

May 19, 2000

Tom Riordan
Public Utility Commission
550 Capitol Street NE Ste 215
Salem, Or 97301

Re: Code of Conduct

Dear Tom:

Much progress has been made toward implementing many of SB 1149's provisions in a cooperative and consensus-building manner. PG&E Corporation is encouraged by the progress made to date, which has been significant, and is pleased that the Commission is now turning its attention to the development of a comprehensive code of conduct. Instituting a strong code of conduct and accompanying affiliate transaction rules are critical components of creating a successful competitive electricity market in Oregon.

The code should govern *all* potential interactions between the utility's role as a provider of electric transmission and distribution transportation services and *any and all* of its and its affiliates' other roles in the electricity marketplace, including the provision of generation and energy-related services to any and all customers. The code should also govern all potential institutional incentives for the utility to subsidize or otherwise provide any preferential advantages from its transportation, billing, customer services or related functions to any of its other functions in the electricity marketplace.

Three primary areas of concern related to SB1149 are: 1) interactions between the utility and its affiliates in the direct access market place; 2) all utility actions related to the provision of transmission and distribution system access and services; and 3) internal utility actions related to the standard offer services. In all three of these areas there is a high potential for the utility to subsidize or unfairly favor its or its affiliates' activities.

In all three instances, the purpose of the code of conduct is to ensure that the utility does not: a) provide preferential treatment to its or its affiliate's competitive operations; b) subsidize competitive activities with ratepayer funds; and c) provide its competitive function, its affiliates, or its internal default energy services provider function with an unfair competitive advantage through preferential access to confidential customer or utility information.

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UTILITIES AND THEIR AFFILIATES IN THE DIRECT ACCESS MARKET

At least two states have enacted comprehensive rules regarding how a utility and its affiliates operate in the direct access market – California and Texas. The California affiliate transaction rules, adopted by the California Public Utilities Commission over two years ago, have proven their effectiveness without impairing the ability of utility affiliates to compete in unregulated markets. We have attached these rules for your review. We have also attached the code of conduct recently adopted by the Public Utility Commission of Texas, which we believe will also function effectively to prevent affiliate abuses. Either of these two rules will provide an excellent blue print for constructing an Oregon code.

RETAIL TRANSMISSION ACCESS PROTOCOLS

We are greatly concerned about how the absence of an independent transmission system administrator, either in Oregon or the greater Northwest, will affect Oregon's nascent competitive retail electricity market. Even though FERC Orders 888 and 889 impose transmission open access requirements and prescribe a code of conduct governing the relationship between the utility's transmission operators and employees involved in merchant activities, FERC's Order 2000 clearly acknowledges that those rules have not eliminated the ability of utilities to bias system operation in a way to favor their own interests. Further, FERC Orders 888 and 889 do not address the many types of changes which need to be implemented to provide non-discriminatory access at the retail level, as opposed to the wholesale level. Moreover, for the most part operation of the utility's distribution grid is beyond the reach of FERC, and therefore is under no Federal open access or code of conduct rules. It is imperative, therefore, that the code of conduct developed by this Commission must deal directly and specifically with system operation to ensure that the utility is unable to favor its competitive interests over those of its competitors (or if it does, such abuse will be relatively easy to detect).

Finally, while FERC has jurisdictional authority over the rates, terms and conditions of retail transmission, FERC's stated policy, from Order 888 through the present, has been to grant broad deference to state regulatory authorities in developing the rules for retail transmission access (provided that such rules remain consistent with FERC policies). This deference offers both an opportunity and a duty for states to craft retail transmission access rules, consistent with FERC policies that assure true non-discriminatory access for competitive retail electric providers. We are therefore pleased that staff has been willing to address these issues as they relate to the code of conduct.

We generally addressed our concerns with the transmission access issues in our May 15, 2000 comments on AR 380. It remains our overriding position that the Commission should develop retail access protocols that are non-discriminatory and foster competition. It is not enough that retail access protocols simply be "non-discriminatory," because the mere statement of such a policy does not make it happen, since utilities can assert that they meet that standard while leaving in place, or creating, operational practices that erect significant barriers to entry for

ESSs. The retail access protocols must meet the following minimum criteria:

1. Transmission Access: At a minimum, the state needs to require the utility to provide to ESSs pro rata access to all of the transmission rights that the transmission provider extends to itself in serving its own retail load in the bundled environment. This is essential to enable ESSs to access competitive generation markets.¹
2. Energy Imbalance: In an unbundled world, a transmission customer's energy imbalances must be settled on an hourly basis (because energy prices vary on an hour-to-hour basis), rather than "returned in like time" periods. The traditional FERC Order 888 energy balancing deadbands (1.5% of scheduled demand) and punitive penalties for imbalances outside such deadbands are also inappropriate because they were developed to meet the needs of users scheduling large blocks of power, and not to ESSs scheduling power to perhaps thousands of full requirements customers with varying load shapes.
3. Must-Offer Resources: Whether or not the bundled utility divests itself of generation, competitive ESSs must be afforded reasonable access at reasonable prices to resources that have the ability to exert market power (including but not limited to resources needed to serve load in transmission-constrained areas).
4. Ancillary Services: Until workable competitive markets for ancillary services are in place, ESSs must be able to access ancillary services resources - very often these resources are owned by the incumbent. The terms and conditions of access must be comparable to those available to the incumbent's default energy services provider. And one of the few ways to ensure both comparability of access and the development of a competitive ancillary service marketplace is to require the institution of transparent ancillary services procurement processes that the transmission provider and the default energy services provider must both follow.²
5. Scheduling and Settlements: Consistent state-wide or region-wide rules, which apply equally to both competitive ESSs and the default energy services providers, are critical. Requiring the utility's default energy services provider function to live by the same rules as all other ESSs will also help to reduce the utility's incentive to create rules and

¹ As a mitigation measure for market power or for less-than-competitive markets, it may also be necessary to allow ESSs the option of trading their rights from illiquid generation hubs (e.g., points at which all generation is owned by one or two entities) to more-liquid hubs.

² The surest way to guarantee that competitive ESSs will have access to competitive ancillary services is to also require that the default energy services provider also be required to acquire ancillary services through open, competitive acquisition processes that rely on transparent market mechanisms, rather than through privately-negotiated long-term contracts. Otherwise, as a monopsony purchaser, the utility could exercise its market power to reduce the prices that it pays below competitive levels; and as a seller of ancillary services under the Order 888 tariff, the transmission owner could choose to selectively discount the price of ancillary services (for example, only when its affiliated default energy services provider is in the market for such services). Thus, both of these aspects of the utility's ancillary services acquisition process must be performed openly, lest the utility undermine the creation of the truly competitive markets upon which ESSs must rely.

protocols that create undue burdens for competitive ESSs.

6. Certification: The technical certification requirements must enable ESSs to contract with other parties to provide 7 * 24 scheduling services. Financial certification requirements must be flexible enough to enable smaller entities to participate in the marketplace.
7. Dispute Resolution: Very quick and impartial alternative dispute resolution (ADR) protocols must be put into place to augment the traditional long, drawn-out dispute resolution processes which are procedurally biased in favor of long-established entities with customer franchises. In the competitive marketplace, the traditional dispute resolution model - one which relies on the premise that the aggrieved party may receive a refund years down the road - is simply unworkable.

UTILITIES AND THE STANDARD OFFER

Finally, a strong code of conduct and affiliate transaction rules are particularly important since the utility will be providing default, cost-of-service and standard offer (SO) options to commercial and industrial customers that will, by their very nature, compete with competitive generation suppliers. This is especially important: a) during the time when the utility is collecting transition charges or distributing transition benefits; and/or b) until a functioning independent transmission system administrator is in place. It is particularly important that the utility not have any incentive to market these supply obligations in competition with competitive suppliers, since the utility's inherent incumbent advantage will be very difficult for a competitive supplier to overcome. Toward this end, several issues must be addressed:

- The SO supplier, the utility, must be prohibited from actively marketing SO service (It may educate customers on options as part of general, unbiased customer education program, but it should not market SO service as a competitive option);
- Employees dedicated to staffing the SO service (including at a minimum, operations, customer service) should be separate from transmission employees, and not have preferential access to transmission information;
- Tariffs should be structured so that the SO service includes the full costs of imbalances using the same criteria that will be assessed to the ESSs;
- SO service should not gain preferential access to utility-owned power sources or transmission or distribution rights, nor should it gain preferential access to information about the status of those resources used to supply power to portfolio customers;
- SO power should be procured and priced separately from portfolio power.

CONCLUSION

An effective code of conduct must be unambiguous and not subject to utility interpretation as to its applicability to a particular set of circumstances. This means the utility

must not be permitted in the first instance, to determine, for example, whether a particular interaction does or does not constitute preferential treatment. The rules must be both prescriptive and proscriptive, and leave little room for the utility to decide what is permitted and what is not, or what is unfair or what is not.

Utilities often argue that at the beginning of competition, the code of conduct should be very broad so as not to interfere with the utility's and its affiliate's ability to compete. However, it is precisely because we are at the start of competition that the rules must be very firm and non-discretionary, so as not to impede the development of competition. If the rules are such that affiliate abuses cannot be detected until they show up in the marketplace, it will be too late. New market entrants will not invest the significant capital required to enter a new market unless they have reasonable assurance the market is not unfairly tilted in the utilities' favor. Because of the inherent advantage of incumbency, the rules must send a very clear signal that affiliate abuses will be quickly and easily detected, well before there is any adverse impact on competition or customer choice.

The PG&E National Energy Group looks forward to working with the Commission and the staff to develop an effective code of conduct.

Sincerely,

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