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October 9, 2002

MEMORANDUM

TO: Council Members

FROM: Dick Watson

SUBJECT: Public Utility Commission panels on the Federal Energy Regulatory Commission's Notice of Proposed Rulemaking on Standard Market Design (SMD) and its recent the RTO West Stage 2 filing

One of the most contentious issues facing the utility industry at the present time is FERC's initiative to impose a standard market design (SMD) on the wholesale electricity market. In so doing, they appear to be trying to impose a market model based on experience in the East that does not fit the physical and operational realities of the Western Power market well at all. In addition, in so doing, the FERC would be asserting its regulatory authority over transmission used primarily to serve retail utilities' native load. This transmission is currently regulated by state commissions. Attached is a copy of a letter from the Western Governor's Association outlining the Governor's main objections to the Standard Market Design.

A related and complicating issue is the subsequent FERC order generally approving the FERC RTO West Stage 2 filing. This filing describes how major Northwest transmission owners, including investor-owned utilities would comply with FERC's desire to see Regional Transmission Organizations established throughout the Country. The order appears to defer to the RTO West filing in many but not all important aspects of the Standard Market Design. There is not unanimity in the region in support of the formation of an RTO. Some vigorously oppose it. Some believe that it is a step toward resolving some of the incipient problems facing the transmission system. The issue of governance of the RTO and the diminution of the role of state and local politically accountable regulators in the oversight of the RTO is significant.

FERC has recently extended the deadline for comment on the SMD until January, giving us some additional time to consider our comments. There are issues of both strategy and substance. For example, should we simply work to stop SMD in its tracks or can it be "fixed?" Is the FERC order on the RTO West filing an indication of FERC's willingness to accept regionally developed solutions or is it a "Trojan Horse" intended to move the region to FERC's goal of the Standard Market Design?

State regulators have been at the forefront on these issues and it is important to hear their perspectives. They are not identical. Because of schedule constraints we have not been able to get representatives from all four state commission at one time. On Wednesday you will hear from Marilyn Showalter, Chair of the Washington Utilities and Transportation Commission; and Marsha

Smith, Member of the Idaho Public Utilities Commission and Chair of the Committee on Regional Electric Power Cooperation (under the auspices of the WGA). On Thursday, you will hear from Roy Hemmingway, Chair of the Oregon PUC and former member of the Council; and Bob Anderson, member of the Montana Public Service Commission and past-President of the National Association of Regulatory Utility Commissions (NARUC).

They have been asked to respond to the following questions:

- What are the transmission problems we have or perhaps don't have in your state and the region?
- How well do FERC's standard market design and RTO West address these problems?



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August 22, 2002

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Dear Chairman Wood and Commissioners Breathitt, Brownell and Massey:

Western governors are in the midst of our review of the Commission's proposed Standard Market Design rule. Our review thus far raises a number of concerns that we want to convey to you. These are listed below. Individual governors and/or the Western Governors' Association will be providing additional comments after we complete our review of the Commission's proposal.

- The SMD rule seems to mark an end to efforts to form voluntary RTOs in the West. This is unfortunate and serves to undercut the enormous time, effort, and expense that has gone into the development of voluntary RTOs in the Western Interconnection.
- Expansion of the Commission's authority into state decisions such as resource adequacy and demand response is not warranted. We agree with FERC that more work needs to be done in these areas and significant efforts are underway in the West. These efforts, which would benefit from FERC's participation, may be undermined by the SMD rule. Rather than imposing an SMD rule from Washington, D.C., we believe FERC should participate in ongoing regional efforts on resource adequacy, transmission planning and demand response.
- Key elements of the SMD proposal are extrapolated from the experience of PJM (Pennsylvania-New Jersey-Maryland), a geographically small, "tight" power pool in the East. We have serious concerns about the wisdom and unintended consequences of trying to graft the PJM approach on to the huge Western Interconnection that spans parts of three nations.

Chairman Patrick H. Wood
Commissioner Linda K. Breathitt
Commissioner Nora Brownell
Commissioner William L. Massey
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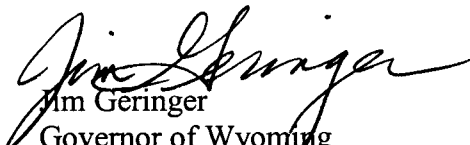
There are significant differences between the experience in the East and the West. For example, the pricing system FERC is proposing has only been tested in systems dominated by thermal generation. In the West, hydropower provides a large share of generation. The West does not use Transmission Loading Relief schemes, a practice the SMD rule attacks. Unlike the PJM region, public power, which is not directly subject to the SMD rule, provides a significant share of the generation and transmission in the West.

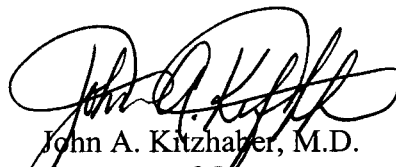
- Our experience in the West over the past two years has shown the immense personal and economic hardship resulting from not fully understanding the implications of changes in electricity policy. The implications of FERC's proposal need to be carefully studied and understood before moving ahead with the provisions of the SMD rule in the West.
- FERC's proposal to unravel protections afforded to utilities' native load customers is very troubling. These protections have been carefully crafted by state PUCs and are time-tested.
- The presently fragile Western economy cannot afford missteps that may result from the unprecedented changes to our electric power system that are embodied in the SMD rule. The uncertainties that would be introduced by the SMD rule may dampen investor confidence and leave the West short of generation.

There may be regions of the country that are anxious to implement the SMD rule. We suggest that FERC test its SMD rule in those regions first and learn from that experience.

We intend to continue our examination of the proposed SMD rule and to share with you and our Congressional delegations our findings.

Sincerely,


Jim Geringer
Governor of Wyoming
Co-lead Governor for Energy


John A. Kitzhaber, M.D.
Governor of Oregon
Co-lead Governor for Energy