Please file the original and fourteen copies in the above referenced docket. Additionally, please file stamp the extra copies and return them to me in the enclosed envelope.

Please do not hesitate to call me if you have any questions. Thank you for your assistance.

Sincerely,

C. Lane Mears
Attorney for Texas Industrial Energy
Consumers

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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ENTERGY SERVICES, INC

DOCKET BL99-57-000

TEXAS INDUSTRIAL ENERGY CONSUMERS'
NOTICE OF PROTEST

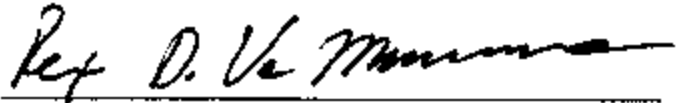
Texas Industrial Energy Consumers ("TIEC") submits this Notice of Protest in the above-referenced proceeding in accordance with Rule 211 of the Federal Energy Regulatory Commission's ("FERC") Rules of Practice and Procedure. TIEC has separately filed a Motion to Intervene in this proceeding.

1. TIEC is an unincorporated association of industrial companies with operations in Texas. TIEC member companies own and operate industrial facilities in Entergy Gulf States, Inc.'s ("EGSI") service territory and purchase electrical power from EGSI. EGSI is an Entergy Operating Company on whose behalf, among others, the petition of Entergy Services, Inc. ("Entergy") was filed. Thus, Entergy's Transco proposal may significantly affect both the cost and availability of transmission service to TIEC member companies.

2. TIEC's concerns with regard to Entergy's Transco proposal are outlined in the attached Exhibit "A." TIEC understands that the Louisiana Energy Users Group ("LEUG") has or will express similar concerns regarding Entergy's petition.

Respectfully submitted,

MAYOR, DAY, CALDWELL & KEETON, L.L.P.



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CERTIFICATE OF SERVICE

I, C. Lane Mears, Attorney for TIEC, hereby certify that a copy of TIEC's Notice of Protest was served on all parties of record in this proceeding, on this 4th day of May, 1999, by First Class, U.S. Mail, Postage Prepaid.



C. Lane Mears

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ENTERGY SERVICES, INC.

DOCKET EL99-57-000

COMMENTS OF TIEC

Subject to curing certain defects described herein, the Texas Industrial Energy Consumers ("TIEC") generally support the concepts embodied in Entergy's Transco proposal as described in Entergy's Petition in Docket No. EL99-57-000 as a positive step toward the establishment of Regional Transmission Organizations ("RTOs"). The Commission should note that TIEC only sees an Entergy Transco as a first step toward an RTO. TIEC, which has several members that are also members of ELCON, supports ELCON's stated view that ultimately there should be only three RTOs, one each for the Eastern Interconnection, Texas Interconnection, and Western Interconnection. In addition, TIEC believes that Entergy's Transco will have to further evolve significantly over time in order to meet the ideal of an RTO. It is important to have, as soon as possible, an indication of the Commission's general reaction to the Entergy Transco concept and direction as to needed modifications. This will permit Entergy to move forward to develop an actual Transco that combines transmission assets from multiple owners into a single entity. This is critical to the development of competitive generation markets at the retail and wholesale levels. Because Entergy has committed itself to "abide by the outcome of any final and non-appealable rulemaking order that might modify any relevant regional transmission organization related policies or principles,"¹ this decision need not await the outcome of a generic proceeding.

While TIEC is generally supportive of Entergy's proposal because of Entergy's commitment to abide by any RTO rulemaking, TIEC has several concerns that must be addressed in the Commission's declaratory order. These concerns are in the following areas:

¹ Petition of Entergy Services, Inc. for Declaratory Order Regarding Compliance of Transco Proposal with Applicable ISO Principles, at 4 n.5 (filed April 5, 1999) (hereinafter "Petition").

- Election of Board Members;
- Performance-Based Ratemaking;
- Transmission "Cost Shifting";
- Control Area Operations;
- Size and the Competitiveness of Power Markets, and
- Market Monitoring.

Election of Board Members

As proposed, the Transco would be a Limited Liability Company ("LLC") created under Delaware law that would be managed and governed by an independent, seven-member Board. The Board members would have no financial interest in or ties to the Member Companies, other than those specified in the LLC Agreement. The initial slate of potential Board members would be selected by a nationally-recognized executive search firm that is itself selected by the Member Companies. All of the Member Companies will be transmission owners initially. This approach is consistent with that approved by the Commission for the Midwest ISO in *Midwest Independent Transmission System Operator, Inc., et. al.*, 84 FERC ¶ 61,231 (1998).

While the development of the slate of Board candidates is consistent with Commission precedent, the actual election of the Board is not. Under Entergy's proposal, the Member Companies, all of which will initially be participating transmission owners, would elect the initial Board members from the slate of candidates established by the search firm. Under this process, Entergy and the other Member Companies would clearly be able to select Board members with backgrounds that favor transmission owner positions on various issues. This initial election would result in a Board that would be anything but independent. The only way to

ensure that the Board is independent would be to require that the Board be initially elected by a Stakeholder Committee, not by the Member Companies alone.

Such a Stakeholder Committee should include representation by each retail customer sector (*i.e.*, industrial, commercial, and residential) in addition to representation from transmission owners and wholesale transmission customers. Note that Entergy indicated on page 11 of its Petition that it "will not oppose the use of an appropriately structured Stakeholder Committee to make the final board selection if the Commission believes such a process is critical to ensure independence."² Also, note that the Commission considered the initial election of the Board to be of such importance in *Midwest Independent Transmission System Operator* that it required that the Midwest ISO Participants allow 60 days for non-transmission owners to join the Midwest ISO prior to allowing the initial election of the Board to take place.³

After the initial election of Board members, Entergy proposes that Board members whose terms are not concluding elect replacements when vacancies on the Board arise (either through removal or the expiration of a Board members' term). In the event remaining Board members could not agree on the selection of replacements, replacements would be elected by Entergy and the other Member Companies. TIEC protests this latter provision. To ensure that the Board cannot be influenced by Entergy (and the other Member Companies) and that the Board is accountable to someone, Board member vacancies should be filled by an election by the Stakeholder Committee, not the remaining Board members or Entergy (and the other Member Companies). TIEC asks the Commission to direct Entergy to correct this problem.

Entergy proposes to modify the Transco's Board member replacement scheme if at some point more than 50% of the interests in the Transco are held by Member Companies that are not

² Petition at 11.

³ *Midwest Independent Transmission System Operator, Inc., et. al*, 84 FERC ¶ 61,231, at 23 (1998).

current transmission-owning entities. In this event, vacancies on the Board would be filled by a vote of the Member Companies, rather than the remaining Board members. TIEC does not object to the idea that eventually the Board could be elected by Member Companies rather than the Stakeholder Committee. However, the 50% threshold is too low and there are others besides transmission owners who could exert market power through control of the Transco Board. It should be noted the term "transmission-owning entity" has little meaning under the Transco. The initial Member Companies become Member Companies by either transferring *ownership* of their transmission facilities to the Transco or leasing their transmission facilities to the Transco. Moreover, it is not ownership of transmission alone that is the problem. Rather, it is the *control* of transmission *by any market participant* that raises the market power concerns.

TIEC believes that the Commission should not allow the Member Companies to elect the Transco Board unless at least 67% of the interest in the Transco is owned by Member Companies who are not *market participants* at the time of the election.

The 67% threshold would make it difficult for market participants to unduly influence other non-market participant Member Companies to vote in a manner that favors market participants. By tying the threshold to market participants rather than transmission-owning entities, the Commission would ensure that the provision covers abuse by both the incumbent vertical utilities of today and the potentially large generation-only entities of tomorrow.

Performance-Based Ratemaking

Entergy has requested guidance from the Commission in regard to whether and under what circumstances it would permit Performance-Based Ratemaking ("PBR") style incentive regulation. Entergy describes the type of PBR that it has in mind as one that would encourage the Transco to maximize throughput, relieve congestion, and enhance reliability. Entergy also

indicated that it will precisely describe its PBR proposal when it makes its Section 205 filing for the Transco.

TIEC is not opposed to the concept of PBR for transmission service. However, any PBR allowed by the Commission should be balanced and fair for both transmission customers and the Transco. PBR should not encourage transmission solutions that relieve congestion over generation solutions when generation solutions are more economical. Moreover, PBR should not reward the Transco for actions it would otherwise have taken without PBR and should not reward it for just ordinary performance. Finally, with PBR a Transco should be penalized for bad behavior as much as rewarded for good behavior. Just rewarding good behavior could lead to complacency and mediocrity if goals with rewards become unachievable in a given year of operation.

Transmission "Cost Shifting"

Entergy notes in its Petition, "The prospect of cost shifting among transmission owners could be a deterrent for transmission owners whose existing tariffs are relatively low-cost."⁴ Entergy goes on to propose that, "in addition to meeting the Commission's existing pricing standards, the transmission proposal developed by Member Companies should not result in cost shifting among transmission owners solely due to the implementation of the Transco."⁵

TIEC supports a "no cost shifting" policy as an acceptable initial standard for developing RTOs, *provided that* rate pancaking is eliminated and pricing of embedded transmission costs is not done on a distance-sensitive basis. The removal of rate pancaking is one of the greatest benefits provided by RTOs because it increases the number of suppliers that have the same delivery cost from which a customer can choose. This helps to dilute the market power of

⁴ Petition at 27.

⁵ *Id.*

incumbent suppliers. It must be recognized that in general the generation cost component of electric service is far larger than the transmission cost component. Therefore, limited cost shifting caused by removing rate pancaking may be tolerated for transmission rates in order to reap the benefits of the greater savings in generation charges provided from enhanced competition.

TIEC is also concerned with the potential use of distance-sensitive transmission rates to recover embedded transmission costs. Unlike regional postage-stamp or license-plate transmission rates, distance-sensitive transmission rates do *not* enhance competition. Distance-sensitive transmission rates favor local generation over remote generation by effectively providing a more heavily discounted transmission rate for delivery from local generation versus the transmission rate for delivery from remote generation. Considering that incumbents, especially in retail competition scenarios, own nearly all of the local generation, distance-sensitive transmission rates elevate the already high market power of incumbents, even if the distance-sensitive transmission rate for long-distance transmission service is significantly lower than the sum of the old pancaked transmission rates. This is because the distance-sensitive transmission rate for delivery from local generation would be even lower.

Distance-sensitive transmission rates are also inconsistent with the Commission's transmission discounting rules under Order Nos. 888, 888-A, and 888-B that require that when a discount is offered to a customer over one path to a specific point of delivery, the transmission provider must offer the same discount to all other transmission customers over *all* unconstrained paths to that same point of delivery. Therefore, under Order Nos. 888, 888-A, and 888-B, a transmission provider cannot normally offer a discount based on distance.

As a final note, distance-sensitive transmission pricing is not necessarily efficient. This is because distance-sensitive transmission pricing can encourage customers to elect a short-distance transaction over a constrained path instead of a long-distance transaction over an unconstrained path. Thus, distance-sensitive pricing can send signals that could adversely affect transmission congestion.

Control Area Operations

Entergy's proposal is silent on whether it will be the NERC control area operator for its transmission system. However, it does appear that by transferring all of its transmission employees to the Transco, Entergy may be implying that the Transco may be the NERC control area operator for the Transco.

TIEC believes it is critical that the Transco be the NERC control area operator for its transmission system. This will ensure that Ancillary Services and transaction scheduling will truly be provided on a non-discriminatory basis. Note that this does not mean the Transco should perform an economic dispatch function. Economic dispatch is a generation scheduling function that should be performed by each market participant on its own. The Transco's role should be limited to providing reliable transmission service and moment-to-moment balancing of load and generation as the default supplier of Ancillary Services on its transmission system.

Size and Competitiveness

TIEC believes the Commission should provide clear guidance to Entergy that an Entergy-only Transco would not be accepted by the Commission as an RTO. While Entergy is accurate in stating that its transmission system is extensive and covers a broad geographical area, Entergy fails to understand the true meaning of "size." A properly "sized" RTO is one which *reduces* pancaking of transmission rates and contains generation within its boundaries that is owned by a

number of different entities sufficient to allow a reasonable chance for vibrant competition. An Entergy-only Transco would fail the "size" test in both respects.

An Entergy-only Transco would *not* further reduce transmission rate pancaking in the region. Thus, an Entergy-only Transco would fail at meeting the Commission's long-held goal of reducing transmission rate pancaking. Moreover, nearly all of the generation contained within the boundaries of an Entergy-only Transco would be owned by Entergy. This would leave Entergy as a dominant market participant in the power markets within the Transco, especially under retail competition. It should be noted that Entergy would retain this dominance, as a result of unreduced rate pancaking and generation ownership inside the Transco, even if Entergy *divested* itself of its interest in the Transco.

As stated earlier, TIEC believes that ultimately there should be only three RTOs: one each for the Eastern, Texas, and Western Interconnections. In addition, TIEC agrees with the post-conference comments of the Louisiana Energy Users Group ("LEUG") filed on June 25, 1998 in Docket No. PL98-5-003 which proposed four criteria for sizing RTOs. These four criteria are as follows:

1. Installed generation within the boundaries of the ISO [RTO] should not exhibit a market concentration with a Herfindahl-Hirschman Index ("HHI") in excess of 1,800.
2. As a minimum, the ISO [RTO] should cover the systems of two different transmission owners.
3. The transmission systems of the ISO [RTO] should be electrically contiguous.
4. A minimum of 90% of power flow created by any transaction internal to the ISO [RTO] should flow on the transmission system of the ISO [RTO].

Notably, the three ideal RTOs would easily meet all four of these criteria.

While TIEC believes these four criteria are still applicable, we recognize that these criteria were proposed in the context of the Commission ordering the establishment of ISOs or other independent transmission entities. Therefore, TIEC believes that these four criteria could be tempered in order to balance the ultimate needs of an RTO with the reality of soliciting voluntary participation in the Transco. Therefore, to strike the proper balance, we strongly recommend that the Commission provide guidance to Entergy which indicates that as a minimum the Transco must meet the following conditions related to size and competitiveness:

- Initially, the Transco must consist of at least one other transmission-owning Member Company besides the Entergy Operating Companies.
- The Transco must be electrically contiguous.
- Within three years of final Commission approval of the Transco, members of the Transco must reduce the total HHI for installed generation capacity located within the boundaries of the Transco to below 1,800 by adding new transmission-owning Member Companies, divesting generation, or some combination of the two.⁶
- The Transco must conform to all minimum sizing and competitiveness requirements the Commission may generically apply to RTOs.

Market Monitoring

Appendix 3 of Entergy's Petition contains a Market Monitoring Plan. Under the Plan, the Transco would establish a Market Monitoring Unit to monitor compliance with the rules, standards, procedures, and practices of the Transco. The Unit would also identify flaws in the

⁶ Note that for simplicity, transmission capacity across the Transco boundaries would be considered zero and transmission capacity inside boundaries of the Transco would be considered infinite.

Transco operating rules, standards, procedures, and practices. Finally, the Market Monitoring Plan would expire five years after the effective date of Transco operations.

TIEC protests several aspects of the proposed Market Monitoring Plan. First, considering that the Transco is a for-profit entity, TIEC believes that the Market Monitoring Unit should be an entity completely separate from the Transco and the Board of the Transco. It would be more appropriate for the Market Monitoring Unit to report to the Stakeholder Committee and the FERC. Second, TIEC believes that the Market Monitoring Plan should be expanded to monitor generation markets in addition to transmission service. Finally, the sunset provision of the Market Monitoring Plan should be deleted.

Conclusion

While TIEC generally supports Entergy's Transco proposal, the proposal does not comply with applicable ISO principles in several important respects, as described above. Therefore, TIEC respectfully requests that Entergy's petition for a declaratory order that the existing proposal complies with applicable ISO principles be denied. TIEC recommends that the Commission indicate that Entergy's Transco proposal should be modified consistent with the above recommendations.

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