

Restructuring at the Crossroads: The APPA White Paper

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What Is APPA?

- The American Public Power Association
- The DC trade association representing publicly-owned electric utilities (state and local ownership—not TVA, BPA, etc.)
- More than 2,000 public power communities, ranging from large cities to small towns
- 43 million people served—14% of nation's electric customers

The Public Power Model

- Local ownership and local control
- Not-for-profit—goal is reliable service at reasonable rates
- Vertically integrated
 - Some systems own and operate their generation, transmission, distribution
 - Some systems contract for transmission and generation service with joint action agency, which builds/contracts for generation and obtains transmission service from third parties

Public Power Model--II

- Orientation is conservative, infrastructure-based and long term
- Emphasis is on maintaining a portfolio of generation assets/contracts that will support reliable service over time
- This model has served us well financially over the last few years—our sector has maintained credit stability (even improved slightly), while other sectors of the industry suffered substantially

Evolution of APPA's Positions

- APPA was an early and strong supporter of FERC's open access transmission policy and ISO formation
- It saw ISOs as a way to:
 - Provide non-discriminatory transmission service
 - Eliminate pancaked transmission rates
 - Act as a platform for collaborative regional transmission planning and construction

But a Funny Thing Happened on the Way to Open Access...

- FERC's RTO policies over time seem to have lost sight of these goals, instead focusing on:
 - Implementation of centralized, RTO-run markets for day ahead/real time energy, capacity and ancillary services
 - Use of Locational Marginal Pricing (LMP) to price transmission congestion
 - “No Generator Left Behind” pricing policies (e.g., May 2004 Reliability Compensation Policy in Docket No. EL03-236)

Resulting in Increasing Discontent...

- The concerns of APPA members in RTO regions bubbled up at the June 2004 Annual APPA Meeting, leading to a special September 2004 meeting in DC
- Speakers from each RTO region and non-RTO regions discussed their situations
- Bottom Line: Those in RTO regions generally were not happy, and those not in RTO regions were generally happy they were not in RTO regions

Enter the White Paper

- APPA Staff took what it had heard and developed a draft white paper setting out concerns with FERC transmission policies
- The paper suggested “mid-course corrections” for RTO regions and possible ways forward in non-RTO regions
- After 14 drafts and comments by numerous members, the APPA Board approved it unanimously
- It was publicly released on 12/09/04

The Nub of the Problem

- “APPA members located in RTO regions report substantial, across-the-board problems with spiraling RTO costs, unaccountable governance, lack of understanding of transmission customer and end-user needs and less-than-satisfactory service options. They see more and more RTO services being provided through questionable market mechanisms, and RTO resistance to any questioning of the economic theories underpinning these actions.” APPA White Paper at 6.

Lack of Long-Term Rights

- Load Serving Entities are unable to obtain long-term FTRs to hedge transmission costs associated with both existing and new generation resources (owned or contracted for)
- This hinders public power participation in/purchase of new long-term generation resources, including environmentally desirable resources (e.g., wind)

Others Have Noticed This Too...

- “Moody’s believes there is potential risk in the short-term marginal pricing model being used in various regional energy markets in the U.S. Without long-term contracts for transmission rights and price certainty for the transmission of energy from new generation facilities, cost recovery in the long term may not be assured.” (Moody’s September 2004 “Special Comment” on Public Power Credit Issues, at page 4.)

Need for New Transmission Construction

- “Rather than pigeon-holing new transmission facilities as needed for either reliability or economic purposes, the focus should be on how much transmission is required both to keep the lights on and to keep rates to consumers to just and reasonable levels. Instead of leaving most transmission construction to the vagaries of the “market,” an RTO must develop a rigorous regional transmission planning and construction process that ensures the region has a robust (but not gold-plated) transmission system.”
APPA White Paper at 11-12.

And We Want To Be Part of the Construction Solution

- “An important way to address TOs’ reluctance to construct needed new transmission facilities would be to encourage joint participation by other utilities serving load in regional transmission systems and in new transmission construction projects....Such joint projects could reduce the financial burden and spread the perceived transmission-investment risks for the incumbent IOUs.” *Id.* at 12-13.

RTO Cost Accountability

- APPA members have become alarmed by the increasing development and operational costs of RTOs over time
- APPA members are having to ramp up their own internal operations to cope with RTO operations, adding staff, hardware and software, paying lawyers/consultants
- Complicated (and often erroneous) settlements can take months/years to resolve

Again... We Are Not Alone

- “During its 6-plus years of existence, administrative costs for the CAISO have totaled over \$1.4 billion. This \$1.4 billion did not pay for a single transmission line nor has it added a single MW of **generation.**” Comments of Southern California Edison Company, filed November 9, 2004 in Docket No. RM04-12-000.

FERC May Act On The RTO Cost Issues This Year

- FERC issued a 9/16/04 NOI on RTO Accounting/Reporting in Docket No. RM04-12-000
- Comments filed indicated that many in the industry share APPA members' concerns about RTO cost accountability
- Recent indications are that FERC may use this docket to explore the larger issue of RTO cost containment and accountability

RTO Governance Issues

- “...[I]ndependent boards can lack direct accountability to the industry participants in the RTO’s regions and to the electric customers the RTO ultimately serves....This lack of RTO accountability to customers and stakeholders creates the widely held view that RTOs have only one dominant stakeholder—FERC.” APPA White Paper at 17.

FERC is Listening...

- Trade press reports indicate that some at FERC are interested in revisiting the issue of RTO governance structures to ensure that stakeholder concerns are adequately addressed, without eliminating independence (See, e.g., Electric Utility Week, January 17, 2005 issue)
- Upcoming meeting between FERC Commissioners and ISO Board members announced at 1/19/05 FERC meeting...

Policy Advice for Regions without RTOs

- FERC should abandon its “RTO or bust” approach, and allow regional flexibility
- Foster lower-tech, cost-effective measures that can provide RTO-style benefits at less cost (e.g., WestTrans OASIS)
- Encourage inclusive regional transmission planning and construction processes in which all affected wholesale market participants take part, and joint ownership

Signs That We Are Not Alone...

- APPA's website had over 20,000 downloads of the White Paper in December 2004 alone—many more than we have ever had for any document
- CATO Institute came out with its Policy Analysis No. 530, “Rethinking Electricity Restructuring,” less than 2 weeks before our paper (can the Harmonic Convergence be far behind???)

More Signs...

- PJMICC Whitepaper was made public in December 2004; identifies many of the same problems
- Progress and Freedom Foundation's December 23, 2004 Commentary: "Electric 'Restructuring:' What Went Wrong"
- Jay Morrison/Christensen Associates' articles in Jan/Feb 2005 Electricity Journal
- 02/17/05 ELCON Speech

Where Do We Go From Here?

- Get rid of price caps and capacity markets and go hell for leather? (Politically DOA and too dangerous when market power present)
- Go back to traditional cost of service pricing for everything? (Likely too late)
- Analyze what works in the real world (as measured by *what gets needed infrastructure built at a reasonable cost*) and who has market power (and mitigate accordingly)—and remember that *less can be more*
- Is the era of faith-based restructuring finally ending? We hope the answer is yes.