

ALLIANCE OF STATE LEADERS PROTECTING ELECTRICITY CONSUMERS

March 5, 2003

Spencer Abraham
Secretary of Energy
U.S. Department of Energy
1000 Independence Avenue, SW
Washington, DC 20585

Dear Secretary Abraham:

We are writing to express our keen interest in the analysis, which Congress has required the Department of Energy (DOE) to perform as part of the 2003 Appropriations Bill, of the effects of FERC's proposed Standard Market Design (SMD) on regional electricity prices. We want to express our desire to assist DOE in any way possible to perform this very important study, express our expectations and hopes for the types of analyses that will be included in the study, and express our interest in the nature and extent of public review to be afforded the study.

As you know, in the fall of 2002 the Southeastern Association of Regulatory Utility Commissioners (SEARUC) sponsored a more limited analysis of the costs and benefits of RTO formation and SMD for the southeastern U.S. The SEARUC study did not include several key SMD-related issues that we hope DOE will include, in order to provide a complete and technically accurate assessment consistent with the Congressional guidelines. Any analysis will need to provide for a robust market assessment under two scenarios: when prices are competitive in the wholesale electric markets, and when market power is being exercised. This two-pronged approach should include the effect of locational marginal pricing (LMP) and participant funding on wholesale and retail customers, and the effect of congestion revenue rights (CRR) markets on wholesale and retail customers. The same is true for DOE's analysis of energy-balancing markets, since the behavior of all three types of markets will be closely linked.

Further, we urge DOE to define competitive market prices for generation and CRRs, as well as to illustrate how prices might deviate from competitive levels due to the potential exercise of market power in each of the types of markets included in the SMD. In particular, the study will need to determine to what extent the types of market structures mandated in the SMD will facilitate or change the likelihood of market power being exercised in wholesale and retail markets. This determination is needed to properly address the effect of SMD "on the reasonableness of electricity prices" as required by Congress. However, we also believe that DOE will separately need to define under what circumstances wholesale electricity prices will be "just and reasonable" as required by the Federal Power Act. Finally, we expect that DOE will need to analyze the effect on wholesale and retail electricity prices of the higher cost of capital that non-regulated entities will demand from their investments in generation and transmission facilities in comparison to regulated public utilities, if they are operating in an SMD/RTO environment in contrast to today's regulatory environment. Since today's regulatory environment differs significantly among the various regions of the U.S., and because the physical

infrastructure of the electric system similarly varies by region, we expect that this study will include separate regional sensitivity analysis for each major region of the U.S., as we believe Congress intended.

In addition to submitting your multi-regional study to the appropriate Congressional Committees, we suggest that DOE submit the study to the public for formal written comments, allowing at least a 60-day public comment period. In order to allow the public to fully understand your study, we hope that DOE will make available all relevant workpapers and materials on which the study relied on the DOE website for public review and inspection. Since this study will be a very important contribution to the debate over whether or not the proposed SMD rules (and RTOs generally as defined in FERC Order No. 2000) make sense for the various regions of the U.S., we believe that DOE should allow public access to the materials that underlie your entire analysis, including the assumptions and data inputs and computer model runs performed. In addition, DOE should organize regional technical conferences to discuss the findings of the study and the concerns specific to each region.

In addition, we are eager to work with DOE in helping to design the assumptions, work statement and methodologies for this complex and important study. Thus, the Alliance would like to serve on a stakeholder committee to provide appropriate input to your study team. We strongly believe that this study must be performed in a scientifically-defensible manner, independent of FERC and the past analyses that FERC has performed of the SMD and of RTOs. Therefore, the due date for the study of April 30, 2003, may be unrealistic. In fact, given that FERC is planning to issue a new whitepaper on its interim SMD decisions at the end of April, DOE does not have what will soon be the most relevant "current version of the proposed rule" on which it could base its price analysis. Thus, we support DOE taking whatever amount of time it needs to do a careful job with this study, perhaps several months beyond the April 30 due date.

If you have any questions about this letter, please contact us directly.

Sincerely,



Marilyn Showalter
Washington Utilities and
Transportation Commission
Alliance Co-chair



Jim Kerr
North Carolina Utilities Commission
Alliance co-chair