

The Regulatory Alliances

The expression "Regulatory Alliance" is meant to differ from regional regulation as normally understood. An alliance is any group joined in purpose for mutual benefit. All profits and losses are to be shared by all members. In the Network Model, a regional alliance (partnership) of regulators would form to open up wholesale transmission service. The mutual gain is the savings in generation resources; however, for cooperation to work and last, the mutual gains from saving generation resources must be shared fairly.

In a recent NRRI report on regional regulation, cooperative clubs were described and detailed.³ Their purpose is to make the dependency among regulators an asset, a source of mutual benefit. They are defined as voluntary groups with an agreed-upon protocol to form and put forth joint policies. Their design can vary, but members are always autonomous, and participation is always voluntary and selective. Cooperative clubs are *not* regional sovereigns with regulatory powers; they are simply forums to reach and put forth mutual agreements.

The view of regional regulation expressed here differs widely from more well-known versions. Most involve a new layer of regulation: a self-governing entity with regulatory powers. Our form of regional regulation does not; nor would such a new layer of regulation work anyway because neither the states nor the FERC are about to willingly give up any of their autonomy. However, the need for regional oversight exists, and will only grow as competition grows within the wholesale power market and as those markets become more regional.⁴ The basic dilemma is clear: the industry does business on a regional level, but regulators operate on the state and federal levels. This lack of

³ Douglas N. Jones et al., *Regional Regulation of Public Utilities: Opportunities and Obstacles* (Columbus OH: The National Regulatory Research Institute, 1992), Part III.

⁴ See Robert Poling et al., *Electricity: A New Regulatory Order?* (Washington, D.C.: U.S. Government Printing Office, 1991), 68-71, on the growth of the wholesale power market.

balance has already sparked disputes; and a poorly framed transmission policy would only make matters worse. Clearly, to restore balance, regulators must come together, and as a group, form their own regional offshoots.

A club's design, its unity, depends on the extent of mutual dependency. In general, as codependency grows, regulators must cooperate more and align their policies more in order for any one of them to work. In the electric industry, dependency can come from mergers, power pools, joint ventures, new technology, the transmission network, new regulations, as well as from other sources. As the industry becomes more regional, more mutually dependent, more inseparable, so do the jurisdictions. The policies of regulators can spill over and become entangled. The spillovers can evoke policy loop flows because the industry operates on a regional level. Like electrical loop flows the policies of one jurisdiction can spill over to the chagrin of others.

Like any unattended flow, policy flows can become turbulent and disturb regulatory outcomes, making the regulatory process unstable and uncertain until regulators accept their mutual dependence, cooperate, and put forth mutual agreements. Although dependency may work to remove or limit autonomy, cooperation works to regain it. The agreements can be complex and involve joint action, or be simple and involve mutual limits on individual action.⁵ Their purpose, however, is not to create dependency nor to remove it, but to mold it to the benefit of all.

As mentioned, the Regulatory Alliances are cooperative clubs, not sovereign bodies. They have no leaders, nor powers beyond their members, nor status to write new laws. They are not legal entities gaining power from and ultimately having power over the states. The Alliances would each have a FERC member, at least one NERC representative, and any given number of state commission members. The members are autonomous, and participation is voluntary and selective. Although, those with an agreement can pursue it without the consensus of others, assuming its lawful, the goal of

⁵ Ibid., 221-36. There are three basic types of agreement (episodic, sequential, and coordinated) of varying complexity.

an Alliance is to reach mutual outcomes and turn mutual dependency into a source of mutual benefit so that it does not become a source of mutual opposition.⁶

To do this, regulators must find points of mutual gain and mold them into policies of mutual benefit. The benefit must be shared by all; otherwise, there is no incentive to cooperate. To be workable, cooperation must be incentive compatible. This prompts a healthy respect for equity, putting it on a par with efficiency. It urges continuity by urging regulators to redress ill-fated policies and settle them fairly. It prompts them to use new gains to settle old disputes, and to turn dispute resolution into a search for greater gains through greater levels of cooperation and efficiency.

One source of dependency among jurisdictions comes from the limited authority each has over wholesale transmission service. The FERC has control over the price of wholesale transmission services due to the Energy Policy Act of 1992 and those acts of Congress preceding it. It also controls the terms and conditions of access. The states have control over major transmission investments because of their control over siting and environmental issues. The NERC has control over the technical issues of reliability and system-to-system interconnection. This makes the FERC responsible for allocative efficiency, the states responsible for investment efficiency, and the NERC responsible for technical efficiency.

These sources of efficiency are themselves conditional. Allocative and investment efficiency are moot without technical efficiency. Investment efficiency is unlikely unless the transmission network is used wisely: current usage signals future network needs. Allocative efficiency is impossible unless transmission investments are where they belong most. Total efficiency--the sum of allocative, investment, and technical--is unlikely, if not impossible, unless regulators cooperate and together hone their policies.

A better use of generation resources is the benefit cooperation makes possible. However, this rests on having a coherent transmission policy: one that rewards quality

⁶ The Regulatory Alliance is an information-sharing, consensus-building forum whose product-jurisdictional agreements--need not be collective. The success of an Alliance does not rest on its ability to reach unanimous agreements, but rather on its ability to reach agreements that minimize turbulent policy flows; that is, that relieve jurisdictional disputes.

wholesale service. The FERC's desire for competitive wholesale power markets depends on the willingness of states to site new transmission facilities. Yet, unless rewarded, a state has no incentive to site new facilities particularly when the benefits go to others. On the other hand, the ability of states to serve their populace will depend upon the FERC's willingness to preserve the regulatory bargain. This, in turn, rests on how well the states embrace the goals of the FERC. Acting alone, no jurisdiction can assure a desirable outcome; such assurances can come only from working together with an eye toward mutual benefit.

Regulatory Alliances can only survive as long as the mutual gains are mutually shared. If not, cooperation will fail and the jurisdictions may try to dominate one another. The idea is to induce cooperation, not coercion. Some states, for instance, might become the natural providers of transmission service, others might become sellers of power, and still others might become primarily buyers of power. An equitable process would choose to reward TOUs and transmitting states for their contribution. A voluntary process would have no choice but to reward them.

With fair sharing, transmitting states have every incentive to open up their systems and make wise investments. In the electric industry, regulators need to cooperate and share mutual gains because no jurisdiction has complete sovereignty. No jurisdiction has complete authority over all matters of industry. For regulators, the electric industry is a shared good; so it only makes sense to cooperate. The alternative for regulators is to compete for jurisdiction and to become mutually opposed, but such contests are seldom in the public interest.⁷

⁷ The states, due to their control over retail rates and transmission siting, could form their own Alliances if cooperation with the FERC proves unattainable. Say, for example, low-cost generation utilities in state A require transmission service from TOUs in state B to market their power to buyers in state C. The states could form an Alliance in which TOUs of state B are rewarded for optimally providing and expanding transmission service. Regardless of the wholesale power and transmission rates set by the FERC, the state-only Alliance could divide the net generation cost savings in any manner desired. A state-only Alliance would not be as efficient as the Regulatory Alliance because not all entities involved in the sale and purchase of wholesale power fall under state commission jurisdiction. There exists a free-rider problem making state-only Alliances a second-best outcome.

The authors' proffered solution is to form cooperative clubs, the Alliances, not as a new layer of regulation, but as a new way to layer those already there. Their role is to discern jointly the who, the what, and the how of transmission service, and from this, craft balanced policies. As the main conveyor of policy, they have the Transmission Cooperatives.

The Transmission Cooperatives

Regulatory Alliances, comprised of regulators, oversee Transmission Cooperatives made up of TOUs. The Cooperatives put forth the policies of the Alliance. Their design would come from the system-to-system webbing already lacing together utilities. Transmission systems acting in union, such as, regional holding companies or power pools, would form natural cooperatives, or at least their hubs. Systems related by strong loop flows would form natural cooperatives. However they begin, their design should adapt to the changes taking place around them, changes they help to author.

The groupings are not special in and of themselves; their main purpose is to conserve both industry and regulatory resources. The driving force behind greater conservation is greater competition. Competition is a process of voluntary exchange; it creates new relationships; it creates new dependencies as it replaces old ones. As the web of dependency changes, the Alliances and Cooperatives will both need to evolve. This means that memberships, especially that of state commissions and TOUs, will change in response to changes in regional activities.

Some Regulatory Alliances may merge, others may split up and form smaller ones, some may stay unchanged. Some state commissions may belong to one Alliance, others to more than one. With time, many different groupings can emerge. Some Alliances may have only one Transmission Cooperative, some may have several. Some TOUs, like large regional holding companies, may belong to more than one Cooperative. TOUs within some Cooperatives may be subject to more than one Alliance. The number of combinations is large and it helps to have some overlap. Overlap among alliances will bring continuity to the competitive process and make it easier to coordinate