

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Standards of Conduct for Transmission)
Providers) **Docket No. RM01-10-000**
)
)

COMMENTS OF CINERGY SERVICES, INC.

These comments are filed by Cinergy Services, Inc. ("Services") on behalf of itself, its gas and electric utility affiliates (PSI Energy, Inc. ("PSI"), The Cincinnati Gas and Electric Company ("CG&E"), The Union Light Heat and Power Company ("ULH&P")), and Lawrenceburg Gas Company, its gas transmission company (KO Transmission Company), and its new energy affiliates engaged in multiple non-regulated energy-related activities (collectively "Cinergy").

Services and its employees perform various management, administrative and operational services for affiliated companies pursuant to a variety of agreements, some of which have been approved or accepted by this Commission, the Securities and Exchange Commission ("SEC") and/or the state utility commissions of Indiana, Ohio, and Kentucky. Among other things, distinct groups of Services employees perform for the Cinergy Operating Companies the activities currently regulated by FERC's Order No. 889 Standards of Conduct.¹ One group of employees performs "wholesale merchant

¹ *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, 61 Fed. Reg. 21,721 (May 10, 1996), 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,035 (1996), *order on reh'g*, Order No. 889-A, 62 Fed. Reg. 12,484 (March 14, 1997), 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,049 (1997),

functions" (i.e., joint off-system sales) as well as joint generation dispatch and joint off-system purchases; another group performs "transmission and reliability functions," operating the joint transmission system and administering the joint open access transmission tariff ("OATT") on file with FERC.

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EXECUTIVE SUMMARY

Cinergy generally supports the Commission's efforts to adopt common principles to govern affiliate relations in both the gas and electric industries. However, Cinergy believes that there are legitimate timing and substantive issues that must be factored into the details of a final rule, that may require differentiation in either the rules themselves or how they are applied. In the past, the Commission has been careful to seek to narrowly tailor its affiliate rules to accomplish intended objectives in the manner that is otherwise least intrusive into the ordinary operations of affiliated companies.² Cinergy urges the same approach here.

order on reh'g, Order No. 889-B, 81 FERC ¶ 61,253 (1997), *order on reh'g*, Order No. 889-C, 82 FERC ¶ 61,046 (1998).

² See, e.g., *InterCoast Power Marketing Co.*, 68 FERC ¶ 61,248, at 62,133 (1994) (stating, with respect to Codes of Conduct: "The possibility of affiliate abuse raises a difficult issue. While we must guard against affiliate abuse, we also do not want to burden affiliated power marketers with excessive, unnecessary regulatory requirements."); *Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, Order No. 497-A, 54 Fed. Reg. 52,781 (Dec. 22, 1989),

Cinergy supports the expansion of the definition of "affiliate" in the NOPR to include additional competitive activities that are related to, engaged in or could benefit from the market power of affiliated transmission providers.³ The Commission rightfully notes that the original definition of "affiliate" for purposes of current standards of conduct and disclosure requirements may be too narrow, given the scope of new activities in which affiliates of jurisdictional gas and electric transmission-owning entities are engaged. The definition now needs to be expanded to encompass non-regulated "new energy" activities that could unfairly benefit from preferential treatment by transmission providers within their corporate structure.

On the other hand, an overbroad definition of "energy affiliate," as that term is now defined in the NOPR, will produce results that the Commission could not have intended. For example, under the language of the NOPR, PSI transmission operators could not coordinate with CG&E transmission operators, since they are "energy affiliates" of each other, even though the two transmission systems are operated jointly today, as required by this Commission. Moreover, as currently drafted, the NOPR would require disaggregation of the management and operation of certain holding company structures, contrary to approvals of this Commission, the Securities and Exchange

1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,868, at 31,589 (1989) ("Order 497-A") (stating, with respect to gas standards of conduct: "In determining the appropriate action to take, the Commission sought to fashion a rule that would prevent these abuses with the least regulatory infringement necessary. The Commission believes that the course it adopted in the final rule of establishing standards of conduct and reporting requirements has been effective in curbing affiliate abuses without the need for more intrusive measures.")

³ As the Commission notes in the NOPR, "affiliated" principles may apply to both separately incorporated entities within a corporation or to functional units within a single corporate entity. Except where specifically discussed, Cinergy uses the word "affiliate" broadly in these comments to denote both types of relationship.

Commission and state commissions. Cinergy does not believe that the Commission intends to preclude joint transmission operation (and other similar activities that are not harmful to the competitive wholesale markets) or to create rules that conflict with regulatorily-sanctioned corporate structures, so the NOPR needs to be revised to take into account functional activities, and the definition of "energy affiliate" needs to be carefully crafted to avoid harmful and unintended results.

Cinergy is also concerned that the Commission's new rulemaking appears to impose unbundling requirements for the "retail sales function" that may be appropriate given the current state of development in the gas industry, but that fail to recognize current realities in the electric industry, particularly given the state of retail electric deregulation. In fact, "retail sales function" has not been clearly defined in the NOPR and the type of activities to which it refers is uncertain. As with the definition of "energy affiliate," a broad brush approach to retail separation will have serious and expensive consequences to utilities and their customers, and could easily cause integrated utilities to violate, or at least not be able to fulfill, their obligations under state laws, as explained in these comments.

Nonetheless, Cinergy believes that the rules can be crafted to fit both industries without sacrificing the Commission's goals in either industry. Below, Cinergy explains its view of the development of the gas industry, and how this has differed from the development of the electric industry in areas that are fundamental to the Commission's proposal. Following that, Cinergy analyzes specific aspects of the Commission's rules, and proposes small but important revisions to best accommodate the rules to the realities of both industries.

Finally, Cinergy does not support restrictions on affiliate access to transmission service or on pricing policies for affiliate transactions. The rapid progress of deregulation in the gas industry, and the enormous number of new and successful entrants in both the gas and electric industries, are clear evidence that the affiliate rules have worked well. In those few instances where affiliate abuse has been alleged, the Commission has been able to step in and rectify the situation, if appropriate. The market will benefit from more participants rather than fewer. In a competitive market, the participants must be able to compete on an equal basis if they are to survive. Putting access restrictions or pricing handcuffs on an affiliate will cripple it unfairly, and in some cases may substantially interfere with obligations to serve native load. The Commission's goal should be to ensure that competitive activities within a corporation are neither unduly benefited nor unduly harmed by their relationships with transmission providers.

**THE COMMISSION SHOULD BE EXPLICIT ABOUT THE GOALS OF
THE NOPR AND SHOULD TAILOR ITS NEW RULES TO
ACHIEVE THOSE GOALS.**

Prior to finalizing new rules in the instant docket, Cinergy urges the Commission to clarify and to make explicit in its preamble to the rules the principles that underlie its actions and the goals it hopes to accomplish. It should then explain how each change it adopts is founded on those principles and advances or achieves the stated goals. Cinergy believes that the NOPR, as proposed, is overbroad in its scope and effect. Clarity as to purpose and goals would help to focus the scope of the rules to legitimate problem areas.

The goals of rules for affiliate conduct can be simply stated. The central goal is to optimize the efficiency and reliability of this nation's energy infrastructure. This is to be accomplished by:

- (1) promoting the development of robust and competitive wholesale gas and electric markets through principles of equal access to transmission service and standards applied in a non-discriminatory manner to all market participants; and
- (2) coordinating in a considered manner state/federal jurisdictional boundaries and respecting state law requirements of jurisdictional utilities.

Underlying these goals is the fundamental principle that monopoly transmission providers should not be permitted to transfer benefits of their market power to affiliates operating in related competitive markets. Once this general principle is enunciated and the goals defined, they will then provide an appropriate legal and policy framework for the development of a final set of rules that will be focused, effective and not overly broad in their scope. To the extent that affiliate transactions and intracorporate dealings do not run afoul of these principles, they should not be affected by the new rules. And to the extent that affiliate relationships and intracorporate dealings actually promote or advance the key goals, they should be encouraged by and specifically exempted from the rules.

I. THE GAS INDUSTRY HAS UNBUNDLED AND DEREGULATED MUCH MORE RAPIDLY THAN THE ELECTRIC INDUSTRY AND WITH FAR FEWER JURISDICTIONAL IMPEDIMENTS.

A. Original affiliate rules in the gas industry took into account the integrated nature of the pipeline sales obligation.

The history of the development of affiliate standards in the natural gas pipeline industry is instructive to an understanding of: (1) next steps in the gas industry and (2) applicability to the electric industry. Application of the standards of conduct and non-disclosure requirements for gas pipelines and their marketing affiliates tracked the

evolution of deregulation and unbundling in the industry. The first affiliate rules⁴ were issued while interstate gas transmission and sales were still an integrated and regulated function. Interstate pipelines had heavily regulated sales "service obligations" to their distribution and direct sales customers that could not be changed or abandoned absent the approval of the Commission.⁵

The first affiliate standards adopted by this Commission thus allowed the pipelines to continue fulfilling their service obligations. Separation and non-disclosure were required "to the maximum extent practicable," and the Commission interpreted this

⁴ *Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, Order No. 497, 53 Fed. Reg. 22,139 (June 14, 1988), 1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,820 (1988) ("Order 497"); *order on reh'g*, Order No. 497-A; *order extending sunset date*, Order No. 497-B, 55 Fed. Reg. 53,291 (Dec. 28, 1990), 1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,908 (1990) (Order 497-B"); *order extending sunset date*, Order No. 497-C, 57 Fed. Reg. 9 (Jan. 2, 1992), 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 30,934 (1991) ("Order 497-C"), *reh'g denied*, 57 Fed. Reg. 5,815 (Feb. 18, 1992), 58 FERC ¶ 61,139 (1992); *aff'd in part remanded in part, Tenneco Gas v. FERC*, 969 F.2d 1187 (D.C. Cir. 1992), *order on remand and extending sunset date*, Order No. 497-D, 57 Fed. Reg. 58,978 (Dec. 14, 1992), 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 30,958 (1991) ("Order 497-D"); *order on reh'g and extending sunset date*, Order No. 497-E, 59 Fed. Reg. 243 (Jan. 4, 1994), 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 30,987 (1993) ("Order 497-E"); *order denying reh'g and granting clarification*, Order No. 497-F, 59 Fed. Reg. 15,336 (Apr. 1, 1994), 66 FERC ¶ 61,347 (Mar. 24, 1994) ("Order 497-F"); *order extending sunset date*, Order No. 497-G, 59 Fed. Reg. 3,284 (June 26, 1994), 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 30,996 (1994) ("Order 497-G").

⁵ *See e.g., Pipeline Service Obligations' and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636-B, 57 Fed. Reg. 57,911 (Dec. 8, 1992), 61 FERC ¶ 61,272, at 62,038 (Nov. 27, 1992) (stating prior to unbundling "pipelines' service obligations to their sales customers extended beyond the expiration of their sales contracts with those customers."); *Northern Natural Gas Co.*, 24 FERC ¶ 61,267, at 61,552 (1983) ("[N]otwithstanding contract terms . . . service obligation will continue until [a company] has filed for and received from the Commission abandonment authorization under Section 7(b) of the Natural Gas Act."); *Panhandle Eastern Pipe Line Co.*, 57 FERC ¶ 61,265, at 61,862 (1991) ("Any substantial change in the contract demand, and the pipeline's service obligation, must be effectuated pursuant to section 7.").

to allow reasonable accommodation of the regulatory rules and business exigencies of the time.⁶

As the pipelines' sales obligations de-aggregated from the transmission function under Order No. 636, exceptions from the full applicability of the affiliate rules became rare. Stated another way, as the legal and regulatory duties imposed on the pipeline sales function were lifted and the function was increasingly conducted through deregulated affiliates, the need for exceptions and special treatment for integrated, regulated operations substantially decreased.⁷ As this Commission considers the appropriate

⁶ When first adopted, Standard E of Order 497 applied only to operational personnel. "The Commission [did] not believe it . . . necessary to require separation of support personnel to prevent the occurrence of undue preferential treatment of a marketing affiliate by its affiliated pipeline." Order 497. However, by the time of unbundling, Standard E was not limited to operating personnel only. Order 497-F; *Amoco Production Co., v. Natural Gas Pipeline Co. of America*, 83 FERC ¶ 61,197 (1998) (stating Standard E applies to all employees, operating and non-operating). *See also*, Order 497 ("The Commission . . . is not mandating organizational separation, but only requiring that it be undertaken to the maximum extent practicable. Different pipelines are faced with different practical circumstances and may not be able to accomplish organizational separation to the same degree.") *order on reh'g*, Order 497-A ("The final rule established standards of conduct . . . [that provide] a pipeline: . . . must, to the maximum extent practicable, provide for the independent functioning of operating personnel of the pipeline and the affiliate. . . . The Commission does not believe that it must mandate organizational separation of a pipeline and its marketing affiliate at this time.").

⁷ *See e.g., East Tennessee Natural Gas Co.*, 65 FERC ¶ 61,389, at 63,061 (1993) ("Before Order No. 636 . . . pipelines' sales and transportation functions were combined, but pipelines' sales could not be combined with affiliates' sales. Indeed . . . the Commission expected gas supply functions of pipelines and their affiliates to be handled by different personnel and ordered pipelines to separate those functions if they had not done so voluntarily. Order No. 636 brings a fundamental change to the implementation of Order No. 497. Pipelines' sales must be treated as the functional equivalent of marketing affiliates' sales with the prohibitions and record-keeping requirements of Order No. 497 applying to transactions between pipelines' sales and transportation divisions."); *Standards of Conduct and Reporting Requirements for Transportation and Affiliate Transactions*, Order No. 566-A, 59 Fed. Reg. 52,896 (Oct. 20, 1994), 69 FERC ¶ 61,044 (1994) ("In light of the changes effected by Order No. 636 and by the Commission's review of its existing Order No. 497 requirements, the Commission in Order No. 566

structure of affiliate rules for the electric industry of 2002, it must fashion those rules around the existing business, legal and regulatory environment facing the companies affected. The principles and goals of the rules can be the same for both the electric and gas industries, but the two industries are simply not at the same point in the "deregulatory life cycle." The new rules must recognize both state and federal legal requirements imposed on utilities, and achieve their goals of moving the competitive part of the industry forward while honoring the existing legal requirements and not destroying the efficiencies of a partially regulated/partially deregulated system.

B. The wholesale market for electricity is closely tracking the history of deregulation in the gas industry. This is in contrast to electric retail deregulation, which has been sporadic in timing and varying in structure from one state to the next.

The wholesale electric market has become competitive over the last several years and the Commission has imposed standards and codes of conduct between wholesale marketers and transmission providers that Cinergy has supported and encouraged. In fact, Cinergy's non-regulated affiliates are active in many areas of the wholesale market, and it is vital to the success of their initiatives that they have equal and non-discriminatory access to the transmission grid. Cinergy has been a leading advocate for open access, ISOs, and responsible affiliate rules.

made significant changes in the Standards of Conduct and the tariff and reporting requirements."); *Northwest Pipeline Corp.*, 94 FERC ¶ 61,055, at 61,257 (2001) (noting that after unbundling, "the Commission expanded its affiliate regulations so that more information is provided by the pipeline to permit monitoring and self-policing of affiliate transactions. . . . [A] pipeline is required to post: (1) the names and addresses of its marketing affiliates; (2) a complete list of the names of operating personnel and facilities that are shared by the pipeline and its marketing affiliates; and (3) organizational charts and job titles and descriptions.").

Cinergy also has been a leading advocate for retail deregulation, and was instrumental in working with the Ohio legislature as it structured and passed legislation opening retail markets to competition in the state. However, the state of retail deregulation is much different than either the competitive elements of the wholesale electric market or the deregulation and unbundling of sales and transmission in the gas industry.

A key distinction stems from the fact that electric utilities have been and many still are fully integrated, in that they produce, transmit, distribute and sell the end product within a single corporate entity. Further, they operate pursuant to state law, and much of what they do is outside the jurisdiction of this Commission. Even though the wholesale market for electricity and the transmission function may be similar in several respects to the gas industry as it has deregulated, the retail sales function has been integrated with the generating, transmission and distribution functions pursuant, in many instances, to state laws. In essence, the bundled production, transmission, distribution, and retail sales electric business is analogous to the wholesale gas industry pre-unbundling and pre-deregulation.

The states themselves are in various stages of evolution with regard to competitive retail access and the de-aggregating of the integrated utility functions of production, transmission, distribution and retail sales. In many states no competitive retail access is permitted. In those states (such as Indiana and Kentucky), retail sales and distribution remain fully integrated with transmission and generation. There can be no harm to the competitive *retail* market in those states, because it does not exist. Captive customers are protected by regulation, and they must receive reliable service from their

integrated utility because they have no alternative. As strongly as Cinergy believes in customer choice, it cannot mandate it, and it must obey the governing statutes and must fulfill the regulatory obligations in the states in which it operates.

In other states (such as Ohio) full retail access to the competitive market is available to customers and the competitive sales function is unbundled from the regulated distribution and transmission functions. However, even in states which have legislated retail access, most (if not all) require that the former utility provide sales service as the provider of last resort.

As long as it remains an integrated utility in some states, with an obligation to serve, or to the extent that it must serve as the energy supplier of last resort in other states, Cinergy must retain the ability to fulfill its obligations in the most efficient, cost-effective, and customer-responsible manner possible. Affiliate rules that ignore state and federal laws that require Cinergy to operate an integrated system, hinder Cinergy's ability to do this, or make it more burdensome or costly, must be closely scrutinized. Rules that do not provide a clear and definable benefit to the reliability and efficiency of at least the wholesale market should not be adopted at all.

Given the nature of the electric industry and the division of jurisdiction between states and the Commission, a key question as the Commission considers changes to its affiliate rules should be how to allow utilities to continue to provide either (1) their integrated supply functions to retail customers or (2) their provider of last resort functions without doing harm to either their retail customers or to the competitive wholesale electric market. There is a requirement for balance and accommodation between state and federal jurisdictions and policies that typically did not exist in the gas industry. At

least in the short-term, it will require the Commission to be focused in its approach and to differentiate between fully integrated electric utility functions and unbundled functions (whether they be gas or electric) as it formulates new affiliate rules. While Cinergy believes that the overriding principles should be the same for both industries, the inquiry should not be whether the gas industry should have the same or different standards from the electric industry. The inquiry should be whether the details, timing and applicability of the rules must be identical as between fully unbundled activities and activities still integrated within the fabric of retail utility service. On this point, Cinergy believes that accommodations recognizing the current business and legal realities of electric utilities and retail service obligations are both necessary and appropriate.

II. TO MAXIMIZE RELIABILITY AND ACHIEVE SUBSTANTIAL COST EFFICIENCIES, CINERGY OPERATES AN INTEGRATED AND COORDINATED ELECTRIC SYSTEM, AS REQUIRED BY THIS COMMISSION, THE SECURITIES AND EXCHANGE COMMISSION AND THE STATE COMMISSIONS HAVING JURISDICTION.

Cinergy Corp. is a registered holding company under PUHCA. It owns and operates PSI, CG&E, ULH&P, Lawrenceburg Gas and KO Transmission, all "energy affiliates" under the NOPR. PSI is a fully integrated electric utility serving areas of Indiana. CG&E is currently a fully integrated electric utility and also a gas distribution company in Ohio. ULH&P provides retail gas and electric sales and distribution services in Kentucky. Lawrenceburg Gas is a gas distribution utility in Indiana. KO Transmission is a small interstate pipeline spur which interconnects two longhaul pipelines with the CG&E and ULH&P distribution systems. Services, which performs management, administrative and operational services for all the Cinergy companies, is

also an "energy affiliate" under the broad definition of the NOPR. As Cinergy currently reads the NOPR, it would require complete disaggregation of the management and operation of these utilities and regulated businesses, contrary to the requirements of the SEC and the state commissions and also contrary to this Commission's own orders. Further, Services could not continue to provide services across the various companies and activities, as it does today. Cinergy seriously questions whether this is the intent of the NOPR, but it is clearly the *result* unless the definition of the term "energy affiliate" is aligned to fit more precisely the principles and goals of the rulemaking. In any event, as discussed herein, the Commission's goals can be achieved without the overbroad nature of the proposed rules as drafted.

For purposes of this section of its comments, Cinergy has assumed that the Commission has not intended to treat Services as an "energy affiliate," even though, as proposed, the rule would have that effect. The demise of Services would substantially increase the cost impacts discussed below. Additionally, Cinergy urges the Commission to clarify or modify the proposed rules to make it clear that they do not require separation of the retail distribution (pipes and wires) business from the company's transmission function.

Assuming, however, that full retail distribution separation *is* the intent of the NOPR, Cinergy has conducted a preliminary review of its operations to ascertain the cost impact.⁸ Since the proposed rule is both vague and overbroad, Cinergy has made certain

⁸ In the time allowed for these comments, Cinergy has not been able to identify costs of duplicating or restructuring many of its corporate systems, such as financial systems, if such were encompassed in a final rule. Cinergy also has not attempted to quantify costs associated with necessary duplication of corporate support personnel, such

assumptions in its analysis. Preliminary findings indicate a *minimum* adverse impact over a five year period in the range of \$190-\$210 million. As noted above, this minimum estimate does not contemplate a total restructuring of Services, nor does it attempt to quantify potential adverse impacts on reliability or customer service, if separation is required and communication between transmission and distribution personnel is restricted. The following describes some of the critical areas that would be impacted.

A. Electric System Operations

Transmission and Distribution Operations – Cinergy operates two (2) regional transmission and distribution operations control centers. Each of the transmission and distribution operations control centers performs both transmission and distribution operation functions. Complete separation of the distribution functions from the transmission functions would require duplication of systems (such as shared radio and communications systems), new computer equipment and software, and additional personnel. Other costs needed to implement the physical separation of the two functions (e.g., leasing additional space, moving people and equipment, etc.) have not been included in the review.

Although the NOPR contains an exception for emergency situations, it is not clear what constitutes an "emergency" or whether backup centers would need to be separated. Current emergency backup centers, needed if the primary operations control centers become inoperable or must be vacated (depending on the emergency), are used to support both the transmission and distribution functions, and as such may require additional

as legal, accounting, human resources, etc. that could be required, or costs associated with disaggregation of joint transmission operations.

infrastructure and systems depending on the degree of separation required. These costs were not included in the evaluation.

Transmission and Distribution Planning –The planning function plans both the transmission and distribution systems on an integrated basis. These two systems support each other from a reliability standpoint and it is not clear how that integration and reliability could be safeguarded under a regime of separate system planning. Furthermore, integration of the functions results in the ability to optimize the design and use of the transmission and distribution systems, both economically and from an efficiency standpoint. Additional personnel and computer equipment (hardware and software) would be required if the planning function were to be separated.

Energy Management System (EMS) – The existing EMS system, used to monitor and operate the electric power grid and generation functions, could be modified and reprogrammed (at not insignificant costs) to create profiles for a distribution company to use and still restrict transmission related information similar to the approach used today with the wholesale merchant function. However, in an emergency, if transmission personnel could not coordinate with distribution personnel, reliability is compromised.

B. Construction, Maintenance and Engineering Organizations

The impact on the construction, maintenance and engineering organizations would be enormous. The engineering functions utilize the same computer systems (hardware and software) and personnel to perform engineering services for both transmission and distribution. The skills for the construction, maintenance and engineering functions are very similar, and use of the same workforce to do both is highly efficient. Many electric substations contain both transmission and distribution

equipment, and often transmission and distribution lines and equipment are attached to the same support structures. Construction and maintenance crews perform work on both transmission and distribution systems and crews can be shifted between systems if work slows in one area. During storms, crews can work either system to more quickly and efficiently restore service. Substation relay, test, construction and maintenance crews are trained to work on/with equipment on both systems.

A substantial increase in the labor force and associated vehicles and equipment could be required if full separation of the retail distribution from the transmission function was required.

C. Metering, Data Collection, Billing and Account Management

A separation of the retail functions, including metering and billing, would require additional metering capability, additional personnel and duplication of systems. There also likely would be confusion and disruption in customer bills and potential violations of state tariff requirements.

D. Database and Software Applications

A preliminary review of Cinergy databases and software applications identified several systems that are used by both the transmission and distribution functions. These systems include databases used to track rights of way, grants and easements, asset definitions of electrical equipment, and systems that track the geographical location of equipment. Applications used to design construction projects that utilize this data are also shared. Additional shared applications include systems that are used for purchasing, accounts payable, inventory, work and contract management,

and eProcurement. Separating or duplicating these applications and databases could take one to three years to complete, depending on resource availability, at a considerable cost.

In sum, integrated operation of regulated transmission and distribution pipes and wires does nothing to harm the wholesale gas and electric commodities markets. To the contrary, integration and coordination of these functions increases system reliability and provides substantial cost savings that ultimately accrue to the benefit of all consumers. This type of integration should be encouraged, not discouraged by affiliate rules and Commission policies.

III. ONLY RULES THAT ARE BASED ON FUNCTIONAL RESPONSIBILITIES WILL ACHIEVE THE COMMISSION'S GOALS OF ENSURING THAT COMPETITIVE ACTIVITIES UNDER THE SAME CORPORATE UMBRELLA AS TRANSMISSION PROVIDERS DO NOT RECEIVE PREFERENTIAL TREATMENT.

A. The new rules as applied to integrated operations and services should focus on a functional analysis rather than on the formality of corporate boundaries.

The NOPR states (p.2-3) that the Commission is not "proposing to change" principles on which electric and gas standards are based, namely:

- (1) "separating employees engaged in transmission services from those engaged in commodity marketing services, i.e., marketing or sales of natural gas or electric energy" and
- (2) "ensuring that all transmission customers, affiliated and non-affiliated, are treated on a non-discriminatory basis".

Cinergy agrees with these principles, which can only be achieved by rules that are applied functionally, rather than on the basis of corporate entity. Under the existing

electric standards, transmission/reliability employees are separated from wholesale merchant employees along functional lines. Information sharing restrictions follow the same functional lines. In adopting this approach, the Commission reasoned that it was not seeking to require corporate divestiture, but rather only the functional unbundling necessary to prevent leveraging of transmission market power, in the form of preferential treatment or superior access to transmission information, to advantage affiliated merchants. Functional (rather than corporate) separation was sufficient to accomplish this.⁹ Thus, senior managers, officers and directors, as well as support employees, who were not engaged in directing, organizing, or executing transmission/reliability or wholesale merchant functions, could be shared between business units and affiliates.¹⁰

One of the goals of the NOPR is to extend affiliate rules to "new energy" affiliates and activities. The NOPR states that new-style non-marketing affiliates "compete against non-affiliates for transmission services, in capacity release transactions, in power sales, and in siting new generation." NOPR at p. 8. Another concern is "asset managers." NOPR at p. 9. At core, each of these new-style energy affiliates is a potential concern because they compete with non-affiliates for transmission service, or because the

⁹ See *American Electric Power Service Corp.*, 81 FERC ¶ 61,332, at 62,512 (1997) ("AEP") ("The Commission did not extend separation of functions to require the corporate unbundling of transmission and generation control functions or to mandate the divestiture by transmission providers of their generation assets.").

¹⁰ *Id.* at 62,513 ("Transmission providers may allow senior managers, officers, or directors to have ultimate responsibility for both transmission system operations and wholesale merchant functions, as long as the persons with shared responsibilities do not participate in directing, organizing, or executing transmission system operations or reliability functions or wholesale merchant functions. Further, transmission providers may share "support" staff, such as legal counsel, accounting services and data processing who do not participate in these activities. We caution, however, that the standards preclude all employees, including employees with broad responsibilities and support staff, from acting as conduits for improper communications between transmission operations employees and wholesale merchant employees.").

transmission provider has information about its non-affiliate customers that an affiliate could use to its advantage. ("[W]hen the employees engaged in transmission services function independently, there are significantly fewer opportunities to give preferential treatment to affiliates engaged in or involved in commodity transactions or other business activities that compete with non-affiliated customers of the transmission providers."

NOPR at p.15. "[P]ipelines may be sharing confidential information with their non-marketing affiliates that could improve the affiliates' ability to secure deals or compete against non-affiliates." NOPR at p. 21.)

Under the logic of the electric standards, the goal of the NOPR should be satisfied (and given the nature of integrated electric operations, can *only* be satisfied) by extending separation requirements and information sharing restrictions along functional lines to those employees operating in non-regulated businesses that compete for transmission service or that compete with transmission customers (which we will call "New Energy Functions"). Division along corporate boundaries without regard to function would decimate the ability of a services company like Services to operate. Yet, that is exactly what the NOPR accomplishes when it states that the separation requirements and information sharing restrictions apply between transmission function employees and "all employees" of energy affiliates. The fact that the electric industry is not divided precisely into neat corporate bundles, makes it impossible to achieve the goals of the rule without modification. The Commission itself has frequently recognized that corporate form is neither the basis for, nor a limit to, its regulatory reach.¹¹ Indeed, the functional

¹¹ See, e.g., *KN Wattenberg Transmission Limited Liability Co. v. Public Service Co. of Colorado*, 83 FERC ¶ 62,289, at n.25 (1998), citing *Transcontinental Gas Pipeline Corp., v. FERC*, 998 F.2d 1313 (5th Cir. 1993). ("Where we find the federal regulatory

separation requirements of the electric standards of conduct were premised on looking past the corporate form to function. There is no reason for the Commission to depart from its tradition of looking beyond the corporate form here. Regulation on the basis of form will result in unnecessary and egregious costs and consequences that far outweigh any possible benefits.

B. The practical effect of the NOPR is to produce results that are overreaching and unjustified.

With few exceptions, the NOPR, if applied literally as proposed and in the extreme, could prevent transmission providers from sharing senior officers, directors and managers, as well as support staff, with energy affiliates, notwithstanding that such shared employees might not be directly engaged in either Transmission Functions or New Energy Functions. Issues regarding senior corporate management, who continue to have fiduciary obligations, were not specifically addressed in the NOPR. While a shared officer might be possible in theory if not engaged in transmission functions, in practice, under a broad application of the NOPR, that officer may not be able to fulfill fiduciary obligations to the transmission provider if he/she would be prohibited from obtaining any

scheme to be frustrated by the use of separate corporate entities, we may look through the separate corporate forms and treat the different entities as one and the same for purposes of regulation."); *Enova Corp.*, 79 FERC ¶ 61,107, at 61,493 (1997) ("[W]hile section 203 is applicable only to actions taken by public utilities, we will look beyond the corporate form of a transaction, and regard a parent and subsidiary as one company, in instances where the control over a public utility and its jurisdictional facilities is transferred from one corporate entity to another."); *KN Energy, Inc.*, 69 FERC ¶ 61,377, at 62,431 (1994) ("[I]f an affiliated gatherer acts in concert with its pipeline affiliate in connection with the transportation of gas in interstate commerce and in a manner that frustrates the Commission's effective regulation of the interstate pipeline, then the Commission may look through or disregard the separate corporate structure and treat the pipeline and gatherer as a single entity."); *San Diego Gas and Electric Co. v. Alamito Co.*, 38 FERC ¶ 61,241, at 61,788 (1987), citing *Iowa Southern Utilities Co.*, 35 FERC ¶ 61,149 (1986) ("[A]n agency may disregard corporate form in the interest of public convenience, fairness, or equity. ").

transmission information. The same is true of many support functions, such as legal and financial back-office functions. Cinergy believes it is critical and strongly urges the Commission to narrow the definitions and clarify in a final rule that senior corporate management and support personnel may continue to be shared, but will also continue to be subject to the No Conduit rule.

1. Separation of Integrated Regulated Holding Company Operations

Using the Cinergy system as an example, "energy affiliate" restrictions should not apply as between the electric transmission systems of PSI and CG&E (or the Services employees performing transmission functions for both), nor as between Cinergy's electric and gas transmission operations. Nor does it make any sense to separate out and impose non-disclosure requirements on the regulated pipes and wires distribution functions. As discussed in detail above, joint operation and maintenance of and planning for Cinergy's regulated pipes and wires, both transmission and distribution, create substantial cost savings and operational efficiencies which do nothing to harm (or even impact) the competitive wholesale markets. The transmission and distribution functions share joint data bases, and systems such as EMS and OMS are, and should continue to be, fully integrated.

It is important to note that pursuant to policies of the SEC under PUHCA, a large number of Cinergy employees are actually employed in Cinergy Services. They are required to provide services to the various corporate affiliates under contracts, many of which are approved or accepted by both the SEC and the three state utility commissions having jurisdiction over Cinergy's utility operations. The SEC and the states have established this framework to maximize efficiency and integration of operations and to

ensure proper allocation of costs. Changes in these service agreements require approval of or acceptance by the states and the SEC. Since employees providing transmission services are in Services, as are employees engaged in wholesale sales and other competitive activities, full corporate separation should not be required and the entirety of Services should not be "tainted" by operation of the new rules. Services cannot be defined as an "energy affiliate," exposed to the wide ramifications of that definition as proposed in the NOPR, without causing it to run afoul of state and SEC orders. For these additional reasons, Cinergy urges, as set forth above, that standards of conduct separation of functions requirements and information sharing restrictions continue along functional lines, as they exist today.

2. Separation of Retail Function

Cinergy's retail sales function is, in essence, divided into two functionally separate parts. The first group ("Account Reps") consists primarily of account managers and economic development personnel who manage the regulated utilities' tariffs, customer relations, and customer service questions. They do not "sell" power in any traditional sense and their relationship to the wholesale electric and gas markets is remote, at best, while their need to understand operational distribution and transmission issues which may affect their customers is key to maintaining good utility customer service. Hence, these personnel are grouped with Cinergy's transmission and distribution functions. When a service problem is encountered, a retail customer does not know, nor does he care, whether it is a distribution or a transmission problem. He simply wants it fixed, and he should not have to make multiple calls throughout a corporation to get answers to his questions. Requiring separation of the people who manage regulated

retail customer service, which is nearly always wires or tariff-related, will dramatically change the way Cinergy's utilities provide service to their customers, and will increase costs *with no real impact on the competitive wholesale market.*

The second group of service providers to the retail market ("Dispatchers") are the persons responsible for serving Cinergy's retail and wholesale commitments. As such, these personnel make purchases and sales in the competitive wholesale market. Because these Dispatchers are engaged in wholesale merchant functions, they are classified as such, and already are functionally separated from the transmission function personnel (including the Account Reps), and already are required to abide by the standards of conduct. Because the Dispatchers are the only persons engaged in retail activities who actually compete with users of the Cinergy transmission system, Cinergy submits that these are the only personnel that should be functionally separated. In other words, the Account Reps, who do not compete for use of the Cinergy transmission system, should not be separated.

Cinergy has no competitive retail energy marketing function within its corporate structure. However, Cinergy believes that for companies that do have such a function, it would be appropriate for that function to be separated from Account Reps for the same reason that Dispatchers should be separated – namely because such competitive retail energy marketing functions will be competing for use of the transmission system.

3. Separation of Other Activities

Extending the rules to functional separation of New Energy Function Employees, as defined below, is appropriate under most circumstances, and, in many respects, mirrors

the standards that Cinergy has already set for itself. Cinergy supports the new rules to the extent that they attempt to cover these types of competitive activities, but views the rules as overbroad to the extent that they would cover most, if not all, of the regulated activities or require corporate restructuring of regulated functions such as gas and electric transmission and distribution.

C. The Commission should adopt a "start to finish" functional approach to integrated utility business activities and services.

Cinergy proposes that the Commission adopt a "start to finish" functional separation and information sharing. This approach has several facets:

(1) Transmission and distribution function personnel (electric and gas) would not be separated within a holding company, regardless of corporate boundaries, and could freely share information amongst themselves.

(2) New Energy Function employees – defined as those employees engaged in day-to-day operations in competitive markets where success is dependent on electric or gas transmission access and transmission information, from start (e.g., generation siting) through intermediate stages (e.g., fuel or energy purchases, futures transactions, brokering) to finish (dispatch and sales) – would be functionally separated from electric and gas transmission and distribution employees, regardless of corporate boundaries, and would be prohibited from receiving transmission information except on a basis equal with other market participants through OASIS, Websites or electronic bulletin boards, as appropriate.

(3) Senior officers, directors and managers, and support personnel not directly engaged in directing, organizing or executing transmission functions or New

Energy Functions may have shared responsibilities for both, and may receive transmission information, *provided* that such employees do not act as improper conduits to pass transmission information to employees engaged in New Energy Functions (the "No Conduit Rule").¹²

(4) Employees engaged in non-competitive functions that rely on transmission information, in particular retail account representatives involved in state-mandated retail sales, would not be subject to functional separation requirements, and could receive transmission information, *provided* that such employees observe the No Conduit Rule.

(5) New Energy Function Employees engaged in generation dispatch would be allowed to have off-OASIS access (on the energy management system maintained by the Transmission/Reliability Function, or otherwise) to aggregate information necessary to perform generation dispatch functions.¹³

¹² Examples of shared responsibilities found acceptable under the old electric standards should translate under the new standards. These include: senior-level policy-making, including establishment of strategic long-term planning goals and acceptable risk standards, but not including day-to-day involvement in business activities (*see, e.g., Dayton Power & Light Co.*, 87 FERC ¶ 61,327 (1999); *Big Rivers Electric Corp.*, 84 FERC ¶ 61,257 (1998); rate design (*see, e.g., Long Island Power Authority*, 88 FERC ¶ 61,013 (1999); *Colorado Springs Utilities*, 87 FERC ¶ 61,013 (1999)); and support functions such as clerical, legal, accounting, human resources, information resources, data processing, financial, maintenance and engineers (*see, e.g., AEP; Duke Power*, 84 FERC ¶ 61,235 (1998); *LG&E Energy Marketing, Inc.*, 83 FERC ¶ 61,130 (1998); *Cambridge Electric Light Co.*, 82 FERC ¶ 61,246 (1998); *Atlantic City Electric Co.*, 82 FERC ¶ 61,028 (1998); *Carolina Power & Light Co.*, 82 FERC ¶ 61,193 (1998).

¹³ Exemption of data required for economic dispatch from the information sharing restrictions is necessitated by the requirement to separate the dispatch function from the transmission function, and is consistent with Commission precedent under the 889 Standards. *See, e.g., Allegheny Power Servs. Corp.*, 84 FERC ¶ 61,316, at 62,419 (1998) ("[W]holesale merchant employees may have access to generation data provided that it cannot be used to derive transmission, market or third-party information. Consistent with this finding, wholesale merchant employees may have access to generation information

D. All rules for affiliate conduct must be grounded in their impact on the competitive wholesale electric and gas markets. Unless an activity or function has a definable adverse impact on wholesale competition, it should not be subject to the rules.

The Commission must ask and the new affiliate rules must address how the Commission can encourage the development of the competitive wholesale electric and gas markets without damaging reliability and increasing costs of the ultimate service to all customers. A key part of this question involves the rights and priorities of retail customers to transmission service. In the gas industry, the question is less complicated, or at least further along in its development, than in the electric industry, where ISOs, RTOs, inadvertent flows, network service, cost allocations, pricing, capacity rights, market design, reliability concerns and other complex issues are still being debated, and where resolution, regrettably, is still at some point in the future. Until these issues are sorted out and equitably resolved, the fact remains that retail electric customers are still carrying nearly the full cost burden (88.064%) of the PSI and CG&E transmission systems, they are entitled to network service and its priorities, and the development of the wholesale market must, at least at this point, be layered on top of existing obligations.¹⁴ It is neither the purpose nor the intent within the scope of the proposed new affiliate rules to alter the rights of affiliated retail customers or any other network customers to network transmission service. Under current rules, these network customers pay for, reserve, and

that is necessary for economic dispatch, such as regulation ranges and regulation rates, area control error (ACE), system frequency, company instantaneous load requirements, and aggregate of net transmission tie interchanges."). *See also Indianapolis Power and Light Co.*, 90 FERC ¶ 61,174 (2000) (providing list of data that is and is not permitted to be made available to wholesale merchant function employees engaged in generation dispatch); *Indianapolis Power and Light Co.*, 92 FERC ¶ 61,002 (2000) (clarifying list from first order).

¹⁴ Retail portion of allocated transmission system demand-related costs per FERC Docket Nos. ER00-188 and ER00-213.

depend on priority to transmission service to meet their electricity needs.¹⁵ Exercise of existing network service rights should not be viewed as adversely impacting development of the wholesale market, nor indirectly precluded through the backdoor mechanism of affiliate rules. In other words, to the extent that PSI, CG&E and ULH&P must fulfill either their service obligations or their role as provider of last resort for power supplies through the provision of network transmission service, coordination and communication of employees to effectuate that service does nothing to harm the competitive wholesale market and should not be precluded.

IV. COMMENTS ON ADDITIONAL POLICY CHANGES

The NOPR asks for comments on various other potential changes in policy regarding affiliate relationships and transactions. NOPR at 24-26.

A. Capacity Limits

One change proposed for discussion would be to limit the amount of capacity an affiliate can hold on a transmission provider. This appears to be a prime example of a concept proposed to address concerns in the natural gas industry that is not justified in the

¹⁵ "The pro forma tariff provides a superior reservation priority to network service or long-term firm point-to-point transmission service." *Madison Gas & Electric Co. v. Wisconsin Power & Light Co.*, 82 FERC ¶ 61,099, at 61,373 (1998) citing *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 1991-1996 FERC Stats. & Regs., Regs. Preambles ¶ 31,048 (1996), *order on reh'g*, Order No. 888-A, 62 Red. Reg. 12,274, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997) ("[N]etwork customers are responsible for paying for a percentage of total system transmission costs in order to serve their designated network loads whether the energy is from designated network resources or from non-designated resources on an as-available basis. Because the network customer pays a load-ratio share of total transmission costs, it receives a higher priority.").

electric industry, and indeed could cause severe hardship in either industry. For example, the Commission has approved numerous state-instigated restructuring plans in which a newly created generating affiliate is responsible, through a back-to-back type agreement, for delivering the power that a franchised utility requires to provide default or standard offer service. Limitations on transmission capacity that an affiliate may hold may well nullify such arrangements, throwing into doubt the means for providing standard offer service to retail ratepayers. Additionally, in the electric industry, "capacity" is not easily defined. It is affected by inadvertent flows and third party reconfigurations to their systems, and it varies from one line or point of connection to the next. Trying to impose capacity restrictions under these circumstances is sure to yield inequitable and uneven results. Affiliates should be neither advantaged nor disadvantaged by their corporate affiliations. As long as there are effective standards of conduct and non-disclosure requirements, additional restrictions on affiliate transactions are unnecessary and in fact will hamper the very competitive landscape they were designed to facilitate. It is axiomatic that the greater the number of viable competitors in a market, the greater the liquidity, the higher the level of innovation and, ultimately, the greater the benefit that accrues to the consumer.

B. Posting Requirements

Given Cinergy's belief that the definition of "energy affiliate" is vague and overbroad as it is proposed in the NOPR, and that the application of the standards of conduct and non-disclosure requirements needs to be narrowed to continue to encourage (rather than eliminate) coordination of regulated activities, it follows that Cinergy is similarly concerned with the overbreadth of the posting requirements. If Cinergy's

functional approach to affiliate relations, as set forth in these comments, is adopted, the posting requirements will still need to be narrowed to conform. Assuming the new posting requirements are reasonably tailored to track functional responsibilities, and limited to transmission and reliability personnel and to New Energy Function operating employees, they could be acceptable. However, to the extent that they continue to apply to all positions (except clerical, maintenance and field positions) in the overbroad manner set forth in the NOPR, Cinergy believes they are unreasonable and unnecessary, not supported by substantial evidence, and will impose a large burden on Cinergy to comply in the manner and timeframe proposed.

C. Physical Unbundling

The Commission requested comments on “requiring the physical separation of transmission functions and affiliates.” There is no evidence that the type of “card key access” physical separation among functions FERC currently requires under the electric standards, along with similar requirements regarding the use of computer firewalls, is inadequate. For all the reasons stated above, Cinergy believes that functional unbundling is the key to successful implementation of affiliate restrictions, and any measures that go beyond functional unbundling are excessive and therefore needlessly onerous.

D. Corporate Unbundling

The Commission also requested comments on “whether the Commission should consider imposing structural remedies.” There are substantial questions as to the Commission's legal authority under the Federal Power Act and the Natural Gas Act to require structural reform, particularly when there are less intrusive alternatives to achieve the Commission's goals. Cinergy would strongly oppose efforts to require corporate

spin-offs or restructuring for reasons which include financial impacts on stakeholders, operational impacts, cost and reliability impacts for customers, state law requirements and similar serious concerns. For the reasons given above, behavioral remedies focused along functional lines are more than adequate, and would have far less economic impact on both the utilities and the ratepayers they serve.

E. Codes of Conduct

Finally, the Commission asked “whether [the Commission should] codify [the] codes of conduct” imposed on the relationship between regulated utilities and merchant affiliates. As the NOPR notes, codes of conduct are imposed to protect the captive ratepayers of franchised utilities. In numerous cases, the Commission has waived some or all code of conduct requirements where captive ratepayers are protected. In other cases, flexibility to react to different factual situations has been key to structuring an outcome that achieves both the Commission's and the company's goals. There are numerous recognized methods of protecting captive ratepayers, and doubtless more will be developed. For all of these reasons, Cinergy does not believe that codification is either necessary or the most effective way to achieve successful results. However, should the Commission decide to codify the standards, such codification should explicitly recognize and allow for case-by-case determinations as to whether a code of conduct should apply. For the same reasons, any codification should be designed to encompass, not displace, established codes of conduct (and exceptions thereto).

CONCLUSION

Cinergy is and has been for many years a philosophical proponent of the competitive market in both wholesale and retail jurisdictions. One of its primary

corporate goals is to advance deregulation and unbundling to the greatest extent possible and to support initiatives such as affiliate rules, ISO's, and other pro-competitive actions that will enable progress to continue without damaging reliability of service or imposing new and unnecessary costs on our customers. However, the state and federal laws that govern Cinergy impose structural restrictions and operating requirements that limit in many respects its choices as to how it provides utility service. Cinergy is still extensively regulated in its utility operations. New affiliate rules should be expanded to encompass many competitive activities that may not technically be covered by the existing rules, but the new rules should not be based upon overly broad definitions and should not be applied indiscriminately and without due regard for existing facts, business and legal realities. Through functional unbundling and a reasoned expansion of the types of activities covered by the rules, as suggested herein, the Commission should be able to achieve its goal to ensure non-discriminatory access to the nation's electric and gas transmission systems without causing unnecessary, costly and inefficient restructuring within integrated operating systems.

Respectfully Submitted,

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December 20, 2001