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RTO Development

Summary

Canadian electricity market participants have learned that watching regulatory developments south of the border is critical to success in electricity trade. The electricity market is continental in nature. Moreover, experience has shown that measures taken by the Federal Energy Regulatory Commission (FERC) to open access to US markets tend to require reciprocal measures to be taken in Canada in order for Canadians to participate in the US market.

In July 2001 FERC outlined its vision for a seamless wholesale energy market in the United States. A cornerstone of that vision is the development of four large regional transmission organizations (RTOs) to operate the transmission systems of numerous utilities and transmission owners in the Northeast, Southeast, Midwest and Western United States. FERC also indicated that it would take a more aggressive approach towards standardizing business practices and market design in order to facilitate the “interregional coordination” of electricity trade. Recently, in a series of orders issued in November, 2001, FERC has affirmed its vision, but has indicated its willingness to take a more consultative and flexible approach towards its fulfillment. The RTO initiative is of interest to Canadian generators, power marketers, and transmission owners because of the continental nature of the North American electricity market.

Order 2000

In order to understand these recent orders, a little background is helpful. The RTO initiative, outlined in detail by FERC in Order 2000 (issued December 20, 1999) <http://www.ferc.gov/news/rules/pages/RM99-2A.pdf> website is the latest step in a progressive series of FERC initiatives designed

to create seamless, non-discriminatory open access to transmission lines that were formerly controlled, both in terms of access and pricing, by vertically-integrated utilities. FERC has continually articulated that open access transmission is the foundation necessary for competitive wholesale power markets in North America.

The RTO initiative was preceded by measures (following changes to the *Federal Power Act* in 1992) that required utilities in certain circumstances to wheel power for others over their transmission lines. In 1996, FERC ordered (in Orders 888 and 889) utilities owning or operating transmission facilities involved in the interstate transmission of electricity (and subject to FERC jurisdiction) to “functionally segregate” their transmission operations from their generation and distribution operations and to provide access to wholesale transmission on a non-discriminatory basis to all market participants in accordance with a prescribed open access tariff.

Orders 888 and 889 had repercussions in Canada. The *pro forma* open access tariff adopted by US utilities required Canadian marketers seeking access to transmission in the US to have reciprocal open access provisions in the transmission tariffs of the transmission owning utilities in Canada with which they were affiliated. As a result, provinces with export-oriented electric utilities (such as British Columbia and Quebec) quickly adopted open access wholesale transmission tariffs in a form that would be acceptable to FERC.

Despite the significant move towards open access that Orders 888 and 889 created, FERC took a further step in Order 2000. Reacting to concerns and complaints from marketers and independent generators, FERC decided that functional separation of transmission operations and the provision by vertically integrated utilities of non-discriminatory open access transmission services was inadequate to achieve its goal of open, fair,



and efficient electricity trade. Accordingly, in Order 2000 FERC ordered all jurisdictional transmission-owning utilities and existing ISO's to participate in negotiations and to file "voluntary" plans with FERC (in accordance with a schedule set out in Order 2000) outlining the manner by which each utility planned to participate in an RTO. "Participation" in an RTO essentially means that each transmission-owning utility will be required to dispose of the ownership or control of its transmission facilities to an RTO. RTOs are required to be independent of all market participants and are intended to eliminate any remaining ability of vertically integrated utilities to use their control of transmission assets to favour their own generation in competitive power markets. In Order 2000 FERC outlined four main characteristics of an RTO:

- (a) independence from all market participants;
- (b) sufficient scope and configuration to properly serve a region;
- (c) operational authority for all transmission facilities under its control; and
- (d) exclusive authority for monitoring the short term reliability of the grid that it operates.

FERC also outlined a series of eight functions that it expected RTOs to perform including:

- (a) tariff administration;
- (b) congestion management;
- (c) parallel path flow management;
- (d) provisions of ancillary services (as a last resort);

- (e) OASIS site administration;
- (f) market monitoring;
- (g) planning and expansion; and
- (h) interregional coordination.

The last function, interregional coordination, requires an RTO to ensure the integration of reliability practices within an interconnection and to ensure the integration of market interface practices among regions.

### Response to Order 2000

In response to Order 2000, numerous discussions between transmission owners and other market participants began, recommenced, or were renewed with vigour across the United States. Approximately 15 RTO proposals were filed in one form or another with FERC, including filings made by pre-existing ISOs such as California and New York. RTO proposals have embodied various business models from not-for profit independent system operators (ISOs) to for-profit "Transcos", to various combinations of the two.

In the Western Interconnection (of which Alberta and British Columbia form a part) there have been three primary RTO proposals. A group of nine Northwest utilities<sup>1</sup> (including the federal power marketing agency BPA) have filed a proposal (RTO West) covering the transmission grid of the Northwest Power Pool and Nevada (approximately 580,000 square miles encompassing the states of Washington, Oregon, Idaho, Utah, Nevada, and portions of Montana,

<sup>1</sup> Avista Corporation, Bonneville Power Administration, Idaho Power Company, The Montana Power Company, Nevada Power Company, PacifiCorp, Portland General Electric, Puget Sound Energy, Inc. and Sierra Pacific Power Company..

Wyoming, and California). The California ISO has filed its own RTO proposal, and a third entity comprised of utilities in the Southwest initially filed a proposal to form a non-profit RTO called Desert Star, which has subsequently been replaced by an RTO proposal for a for-profit RTO called Westconnect.

Canadian utilities have been active in RTO formation, particularly those that trade actively in the United States market. A group of utilities in Atlantic Canada have participated in an RTO proposal with a counterpart in Maine. Manitoba Hydro has signed a coordination agreement with the Midwest ISO. BC Hydro has been active in the development of RTO West. Alberta government entities have also shown some interest in the development of RTO West. FERC has indicated, in Order 2000 and in subsequent orders, that it welcomes Canadian participation in RTOs because the electricity markets are North American in nature. FERC has also acknowledged the need to accommodate provincial and Canadian regulatory requirements in the process.

### Super-Grids and Standardization

The proliferation of RTO proposals and the obvious differences in market designs and rules that became apparent with the filings over the course of fall and winter 2000/2001, raised concerns, particularly among power marketers and large industrial consumers, that the "seams" between RTOs could inhibit the development of the trading opportunities and efficiencies that RTOs were intended to foster.

These concerns, coupled with the new administration's call for a "national electricity grid" led to a bolder vision from FERC of the end-state for the RTO initiative and to a less "voluntary" approach to interregional coordination.



First, in an Order dated April 26, 2001 found at <http://cips.ferc.fed.us/electric/rt/rt01-35.00b.txt> respecting RTO West's filing, FERC described the RTO West initiative as a good "first step" towards the development of a "West-wide" RTO that would encompass the entire Western Interconnection including the regions covered in the RTO proposals of RTO West, Desert Star and the California ISO. FERC described the West as one "natural market" citing, as an example, the trading patterns evident from the crisis in California in the previous year. It ordered RTO West to file, by December 1, 2001, a status report detailing, among other things:

- (a) resolutions of seams issues in the Western Interconnection;
- (b) plans for participation in RTO West by Canadian entities;
- (c) a framework for formation of a West-wide RTO; and
- (d) a timetable for achieving a West-wide RTO end state.

Next, at a technical conference in Washington on June 19, 2001, several Commissioners publicly indicated a desire for stronger interregional coordination between RTOs and expressed the need for uniform communications protocols and business practices across electricity markets.

Then, in a series of Orders dated July 12, 2001, FERC clearly articulated that it wants to see only four RTOs in the United States: one for the Northeast, one for the Midwest, one for the Southeast, and one for the West. In doing so, it ordered the three existing ISO's in the Northeast (NYISO, ISO-NE, and PJM) into mediated negotiations (while accepting PJM as the platform, and rejecting

the NYISO and ISO-NE proposals) to ensure achievement of its goal. It also ordered the emerging RTOs in the Southeast (Grid South, SeTrans, and Southwest Power Pool) to enter into a separate mediated set of negotiations toward the formation of a single RTO for the Southeast. FERC rejected arguments against the creation of a West-wide RTO and reinforced its desire to see a single RTO in the West in a separate Order on Rehearing with respect to RTO West. In these Orders, several Commissioners again expressed the need to adopt standardized interconnection procedures nationally, a sign that FERC's patience with the progress made on this front on a "voluntary" basis was coming to an end.

In the Western Interconnection, FERC's vision of a West-wide RTO met with supporters and detractors. Supporters, such as power marketers and large industrials see large RTOs as a means to eliminate "pancaked" transmission rates and to simplify the logistics of obtaining access to transmission across broad regions. Others, such as small public distribution companies in the Northwest that are dependent on BPA, see any RTO as a threat to the reliability and to the security of access to the transmission system that they feel that they have paid for. They fear that a larger West-wide RTO will be a more remote and unresponsive entity and that its cost will exceed any benefits provided to consumers. FERC's West-wide RTO vision was opposed by representatives of public utility commissions in 11 Western States and met with considerable opposition at the political level.

### **Recent Steps Forward – or Backwards**

FERC has recently indicated that it is prepared to accommodate a more flexible and consultative approach to RTO

development. In an Order issued November 7, 2001, located online at <http://www.ferc.fed.us/Electric/RTO/rto/issuance/RM01-12.pdf> FERC outlined that it will pursue a two-pronged approach to the development of RTOs. The evaluation of current RTO proposals will continue in its existing dockets, while another docket has been created for the purpose of a proposed rule-making to standardize RTO tariffs and market design.

FERC clearly indicated that it had heard the critics of its July orders and offered olive branches to the state commissions and regional interests that had been most antagonistic to its "four large standardized RTO" approach. While reiterating its fundamental objective of creating a seamless, competitive marketplace for wholesale transactions in electric energy and its support for RTOs as a "cornerstone" for the achievement of that objective, FERC acknowledged that broad stakeholder support was necessary in order to achieve its goals, and that its desire for standardization must be tempered with some flexibility in regional market design and in the manner in which certain RTO functions may be fulfilled.

FERC has indicated that its review of existing RTO proposals will be undertaken following consultation with state commissions through the institution of state-federal RTO panels. FERC also indicated that it will work with state commissions in the performance of cost-benefit studies to determine whether, and how, RTOs will yield savings to customers, an analytic step that it had rejected consistently before. It expressly indicated that its rulemaking process to standardize market design rules will "balance the need to remove undue discrimination and excessive costs in transmission services with the need to permit regional differences and market innovation". For Western market



participants, FERC relented somewhat on its goal of a “West-wide RTO”, observing that “it is now apparent that the presence of three sub-regional organizations (bound by a workable seams agreement) under a larger umbrella organization has the potential to succeed”.

While RTO development continues, uncertainty exists with respect to the shape and form that RTOs will ultimately take. Initially many commentators thought that there was a trend to for-profit “Transcos”. More recently, many commentators have argued that non-profit ISOs are a more appropriate RTO vehicle because they have less of a built-in bias for transmission solutions to congestion problems.

Nor do the purposes and functions of RTOs seem to be as cast in stone as they appeared in Order 2000. On November 20, FERC raised the prospect of various entities sharing RTO functions in each region by inviting comments in each RTO docket with respect to the nature and type of entity that would be most appropriate for the fulfillment of each RTO function.

The creation of RTOs on a “voluntary” basis is extraordinarily complex. Large RTOs must seek to balance the interests of public and private transmission owners, marketers, generators, environmentalists, large and small customers, and federal and state regulators. Developing a framework for participation by Canadian entities that have to live under different legal and regulatory systems adds further complexity. Nevertheless, the FERC is unlikely to shrink from the task and there appears to be sufficient political will in support of the RTO initiatives that it will succeed in some form or other. Once RTOs are established they are almost sure to have profound implications for the electricity business throughout western Canada.

This article was prepared by Peter D. Feldberg of Lawson Lundell’s Energy Law group. For more information about this topic, please contact Peter at 403.781.9457 in our Calgary office or any of Gordon Craig, Jeff Christian, or Chris Sanderson, QC at 604.685.3456 in our Vancouver office.

If you would like specific advice on a particular situation or further information on other matters of interest, please feel free to contact any of the members of our Energy Law group.

**VANCOUVER**

- Khaled S. Abdel-Barr 604.631.9233  
kabdell-barr@lawsonlundell.com
- Chris G. Baldwin 604.631.9151  
cbaldwin@lawsonlundell.com
- Jeff Christian 604.631.9115  
jchristian@lawsonlundell.com
- Gordon M. Craig 604.631.9155  
gcraig@lawsonlundell.com
- Chris W. Sanderson, QC 604.631.9183  
csanderson@lawsonlundell.com
- Diana Valiela 604.631.6724  
dvaliela@lawsonlundell.com

**CALGARY**

- Niall Armstrong 403.781.9470  
narmstrong@lawsonlundell.com
- A.W. (Sandy) Carpenter 403.781.9458  
scarpenter@lawsonlundell.com
- Peter D. Feldberg 403.781.9457  
pfeldberg@lawsonlundell.com
- Cecilia A. Low 403.781.9456  
clow@lawsonlundell.com
- Keith W. Templeton 403.781.9455  
ktempleton@lawsonlundell.com

**YELLOWKNIFE**

- Keith B. Bergner 867.766.5326  
kbergner@lawsonlundell.com

**VANCOUVER**

1600 Cathedral Place  
925 West Georgia Street  
Vancouver, British Columbia  
Canada V6C 3L2  
Telephone 604.685.3456  
Facsimile 604.669.1620

**CALGARY**

3700, 205 – 5<sup>th</sup> Avenue SW  
Bow Valley Square 2  
Calgary, Alberta  
Canada T2P 2V7  
Telephone 403.269.6900  
Facsimile 403.269.9494

**YELLOWKNIFE**

702 Northwest Tower  
5201 Franklin (50th) Avenue  
Yellowknife, NWT  
Canada X1A 3S7  
Telephone 867.669.9990  
Facsimile 867.669.9991  
Toll Free 1.888.465.7608

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