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May 8, 2002

VIA HAND DELIVERY

Blanca S. Bayo
Director, Division of Commission Clerk and
Administrative Services
Florida Public Service Commission
4075 Esplanade Way
Room 110 Betty Easley Conference Center
Tallahassee, Florida 32399

Re: Review of GridFlorida Regional Transmission Organization (RTO) Proposal.
Docket No.: 020233-EI

Dear Ms. Bayo :

Please find enclosed for filing in the above-referenced docket the original and 15 copies of the following documents:

1. Petition to Intervene of the Seminole Member Systems 04994 MAY-8 02
2. Seminole Member Systems' Request for Authorization of a Qualified Representative 04995 MAY-8 02
3. Comments of Seminole Member Cooperatives Regarding GridFlorida Compliance Filing 04996 MAY-8 02
4. Seminole Electric Cooperative, Inc.'s Request for Authorization of a Qualified Representative 04997 MAY-8 02
5. Comments of Seminole Electric Cooperative, Inc. Regarding GridFlorida Compliance Filing. 04998 MAY-8 02

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Please stamp the duplicate copy of this letter to acknowledge receipt of the attached.

Thank you for your assistance.

Sincerely yours,

Thomas J. Maida

TJMA/lam
Enclosures
cc: All Parties of Record in Docket 020233-EI

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of GridFlorida Regional Transmission Organization (RTO) Proposal	)))	Docket No. 020233-EI

COMMENTS OF SEMINOLE ELECTRIC COOPERATIVE, INC.
REGARDING GRIDFLORIDA COMPLIANCE FILING

Pursuant to the "Order Establishing Procedure" issued by the Florida Public Service Commission ("FPSC" or "Commission") in this docket on April 3, 2002, as amended by the Commission's April 22, 2002 "Order Granting Joint Motion for Extension of Time To File Comments and Revising Order Establishing Procedure," Seminole Electric Cooperative, Inc. ("Seminole"), an intervenor in the prudence proceeding that culminated in FPSC Order No. PSC-01-2489-FOF-EI issued December 20, 2001 ("December 20 Order"), submits these comments for consideration by the Commission regarding the March 20, 2002 compliance filing by the GridFlorida Applicants.

I. Description of Seminole

Seminole is a non-profit electric generation and transmission cooperative organized under the Rural Electric Cooperative Law of Florida (Chapter 425, Florida Statutes). Seminole's corporate purpose is to supply wholesale electric power and energy at the lowest feasible cost to its ten member non-profit, rural distribution cooperatives. Seminole's member systems provide retail electric service to over 700,000 consumers in 45 Florida counties. In 2001, its member system retail sales were in excess of 12 billion kWh. The map appended as Attachment I reflects Seminole's load distribution in Florida.

Five of Seminole's member systems have load located in the transmission area of Florida Power & Light Company ("FPL"), and Seminole purchases network transmission service from FPL under its open access tariff in order to serve these member systems from Seminole generation resources. Seminole's winter peak load in the FPL area in 2001 was 1,042 MW. This is approximately 30% of Seminole's member load.

Nine of Seminole's member systems have load located in the transmission area of Florida Power Corporation ("FPC"), and Seminole purchases a form of network transmission service, as well as partial requirements service, from FPC under a 1983 bilateral agreement. Seminole also has a 1995 power purchase agreement with FPC. Seminole's winter peak load in the FPC area in 2001 was 2,069 MW. This is approximately 60% of Seminole's member load.

Seminole also operates its own control area in which it serves some of the load of one of its member systems. Seminole's winter peak load in its own area in 2001 was 336 MW. This is approximately 10% of Seminole's member load.

Seminole's owned generation and purchased power resources to serve Seminole's 2002 winter peak load are located throughout the State and equate to approximately 1,917 MW and 2,229 MW, respectively. In addition, Seminole has a purchase power agreement in place with an independent power producer for peaking power that will be coming on line later this year. Seminole also has interchange agreements with a host of utilities in the state.

Seminole owns approximately 270 miles of 230 kV transmission facilities that are integrated into the state-wide bulk transmission grid in north-central and southwest Florida. Seminole also owns approximately 140 miles of miles of 69 kV transmission.

II. Seminole's Interest in This Proceeding

Seminole is eager to see a properly constructed RTO in Florida, one that will, among other things, both eliminate "pancaking," which results in inefficient generation decisions, and allow the bulk transmission system to be operated and planned by an independent organization that does not have a vested interest in wholesale generation markets in the region. To this end, Seminole has been an active participant in the collaborative process which culminated in several filings by the GridFlorida Applicants (namely, FPL, FPC, and Tampa Electric Company ("Tampa")) in Federal Energy Regulatory Commission ("FERC") Docket No. RT01-67, and Seminole has several pleadings pending before the FERC in that docket.1/ Seminole was also an active participant in the mediation proceedings in FERC Docket No. RT01-100. Further Seminole participated as an intervenor in the "prudence" proceeding before this Commission in FPSC Docket Nos. 000824-EI *et al.*, which culminated in the December 20 Order and pursuant to which the GridFlorida Applicants have made the March 20, 2002 compliance filing which is the subject of these comments.

The importance to Seminole associated with the formation of a truly independent and properly functioning RTO in Florida cannot be overstated. First, as is evident from the facts set forth in Part I, above, Seminole's load and resources are spread throughout the State of Florida, so that the ability to economically dispatch its power supply resources without incurring redundant transmission charges and unknown (but potentially significant) congestion charges is

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1/ *See* Seminole April 27, 2001 Application for Rehearing of FERC's March 28, 2001 "Order Provisionally Granting RTO Status"; Seminole July 2, 2001 Protest of GridFlorida Applicants' May 29, 2001 Compliance Filing.

fundamental. Second, the possibility of incurring substantially higher costs is greatly enhanced if Seminole will have to depend on energy markets for imbalance and other services because the market power situation in Florida (discussed at length in the December 20 Order) renders the notion of competitive outcomes an impossibility for the foreseeable future. Thus, the potential for Seminole to be charged monopoly rents for these services is great. Finally, Seminole has significant transmission that is an integral part of the Florida grid, and yet it pays for that transmission in addition to the transmission charges that it incurs from the other transmission providers in the State to serve the same member load, which puts it at a competitive disadvantage *vis-a-vis* the utilities in the state that own all of the transmission facilities within the control areas in which their respective native loads are located.

In brief, the subject proceeding and the related proceedings at the FERC are of great significance to Seminole and its member systems.

III. Overview

In the prudence proceeding that gave rise to the subject March 20, 2002 compliance filing, the GridFlorida Applicants filed with this Commission the GridFlorida documents that had been filed with the Federal Energy Regulatory Commission ("FERC") on May 29, 2001, as a compliance filing in response to the FERC's March 28, 2001 "Order Provisionally Granting RTO Status," 94 FERC ¶ 61,363 (hereinafter "FERC March 28 Order"), in FERC Docket No. RT01-67-001. The FERC has not yet acted on that compliance filing.

As the result of the proceedings before this Commission, the FPSC issued the December 20, 2001 "Order Finding Proactive Formation of GridFlorida Prudent and Requiring the Filing of a Modified GridFlorida Proposal." The December 20 Order, in addition to making a general

finding that the Applicants were prudent in proactively forming GridFlorida, ordered the Applicants to make certain modifications to the GridFlorida proposal "consistent with the terms of this Order" and to file same within 90 days, unless good cause for an extension was shown. (Dec. 20 Order, p. 4.)

The Applicants in their March 20 compliance filing state as follows (in paragraph 8, pp. 4-5):

> The GridFlorida proposal has been amended in this filing in four basic ways. First, GridFlorida has been changed from a for-profit to a non-profit ISO. Second, subject to one exception, at a transmission customer's option that transmission customer's bundled retail load will be exempt from zonal transmission charges under the GridFlorida transmission tariff for a five-year transition period. The GridFlorida Companies will choose to exempt bundled retail load. Under this proposal the Commission will have authority during the transition period to set each of the GridFlorida Company's revenue requirements for existing transmission facilities to support retail transmission service. Third, a get what you bid approach for balancing energy and redispatch has been adopted. Fourth, the GridFlorida planning process has been revised to be more compatible with an ISO structure.

Seminole believes that as to the first three items, those were indeed anticipated by the December 20 Order; however, the changes to the planning protocol (as well as other proposed changes omitted from the above summary and discussed below) not only were not ordered by the FPSC in the December 20 Order but in addition are not necessitated by the change to a not-for-profit ISO (or any other finding of the December 20 Order) and thus should be rejected.

IV. Stakeholder Process

In the Executive Summary, the Applicants aver that the documents filed as part of the March 20, 2002 compliance filing were "established as part of an on-going stakeholder process, which was carried-out after the Order through the GridFlorida Advisory Committee in a series of

meetings." (Executive Summary, p. 1.) Lest the FPSC have a mis-impression that the documents filed with it are the result of a consensus process, Seminole feels obliged to describe the "stakeholder process" referred to by the Applicants.

At an early (January 29, 2002) Advisory Committee meeting, the Applicants indicated the schedule they would follow in distributing documents and receiving comments from the stakeholders. In response to a request that the schedule be extended so that stakeholders would have additional time to review and comment on the draft documents, the Applicants advised that their primary goal was to meet the March 20 filing date set by the FPSC in its December 20 Order, and thus no leeway in the schedule would be entertained. Certain stakeholders were of the view that the Applicants' main goal was not meeting the March 20 FPSC due date, which the FPSC made clear in its December 20 Order was not set in stone, but rather to limit stakeholder input to the bare minimum, keeping in mind that the first documents to be shared with the stakeholders were distributed on February 13, 2002, with other key documents being seen for the first time on March 1, 2002, some 70 days after the December 20 Order and only 19 days before the March 20 filing date.

Compounding the time crunch engendered by the Applicants' force-fed schedule was the fact that the Applicants failed to meet their own deadlines, which failure was particularly detrimental to the stakeholder process as the documents that were late in being distributed were the documents containing the most dramatic and controversial changes from the documents originally filed with the FERC and the FPSC. Because of this fact, the stakeholders, this time through a request of the Advisory Committee, which the Applicants declined to join, requested more time from the FPSC for the Applicants to make their compliance filing so that the

collaborative process could continue and issues be limited. The FPSC denied this request on March 13, 2002, on the ground that it was not a formal motion of parties to the proceeding.

In brief, the stakeholder process, which had the potential to substantially narrow the issues before the FPSC in this proceeding, was only a limited success. Had the Applicants shared documents with the stakeholders in a more timely fashion and/or joined in the request for more time to make the compliance filing, the issues being raised by Seminole and other parties could have been, in Seminole's view, substantially circumscribed and the task before the FPSC considerably lightened.

V. Jurisdictional Issues

As the FPSC surely appreciates, this proceeding presents thorny jurisdictional issues. The documents that are under review are, with some notable exceptions, carbon copies of the documents filed with (and for the most part approved by) the FERC in Docket No. RT01-67, to which the FPSC is a party. In addition, as the FPSC is also aware, the FERC is conducting a rulemaking proceeding (Docket No. RM01-12) on some of the very market design issues raised in the Applicants' filing herein.2/ The FPSC is likewise a party to this rulemaking proceeding.

Seminole filed comments with the FERC in Docket No. RM01-12 on April 8, 2002, noting these same facts to the FERC and observing that:

> It appears clear that absent coordination between the FERC and the FPSC, there is likely to be a train wreck, with this Commission prescribing different market design (and possibly other) rules than its counterpart at the state level. Obviously this is not in anybody's best interests, least of all those transmission

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2/ On March 15, 2002, the FERC released a Working Paper in that docket setting forth in very general terms the market design that is currently favored by the FERC staff; there are notable differences between that Working Paper and the Applicants' filing herein.

> customers like Seminole that continue to pay pancaked rates and to incur substantial regulatory costs in an RTO process that seems endless. Seminole urges the FERC to work with the FPSC to ensure that the end result is an RTO that has market design features that will work in Florida. As to those areas in which the GridFlorida applicants are seeking to use the FPSC as a forum to overturn aspects of its FERC filing that have already been approved by this Commission (*e.g.*, the Planning Protocol), the Commission needs to be careful not to permit that to happen. [3/]

Seminole makes the same plea for a coordinated effort to this Commission. Seminole believes that if the FERC and the FPSC strive to work together to produce a functional RTO in Florida, the result will be in the public interest. It is important that neither the Applicants nor any other party to these proceedings be permitted to play one regulatory agency off against another for that party's own gains.

An important goal in this proceeding should be to avoid jurisdictional land-mines. For example, there are many issues pending before the FERC regarding the documents that have been filed with the FPSC in this proceeding.4/ Most of these issues are clearly ripe for resolution by the FERC, and hence Seminole is not raising those issues in this forum. Seminole will note some of these issues specifically since they involve changes made to the GridFlorida filing ostensibly in response to the December 20 Order. A key task for the FPSC is to determine which of the changes involve issues that are properly before it (*i.e.*, are in fact changes made in compliance with mandates of this Commission in the December 20 Order) and which should be deferred to the FERC.

3/ "Comments of Seminole Electric Cooperative, Inc." in Electricity Market Design and Structure, FERC Docket No. RM01-12-000, p. 6.

4/ The issues raised by Seminole that are currently pending are set forth in the pleadings listed in footnote 1, above.

VI. Planning Protocol

The Planning Protocol filed with the FERC in Docket No. RT01-67 and in the FPSC prudence proceeding was the outcome of an extensive collaborative process. Its key accomplishment was to provide for a regional planning process guided by GridFlorida. It is noteworthy that during the collaborative process that culminated in the Planning Protocol filed at the FERC, there were large investor-owned companies on both sides of the negotiating table: FPL and Tampa, as potential divesting companies, wanted a planning process that would be truly regional in nature and would eliminate the parochialism that attends a planning process that leaves too much power in the hands of individual transmission owners; FPC, which intended to retain ownership of its transmission facilities, had different goals. The result was a balanced product that was found by the FERC in its March 28 Order to be "substantially in compliance with the requirements of Order No. 2000, ..." 94 FERC ¶ 61,363 at p. 62,366.5/

Under the disingenuous guise of revising the Planning Protocol "to be more compatible with an ISO structure" (Compliance Filing, p. 5), the Applicants (all of whom will remain transmission owners under the new RTO structure) have undermined the balance that is found in the FERC-approved Planning Protocol. They have accomplished that result by giving to themselves power that was formerly in the RTO. One has only to look at the redline version of Attachment N to understand that the Applicants have rewritten the Planning Protocol from scratch, rather than (as elsewhere in their compliance filing) making conforming edits to reflect

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5/ The GridFlorida Applicants noted in a positive vein in their December 15, 2000 Supplemental Compliance Filing at the FERC that under the Planning Protocol, "GridFlorida is responsible for performing the planning function for all participants." (Supplemental Compliance Filing, p. 42.)

the fact that transmission facilities would no longer be divested.

Several examples should suffice to make the point regarding the drastic philosophical change in the revised Planning Protocol:

* Section V, second paragraph, provides that upon receipt of an executed study agreement, "the Transmission Provider shall form, chair, and direct the initiatives of an Ad Hoc Working Group that includes representatives of all affected POs. The Ad Hoc Working Group shall develop expansion alternatives, perform the described studies, and develop the resulting options and costs, which shall be provided to the Transmission Customer by the Transmission Provider." (Redline OATT, Sheet Nos. 215-16.) There is no basis for these requirements; if the Transmission Provider needs assistance from the POs, it may seek same.

* Section V, third paragraph, requires that the Transmission Provider "shall apply ratings that have been provided by the respective POs," and if the Transmission Provider believes that different ratings should apply, the matter may go to dispute resolution, pending which "the Transmission Provider shall use the ratings provided by the PO...." (Redline OATT Sheet 216.) This is but one of several instances of the invocation of the "PO always wins" rule in the event of disputes, which undermines the notion of independent, region-wide planning by an impartial RTO.

* Section VII, next to last paragraph, gives the PO a right of first refusal as to all construction, providing as follows: "The construction of any major new transmission facilities shall be competitively bid. The PO shall have the right to

construct the required facilities by matching the lowest bid for construction of the required facilities." (Redline Sheet 239.) Such a right of first refusal not only unduly favors the PO but in addition will serve to undermine the bidding process, since bidders will know that the POs have only to match the lowest bid to win.

* Section VIII, entitled "Planning Responsibilities of POs," is offensive in its entirety. This sort of mandatory language turns the original concept of independent planning by an RTO on its head. GridFlorida should be encouraged to call upon the POs for assistance where needed, but the POs' attempt in this re-write of the Planning Protocol to insert themselves into the process is destructive and must be disallowed.

The Applicants attempt to rationalize the dismemberment of the Planning Protocol by reference to the change from a for-profit transco to a not-for-profit ISO (*see, e.g.*, Executive Summary, p. 7).6/ The truth of the matter is that the change from a transco to an ISO has nothing to do with the contents of the Planning Protocol. When asked during the stakeholder process to justify the change, the Applicants' only response was that a not-for-profit ISO might have fewer employees to dedicate to planning and that an ISO, since it does not own transmission, might not have the same stake in proper transmission planning. But as was pointed out to them, the

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6/ The Applicants also cite to the fact that they aped a planning protocol of another ISO (the Midwest Independent Transmission System Operator) that has been approved by the FERC. Such an observation is irrelevant to the fact that the Applicants are here trying to override a planning protocol that resulted from an extensive collaborative process and itself was substantially approved by the FERC. In addition, the MISO planning protocol, which pre-dated the FERC-approved Planning Protocol, is for an area substantially larger than GridFlorida (which, some might argue, justifies greater decentralization).

contention regarding number of employees is refuted by reference to the sizable planning staffs of other ISOs, such as PJM, and the contention regarding an ISO's stake in the process is nonsensical on its face since, among other things, one of the benefits of an ISO is that it does not have a vested interest in favoring its transmission facilities (versus those of the POs).

In brief, there is no justification for the dramatic change in emphasis in the Planning Protocol. What has happened, as noted at the outset, is that FPL switched sides, from a divesting company to a transmission-owning company, and it decided that it wanted a more significant role in the planning process. It is to prevent such bullying by large IOUs that RTOs are needed in the first place. It was certainly clear during the stakeholder process that every stakeholder to express a view on the subject strongly opposed the Applicants' effort to re-write the Planning Protocol in the fashion reflected in their March 20 filing herein.

Seminole submits that this is not the proper forum for deciding these Planning Protocol issues. The Planning Protocol, which was the product of an extensive collaborative process and substantially approved by the FERC, is still pending before the FERC as to some outstanding issues. As noted above, the Applicants have attempted to justify the radical changes found in the rewritten Planning Protocol as required by the conversion from a for-profit transco to a not-for-profit ISO. Seminole submits that such a rationale is without basis, but that the proper agency to decide that matter is the FERC, which has required in Order No. 2000 that such a protocol be part of each transmission provider's open access transmission tariff.7/ To the extent that the FPSC likes or dislikes the new Planning Protocol, it should be encouraged to file comments to

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7/ *See* Order 2000, *mimeo.* at 466-92.

that effect at the FERC.

It is important to keep in mind that this proceeding is supposed to be dealing only with a compliance filing consistent with the mandates of the FPSC's December 20 Order.8/ In fact the reason given by the FPSC in its April 3, 2002 "Order Establishing Procedure" for not setting this matter for hearing was "that the nature of this filing is a compliance filing in response to the GridFlorida Order, ..." (Page 1.) The changes to the Planning Protocol, though camouflaged in rhetoric regarding the adoption of an ISO, are only indirectly the result of the ISO form of governance in that it reflects the new power structure in Florida now that FPL (and Tampa) are not divesting their transmission facilities. That is not a reason for change; rather quite the opposite is true since a key reason for having a Planning Protocol is to ensure that planning is conducted in an unbiased manner by an independent body for the betterment of all users of the grid as contrasted to the current system, which provides competitive advantages to the transmission-dominant utilities.

If the FPSC determines that, contrary to Seminole's view, it will act on the merits of the filed Planning Protocol, Seminole respectfully requests that it reject the proposed changes on the basis of being unjustified and contrary to the letter and spirit of Order No. 2000.

VII. Congestion Management, Balancing Service, Operating Reserves and Regulation

Set forth in Attachment P to the OATT is the proposal for congestion management, balancing service, operating reserves, and regulation. For the most part, this is a carbon copy of what was filed with the FERC in Docket No. RT01-67 and with this Commission in the prudence

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8/ December 20 Order, p. 4.

proceeding. Seminole's objections to Attachment P have been filed with the FERC and are pending decision in that forum.9/ Seminole believes that the FERC will deal with those issues in due course, and that there is no need to burden this Commission with those same arguments.

In its December 20 Order, the FPSC correctly noted the serious market power issues in Florida (*e.g.*, December 20 Order, pp. 22-24), and as a result ordered that the Applicants use Alternative B ("get what you bid approach") for the balancing energy/congestion pricing market. (Dec. 20 Order, p. 24.) Seminole agrees with the Commission's logic and conclusion, though Seminole finds the tariff language used to implement Alternative B (Redline OATT Sheets 313-14) to be less than a model of clarity in terms of achieving the goals set forth by the FPSC.

In its July 2, 2001 Protest filed at the FERC in Docket No. RT01-67, Seminole pointed out that Alternative B was superior to Alternative A (Protest, p. 58), but that Alternative B contained flaws that needed to be corrected (Protest, pp. 58-62). Those flaws remain. Seminole does not know whether the FPSC intends to defer to the FERC as to the specifics of Alternative B or whether the FPSC prefers to address those flaws in this proceeding. If the latter is the case, Seminole is appending hereto as Attachment II (and incorporates by reference) excerpts from its July 2 Protest (and appended testimony) dealing with the specific infirmities in Alternative B. Seminole respectfully requests that, if the FPSC determines to address the merits of Alternative B in this proceeding, it order changes thereto consistent with the points made in Attachment I hereto.

The Applicants also do not address the standard for judging the exercise of market power.

9/ *See* April 27, 2001 Application for Rehearing and July 2, 2001 Protest of Seminole Electric Cooperative, Inc.

This is also a topic covered in Seminole's July 2, 2001 Protest filed at FERC in Docket No. RT01-67, the pertinent pages of which are contained in Attachment III hereto (and incorporated herein by reference). Seminole does not know whether the FPSC prefers to defer on this issue to the FERC or to deal with it itself; if the FPSC adopts the latter course of action, then Seminole respectfully requests that the FPSC order the compliance filing amended to comport with the points made in Attachment III hereto.

VIII. Installed Capacity and Energy Specification

Attachment W to the OATT is entitled "Installed Capacity and Energy Specification," known as "ICE." It does not contain a full-fledged ICE proposal, but rather sets forth certain general principles concerning an ICE obligation and provides that "at such time as the Transmission Provider is able to implement such a requirement, all LSEs within the Transmission Provider's transmission area will have a mandatory" ICE obligation. (Redline Original Sheet 404.)

These same principles were set forth in the Applicants' May 29, 2001 compliance filing in Docket No. RT01-67, and do not differ appreciably from the four principles set forth in the Attachment W accompanying the Applicants' December 15, 2000 FERC filing. The FERC noted that while these principles "appear reasonable at first glance, Applicants should clarify them further as requested by the parties before the Commission addresses them on the merits." 94 FERC ¶ 61,363 at p. 62,362. The FERC has not acted to approve any ICE proposal on the merits.

In its March 15, 2002 Working Paper issued as part of the process in Docket No. RM01-12, the FERC noted that long-term generation adequacy is a "contentious" issue that "needs

further discussion among industry participants." (Working Paper, p. 24.) Among its basic principles, the FERC provided that standard market design "may" include measures to ensure adequate long-term generation supplies and that "[p]referably state and regional reliability authorities will coordinate with one another to set a regional, long-term reserve margin to be maintained by LSEs subject to their jurisdiction." (Working Paper, p. 24.) On April 10, 2002, the FERC issued an Options Paper in Docket No. RM01-12 on four key issues to be addressed by it, one of which is long-term generation adequacy. Comments on the Options Paper were filed on May 1.

Seminole submits that there is a reason why the State of Florida is not one of those states with a generation adequacy problem. And that reason is that the FPSC has conscientiously overseen generation adequacy in the state. While there are serious generation issues in the state as regards the authority of independent power producers to construct merchant plants, that problem cannot be laid at the FPSC's doorstep. The FPSC has done its job well of ensuring generation adequacy in the state, and Seminole recommends that the FPSC continue in that role. This would render moot the ICE issue and permit Attachment W to be eliminated from the OATT. Such a result seems entirely consistent with the direction provided by FERC in the Working Paper and with several of the options suggested in its Options Paper.

IX. Transmission Pricing

In response to this Commission's desire to "continue to set the revenue requirements needed to support retail transmission service and retain oversight over cost control and cost recovery" (Dec. 20 Order, p. 15), the Applicants have proposed to provide that at a transmission customer's option, "that customer's bundled retail load will be exempt from charges for zonal

transmission rates during the first five years of RTO operations." (Executive Summary, p. 4.) The Applicants have stated they will elect the option to exempt their bundled retail load from zonal rates during the transition period. (*Id.*) The effect of this new position of the Applicants is to renege on their commitment in their GridFlorida filing at the FERC "to take (and pay for) transmission service under the GridFlorida transmission tariff for all of its load (both retail and wholesale)." (*See id.* at p. 3.)

Seminole has several concerns regarding pricing. First, Seminole assumes from the language used by the Applicants that they intend to take service for all of their transmission needs, wholesale and retail, under the RTO OATT. Thus, the exemption that they are seeking appears only to relate to the zonal rates utilized to recover the transmission revenue requirements of existing facilities (versus the rates for new investment and all other terms and conditions of service under the RTO OATT), and for a limited (five-year) period. If, however, this assumption is not correct, then Seminole would strongly oppose this facet of the filing, both here and at the FERC, on the grounds, among others, that such a feature would prevent comparability from being achieved and thereby undermine one of the principal objectives of creating an RTO.

Second, Seminole assumes that the FPSC will not try to use its rate authority to frustrate the requirement that TDUs' revenue requirements be rolled into the transmission rates of the Applicants and collected accordingly. As of now, the roll-in occurs over a five-year period, whereas Seminole believes it should occur upon commercial operation of the RTO, but Seminole is pursuing that issue at the FERC since, in Seminole's view, FERC is the agency with jurisdiction over this matter. Seminole's sole concern in this forum is that the FPSC not attempt to undermine the ultimate FERC disposition of the TDU issue by denying the Applicants the full

recovery of those costs, whatever the roll-in period approved by the FERC.

The FPSC, in Seminole's view, should view its role as the protector of the well-being and equitable treatment of *all* retail consumers in the state, not just those customers served by the investor-owned utilities whose rates are set by the FPSC. Viewed in this broader context, the FPSC should understand two facts. One is that the customers of Seminole (and FMPA) have been paying pancaked transmission costs for years, *i.e.*, these customers not only directly underwrite the transmission facilities built by Seminole (and FMPA), which provide benefits to all users of the grid, but in addition pay the rolled-in rates of the Applicants. Bulk transmission facilities serve retail loads and are indistinguishable as to the benefits they provide users of the grid. All users of the grid should pay for such facilities regardless of who constructed them. The discriminatory pricing described above needs to be remedied now. The second point is that the impact on retail consumers of finally treating TDUs comparably and fairly will be truly *de minimis*.

Finally, Seminole is concerned about what it perceives to be unduly discriminatory treatment of its non-TDU load by the Applicants. Seminole is a TDU in the FPL and FPC service areas, and as such will have to live by whatever roll-in accommodation the FERC orders. However, part of its load is located in the Seminole control area, which is served from a 230-kV transmission line owned by Seminole (*i.e.*, the Seminole Plant to JEA Firestone line). The transmission facilities and load in that zone should be treated comparably to the transmission facilities and load of FPL, FPC, Tampa, and all of the municipal systems in their respective zones. This can be accomplished simply by adding a Seminole Transmission Rate Zone to the list of Transmission Rate Zones provided in Attachment V of the RTO OATT. The facilities in

the Seminole Transmission Rate Zone will be the Seminole Plant to JEA Firestone line, which currently is a part of the FPL Transmission Rate Zone. The Network Load in the Seminole Transmission Rate Zone will simply be Seminole's distribution cooperative load that is located in Seminole's control area and is directly served by the same Seminole Plant to JEA Firestone line.

Under the Applicant's proposal, there are no other instances in GridFlorida where loads that are within one utility's control area are merged into the zone of another utility. There is no logical or legal basis for discriminating against Seminole simply because only part of its load is non-TDU related. This patent discrimination must be eliminated. Though Seminole believes that this issue should be addressed by the FERC, Seminole is nevertheless bringing the issue to the FPSC's attention because it does not know how aggressive the FPSC intends to be in the pricing area.

X. Governance

Seminole assumes that all matters relating to governance will be left to the FERC to resolve; however, in the event that this Commission determines to address governance issues, Seminole raises several such issues for FPSC consideration.

(1) Most amendments to the governance documents were precipitated by the change from a for-profit transco to a not-for-profit ISO. But according to the Executive Summary (pp. 2-3), "in response to request from various stakeholders, provisions have been added to require that regular and special meetings of GridFlorida's board be open to the public, but to permit the board to discuss confidential and non-public sessions. See Bylaws, Article III, § 4." (Footnote omitted.)

The problem is that the section providing for open meetings also provides as follows:

> For the avoidance of doubt, directors are free to confer and meet outside of regular and special meetings without being subject to the public meeting, notice and related requirements imposed hereunder in respect of regular and special meetings of the Board of Directors. [Redline Bylaws, p. 13.]

Seminole is sympathetic to the need to permit directors to attend social occasions and the like without worrying as to whether they are violating the sunshine laws; but the above-quoted exception inserted into the Bylaws would permit the directors *carte blanche* to discuss anything at any time, so long as they are not at an official meeting. Thus, the directors could engage in unofficial meetings to discuss whatever issues they desired, thereby making the ensuing discussion of such matters at the official meetings a potentially empty (not to mention well-scripted) act. Seminole assumes that such a result was not intended by the Applicants. However, whether intended or not, Seminole urges that the exception crafted above be re-worded to prevent such a result.

(2) Seminole believes that fundamental to the independence guideline set forth in Order 2000 is the prompt removal of the Applicants from the process, so that they have no undue influence over the entity which is GridFlorida and its Board. Therefore, Seminole believes that GridFlorida, Inc. should be established (by independent incorporators) as soon as possible after full regulatory authorizations are received, and thereafter the input of the Applicants should cease except, like all other stakeholders, as members of the Advisory Committee.

Despite suggestions to this effect during the stakeholder process, the Applicants have retained provisions in the Formation Plan that have them "causing" certain actions to occur, *e.g.*, "[t]he Applicants shall cause, as soon as practicable following the selection of the initial board of

GridFlorida, Inc., ...the formation of GridFlorida, Inc...." (Formation Plan, section 2.2); and "the Applicants shall cause the Board Selection Committee's slate of candidates to be elected or named as initial directors of GridFlorida, Inc ...." (Formation Plan, section 3.5.) Seminole believes these provisions should be struck, and if there is a need "to cause" something to happen, which Seminole questions, the Advisory Committee (which is a functioning and representative entity) should be the moving force.

XI. Existing Transmission Agreements ("ETAs") (Attachment T)

One of the most offensive changes in the Applicants compliance filing (and another change unquestionably beyond the mandate of the December 20 Order) is the proposal to move back the cut-off date for when an existing transmission agreement automatically will be converted to service under the GridFlorida transmission tariff. The proposed change, *i.e.* to substitute January 1 of the year in which the RTO begins commercial operation for December 15, 2000, both violates the terms of OATT Attachment T approved by the FERC and exacerbates an ongoing problem - the treatment of grandfathered contracts - that the FERC is attempting to resolve in a far different manner from the Applicants' approach.10/ In addition, this proposed change causes particular heart-burn for Seminole since it entered into a contract with an independent power producer (Calpine) in anticipation of an RTO being in place before service thereunder commences (June 2004), thereby removing any pancaking of transmission charges;

10/ In a document entitled "Options for Resolving Rate and Transition Issues in Standardized Transmission Service and Wholesale Electric Market Design" ("Options Paper") released by the FERC on April 10, 2002, in Docket No. RM01-12, it states as follows (p. 6): "When standard market design is implemented, there will need to be a transition process in place so that most if not all of the transmission provider's customers will be taking service under the new standard market design."

the Applicants' proposal would grandfather that contract and subject the Seminole/Calpine arrangement to pancaked rates.

On December 14, 2000, Seminole entered into an agreement with Calpine Energy Services ("Calpine") for the purchase of approximately 350 MW of combined-cycle capacity with a minimum term of 5 years beginning in June 2004. Seminole also has the contractual right to acquire optional firm capacity in any amount, up to the full generating capability of Calpine's 534 MW combined-cycle unit. The new combined-cycle facility is currently planned for commercial operation in 2003, and will be located in Tampa's control area. The FPSC granted a "need" certification on the project in February 2001, and the Governor and Cabinet (Florida's power plant siting board) approved the project in June 2001. Seminole will take delivery of the power from the Calpine facility (which will be designated a Seminole "Network Resource") at the point of interconnection between Calpine and Tampa's transmission system.

Calpine has applied for an interconnection point with Tampa, and to get in the priority queue for transmission service, Calpine previously applied for long-term point-to-point service under Tampa's current open access transmission tariff for the entire output of the combined-cycle plant from Tampa's control area to the FPC control area. Because of the knowledge that an RTO in the State is imminent, this transmission request along with a number of others were studied jointly by FPL, FPC, and Tampa. On April 29, 2002, Tampa filed at the FERC an unexecuted service agreement between Tampa and Calpine for long-term firm point-to-point transmission service.

At the time the GridFlorida Applicants made their December 15, 2000 Supplemental Compliance Filing in Docket No. RT01-67, Section 9.1 of Attachment T ("Existing

Transmission Agreements") provided different rules for contracts entered into after December 15, 2000. The Applicants explained in their FERC filing that the December 15, 2000 date in Section 9.1 was inserted "to prevent gaming prior to the date GridFlorida commences operation, *i.e.*, to prevent entities from entering into ETAs prior to GridFlorida operations for the sole purpose of obtaining ETA status" and went on to state as follows:

> If, after December 15, 2000, a Participating Owner or Divesting Owner enters into a new ETA, or agrees to purchase or provide long-term transmission service ... under an ETA executed prior to that date, the new service provided under the ETA will be converted to GridFlorida service upon commencement of GridFlorida operations. ... All parties will be placed on notice as of December 15 that this will be the treatment for new transmission service. [*Id.*]

Because of potential confusion regarding the interaction of Section 9.1 of Attachment T with Section 8.1 providing for an extended phase-out of pancaked rates and because Seminole and Calpine had been unable to get the Applicants to agree informally that there would be no pancaking of the Calpine arrangement (under which service would not commence until June 2003), Seminole raised its concerns in a January 30, 2001 Protest with the FERC in Docket No. RT01-67. The Applicants responded as follows:

> After the GridFlorida OATT is placed into effect, the service Calpine obtains from TEC, like other long-term transmission service entered into *after December 15, 2000,* will be converted to service under the GridFlorida OATT. Attachment T, § 9.2. *To the extent Calpine is a designated network resource to serve Seminole network load under the GridFlorida OATT, no additional transmission charge will apply to transmit power from the Calpine unit to the Seminole network load, i.e.*, Calpine will not be subject to an additional point-to-point charge for sales from a designated network resource. [February 16, 2001 Answer of GridFlorida Applicants, pp. 116-17; emphasis added.]

To ensure that the outcome described above would result under the tariff, the GridFlorida Applicants in their May 29, 2001 compliance filing in Docket No. RT01-67 amended Section 9.1

of Attachment T to add the following language after reference to the December 15, 2000 date:

> Notwithstanding the foregoing, if such service is point-to-point service, and the applicable resource will be designated as a Network Resource, the customer receiving such service will have a one-time option, at the time the resource is designated as a Network Resource, to reduce its point-to-point reserved capacity or terminate such capacity. [May 29, 2001 Compliance Filing, Redline Sheet No. 363.]

The issue appeared to be resolved since the understanding of the parties was set forth in a filing approved by the FERC in its March 28, 2001 Order Provisionally Granting RTO Status, 94 FERC ¶ 61,363. But not so. In their March 20, 2002 compliance filing in this proceeding, the GridFlorida Applicants have submitted a revised Attachment T in which in lieu of the December 15, 2000 cut-off date for ETAs, they have substituted "January 1 of the year in which the RTO begins commercial operation." In other words the GridFlorida Applicants are inviting the very gaming that they said they were trying to avoid. The GridFlorida Applicants avoid this obvious point and instead try to rationalize their filing as follows:

> If the date delineating new versus existing investment was not moved, a number of facilities would be considered new investment, and thus charged to all load through the system-wide charge. This would exacerbate, rather than limit, cost shifts. [Executive Summary, p. 10.]

There are a number of flaws in this logic (in addition to the fact that it completely ignores the gaming issue, which was the controlling reason for the December 15, 2000 cut-off date in the first place). First, there is absolutely no evidence that by retaining the December 15, 2000 date for segregating existing from new transmission, the cost shift, if any, would be significant; second, there is no indication that by keeping the December 15, 2000 date the Applicants would be harmed (unless by harm, the Applicants have determined that by moving the cut-off date back, they stand to collect additional pancaked rates); and, third, the Applicants have been

conducting themselves, including making joint studies for new transmission service, on the basis that all transmission facilities built after December 15, 2000, would be rolled-in to a system-wide rate. There is no basis for changing that operating assumption to the prejudice of transmission customers that have relied on it.

In brief, the GridFlorida Applicants put a "gaming" date in their December 15, 2000 compliance filing at FERC, and noted that it was needed to prevent anyone from seeking to avoid taking service under the RTO OATT. That reason is as valid today as ever since all players have been on notice since the date of the compliance filing of the consequences of entering into a transmission agreement after December 15, 2000. In addition, the consequences to entities like Seminole/Calpine of now moving that date, namely pancaked rates, would be in stark violation of both what the Applicants represented to Seminole/Calpine and the FERC and what the FERC is attempting to accomplish through the establishment of RTOs. The Applicants must not be permitted to engage in such self-serving gamesmanship.

XII. Participating Owners Management Agreement ("POMA")

The POMA is another document that has been blessed by the FERC in Docket No. RT01-67, and therefore the only changes to that document that would have been anticipated in the Applicants' compliance filing were those necessary to conform to the December 20 Order. But a review of the redlined version of the POMA submitted on March 20 reflects myriad changes, the majority of which do not pertain to the December 20 Order. The GridFlorida Applicants seem to be using their compliance filing as the basis to try to get the FPSC to opine on matters that are beyond the parameters of the December 20 Order, and thereby set one regulatory agency, the FPSC, against another, the FERC. If the Applicants succeed in getting FPSC approval of a

revised POMA, they will undoubtedly cite this as the basis for filing the revised POMA at the FERC. Seminole urges the FPSC not to get engaged in a turf war with the FERC on matters unrelated to the December 20 Order.

Seminole will provide some examples below of proposed changes to the POMA that fall outside the ambit of the December 20 Order and that are objectionable on the merits. The Applicants' statements to the contrary notwithstanding,11/ it should be clear that most of these changes have been precipitated by the fact that FPL has changed horses, and is now riding a transmission-owing horse (*i.e.*, is subject to the POMA), whereas before, when it was riding a divesting-owner horse (and therefore not a potential signatory to the POMA), FPL wanted a strong GridFlorida.

Revised Sections 4.3 and 5.6 have the effect of permitting POs to not be subject to the POMA (either through termination or failure of a condition precedent) if GridFlorida within six months following the commencement of the term of the Agreement has not "obtained and closed on financing in an amount sufficient to repay Start-up Costs that have been submitted to GridFlorida ...." There is no basis for such a condition precedent. GridFlorida will have much to do during the initial months of its existence, and whether during that time it is able to raise the almost $200 million that the Applicants have assertedly spent in Start-up Costs is frankly not very important in the big scheme of things. The Applicants and others incurring substantial

---

11/ The Applicants aver that the changes to the POMA are to reflect the fact that GridFlorida will be organized as a non-profit corporation, to reflect parallel changes to the GridFlorida Transmission Tariff, and for clarity and in response to stakeholder comment. (Executive Summary, p. 10.) The Applicants omitted the key fourth category: self-serving changes to reflect that now all three IOUs in the state will be POs (instead of just one).

Start-up Costs, like Seminole, are adequately protected by Section 8.5, which requires both that GridFlorida shall reimburse each PO for its Start-up Costs and that "GridFlorida shall exercise commercially reasonable efforts to obtain FERC approval of rates that provide for recovery of Start-up Costs." That same section requires GridFlorida "to make a filing to obtain approval of Start-up Costs incurred by POs, ..." The Applicants have more than adequately protected their financial interests without the automatic-out proviso in Sections 4.3 and 5.6, which should be struck.

Another example of a change not called for by the December 20 Order is the switch from a "negligence" standard in Section 10 (Liability and Indemnification) to a "gross negligence" standard. Seminole objects to the new standard as it does not believe that either GridFlorida or a PO should be responsible for the negligence of the other, which is the practical effect of the proposed change.

Another example of over-reaching is in the area of third party agreements. The supplanted provisions, which appear at page 31 of the redline POMA, were approved by FERC. The new third party provisions (see Section 6.16) are very different. For example, new section 6.16.2 provides that:

> No PO shall enter into any new Third Party Agreements after its Transfer Date that materially impairs GridFlorida's ability to perform its obligations under this Agreement. [POMA, redline version p. 12.]

What this means, of course, is that POs *may* enter third party agreements that impair GridFlorida's ability to perform its obligations under the POMA, a result that Seminole finds objectionable. In any event this sort of proposed change (like numerous others) to the document approved by FERC should not be sanctioned by the FPSC since it has nothing to do with the

mandate of the December 20 Order.

Ironically, in the one area where the Applicants should have made a change to reflect the December 20 Order, the Applicants have not. The POMA has not been modified to reflect the removal of the bundled retail load from the tariff for pricing purposes. Under the terms of the exhibit to the POMA, the Applicants will receive payments for the entire revenue requirements but only be required to pay the RTO for wholesale transactions. Presumably this was an inadvertent error and will be corrected.

Seminole respectfully requests that the Commission reject the proposed changes to the POMA on the basis of being unjustified and inconsistent with the requirements of the December 20 Order.

XIII. Reliability (Attachment O)

A critical issue for Seminole and its member systems is reliability. The member systems presented the FERC with substantial and unrebutted evidence regarding the unacceptably poor transmission service reliability provided them by FPL and FPC, in comparison to the transmission service reliability provided by FPL and FPC to their own native load. Seminole and its members were seeking standards in the Operating Protocol (Attachment O) that would require the RTO to address in a proactive manner the serious reliability issues confronted by the member systems so that comparable service would be more than a catchy phrase.

The FERC accepted Attachment O as filed, including those sections (I.F.3 and 4) addressing transmission service reliability. However, as pointed out by Seminole and the member systems, Sections I.F.3 and 4 had the primary effect of ensuring that the superior transmission service that FPL and FPC had always provided themselves would be maintained.

The details of this issue are set forth in a separate filing being made in this proceeding by the member systems and will not be repeated here. Suffice it to say that the FERC turned a deaf ear on this very pressing issue, for reasons that fail analysis.

The question before this Commission is whether to address this issue in the context of this proceeding. Seminole has taken the position in this docket that the Commission should only address those issues relating to the Commission's December 20 Order, and if the Commission adheres strictly to that logic, it may decline to visit this issue. Seminole raises it because the GridFlorida Applicants themselves argued at the FERC that this reliability issue was uniquely one that *this* Commission should address. In their February 16, 2001 Answer in FERC Docket No. RT01-67 (p. 50), the GridFlorida Applicants maintained that these matters were not within the FERC's purview since it does not have direct responsibility over reliability matters and does not become involved with day-to-day operation of electric transmission systems, concluding that "it appears that the FPSC clearly would assert jurisdiction over the types of issues raised by the Cooperative in this proceeding." (*Id.*)

Thus, whether in this proceeding or a related one, it seems appropriate for the FPSC to address the serious reliability issues raised by the Seminole member systems so that *all* retail consumers in the State are afforded comparably reliable service without regard to who their power supplier may be.

XIV. Terms and Conditions of Service Applicable to Points of Delivery (Attachment R)

The Attachment R filed at the FERC addresses terms and conditions of service applicable to points of delivery. The Applicants in their March 20 compliance filing at this Commission have deleted all of the provisions of Attachment R and substituted the following: "The

Transmission Provider will develop terms and conditions applicable to delivery point interconnections. Until such time as the Transmission Provider develops such standards, the Transmission Provider will utilize the terms and conditions of the applicable Participating Owner." (Redline OATT Sheet 366.)

The rationale provided for this excision of the work product of the collaborative process and substitution of pre-existing PO standards is provided in the Executive Summary (p. 9) as follows:

> Attachment R was specifically drafted for the prior transco structure. Under that structure, point of delivery interconnections typically would have been between the RTO – an independent entity – as transmission owner and the party wishing to interconnect with the RTO's system. In light of the move to the ISO structure, this assumption underlying the prior Attachment no longer will hold true.

That rationale is factually inaccurate and otherwise does not withstand analysis, as demonstrated below.

Attachment R was drafted to handle interconnections between third parties and the RTO (where it owned the transmission in question) or the PO (where it owned the transmission in question). The implication in the above-quoted statement that virtually all interconnections would be with the RTO is false and misleading. The only change from the prior regime is that the ISO will own no transmission, so all (rather than some) of the interconnections will be with POs. Thus the relationship of the ISO to the transactions will be the same as the relationship of the RTO (under original Attachment R) to the PO where the PO retained ownership of its transmission.

To take several random provisions from Attachment R, the appropriate fix for Sections 4.a. and 5.g. (rather than eliminating these provisions) are set forth in redline/strikeover format

below:

> [4.a.] To establish a new Point of Delivery, in accordance with the Local Area Planning Process (Section I.B of the Planning Process Protocol), Customer must execute a new Exhibit with ~~GridFlorida and/or~~ PO ~~, as applicable,~~ for the new Point of Delivery prior to the date upon which the new Point of Delivery is to be established. The Exhibit for such new Point of Delivery shall be attached to the TSA and shall include any special provisions required for the establishment of the new Point of Delivery. New Point(s) of Delivery shall be established in accordance with the OATT and the Planning Protocol.
>
> [5.g.] ~~GridFlorida or~~ PO~~, as applicable,~~ shall install, own, operate, and maintain all lines and equipment located on ~~GridFlorida's or~~ PO's side of a Point of Delivery, as well as the meter, metering equipment and remote terminal unit equipment that may, at ~~GridFlorida's or~~ PO's option~~, as applicable,~~ be located on Customer's side of the Point of Delivery. In such cases, Customer shall provide a location, acceptable to Customer~~, GridFlorida or~~ **and** PO~~,~~ for the installation of such metering and remote terminal unit equipment.

As to sections like Section 3.a (quoted below), no changes would be warranted:

> To the extent that a change in transmission level voltage is caused or requested by Customer as part of the Local Area Planning Process (Section I.B of the Planning Process Protocol), Customer will design, engineer, install, construct or modify, operate, and maintain the facilities on its side of the Point of Delivery to accommodate such higher or lower voltage.

In short, the Applicants have presented no basis for abandoning Attachment R. What we see at work here is the same phenomenon that we have seen at work throughout the compliance filing, namely the Applicants, now that they are *all* POs under the new ISO format, are having second thoughts about some of the protocols that they agreed to when FPL was on the other side of the divestiture fence. Clearly, the deletion of Attachment R is not in compliance with this Commission's December 20 Order, and hence it must be rejected.

XV. Conclusion

Seminole respectfully requests that the Commission take the above comments into consideration in its disposition of the GridFlorida Applicants' March 20, 2002 compliance filing and that it reject those numerous aspects of the compliance filing that are not responsive to the Commission's December 20 Order.

Respectfully submitted,

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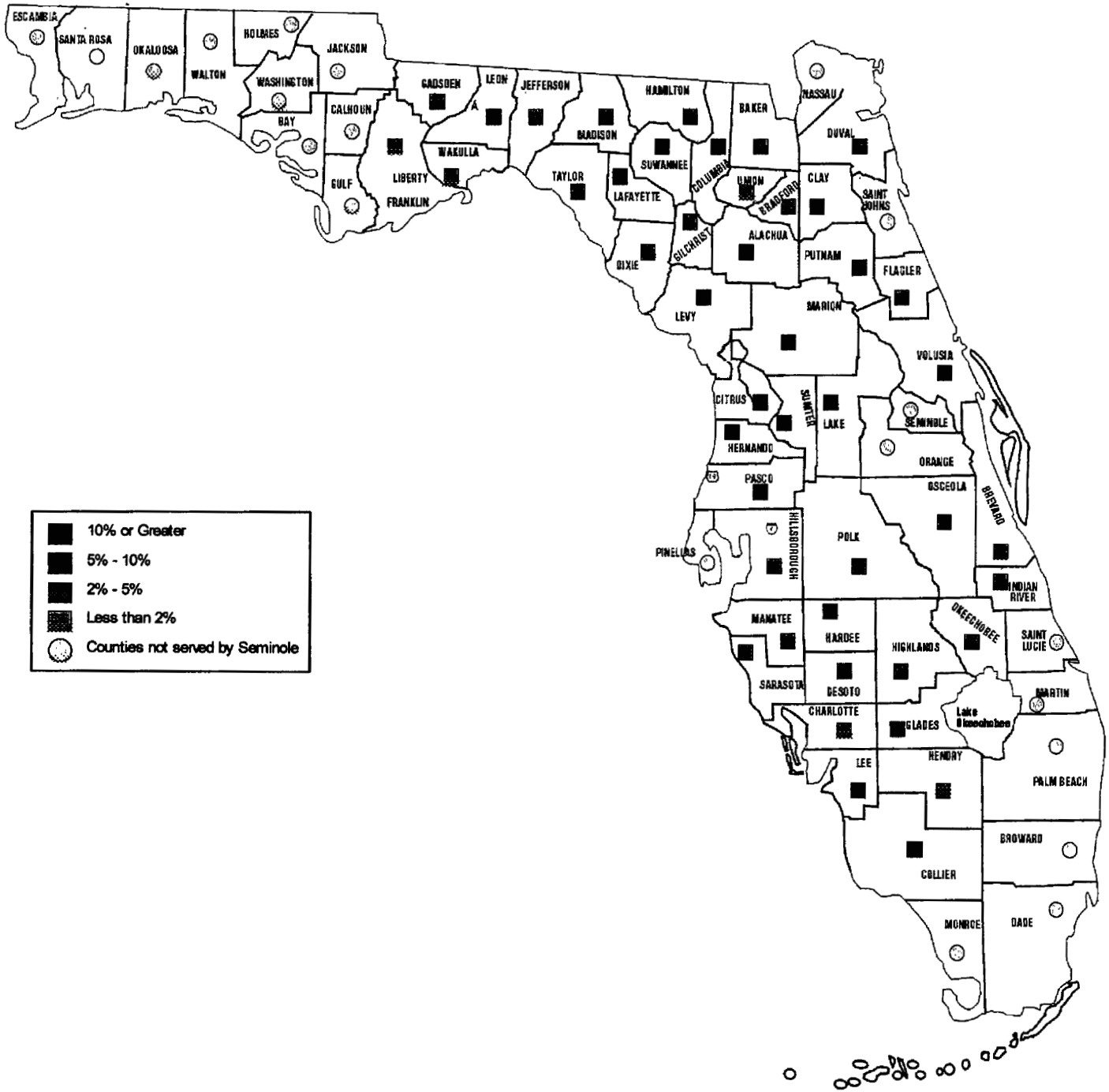
ATTACHMENT I

Seminole Electric Cooperative, Inc. Load Distribution



ATTACHMENT II

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of	)	
	)	
GridFlorida LLC	)	Docket No. RT01-67-003
Florida Power & Light Company	)	
Florida Power Corporation	)	
Tampa Electric Company	)	

PROTEST OF
SEMINOLE ELECTRIC COOPERATIVE, INC.

Miller, Balis & O'Neil, P.C.
Suite 700
1140 Nineteenth Street, N.W.
Washington, D.C. 20036-6600
(202) 296-2960

July 2, 2001

The Commission should approve the Alternative B mitigation plan. The Applicants' primary mitigation proposal is Alternative A, in which GridFlorida would establish a nodal market-clearing price for generators. Entities without market-based rate authority may only bid and may only be paid up to a "Commission-approved cost-based rate based on that entity's costs," either "an existing cost-based rate or a newly filed rate." (Compliance Filing, p. 46.)

Under Alternative B, no single market-clearing price is determined; each selected bidder is paid its bid. Entities without market-based rates are "limited to a cost-based bid (including fixed costs)." (Compliance Filing, p. 47.)

Upon reviewing the Compliance Filing, Dr. Taylor concludes in his supplemental testimony that the Commission should approve Alternative B at this time. Taylor Supp. Testimony at 8-11. Because no seller currently has authority to charge a market-based rate for energy sales through GridFlorida, as a practical matter GridFlorida can only implement Alternative B. GridFlorida will be free to seek approval to implement Alternative A if and when suppliers of energy are able to make a showing that market-based rates will be just and reasonable in the GridFlorida energy markets.

The cost-based bid and price caps must be unit-specific. The tariff language

implementing the cost-based bid and price caps is unclear and must be modified. The Alternative B tariff provision states: "Subject to Section 13.4.2, the Transmission Provider shall pay the Scheduling Coordinator for each Mwh of Excess Generation the inc bid associated with that Mwh of Excess Generation." OATT, Attachment P, section 13.4.1 [Alternative B]. This language is insufficient, because it does not incorporate any requirement that the bids must be based on the seller's actual generating-unit-specific costs, as the Compliance Filing explains the proposal to be.40/

The language in Alternative A at least refers to a cost-based cap, but even this language is obscure: "The Transmission Provider shall pay the Scheduling Coordinator for each Mwh of Excess Generation during a Settlement Period the lower of (a) the Nodal Price at the applicable generator bus during the Settlement Period or (b) the Scheduling Coordinator's cost-based rate cap associated with that Mwh of Excess Generation." OATT, Attachment P, section 13.3.1.1 (Alternative A). What is "the Scheduling Coordinator's cost-based rate cap associated with that Mwh of Excess Generation"? The Compliance Filing states that the rate cap must be a "Commission-approved cost-based rate based on that entity's costs," either "an existing cost-based rate or a newly filed rate." (Compliance Filing, p. 46.) But in order to ensure economic dispatch of generation by GridFlorida, the "cost-based rate cap" must be a *unit-specific* cost-

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40/ Section 13.4.1 [Alternative B] refers to Section 13.4.2, which states that Excess Generation not called on to provide Balancing Service or congestion management is paid the lower of the payment in 13.4.1 or the Nodal Price [defined as in Alternative A as the cost to serve the next increment of load], and such Excess Generation cannot set the Nodal Price. The May 29 Compliance Filing does not explain why these generators should be paid anything in this situation. Taylor Supp. Testimony at 10.

based rate cap, not a cap based on a supplier's average costs. In particular, an "existing cost-based rate" is unlikely to be unit-specific, except for single-asset companies. Taylor Supp. Testimony at 5, 9-10.

Thus, in implementing either Alternatives A or B, the Commission must require a unit-specific cost-based rate and price cap.

The cost-based rate and price caps must exclude fixed costs. The Applicants propose that "the cost-based rate caps are not limited to variable costs, but also permit bids that include recovery of fixed costs." (Compliance Filing, p. 46 (referring to Alternative A).) Thus, under Alternative B, entities without market-based rates are "limited to a cost-based bid (including fixed costs)." (Compliance Filing, p. 47.)

As Dr. Taylor explains in his supplemental testimony, this aspect of the Applicants' proposal is a recipe for inefficiency, double-recovery, and the exercise of market power. Taylor Supp. Testimony at 4-8. The cost-based rate cap should be a marginal-cost-based cap. Here, Dr. Taylor proposes that GridFlorida determine marginal costs by including only variable costs plus a five-percent adder to allow for imprecision in measurement. Taylor Supp. Testimony at 14.

As Dr. Taylor notes, including fixed costs in such an energy charge would be a fundamental change in Commission ratemaking policy. Taylor Supp. Testimony at 4-5. Moreover, a marginal-cost-based bid and rate cap is supported by the basic economic principle that price should equal marginal cost in a competitive market. Bid caps seek to emulate the outcome of a competitive market, and thus should employ marginal costs. Taylor Supp. Testimony at 7-8. This principle underlies Seminole's market-monitoring proposal outlined in the next section. Including fixed costs would also distort energy prices used for congestion

pricing. Taylor Supp. Testimony at 8.

The Applicants contend that they must recover fixed costs in the GridFlorida energy market, but this ignores several fundamental aspects of the current proposal. The GridFlorida energy market would be a *residual* market. Suppliers would recover their fixed costs in other markets: primarily bilateral wholesale contracts and regulated bundled retail markets. Allowing them to recover fixed costs in the GridFlorida energy market would permit a double recovery of these costs. Taylor Supp. Testimony at 5.

The Commission itself realized these points in its most recent orders approving a mitigation plan for the California wholesale markets, which rest upon a determination of a proxy market-clearing price based on the marginal costs of the relevant generating units. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 95 FERC ¶ 61,115, at 61,362-63 (2001), *modified,* Order on Rehearing of Monitoring and Mitigation Plan for the California Wholesale Electric Markets, Establishing West-Wide Mitigation, and Establishing Settlement Conference, *mimeo.* at 31-39 (June 19, 2001) (to be published at 95 FERC ¶ 61,418) (hereinafter, "California June 19 Order"). "[W]hen a supplier has available capacity, it should be willing to sell that capacity on a daily basis as long as it covers its marginal cost of producing it. Since marginal cost pricing best approximates competitive pricing there is no need to include fixed or other costs in the bids." *San Diego Gas & Elec. Co.*, 95 FERC ¶ 61,115, at 61,362.

Dr. Taylor notes that the May 29 Compliance Filing (at 46) incorrectly states that a generating unit might be paid less than its cost-based bid cap when it is dispatched by GridFlorida. Taylor Supp. Testimony at 6. A generating unit will not bid less than its marginal-cost-based bid cap; and it will not be dispatched if its bid is more than the market-clearing price.

Thus, cost-based rate caps as proposed by Seminole will not result in a generating unit being paid less than its cost-based rate cap. Taylor Supp. Testimony at 6-7.

Dr. Taylor also notes that it is important that the Commission require GridFlorida to specify how it will measure marginal cost. Taylor Supp. Testimony at 14-15. In this regard, the Commission should also make clear that marginal costs do not include any "opportunity costs." The Commission's orders on price mitigation in California confirm that Commission policy does not allow opportunity costs to be included in real-time energy balancing markets: "In most cases, opportunity cost should not figure into the calculation of bids, because power that is available in the real-time market has no real opportunity to be sold elsewhere. Therefore, the Commission will not permit suppliers to add a figure for opportunity cost." *San Diego Gas & Elec. Co.*, 95 FERC ¶ 61,115, at 61,364. "Claims of opportunity costs will not be considered because energy that is available in real-time cannot be sold elsewhere." California June 19 Order, *mimeo.* at 39.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

GridFlorida LLC	)	**Docket No. RT01-67-003**
Florida Power & Light Company	)	
Florida Power Corporation	)	
Tampa Electric Company	)	

SUPPLEMENTAL TESTIMONY OF GORDON T.C. TAYLOR, Ph.D.

Evaluation of GridFlorida's *May 29 Compliance Filing*
Re: Market-Monitoring and Mitigation Plan and Market Rules

On Behalf of
Seminole Electric Cooperative, Inc.

July 2, 2001

Q. Would allowing fixed costs in energy bids have any affect on congestion management?

A. Yes. Energy prices would be distorted by allowing the addition of fixed costs in the rate cap. As a consequence of distorted energy prices, congestion management would be distorted. First, congestion prices would be inefficient, since they would not reflect marginal cost. Second, generation dispatch would be inefficient, since it would not be based on marginal cost.

§ 2.3 Payment Method to Sellers of Energy

Q. What have the Applicants proposed as the basis for bids to supply energy?

A. The Applicants propose that sellers with market-based rate authority may offer ("bid") to sell energy at unrestricted prices but that sellers without market-based rate authority would be restricted to bid only their cost.

Q. What have the Applicants proposed as the basis for the payment to suppliers of energy?

A. The Applicants propose two alternative systems of payment. In Alternative A, a nodal market-clearing price for generators would be established. Each seller of energy with market-based rate authority would receive the market-clearing price. Entities without market-based rate authority could bid and be paid only up to a "Commission-approved cost-based rate

based on that entity's costs," either "an existing cost-based rate or a newly filed rate." (CF 46.) In Alternative B, each seller of energy would be paid its bid regardless whether its bid is unrestricted or cost-based. (CF 45.)

Q. Are there any problems with Alternative A as filed?

A. Yes. Alternative A is set forth in the GridFlorida OATT, Attachment P, Section 13.3.1.1, which reads that: "The Transmission Provider shall pay the Scheduling Coordinator for each MWh of Excess Generation during a Settlement Period the lower of (a) the Nodal Price at the applicable generator bus during the Settlement Period or (b) the Scheduling Coordinator's cost-based rate cap associated with that Mwh of Excess Generation." As I noted before, under Alternative A as filed the cost-based rate cap includes fixed costs. This could result in a market-clearing price that exceeded the marginal cost of the marginal generating unit. In addition, this would allow a seller without market-based rate authority to receive payments for energy exceeding its marginal cost

Moreover, the tariff language in section 13.3.1.1 is obscure, since it does not explain the calculation of "the Scheduling Coordinator's cost-based rate cap associated with that MWh of Excess Generation." The language should be clarified to state clearly that the cost-based rate cap applies to each generating unit separately and that the cost-based rate cap must be calculated for each generating unit separately. The cost-based rate cap should not be based on the seller's average cost of its portfolio of generating units and/or purchases, on the generation seller's highest cost generating unit, on the generation seller's opportunity cost, or on anything other than the energy cost of the specific generating unit whose output is being bid. Since it is

unlikely that any generation seller has an "existing cost-based rate" for a specific generating unit, such rates would have to be filed.

Q. Are there any problems with Alternative B?

A. Yes. The GridFlorida OATT, Attachment P, Section 13.4.1 [Alternative B] states that: "Subject to Section 13.4.2, the Transmission Provider shall pay the Scheduling Coordinator for each MWh of Excess Generation the inc bid associated with that MWh of Excess Generation." In addition, Section 13.4.2 states that Excess Generation *not* called on to provide Balancing Service or congestion management would be paid the lower of the payment in Section 13.4.1 or the Nodal Price (defined, as in Alternative A, as the cost to serve the next increment of load), and that such Excess Generation cannot set the Nodal Price. This statement is unclear, particularly since the Applicants provide no basis for sellers of generation not called on to be paid anything.

Q. Would Alternative B adequately mitigate market power?

A. No. The Applicants state that under Alternative B "there is no market price to be artificially driven up through an improper bidding strategy." (CF 47.) However, through export withholding of lower-cost generation, a seller could increase the price of energy in Florida. Thus, market rules that provide for selling low-cost generation first in Florida are required in conjunction with Alternative B.

Q. Assuming that fixed costs are removed from energy bids as you recommend, should the Commission approve Alternative A or Alternative B?

A. Since no entity has been granted market-based rate authority to sell energy in the GridFlorida market, at this time Alternative A cannot be approved. Thus, at this time the Commission can approve only Alternative B.

In order for generation sellers to be granted market-based rate authority, the energy market must be competitively structured. If the energy market becomes competitively structured and market-based rate authority is granted, then the Alternative A market-clearing price approach would become appropriate. I recommend that the Commission approve Alternative B and revisit approval of Alternative A at such time as a competitively structured balancing-energy market is extant in GridFlorida and sellers of energy have been granted market-based rate authority.

ATTACHMENT III

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of	)	
	)	
GridFlorida LLC	)	Docket No. RT01-67-003
Florida Power & Light Company	)	
Florida Power Corporation	)	
Tampa Electric Company	)	

PROTEST OF
SEMINOLE ELECTRIC COOPERATIVE, INC.

Miller, Balis & O'Neil, P.C.
Suite 700
1140 Nineteenth Street, N.W.
Washington, D.C. 20036-6600
(202) 296-2960

July 2, 2001

5. The Commission should require GridFlorida to adopt a cost-based standard—the Lerner Index—for identifying the exercise of market power.

The Commission's March 28 Order noted that "the ability of the GridFlorida and market participants to comply with market rules, and the Market Monitor's investigation of compliance with 'market rules,' will be hindered unless such rules are set out in advance of GridFlorida's operation in at least general form." 94 FERC ¶ 61,363, at 62,362. The Commission thus directed the Applicants to "provide an explanation and description of market rules in their compliance filing."

The Compliance Filing contains no such rules. The Applicants argue that such rules

"cannot be fully developed until the Applicants complete and gain Commission approval of the GridFlorida market design." (Compliance Filing, p. 62.)

But there is no need to wait until the market rules are developed before setting forth the standard to judge the exercise of market power. As set forth in Dr. Taylor's direct testimony and reiterated in his supplemental testimony, the Lerner Index provides a correct, established standard by which to detect and judge the exercise of market power in the GridFlorida markets. *See* Taylor Testimony at 9-19; Taylor Supp. Testimony at 11-13. As market rules are devised, the Market Monitor will have to develop further refined market-monitoring procedures to ensure compliance with market rules; but there is no need to wait for the market rules to develop principles for monitoring that do not depend on the specific rules adopted.

The primary purpose of an RTO's market-monitoring and mitigation plan is to mitigate the exercise of market power. Accordingly, the foundation of an RTO's market rules and market-monitoring and mitigation plan should be "an objective standard for identifying and measuring the exercise of market power." Taylor Testimony at 9. The Commission's Order No. 2000 states that an RTO monitoring plan

> should clearly identify any proposed sanctions or penalties and the specific conduct to which they would be applied, provide the rationale to support any sanctions, penalties and the specific conduct to which they would be applied, provide the rational to support any sanctions, penalties or remedies (financial or otherwise) and explain how they would be implemented. [41/]

The Commission has required that market monitors thus operate under rules in which the misconduct and the remedies are clearly spelled out, and the market monitor's discretion to

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41/ Order No. 2000, FERC Stats. & Regs., Regulations Preambles ¶ 31,089 at p. 31,156.

impose sanctions unilaterally is confined to instances in which it has clear authority from the Commission. *See NSTAR Services Co. v. New England Power Pool*, 92 FERC ¶ 61,065, at 61,204-05 (2000); *New York ISO*, 89 FERC ¶ 61,196, at 61,605 (1999). In any event, as Dr. Taylor notes, a purely case-by-case development and implementation of standards for market-monitoring and mitigation would be slow and costly—both in the direct implementation costs to the RTO and in the indirect efficiency costs to market participants which would have to comply with uncertain RTO standards. Taylor Testimony at 10. Dr. Taylor recommends that GridFlorida's market-monitoring and mitigation plan should utilize "a generally accepted standard that can, in practice, be applied to identify and measure when generation sellers have exercised market power." *Id.* at 9-10.

To determine whether a seller's bid (*i.e.*, its offer price) in a GridFlorida market constitutes an exercise of market power, Dr. Taylor proposes that GridFlorida and the Market Monitoring Corporation use the Lerner Index, an accepted measure of market power. *Id.* at 11. The Lerner Index is the ratio of a seller's profit margin (or price-cost margin or "markup") to the seller's bid price:

$$Lerner\ Index = (P\text{-}MC)/P$$

where

P = seller's bid price (*i.e.*, offer price)

MC = seller's marginal cost

The Lerner Index is based on the established understanding in economics that a seller in a competitive market will sell at its marginal cost of production. *See, e.g., NSTAR Services Co. v. New England Power Pool*, 92 FERC ¶ 61,065, at 61,198 n.25 (2000) (describing bidding

behavior in a single clearing price auction). The Lerner Index is zero when the seller's price equals the seller's marginal cost. If the seller's price exceeds marginal cost, the Lerner Index is positive, and it reaches a theoretical maximum of one if the seller's price is infinite.

Because the marginal cost of production in electricity generation varies by the generating unit, the Lerner Index must be calculated separately for each generating unit. A Lerner Index greater than zero signals a markup of price above marginal cost and thus identifies an exercise of market power. The magnitude of the Lerner Index indicates the degree of exercise of market power. Taylor Testimony at 11.

The Lerner Index is a means of detecting and measuring the exercise of market power. It does not answer the question of how the exercise of market power should be deterred or mitigated or remedied. Seminole proposes such measures below. But as Dr. Taylor notes, the effect of using the Lerner Index to measure the exercise of market power in the GridFlorida markets is to impose a marginal-cost bid cap. *See id.* at 16, 27. Bids above marginal cost are deemed to be the exercise of market power and thus will trigger the RTO's mitigation and remedial measures. The Applicants contend that their proposed mitigation measures are "designed to ensure that entities without market-based rate authority cannot recover more than their costs." (Compliance Filing at 45.) The Lerner Index in effect applies such a bid cap on all generation sellers. Using the Lerner Index protects against the exercise of market power by all sellers, even sellers that have been able to show that they should not be able to exercise market power in some conditions.

The Lerner Index is grounded in the fundamental economic principle that all sellers in competitive markets will bid their output at their marginal cost. Sellers that are not exercising

market power would have an incentive to bid their marginal costs. Taylor Testimony at 12; Taylor Supp. Testimony at 15-16. The Lerner Index appropriately measures the exercise of market power by sellers with market power in the GridFlorida markets, and the enforcement of the Lerner Index provides a means of mitigating the exercise of market power in those markets. It would provide an accepted, objective standard for identifying the exercise of market power. *Id.* at 14.

Dr. Taylor notes that the use of the Lerner Index would have several practical effects for GridFlorida. It would become an effective marginal cost bid cap on all sellers and would mitigate the exercise of economic withholding. It would automatically change with changes in costs and thus not need to be re-set to remain effective. *Id.* at 16.

Dr. Taylor explains that it would be relatively easy to apply, because marginal cost is relatively easy to determine in the electric power industry, and in any event GridFlorida can require generators to provide the necessary information to calculate a unit's marginal cost (*e.g.*, the unit's heat rate, fuel cost, and other relevant information). *Id.* at 19-20. Because of potential errors in measurement, however, the Market Monitor would apply an enforcement "deadband" and only take action if a seller's bid exceeds 105 percent of its measured marginal cost. *Id.* at 20.

Further, Dr. Taylor explains that the Lerner Index would ensure allocative efficiency in GridFlorida's generation markets, because units would be bid, and would be dispatched, based on their marginal costs. The result would be (1) prevention of profiteering in times of shortage; (2) economic efficiency in production; (3) elimination of the higher prices, lower output, and deadweight losses associated with monopolies; (4) elimination of the incentive for economic withholding by bidding above marginal cost; (5) elimination of the incentive for collusive

bidding among suppliers; (6) greater confidence in GridFlorida's generation markets; and (7) an objective measure of market-power overcharges. *See* Taylor Testimony at 27-31.

The use of the Lerner Index to measure the exercise of market power will not prevent sellers from recovering their fixed costs, even of peaking units that run but a few hours each year. An integral part of the Applicants' proposal is the ICE requirement and a reliance on bilateral contracts for installed capacity and associated energy. Sellers can recover their fixed costs under such bilateral arrangements; they need not recover their fixed costs in the GridFlorida markets for energy and ancillary services. *See id.* at 34-35; Taylor Supp. Testimony at 5, 16.

Dr. Taylor's testimony makes the important point that *GridFlorida should not use the opportunity costs of forgone sales to determine a seller's marginal costs. See id.* at 21-27. "Allowing generation sellers to substitute their claimed opportunity cost for their marginal cost in submitting bids in auction markets with market-clearing prices would destroy the usefulness of the Lerner Index as a market-monitoring tool." *Id.* at 21. Only the seller's own operating costs are relevant in determining its allowable bid price in Florida. A generator in a competitive market should be bidding no more than its actual marginal costs. In particular, if the expected market price is higher outside Florida, that means that the generator presumably should be bidding there, not in Florida. By bidding in Florida, the seller demonstrates that the expected value of the forgone opportunity (the out-of-state sale) was less than the expected value of the sale in GridFlorida. *Id.* at 22-24.

For similar reasons, the Commission's recent orders directing mitigation remedies for the California wholesale electric markets rejected the use of opportunity costs to justify a bid price. *San Diego Gas & Elec. Co.*, 95 FERC ¶ 61,115, at 61,364; California June 19 Order, *mimeo.* at

37-39.

Indeed, what if the external market—the source of the seller's "opportunity cost"—is itself non-competitive? Should the supra-competitive price there inflate the allowable bid in Florida? The answer is assuredly no. "[T]he prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." *FPC v. Texaco*, 417 U.S. 380, 397 (1974). Allowing bids to be justified by such "opportunity costs" would do what the FPA forbids: make the "standard of the marketplace" outside GridFlorida, whether or not such markets are competitive, the "final" arbiter of the "reasonableness" of a rate demanded by a seller in the GridFlorida markets. *Id.* at 396-97. *See also Elizabethtown Gas Co. v. FERC*, 10 F.3d at 870. "Congress could not have assumed that 'just and reasonable' rates could be conclusively determined by reference to market price." *FPC v. Texaco*, 417 U.S. at 399.

As Dr. Taylor notes, the practical effect of using the Lerner Index is to extend marginal-cost bid caps on all sellers in the GridFlorida markets. *See* Taylor Testimony at 16, 28; Taylor Supp. Testimony at 16. The Commission has required the use of marginal-cost bid caps in its orders on the California wholesale markets. *See San Diego Gas & Elec. Co.*, 95 FERC ¶ 61,115, at 61,362-63, *modified*, California June 19 Order, *mimeo.* at 31-39. This idea is not new; the Commission has previously approved this approach with respect to ISOs. *New England Power Pool*, 85 FERC ¶ 61,379, at 62,482-83 (1998) ("to properly mitigate a seller's market power in the ISO's energy market, the ISO should be able to require a seller to submit bids that reflect its actual marginal costs, the level at which suppliers lacking market power would ordinarily be expected to bid."); *Pacific Gas & Elec. Co.*, 81 FERC ¶ 61,122, at 61,546 (1997); *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257, at 62,270 (1997).

When Seminole submitted its proposal for market-monitoring and mitigation, based on the Lerner Index, in its protest of the Applicants' December 15 Filing, the Applicants in response hyperbolically argued that Seminole's proposal "would completely eliminate any incentive for any new generation to be located in Florida and likely would cause existing generation to be shut down" and "provides even less incentives for new generation than did California."42/ In effect, the Applicants contend that an energy market that produces market prices at marginal cost (*i.e.*, an efficient energy market) does not provide adequate incentive to build and operate generation. Hence, the Applicants propose to include fixed costs in their proposed bid and rate caps.

The Commission should (once again) reject the Applicants' contention—as it subsequently has done in the California proceedings, where it has imposed limited marginal-cost based bid caps.43/ The Applicants ignore the fact that other elements of their proposal ensure that sellers will recover their capacity costs outside GridFlorida's balancing energy market. In particular, the combination of an installed capacity requirement for load-serving entities and wholesale capacity markets will provide the means for the owners of new generation in Florida to recover their capacity costs.44/ Seminole supports the retention of installed capacity and energy requirements precisely to avoid a California-style debacle in Florida. The lessons to learn

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42/ Answer of Florida Power & Light Company, Florida Power Corporation, and Tampa Electric Company 80-81 (Feb. 16, 2001) ("Applicants' Answer").

43/ *See San Diego Gas & Elec. Co.*, 95 FERC ¶ 61,115, at 61,362-64; California June 19 Order, *mimeo.* at 31-39..

44/ Taylor Testimony at 34-36; Taylor Supp. Testimony at 5, 16. *See* California June 19 Order, *mimeo.* at 38 ("Negotiated bilateral agreements have, in large part, replaced [the spot] market and provide opportunity for any seller to structure the arrangements necessary to recover its costs.")

from California do not include a greater tolerance for energy prices above marginal cost as a means to stimulate market entry.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

GridFlorida LLC	)	**Docket No. RT01-67-003**
Florida Power & Light Company	)	
Florida Power Corporation	)	
Tampa Electric Company	)	

SUPPLEMENTAL TESTIMONY OF GORDON T.C. TAYLOR, Ph.D.

Evaluation of GridFlorida's *May 29 Compliance Filing*
Re: Market-Monitoring and Mitigation Plan and Market Rules

On Behalf of
Seminole Electric Cooperative, Inc.

July 2, 2001

Section 3. UNRESOLVED ISSUES IN MARKET-MONITORING PLAN

Q. What is the purpose of this section of your testimony?

A. My purpose is to evaluate the Applicants' May 29 Compliance Filing to determine whether the issues that I raised in my direct testimony have been properly resolved: (1) standard for identifying the exercise of market power; (2) measurement of generation marginal cost; (3) benefits of GridFlorida's adopting the Lerner Index; (4) marginal-cost bid caps; (5) Applicants' request for market-based rate authority; (6) market rules for mitigating market power; (7) procedures for implementing market monitoring and mitigation; (8) proposed sanctions and penalties for exercising market power; and (9) facilitating consumer-demand response.

§ 3.1 Standard For Identifying the Exercise of Market Power

Q. Have the Applicants adopted or proposed a standard for identifying the exercise of market power?

A. No. The Applicants have neither adopted nor proposed a standard for identifying the exercise of market power. The Applicants want to postpone completing their market-monitoring plan and have avoided addressing, much less adopting, a standard for identifying the exercise of market power. Whereas some details of a market-monitoring plan may need to be worked out later, and then submitted for Commission approval, there is no reason to delay establishing now the standard that will be used for identifying the exercise of market power.

In fact, the development of market rules would be facilitated if the standard that will be applied to identify the exercise of market power is established now. There is a fundamental need in every RTO's market-monitoring plan for an objective standard for identifying and measuring the exercise of market power. In my direct testimony, I explained the advantages of using the Lerner Index for this purpose, and I proposed that the Commission require GridFlorida to adopt the Lerner Index as the standard for identifying the exercise of market power. Since the May 29 Compliance Filing proposes that bid caps for balancing energy include fixed costs, the GridFlorida Applicants implicitly reject the Lerner Index, which identifies market power as bids above marginal cost.

Q. Did the Commission's March 28 Order require GridFlorida to adopt a standard for identifying the exercise of market power?

A. No. The Commission did not address establishing such a standard.

Q. Why is a standard required?

A. A proactive and effective market-monitoring plan requires a generally accepted standard that can, in practice, be applied to identify and measure whether generation sellers have exercised market power. A market-monitoring plan without a standard for identifying and measuring whether sellers have exercised market power as its foundation would be administratively infeasible, since without a standard, GridFlorida or the Commission would have to prove whether any particular action constituted the exercise of market power and caused anticompetitive injury. Moreover, without a standard, market participants would have no guidance on acceptable and unacceptable market behavior.

Q. What are the advantages of the Lerner Index?

A. I discussed the Lerner Index in detail in my direct testimony. In summary, the Lerner Index is a traditional and widely accepted method for measuring the exercise of market power,[1] since it measures market performance that "directly reflects the economically inefficient departure of price from marginal cost associated with monopoly."[2] If required by the Commission, the Lerner Index would provide GridFlorida with a generally accepted foundation for its market-monitoring plan. Without a standard for identifying the exercise of market power, GridFlorida's market-monitoring plan would be ineffective. Thus, I continue to recommend that the Commission require GridFlorida to adopt the Lerner Index for identifying the exercise of market power.

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[1] Abba P. Lerner, "The Concept of Monopoly and the Measurement of Monopoly Power," *Review of Economic Studies* (June 1934), pp. 157-175 ("the mark of the absence of monopoly is the equality of price or average receipts to marginal cost.")

[2] F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance* (Boston, MA: 1990), p. 70.

§ 3.2 Measurement of Marginal Generating Cost

Q. Has the Commission or the Applicants determined how to measure marginal generating cost?

A. No. Neither the Commission nor the Applicants have even addressed how to measure marginal generating cost. Since the marginal cost of specific generating units must be measured in order to apply the Lerner Index, the Commission should require GridFlorida to propose how marginal cost will be calculated. Implicitly, the Applicants in their May 29 Compliance Filing reject use of marginal cost, since they would include fixed costs in the cost of balancing energy. Moreover, the tariff language does not clearly require generating-unit-specific cost-based bid caps, as noted before, and the Applicants have declined to provide market rules that specify how costs would be measured for purposes of the cost-based caps.

In my direct testimony, I described how marginal cost can be measured. I addressed inclusion in marginal cost of various types of legitimate and verifiable costs and the separate bidding of certain costs (for example, start-up costs and no-load costs). I recommended that the GridFlorida market monitor calculate the marginal cost for the specific generating units that set the market-clearing price, and to take into account possible measurement inaccuracies, I recommended that the GridFlorida market monitor should not take action unless a generation seller's bid is 105 percent of the measured marginal cost (enforcement "deadband").

Also in my direct testimony, I explained in detail why the Commission must restrict GridFlorida from allowing generation sellers to use opportunity cost to measure marginal cost. I explained that the opportunity cost of expected foregone prices is always less than the expected price in the market where the generation seller bids. Moreover, I explained that even

though a generation seller bidding in the GridFlorida market would be required to bid its marginal cost, the seller nonetheless would receive an amount at least equal to its expected opportunity cost. Thus, a generation seller bidding its opportunity cost in the GridFlorida market clearly would not be a price taker content with the market-clearing price.

In summary, I concluded that requiring bids at marginal cost calculated using traditional cost of service does not disadvantage generation sellers with market-based rate authority bidding into clearing-price markets (if they are seeking only a competitive price consistent with the criteria under which they were granted market-based rate authority), since they would be paid the market-clearing price even though they bid their marginal cost. I continue to recommend that the Commission require GridFlorida to propose how to measure marginal cost.

§ 3.3 Benefits of GridFlorida's Adopting the Lerner Index

Q. Have the Applicants or the Commission examined the public interest benefits from GridFlorida adopting the Lerner Index as the standard?

A. No. In my direct testimony, I explained in detail that by requiring GridFlorida to adopt the Lerner Index as the standard for identifying and measuring the exercise of market power, the Commission would create several public interest benefits: (1) prevention of profiteering in times of shortage; (2) realization of economic efficiency in production; (3) avoidance of the increased price, reduced production, and deadweight losses that result from monopoly; (4) elimination of the incentive for economic withholding; (5) elimination of the incentive for collusive bidding; (6) creation of confidence in GridFlorida's generation markets; and (7) provision of an objective measure of market-power overcharges.

In summary, adopting the Lerner Index would provide the standard that a bid above the marginal cost of a generating unit constitutes the exercise of market power. In competitively structured markets, sellers bid their marginal cost. The practical effect of adopting the Lerner Index would be to prohibit bids from each generating unit that are above marginal cost, thereby achieving the competitive-market result to ensure that rates are just and reasonable.

§ 3.4 Marginal-Cost Bid Caps

Q. Have the Applicants addressed marginal cost bid caps?

A. The Applicants have addressed marginal cost bid caps only indirectly. Requiring the Lerner Index as the standard for identifying the exercise of market power would have the same effect as requiring marginal-cost bid caps. The Applicants propose cost-based bid and rate caps that include fixed costs. Since marginal cost does not include fixed cost, the Applicants have implicitly rejected marginal cost bid caps.

In my direct testimony, I explained how owners of generating units, including peaking units, could recover their investment costs and earn a reasonable profit even if bids are limited to marginal cost. The Applicants have proposed an ICE obligation that (when fully developed) would create an obligation for load-serving entities to have sufficient generating resources to supply their forecasted peak load and reserves. Although the ICE obligation is currently undeveloped, when fully developed it would allow sellers of generation the recovery of investment cost and the ability to earn a reasonable profit. Thus, the ICE requirement is an integral part of the GridFlorida market design to attain competitively structured market results, since it supports marginal cost bid caps for energy.

Since I continue to support adopting of the Lerner Index for identifying the exercise of market power, implicitly I continue to support the adoption of marginal-cost bid caps.

§ 3.5 Applicants' Request for Market-Based Rate Authority

Q. Have the Applicants modified their request for market-based rate authority for GridFlorida generation sellers with market power?

A. Yes. In my direct testimony, I explained that the Applicants implicitly requested market-based rate authority for all sellers of generation, since the Applicants requested that even generation sellers not granted market-based rate authority be allowed "to receive the market-clearing price."[3] Since a market-clearing price is a market-based price, authority to receive the market-clearing price is in effect market-based rate authority.

The Applicants have now modified their request into Alternative A and Alternative B. I have addressed these alternatives above and concluded that (1) Alternative A cannot be approved at this time since it provides for a market-clearing price and no entity presently has market-based rate authority in the GridFlorida markets; (2) Alternative B can be approved at this time if the inclusion of fixed costs in cost-based bids is prohibited; and (3) Alternative A may be approved at some later date when sellers are granted market-based rate authority.

§ 3.6 Market Rules for Mitigating Market Power

Q. What is the purpose of this section of your testimony?

A. In my direct testimony, I recommended five market rules designed to decrease the ability of sellers of generation in GridFlorida to exercise market power. My purpose in this

[3] Supp. Filing, p. 40 (emphasis added).

section is to explain that if Alternative B is approved, wherein each seller of energy would be paid its bid, that only Market Rules 1 and 5 are required, but that if Alternative A is eventually approved, wherein each seller granted market-based rate authority would be paid the market-clearing price, that Market Rules 2, 3, and 4 would be required in addition to Market Rules 1 and 5. Although for convenience I restate here each of these five rules, for brevity I do not repeat the rationale for each of these rules that I provided in my direct testimony.

Q. What is the purpose of Market Rules 1 and 5 that you propose?

A. The purpose of Market Rule 1 is to mitigate export withholding, by ensuring that generating capacity sited in peninsular Florida is available to the GridFlorida markets. This problem will continue to exist regardless whether Alternative A or B is approved:

> **Market Rule 1**: GridFlorida participants with generating capacity sited in GridFlorida must offer their generation for sale in GridFlorida before offering any generation for sale outside of GridFlorida, must schedule generation at least sufficient to meet their GridFlorida loads (including reserves and ancillary services) and grandfathered other loads, and must dispatch their generating units in merit order, and may not sell generation outside GridFlorida at a lower net margin than offered in GridFlorida.

In their May 29 Compliance Filing, the Applicants have not adopted my proposed rule but instead simply repeat their original proposal that "All generation owners must submit bids for the uncommitted capacity of any unit that is on line, as well as for all quick start units." (CF, p. 46)

In contrast to the Applicants' vague language, the rule I propose would establish a requirement that generating capacity sited in GridFlorida be offered first in GridFlorida. This rule is critical to ensuring an adequate supply of electric power in GridFlorida markets, and is

therefore critical to enhancing reliability and minimizing the occurrence of price spikes from artificial scarcity. The requirement in the Applicants' ICE proposal that electric utilities obtain generation supply (including reserves and ancillary services) at least sufficient to meet their GridFlorida and grandfathered other loads ensures that the electric utilities will acquire generating capacity long term sufficient to meet the requirements of their forecasted peak loads. However, this capacity must be available to meet load in GridFlorida rather than being exported.

The requirement that electric utilities dispatch their generating units in merit order based on marginal cost reduces their ability to increase prices arbitrarily in clearing-price markets by scheduling their generating units out of economic order (*e.g.*, not starting a lower-variable-cost unit). This measure also reduces the potential for physical withholding from GridFlorida markets.

The purpose of Market Rule 5 is to ensure that the GridFlorida bidding-procedure markets will function successfully by creating them as residual markets that encourage adequate investment in generating capacity:

> **Market Rule 5**: In order to provide incentive for long-term investment in electricity supply and to reduce price volatility in the spot markets, GridFlorida participants will abide by an installed capacity and energy (ICE) obligation set by an appropriate independent entity on every Load Serving Entity (LSE).

This market rule responds to the market problem that the uncertainty over how GridFlorida markets will behave in the medium to long term may lead to inadequate investment in generating capacity. The Commission has approved GridFlorida's ICE proposal in concept.

The ICE proposal should be completed before implementation of any of the other markets. The reason is that the ICE obligation is the cornerstone of the GridFlorida markets required to ensure an adequate and reliable supply of electric power in peninsular Florida.

Q. What is the purpose Market Rules 2, 3, and 4 that you propose?

A. These rules are required under Alternative A in addition to Market Rules 1 and 5 to mitigate market power.

The purpose of Market Rule 2 is to mitigate the incentive to exercise market power by economic, physical, or export withholding:

> **Market Rule 2**: GridFlorida participants with a market share greater than 20 percent will be paid the marginal cost of each of their generating units rather than the market-clearing price.

In their May 29 Compliance Filing, the Applicants did not directly address Market Rule 2. Instead, the Applicants proposed Alternatives A and B discussed above (in Subsection 2.3) that would include fixed costs in cost-based bids for balancing energy.

The proposed GridFlorida markets are new markets wherein no electric utility has been granted market-based rate authority. Since no electric utility has been granted market-based rate authority in the GridFlorida markets, the Commission's 20 percent standard for granting market-based rate authority is a minimum standard to assist in preventing the exercise of market power. Market Rule 2 should be adopted because it helps mitigate market power and provides an incentive to divest generation, thereby promoting the development of a competitively structured market.

The purpose of Market Rule 3 is to mitigate the exercise of market power in load pockets within GridFlorida:

> **Market Rule 3**: A GridFlorida participant with a generating unit located in an area within a GridFlorida transmission-constrained area will be limited to recovery of the higher of the GridFlorida market-clearing price or its marginal cost during periods in which transmission constraints limit imports of the relevant product (energy, reserves, or other) creating a market share for the participant in the load pocket of more than 10 percent.

The Applicants in their May 29 Compliance Filing did not address whether there would be market power in load pockets within GridFlorida. Market Rule 3 should be adopted because it is designed to mitigate the exercise of locational market power within load pockets.

The purpose of Market Rule 4 is to reduce the incentive to exercise market power by physical withholding:

> **Market Rule 4**: GridFlorida participants experiencing a unit outage (other than a GridFlorida-approved outage for scheduled maintenance or a GridFlorida-certified forced outage) must sell all energy from their other generating units sited in GridFlorida into the GridFlorida markets and will be paid their marginal cost for each generating unit accepted for dispatch rather than the market-clearing price.

This measure ensures priority use of Florida-sited generating units for supplying Florida markets, even though the seller may have grandfathered contracts to export generation. This measure also provides an incentive to bring units with forced outages back on line quickly. Since this measure assumes that an outage is the exercise of market power (except outages for planned maintenance pre-approved by GridFlorida), provision must be made for sellers to

obtain prompt certification from GridFlorida of the legitimacy of any forced outage before they can resume receipt of the market-clearing price.

§ 3.7 Procedures in Support of Market Monitoring and Mitigation

Q. Have the Applicants or Commission addressed the four market procedures in support of market monitoring and mitigation that you proposed?

A. No. The Applicants did not address any of them; the Commission addressed the first two but not the second two. The four market procedures that I propose are necessary in order for GridFlorida's market-monitoring and mitigation plan to be successful. I will repeat each Market Procedure here, but for brevity I will not repeat the rationale for each that I provided in my direct testimony.

Q. What is the purpose of the first market procedure that you propose?

A. GridFlorida's market-monitoring plan must adhere to certain information-disclosure requirements in order to be successful.

> **Market Procedure 1**: Market information will be disclosed quickly, publicly, and completely (including bids identified by bidder).

This market procedure would allow private antitrust enforcement, as well as other remedies that may be available to customers before the Commission or elsewhere. Moreover, this measure would provide genuine transparency of price-setting behavior and thus promote efficiency and confidence in the effectiveness of GridFlorida's market-price-setting mechanisms. In addition, this measure would deter anticompetitive conduct by making market information available for enforcement purposes by market participants who believe

they have been overcharged by the exercise of market power by a generation seller or by generation sellers.

Q. Is GridFlorida's information-disclosure policy consistent with implementation of a market-monitoring system?

A. No. GridFlorida's information-disclosure policy is unduly restrictive. Specifically, GridFlorida's information policy of not releasing all market information until six months have passed deters standard antitrust enforcement policy. The potential for standard antitrust enforcement may provide the greatest pressure for achieving just and reasonable rates and standard antitrust enforce policy depend heavily on private enforcement to augment federal and state enforcement

The adoption by GridFlorida of the Lerner Index for identifying and measuring the exercise of market power would have the effect of creating marginal-cost bid caps. With marginal-cost bid caps, collusion based on bidding strategies would not be possible. Collusion would be confined to physical and export withholding, which can be addressed with market rules. Thus, in the case of GridFlorida, any Commission concern with the quick release of market information assisting bidding collusion would be unfounded. I recommend that all market information received or generated by GridFlorida regarding bids, transactions, dispatching, minimum run times, etc. be made readily available and obtainable by anyone without delay.

Q. What is the purpose of the second market procedure that you propose?

A. The purpose of the second market procedure is to ensure that the market advisor has an adequate staff and remains independent of the other GridFlorida staff:

> **Market Procedure 2**: A market advisor (with a staff), completely independent of the GridFlorida staff, will be responsible for market monitoring and mitigation but will share offices with GridFlorida and have equal and simultaneous access to all information and data in the possession of GridFlorida though direct computer interconnection, and complete access to all GridFlorida facilities and personnel to facilitate real-time market-monitoring and mitigation.

This market procedure would contribute to ensuring impartial and objective market monitoring, promote the transparency of market transactions, and foster confidence in market-price-setting mechanisms. An independent market advisor, which aggressively seeks out and punishes abuses of market power that could conceivably impede the operation of GridFlorida's markets, would serve to avoid even the appearance of conflict of interest.

Q. What is the purpose of the third market procedure that you propose?

A. The purpose of the third market procedure is to prevent generation sellers from spreading their generating assets among different organizational titles in order to disguise their control of generation in the market:

> **Market Procedure 3**: Affiliated sellers will be treated as if a single entity consistent with the Order No. 2000 ten-percent affiliate rule stated in18 C.F.R.§ 35.34(b)(3)(2000).

This measure ensures that a seller will not assign its generating units (or portions of generating units) to affiliates in order to subvert the GridFlorida's market monitoring plan.

Q. What is the purpose of the fourth market procedure that you propose?

A. The purpose of the fourth market procedure is to allow GridFlorida or courts to require restitution for overcharges:

Market Procedure 4: GridFlorida bids and prices will be exempt from the filed rate doctrine (*i.e.*, will be subject to refund), and generation sellers' market conduct will be subject to antitrust enforcement.

This measure assists in deterring anticompetitive conduct, facilitates prompt and effective remediation when such conduct occurs, and avoids burdening the Commission's administrative processes.

§ 3.8 Sanctions and Penalties for Exercising Market Power

Q. Have you recommended that GridFlorida have the authority to impose penalties?

A. Yes. I continue to recommend, as I explained in my direct testimony, that while imposing penalties should be left to the courts, the Commission must provide the GridFlorida market monitor with the authority to require the restitution of "market overcharges" caused by the exercise of market power. Thus, the Commission should provide GridFlorida with the authority to require, by refund, the restitution of market overcharges, including the refund of market overcharges caused by a generation seller inflating the market-clearing price above marginal cost, not just the refund of the overcharges on the generation seller's sales.

§ 3.9 Facilitating Consumer-Demand Response

Q. Have the Applicants proposed how they would facilitate consumer-demand response to mitigate market power?

A. No. The Applicants have basically stated that they can't facilitate consumer-demand response. I continue to recommend that the Commission require GridFlorida to develop the means to achieve reductions in consumption in response to higher prices to reduce

the severity of the shortages whether the shortages are created by natural causes or by the exercise of market power.

Section 4. OVERALL CONCLUSION AND RECOMMENDATIONS

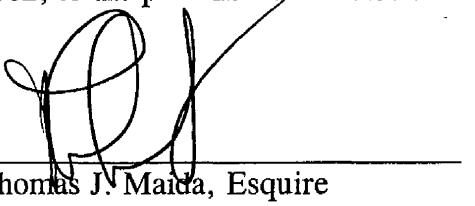
Q. What is your overall conclusion and your recommendations?

A. I renew my overall conclusion and recommendations stated in my direct testimony as modified herein. My primary recommendations are that the Commission require GridFlorida to adopt the Lerner Index as the standard for identifying and measuring the exercise of market power and require GridFlorida to adopt the market rules and market procedures that I have proposed.

Q. Thank you.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was sent by hand delivery (*) or U.S. Mail, on this 8th day of May, 2002, to the persons listed below:



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