TESTIMONY OF JAMES J. HOECKER

DOCKET NOS. 001148-EI, 010577-EI AND 000824-EI

AUGUST 15, 2001

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power & Light Company's proposed merger with Entergy Corporation, the formation of a Florida transmission company ("Florida transco"), and their effect on FPL's retail rates.	**DOCKET NO. 001148-EI**
In re: Review of Tampa Electric Company and impact of its participation in GridFlorida, a Florida Transmission Company, on TECO's retail ratepayers.	**DOCKET NO. 010577-EI**
In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light.	**DOCKET NO. 000824-EI** **FILED: August 15, 2001**

TESTIMONY OF
JAMES J. HOECKER

Q. Please state your name and occupation.

A. My name is James J. Hoecker. I am a partner in the law firm of Swidler Berlin Shereff Friedman, LLP.

Q. Please briefly describe your background.

A. I was a Commissioner at the Federal Energy Regulatory Commission ("FERC" or "the Commission") from 1993-2001. I was Chairman of FERC from June 1997 to until January 2001, and I was Chairman of FERC at the time of the issuance of Order No. 2000. (FERC Stats & Regs. ¶ 31,089 (2000)). I was also a Commissioner when FERC issued Order No. 888, which requires open and non-discriminatory access to electric transmission facilities and services. (FERC Stats. & Regs. ¶ 31,036 (1996)). Although adopted before I joined the Commission, Order No. 636, which required interstate natural gas pipelines to provide open and non-discriminatory access to transportation facilities and

services, was largely implemented during the early months of my tenure at FERC. I am the first former Commission staff member to serve as a Commissioner and as Chairman. In the early 1980s, I served as Assistant General Counsel for Rulemaking and Legislative Analysis, Assistant General Counsel for Gas and Oil Litigation, a personal advisor to two Commissioners, and in other posts. My career in energy regulatory law, both in and out of government, extends back to 1979.

I. INTRODUCTION

Q. What is the purpose of your testimony in this proceeding?

A. I am presenting testimony on behalf of Florida Power and Light Company ("FPL"), Florida Power Corporation ("FPC"), and Tampa Electric Company ("TECO") (the "Joint Applicants") with respect to two issues. First, I explain that it is FERC's clearly stated policy that all transmission-owning utilities should join a Regional Transmission Organization ("RTO"), and that FERC is prepared to take significant actions to enforce that policy. Second, I describe the various benefits that FERC anticipates will result from the formation of RTOs in every region of the country and the operation of transmission systems independent from the interests of market participants in the business.

I wish to make clear that, given my prior position at FERC, restrictions under Federal law and the District of Columbia Rules of Professional Responsibility necessarily limit the scope of my testimony. I will not testify on any aspect of the Joint Applicant's Grid Florida filing before the Commission. (Docket Nos. RT01-67-000 and RT01-67-001).

II. FERC'S POLICY RATIONALE FOR RTOs

A. BACKGROUND

Q. What were the reasons for FERC's issuance of Order No. 2000?

A. Order No. 2000 was the next logical step to achieving the policy goals that the Commission set in 1996 when it issued Order No. 888, which required all FERC-jurisdictional transmission owners to file open access transmission tariffs to improve efficiency and promote competition among energy suppliers. In implementing the Energy Policy Act of 1992 ("EPAct"), the Commission had made its overall approach clear: "Our goal is to facilitate the development of competitively priced generation supply options, and to ensure the wholesale purchasers of electric energy can reach alternative power suppliers and vice versa." (Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Stats. and Regs. ¶ 32,507 at 32,866 [Order No. 888 NOPR]). In handing down Order No. 888, I believe FERC was responding to the pro-competitive spirit of EPAct and to the major changes that were taking place in the electric industry both as a result of the Public Utility Regulatory Policy Act of 1978 and new market realities. Those changes include the advent of independent or non-utility generation, the growing number of bulk power transactions, and the increased use of gas turbine technology. Moreover, I believe the Commission was responding to what it believed was a growing public policy and industry preference for more energy competition and less regulatory intrusion into energy markets. Order No. 888 was a recognition that more efficient use of existing

transmission assets would be critically important to the operational and financial health of the industry and consequently to consumers.

In addition, there was important FERC precedent for the 1996 open access policy initiative. FERC had already issued Order Nos. 436, 500, and 636, paving the way for open-access and competition in the natural gas pipeline industry. Both pipelines and transmission wires form networks of facilities that are essential to the interstate commerce in energy. As I later describe more fully, by 1996 the Commission had separated the suppliers of gas transportation services from the sellers and traders of the commodity. It had already dealt with many of the market power, stranded costs, and transparency issues that arise as an energy industry moves towards greater competition. Prior to No. 888, reform of the gas pipeline industry had been successfully completed.

Order No. 888 was intended, in part, to address the fact that some transmission-owning utilities could either deny service to third party users or treat third party users of transmission differently than when those utilities transmitted their own generation, a source of discrimination FERC had until then addressed on a case-by-case basis. (*See e.g.*, *American Electric Power*, 64 FERC ¶ 61,279, *reh'g granted*, 67 FERC ¶ 61,168, *clarified*, 67 FERC ¶ 61,317). By requiring all utilities to separately offer and price transmission services, so-called "functional unbundling," announcing that transmission owners would have to receive service on the same terms as they offered to others, and issuing a standardized *pro forma*

OATT establishing non-discriminatory terms and conditions of service, FERC was showing its determination to bring fundamental change to the wholesale portion of the power industry. FERC was persuaded that competitive generation markets would bring tangible benefits to consumers. In 1996, FERC estimated those benefits to be between $3.76 billion and $5.37 billion per year, nationally. (Order No. 888 at 31,652).

FERC became disappointed with the results of Order No. 888, however. In 1999, FERC concluded that remedies and guidance established in Order No. 888 were not sufficient, in and of themselves, to create the more competitive markets that FERC had anticipated. In formulating Order No. 2000, FERC reviewed evidence that open access to the transmission grid, as owned and managed by vertically integrated utilities, as a whole was not attaining the kind of efficiency, fairness, and reliable operation of the system that was contemplated. (Order No. 2000 at 30,992).

FERC found that there were two broad categories of transmission-related impediments to a more competitive wholesale electric market: (1) engineering and economic inefficiencies inherent in the current operation and expansion of the transmission grid, and (2) continuing opportunities for transmission owners to unduly discriminate in the operation of their transmission systems so as to favor their own or their affiliates' power marketing activities. (Order No. 2000 at 31,003). Two prominently featured examples of the transmission related

impediments mentioned by FERC were the potential for vertical market power abuse and the existence of pancaked rates.

FERC therefore concluded that new entities that would have the authority to control transmission operations within an entire region of the United States would "(1) improve efficiencies in transmission grid management; (2) improve grid reliability; (3) remove remaining opportunities for discriminatory transmission practices; (4) improve market performance; and (5) facilitate lighter handed regulation." (Order No. 2000 at 30,993). These remain the objectives of the Commission in promoting RTOs.

Q. Why was FERC concerned about the potential for abuses of vertical market power?

A. Many transmission owners not only provide transmission services, but also own generation and serve load. They therefore have incentives to participate in the bulk power markets in ways that primarily benefit their own power sales and native load customers over those of others. Even though Order No. 888 required every transmission owner to file an OATT with specified terms and conditions, transmission owners retained discretion as to how such service was to be provided. FERC noted in its Notice of Proposed Rulemaking ("NOPR") for Order No. 2000 and in the Final Rule, that it is "[t]he inherent characteristic of monopolists" to act in their own self-interest when possible. (Order No. 2000 at 31,004). FERC explained the shortcoming of Order No. 888 by stating that,

"functional unbundling does not change the incentives of vertically integrated utilities to use their transmission assets to favor their own generation... ." *Id.*

FERC also noted that transmission owners make decisions that can have a significant impact on transmission service availability, such as the calculation of available transfer capability ("ATC") and total transfer capability ("TTC"). FERC explained that actual discrimination may not be detected in a what FERC called a "non-transparent" market and, even when possible instances of discrimination can be identified, it is difficult if not impossible to determine whether the behavior in question was motivated by competitive interests or was an impartial operating or technical requirement. (Order No. 2000 at 31,005). Such lack of transparency gave transmission customers reason to believe that, whenever they were denied transmission service, capacity was probably being used to transmit the energy of the transmission owning utility. FERC soon received complaints from third party generators in unprecedented numbers, alleging that transmission owners were discriminating in favor of their own bulk power sales. These complaints were difficult for FERC to evaluate, irrespective of the merits. Furthermore, even if there was no actual discrimination, FERC was concerned that the perception that transmission owners were favoring themselves would foster distrust of markets, discourage investment in electric markets, and reduce the benefits of competition. The various comments that FERC received in response to the NOPR confirmed a widespread perception of discrimination.

Q. Was Order No. 2000 based on findings of actual discrimination by transmission owners against other users of their transmission assets? To apply such generic policies, must FERC find discrimination in fact?

A. FERC's actions in Order Nos. 888 and 2000 were based on its broad understanding of developments in the electric power business as well as specific instances where discrimination occurred or was alleged to have occurred. In addition to promoting economic efficiency and increasing supply options, the Commission wanted to diminish the opportunities for discrimination in the increasingly competitive wholesale power market. As I mentioned, it had done something similar in Order No. 436, by "unbundling" all interstate pipeline services with the expectation that this would promote the interest of competitors who had to rely on existing pipelines for transportation to reach end use markets. In approving FERC's actions, the Court of Appeals noted that the Natural Gas Act – a statute very similar to and contemporaneous with the Federal Power Act – "fairly bristles with concern for undue discrimination." (*Associated Gas Distributors v. F.E.R.C.*, 824 F.2d 981, 998 (D.C.Cir. 1987) ("Associated Gas")). In other words, the Commission has broad discretion to address undue discrimination, provided it engages in reasoned decision making.

Q. What was FERC's concern about pancaked rates?

A. Under Order No. 888, each transmission owner established its own transmission rates. If a buyer and seller of power are far apart and the transmission component of the transaction involves using the systems of more than one transmission

owner, the transmission customer typically pays an additional transmission rate for each system the transaction crosses. When more than one transmission rate is paid for a single bulk power transaction, it is said that the rates are "pancaked."

The problem arises because transmission system ownership is tied to historic utility service territories. The result is a patchwork of different rates and requirements for systems located in a single state or region. As a consequence, a regional transaction that otherwise would be economic can be rendered uneconomic, not to mention less efficient, by the imposition of pancaked rates. It follows, on the other hand, that if a single transmission rate were developed for an entire region, the resulting rate could be significantly lower than the combination of the pancaked rates of the individual system owners of that region. To the extent that this difference in transmission rates makes a transaction more or less attractive, it will seriously affect whether purchasers of power have real competitive supply options or not. Consequently, the elimination of pancaked rates could lead to greater access to the generation resources in a region.

Q. Are there any other reasons listed by FERC for the issuance of Order No. 2000?

A. There are several other reasons and anticipated benefits in addition to curbing market power and eliminating pancaked rates, including: (1) more efficient planning on a regional basis; (2) the ability to improve regional reliability through regional operations; (3) improved emergency response; and (4) more efficient

treatment of loop flows. (Order No. 2000 at 31,003 – 31,028). I describe these benefits in greater detail later in this testimony.

Q. Can you identify any other factors that contributed to the issuance of Order No. 2000, which are not specifically mentioned by FERC in that Order?

A. Since the 1980s, the Commission has been a catalyst for reform in another network industry. The interstate pipeline system suffered from inefficiencies similar to those I described as affecting electric transmission. The Commission "unbundled" the gas transportation function from the sales of gas itself in an effort create a competitive gas market to flow through to customers the benefits of wellhead price decontrol. A series of FERC orders in this area created an open, transparent, liquid, and commercially fair interstate gas market place.

The first such order was Order No. 436, issued in 1985. It established an open access regime that allowed each interstate natural gas pipeline to develop its own open access tariff. Compliance with this order was voluntary. Not surprisingly, each pipeline filed a tariff with provisions that were usually inconsistent with other pipeline tariffs, which failed to enhance the ability to move natural gas over multiple pipelines. Order No. 436 was therefore followed by a series of subsequent orders that established standard practices across multiple systems, making transactions more competitive and driving down prices of the commodity. Although Order No. 436 was voluntary, the industry recognized the Commission's direction and swiftly implemented the Order. The process of

market and policy evolution has nevertheless continued through Orders Nos. 636 and 637, the latter issued in 2000.

The Commission's decision in Order No. 888 to develop a *pro forma* OATT for all transmission owners to apply was a response to the various kinds of problems and the lack of uniformity that it encountered in reforming the pipeline industry. However, the electric transmission grid is even more highly interconnected than the interstate pipeline system and FERC was therefore correctly concerned that variations in utility tariffs would make it extremely difficult for market participants to engage in transactions using more than one system. The OATT was a way to minimize those variations and deviations, which were permitted only for terms of service that were deemed superior to the OATT. On the other hand, such uniformity may have come at the expense of innovation, locking in approaches to issues such as congestion management, capacity allocation and rates that were often not optimal. In my view, RTOs can once again unlock the creative process and give stakeholders a way to find the most efficient and appropriate solutions for each region, while still maintaining efficiency and non-discrimination.

Under Order No. 2000, RTOs will provide transmission service over a large region. On that basis, the Commission has said it will allow RTOs to develop their own innovative solutions to various problems rather than either mandating a single approach or locking in the initial RTO characteristics and functions for the

future. Even if different RTOs have different approaches to the same issue, the regional scope of such RTOs will permit a uniform approach to transmission service within that region, thereby facilitating the development of large bulk power markets that address the new market realities which often prove hard to predict. This flexibility, in combination with the consolidation of transmission operations within a region, intended ultimately to benefit consumers, including those who reside in Florida.

III. FERC'S POLICY IS THAT ALL TRANSMISSION OWNERS IN THE UNITED STATES SHOULD JOIN AN RTO

Q. What is FERC's policy with respect to transmission owner participation in RTOs?

A. FERC stated in Order No. 2000 that its "objective . . . is for all transmission-owning utilities to place their transmission facilities under the control of an RTO in a timely manner." (Order No. 2000 at 30,993)(emphasis added). In its Order on Rehearing of this issue , FERC was even more forceful, stating that its "objective in promulgating Order No. 2000 was to have all transmission-owning entities in the Nation, including non-public utilities, place their facilities under the control of appropriate RTOs in a timely manner." (Order No. 2000-A FERC Stats. & Regs. ¶ 31,092 at 31,355 (2000)) (emphasis added).

FERC established a mandatory process that all jurisdictional utilities were required to follow. Under 18 C.F.R. § 35.34(c), all utilities were required to make

a filing on October 16, 2000, in which they either submitted a proposal to join an RTO or made an "alternative filing" pursuant to 18 C.F.R. § 35.34(g), which requires the utility to provide:

> (1) A description of any efforts made by that public utility to participate in a Regional Transmission Organization;
>
> (2) A detailed explanation of the economic, operational, commercial, regulatory or other reasons the public utility has not made a filing to participate in a Regional Transmission Organization, including identification of any existing obstacles to participation in a Regional Transmission Organization; and
>
> (3) The specific plans, if any, the public utility has for further work toward participation in a Regional Transmission Organization, a proposed timetable for such activity, an explanation of efforts made to include public power entities in the proposed Regional Transmission Organization, and any factors (including any law, rule or regulation) that may affect the public utility's ability or decision to participate in a Regional Transmission Organization.

As the above language makes clear, FERC did not intend for utilities to simply be able to decide to opt out of RTO participation. Instead, all utilities were required to describe the specific obstacles to their participation and their plans for

overcoming those obstacles. This requirement was clearly intended to further FERC's policy goal that all transmission owners participate in an RTO.

To my knowledge, neither the Commission nor any individual Commissioner has wavered from that fundamental message since the adoption of Order No. 2000 nearly two years ago. However, the Commission's continued, and perhaps heightened, commitment to full transmission owner participation in RTOs is reflected in the RTO orders issued on July 12, 2001 ("July Orders") in which FERC reiterated its goal of establishing RTOs, and then went a step further by deciding that there should be only a few large regional RTOs in the country. (Docket Nos. RT01-35-001, RT01-95-000, RT01-2-000, RT01-34-000, et al., RT01-74-002, RT01-77-000, RT01-86-000, et al., RT01-88-000, et al., RT01-98-000, RT01-99-000, RT01-100-000). For instance, an Order Initiating Mediation states that it is necessary to form a single large southeastern RTO. (96 FERC ¶ 61,066 at 61,285) ("Southeastern Mediation Order"). Commissioner William Massey, in a concurring opinion notes that "...the Commission adopts as its firm objective a single RTO for the Northeast, one for the Southeast, one for the Midwest, and one for the West. We state this objective for four RTOs covering the entire nation." *Id.*

Q. But didn't FERC state in Order No. 2000 that it was adopting a "voluntary approach to RTO formation"?

A. Yes, and it did that. The question that FERC had to address was how best to achieve its goal of putting all transmission facilities under the control of an RTO. In the past, when FERC has mandated major industry restructuring --for example,

the requirement that both natural gas and electric companies provide open access to pipelines and transmission lines, respectively -- its authority to issue such a generic ruling has been challenged and the validity of the entire program, although later affirmed, left up in the air pending a ruling on appeal. Given that the Federal Power Act fails to specifically mention RTOs and that its RTO initiative would probably lead to litigation, the Commission decided to take a route other than a mandate. It stated: "we want the industry to focus its efforts on the potential benefits of RTO formation and how best to achieve them, rather than on a non-productive challenge to our legal authority to mandate RTO participation." (Order No. 2000 at 31,033). In Order No. 2000-A, however, FERC made clear that it did not think that its "voluntary approach" meant that utilities would not ultimately join an RTO, explaining "[t]hat we have not chosen to mandate RTO participation does not mean that we have avoided our obligation to address the impediments to competition that we have identified; it merely means that we have chosen a method to address those impediments that we believe will efficiently achieve the results we desire." (Order No. 2000-A at 31,358) (emphasis added).

Q. If RTOs fail to form as the Commission expects or desires, do you believe the agency will change course, either by penalizing latecomers or simply mandating compliance with Order No. 2000?

A. Yes. While I cannot predict what FERC will do in this regard, there are increasing indications that the Commission is growing impatient on this issue. The series of July Orders I mentioned previously strongly endorses the concept that as few as four RTOs should administer the Nation's transmission system,

even though no current proposal has that scope. These orders clearly suggest a more prescriptive attitude toward RTO formation and less willingness to defer to stakeholders and RTO proponents with regard to the structure, organization, or geographic scope of RTOs. Moreover, the Commission's orders signal that the flexibility associated with Order No. 2000 is diminishing, that rate incentives may meet with a cooler reception, at least until an acceptable RTO is formed, and that existing RTOs must get independent boards in place more quickly. The Orders also make clear that applicants might receive extra time to organize these large RTOs, past the December 15, 2001 deadline for operation set forth in Order No. 2000.

I think the Florida Public Service Commission staff hit the nail on the head in its September 2000 Policy Analysis Briefing Paper: The Viability of an RTO in Florida. At page 16, it states:

> While Order No. 2000 stated that RTO development is voluntary in nature, in reality FERC has made it clear that it expects all transmission-owning utilities to comply. Although the FERC lacks the direct legal authority to mandate participation in RTOs, it has stated its intent to use its regulatory authority in other areas ...to force compliance with Order No. 2000.

I agree with the Florida staff's view of FERC's intentions, even if I might disagree with its analysis of FERC's authority in this case. In any event, the consequences of refusal to comply with the Commission's policy and a reluctance

to participate in an RTO may go well beyond loss of the promised incentive rate treatments or reduction of the flexibility and deference that Order No. 2000 touted as part of RTO formation. Strategic transactions involving a utility that is not part of an RTO process will almost certainly face an uphill battle for approval at FERC, even if they do not involve RTO matters .

It is a useful reminder that Order No. 2000 states that, notwithstanding the importance of voluntary RTO formation, FERC does not preclude "the exercise of any of our authorities under the FPA [Federal Power Act] to order remedies to address undue discrimination or the exercise of market power, including the remedy of requiring participation in an RTO, where supported by the record." (Order No. 2000 at 31,028). Thus, FERC explicitly left open the possibility that it might order a utility to join an RTO if the utility declined to file its own proposal. Moreover, FERC indicated that it might resort to penalties on non-compliant utilities, including denial of Section 203 approval for dispositions of assets or revocation of market-based rate authority.

Q. Has FERC ever established such a voluntary program that ultimately became mandatory in effect or in law?

A. Yes. Order No. 436, which I described briefly above was described as a "voluntary" program by FERC. In that Order, FERC made clear that if a pipeline wanted to take advantage of a blanket certification for transportation service and all the accompanying benefits like rate flexibility, it would have to commit to provide transportation on a non-discriminatory basis under the new, voluntary rules. The Court of Appeals for the District of Columbia Circuit noted that this

"voluntary" program was structured so that any company not receiving the blanket certificate would soon be uncompetitive and a candidate for bankruptcy. (*Associated Gas* at 1024). By the end of the decade, nearly all pipelines had filed for a blanket certificate.

Q. In advancing RTOs or similar policies, does the Commission take into account the different characteristics of individual utilities' transmission systems, the geographic limits on transmission operations, or the nature and diversity generation in various states and regions?

A. Yes. One of the goals of Order No. 2000 was to recognize and, if possible, to accommodate the differences among states, markets, and transmission systems. Both in its NOPR and in the Final Rule, the Commission rejected a "cookie cutter" approach to RTO formation. It stated that RTO boundaries should:

> [F]acilitate essential RTO functions and goals, recognize trading patterns, mitigate the exercise of market power, ... not necessarily split existing control areas or existing regional transmission entities, encompass contiguous geographic areas and highly interconnected portions of the grid and take into account useful existing boundaries (such as NERC regions) and international boundaries.

(Order No. 2000 at 31,076-31,077). Recognizing that these factors would vary throughout the country, the Commission declined to adopt a one-size-fits-all approach regarding the necessary size and configuration of RTOs.

Having said that, I think the Commission believed, and still believes, that electric systems tend to be both highly integrated and operationally similar over several states, including some states that have unusual characteristics. I believe FERC has heard all of the conceivable arguments about the uniqueness of individual companies and regions and recognizes that all regulators, particularly at the federal level, must certainly take into account those differences in setting policy. However, FERC will also tend to favor relatively more uniform development of RTO characteristics and functions for all bulk power markets, at least across as many service territories as comprise a "natural market," a prominent concept in the July Orders. Florida arguably constitutes such a market.

Q. In your estimation, is FERC predisposed against single-state RTOs?

A. FERC has made it clear that it favors RTOs encompassing large regions and is considering a Southeast RTO that eventually could include Florida. In its July Orders, it has reemphasized that bigger is better when it comes to RTOs. Nevertheless, FERC has already granted provisional approval to the GridFlorida RTO, which lies entirely within the state. Moreover, the July Orders encourage but do not require GridFlorida's participation in the Southeastern RTO mediation process. Florida's geographic circumstances and the degree of its interconnectedness with bulk power markets elsewhere in the Southeast will be important factors in any FERC decision to continue to support a single state RTO for Florida. However, I also believe that FERC's continued receptivity to that final outcome will depend in part upon the prudency determination in this case

and the Florida Commission's interest and support in moving forward with RTO formation.

Q. In light of FERC's desire to see RTOs administer all transmission assets, what benefits accrue to states and utilities that actively implement RTOs before they might otherwise be compelled to do so?

A. In my view, FERC's policy is that the increased competition fostered by establishing RTOs will serve consumer interests everywhere, if these new institutions are properly implemented consistent with FERC guidelines. I have always viewed RTOs as a necessary basis for increasing wholesale electricity competition as well as an important contributor to efficient system operations. I think that the FERC still shares this view. The Commission is therefore likely to view any unnecessary delays in RTO formation as actually denying consumers the associated net benefits. It is difficult to predict whether FERC's impatience in such circumstances might incline it to be more prescriptive and less deferential to states and stakeholders, but that is a possibility.

As I stated before, delays in Order No. 2000 implementation may also create regulatory obstacles for utilities seeking FERC approvals. Moreover, delay may cost those companies the incentive ratemaking treatment the Commission promised transmission owners in Order No. 2000, which were designed to encourage new investment in the system and higher levels of efficiency and productivity.

Q. How have public utilities responded to Order No. 2000?

A. Based on a review of FERC filings, it appears that the only FERC-jurisdictional public utilities that have indicated that they do not intend to join an RTO are certain electric cooperatives and the Northern Maine Independent System Administrator, which administers the transmission systems of two utilities in northern Maine. The overwhelming majority of the investor-owned utilities have filed to join an RTO, however. As of this date, at least 97 initial RTO filings have been made with FERC. This is in addition to some early RTO filings made prior to the issuance of Order No. 2000. This response by transmission owning utilities is not surprising, given FERC's clearly articulated policy and the Order No. 2000 framework, which prescribed dates for an initial filing with FERC and for final compliance with that Order.

IV. BENEFITS OF RTO PARTICIPATION

Q. What benefits did FERC see resulting from RTO participation?

A. As discussed above, one of the primary goals of Order No. 2000 was to put the control over transmission facilities into an entity that is independent of all market participants. FERC believed that this would eliminate even the perception that transmission is being operated in a discriminatory fashion. RTOs will support real wholesale competition by expanding the market and reducing barriers to economical transactions. That means more supply options and from that will come lower rates and sustained reliability at the bulk power level. Those benefits derive from a reduction of pancaked rates and limitations on the ability of

generators to exercise market power. In addition, RTOs mean more efficient planning on a regional basis, the ability to improve regional reliability through regional operations, improved emergency response, and more efficient treatment of loop flows.

Q. What are the benefits of an RTO regarding transmission planning?

A. FERC believes that a single entity coordinating transmission planning and expansion within a region will result in the least cost outcome for such planning and expansion. The rationale behind this position is that in a situation where there are multiple transmission systems, one system may make transmission investments without regard for the planned development or constraints in other systems. (Order No. 2000 at 31,164). A single entity charged with transmission in a Florida RTO, for example, would view transmission constraints in a much larger context and with more complete information. Whereas a single utility might determine that additional generation was needed to provide energy to a high-demand area, an RTO may look at the same situation and conclude that it is more cost-effective to build transmission from one locale with a surplus of generation to the area experiencing a deficit.

Q. How does FERC perceive the benefits of RTOs regarding grid reliability?

A. The reliability of the transmission grid is enhanced by RTOs in several ways. Short-term reliability will be enhanced by a centralization of several transmission functions. RTOs will have the exclusive authority for receiving, confirming, and

implementing all interchange schedules. RTOs will have the right to order redispatch of any generator if it is necessary for reliability purposes. In addition, RTOs will have the authority to approve or disapprove scheduled outages of all of the transmission that it operates. An RTO will assess whether NERC regional council standards affect reliability and be responsible for informing FERC. (Order No. 2000 at 31,092, 31,104-31,106).

Short-term reliability will also benefit from an RTO's ability to move transmission anywhere on its system with greater ease and at a lower transaction cost than if several entities were involved. As I explained above, if one area of the state is experiencing an energy deficit, an RTO will in the short-term, more efficiently provide that load with energy. In the long-term, such loads will benefit from the greater scope of the RTO's transmission planning.

Q. How does FERC perceive the benefits of RTOs regarding emergency response?

A. An RTO is better suited to responding to emergency outages due to the fact that it has responsibility for both short-term reliability and long-term planning. In addition, the RTO's role as provider of last resort of ancillary services, its role in designing programs to manage and eliminate congestion, and the scope of the RTO allow it to more effectively anticipate potential outages. For example, an RTO would foster a much easier and cost-effective transfer of power across the state from an area with surplus generation to an area experiencing an unexpected

outage. The RTO's role as transmission planner for an entire region and the RTO's role in assuring short-term reliability and ancillary services, as described above, will make it more likely that path constraints are addressed and that adequate reserves are scheduled and on-line, ensuring that transmission capacity is available to ensure that energy can get to areas that require it unexpectedly.

Q. What are the benefits of RTOs with regard to efficient treatment of loop flows?

A. While Florida's loop flow problems may not be as serious today as in other regions, control by a single entity of transmission over multiple service territories, for example the entire Florida transmission system, can eliminate the adverse effects of parallel path flows. (Order No. 2000 at 31,130). If all power flows within the system are centrally managed and controlled under a single set of protocols and there were no separate paths over which power could flow, loop flow problems created even by transactions outside the controlled system would be minimized or eliminated. As a general matter, central control and management power flows on the grid results in more reliable operations.

Q. The benefits that you listed relate in part to creating competition among suppliers in the wholesale market. Can such benefits be obtained in Florida, given the effect of the Florida Electric Power Plant Siting Act on merchant plants?

A. Although I am not an expert on Florida law, I understand that the Siting Act does not absolutely bar the construction of new non-utility generation plants in Florida. The Siting Act provides for a determination of need for the construction of generating plants with a steam cycle greater than 75 MW in capacity. Under the Siting Act, such plants must be fully committed to Florida consumers who purchase power at retail rates. However, as Mr. Naeve testifies, plants with a steam cycle below 75 MW in size and any size plant that does not have a steam cycle, such as a simple cycle peaking plant, are exempt from the requirement to obtain a need certificate under the Siting Act. Such plants, therefore, do not need to be owned by or dedicated to a load serving entity.

Even if it were correct that there may be fewer merchant plants in Florida due to the Siting Act, the creation of an RTO still would provide significant benefits in improving the efficiency of Florida wholesale markets. There are a large number of bulk power transactions in Florida today, involving not only the Joint Applicants but also cooperatives and municipal utilities. Currently in Florida, there are multiple transmission systems, operating within several NERC control areas. Administration of Florida's current patch-work transmission system by a single RTO will eliminate pancaked rates, and improve efficiency in congestion management and capacity allocation. More efficient transmission access will permit more efficient bulk power transactions, for both existing in-state generation and out-of-state producers, which should result in lower power costs for consumers. Administration of these systems by one independent entity will

also result in many of the RTO benefits I described above, which do not depend on the unlimited construction of merchant generation in the State of Florida to yield large benefits for consumers. For example, if the Florida grid were administered by an RTO, no longer would different companies be engaged in developing their own expansion plans for only discrete parts of the grid. Rather, an RTO will be able to look at the entire grid, and in cooperation with state officials, develop both short and long-term transmission planning solutions that result in the most efficient transmission and generation expansions. In turn, developers of new generation will be able to anticipate where in the state it would make the most sense to locate new generation projects. These RTO-related benefits are, in my view, entirely consistent with the supply adequacy, service reliability, and environmental mitigation purposes of the Siting Act, as described by the Florida Supreme Court. *Nassau Power Corp. v. Deason*, 641 S.2d 396, 398-399 (Fla. 1994).

Although there appears to be a significant amount of new generation planned or under construction in Florida, both by independent power producers and public utilities, the development of an RTO in Florida can also provide Florida consumers with greater access to out-of-state power sources. If a relatively large amount of economical surplus generation materializes elsewhere within the reach of the Florida system, RTOs can facilitate access to that competitive source of generation for Florida consumers.

Q. Are there any other benefits that you see from an RTO?

A. As I stated above, FERC has indicated that it will be much more receptive to special rate and service innovation from RTOs than it has been to deviations from the Order No. 888 *pro forma* tariff by individual transmission owners. I see no reason why innovation should be any less important for Florida than for other states and regions. It is difficult to foresee exactly what innovations will arise in the future, but the ability to seize the opportunities created by new technologies, rapidly changing economic realities and demographic shifts, or new industry requirements is an important benefit.

Q. Have you, or has FERC, calculated the approximate dollar benefit to Florida from an RTO?

A. Such benefits are extremely hard to predict and they ultimately depend on many variables, including how well the wholesale market is finally administered. The net benefits may also reach different levels in different states and regions. In addition, costs may exceed the benefits in the early months or years in some cases. So, there are many uncertainties and the FERC has acknowledged them. Overall, however, it envisioned in both Order Nos. 888 and 2000 a major efficiency gain of several billion dollars annually from competition, transmission access, and unbundling, according to Order Nos. 888 and 2000. RTOs are a sound way of achieving the anticipated end results, in my view.

Q. Do the benefits that you have identified outweigh the costs of RTO formation?

A. Although there is no denying that there can be significant costs to RTO formation in the short run, I believe that the benefits of RTOs should clearly outweigh these costs in the long run. I do not deny that these benefits can be very difficult to quantify. For example, it is difficult to predict what level of environmental benefit and what downward pressure on prices may result from better access to out-of-state generation supplies. Likewise, it is difficult to quantify the benefits of regional congestion management and elimination of rate pancaking. At the same time, the wholesale market that depends on an RTO should be more robust and better able to serve the power needs of the growing number of Floridians in the future. The success of any market reform, including RTOs, will require commitment and sustained effort, whether there is one Southeastern RTO of which Florida is a part or whether a Florida only RTO becomes operational. I think it is fair to say that FERC believes that efficiency benefits and the benefits of competitive supply options will be best realized by Floridians under an RTO.

To recap, management of the transmission system by a single large RTO will reduce system costs by allowing the RTO to plan the most efficient transmission expansion and, will encourage efficient siting of generation throughout the State of Florida and the Southeastern United States. In addition, an RTO will focus on reliability by developing region-wide solutions. Greater transparency in the wholesale market will create confidence in the electric generation sector,

encourage sales to, and participation in, the Florida market. In sum, Florida can expect ever-greater demand for energy over the next few years. If sufficient economical capacity can be encouraged to develop both in and outside the State of Florida, Florida consumers stand to benefit from lower rates and greater reliability. RTOs are a major component of making this happen.

Q. California's experience with high prices, blackouts, and state bailouts are an indication of what can happen under a deregulated wholesale power market administered by a FERC-approved grid administrator. Why should Florida open itself to the possibility of such problems?

A. Of course, Florida should not open itself to the kinds of problems experienced in California since May 2000. It should not select a power market design that relies exclusively on spot transactions. It should not discourage risk management by prohibiting bilateral transactions and long-term contracts. Florida needs to be more vigilant than California when it comes to identifying and meeting the challenges of demand growth. It should not trap its utilities between a retail rate freeze, including the obligation to serve, and the price movements in the wholesale markets. It should not mandate or otherwise sanction generation asset divestiture without ensuring that utilities have access to capacity adequate to serve loads. Florida does not seem inclined to implement stakeholder governance of the kind that proved a serious problem for the California ISO. Of course, California does not yet participate in a FERC-approved RTO and Florida may therefore achieve Order No. 2000 compliance before California.

I believe events in California are distinguishable from what we can expect in Florida and I am sure that the lessons of California are being learned and applied elsewhere. I do not think that California's problems were caused by measures promoted by Order No. 2000.

One final point. Whenever I am asked about what will help make for an effective transition to a restructured electric power industry, I always mention the importance of coordinating state and federal interests, a task that has been especially difficult with respect to California. In my 1996 concurring opinion on Order No. 888, I said something that is still germane: "Perhaps no single issue will influence the success or failure of restructuring as will the capacity of the FERC and state regulators to reach meaningful accommodations as the electric utility industry becomes increasingly subject to market forces."

V. SUMMARY AND CONCLUSION

Q. Would you please summarize your conclusions?

A. Yes. There are two main points that I would like for the Florida Commission to take from my testimony.

First, Order No. 2000 established a federal policy that all transmission owners join an RTO. Although Order No. 2000 stops short of mandating that every electric utility join an RTO, all transmission-owing utilities face the substantial

likelihood that, if they refuse to affirmatively propose an RTO, they ultimately would be forced to do so by FERC, either directly or through penalties and possibly without the flexibility Order No. 2000 allows.

Second, there are important benefits from RTO participation that should apply to the Florida region as a result of the Joint Applicants' decision to propose GridFlorida. While these benefits are difficult to quantify and will depend in part on how well any RTO is structured and operated. The Commission views its experiences in regulating wholesale markets as highly supportive of RTOs. RTOs, it believes, will provide substantial advances and benefits over the current balkanized transmission system.

Q. Does that conclude your testimony?

A. Yes it does.