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HARVARD ELECTRICITY POLICY GROUP SEMINAR

Forum: Coordination of Federal and State Regulatory Decisionmaking
What Cooperative Mechanisms are Most Promising for Dealing with Electricity
Deregulation?

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MEETING SUMMARY

As the electricity industry reinvents itself, accompanying modifications of both federal and state-level jurisdiction will be necessary. In some cases, conflicts and gaps between federal and state jurisdiction will need to be addressed. What cooperative mechanisms will yield the best results from these coordinated efforts?

This summary necessarily abbreviates the presentations and discussion at this session. A list of materials that were circulated at the meeting is included for further reference.

Session I: Problems Requiring Coordination Between State and Federal Regulators

A number of critical problems in electricity today entail a great deal of state interest, a great deal of federal interest, and a bit of jurisdiction for both the agencies. Often in these situations, neither agency has the jurisdiction or authority to really resolve the issue or provide coherent policy. What are some of these problems and how have they been addressed, successfully or unsuccessfully, in the past?

First Speaker:

Because of a number of ongoing changes in the industry, the problem of trapped costs in transmission has much greater significance than it once did. There are four types of conflicts:

- Conflicts in perception of the service provided: is it transmission or

generation?

- Disagreement over who benefits: wholesale or retail customers?
- Disagreement over the cost-effectiveness of the service provided or assets used
- Differences over the appropriate level

of risk compensation

- Combinations of the above

As long as we have a regulated market for transmission, the problem of trapped costs will remain significant, especially as transmission becomes a scarce resource. A number of changes in the industry will exacerbate the problem as time goes on:

- The increase in the level of third-party transmission service being provided.
- The gradual expansion of unbundled service and retail access, blurring the distinction between generation and transmission.
- Inconsistent pricing policies at the wholesale level in the context of comparability.
- Conflicts over who benefits (i.e., the comparability vs. native load debate).
- Competitive pressures for unbundling and the question of what is a transmission service.
- Utilities under pressure to forego preemption benefits.

Given the magnitude and potential consequences of these problems, the only way of addressing them in the short term may be a clear and preemptive allocation of authority to a single regulatory body. "Constructive dialogue" between the states and FERC on every single case will work, both because of the complexity of the problem, and

because of other issues arising from market restructuring. In the short term, we will have consolidation of pricing decisionmaking, either at FERC or at some regional level.

Over the long term, we will move away from having to deal with this problem through a restructuring of the overall process of power supply, and will eliminate the whole question, "Who regulates which portion of the conductor using what pricing model?" The issue of trapped cost entirely disappears as we move toward more of a market determination of pricing.

Second Speaker:

Section 211 enables the FERC to issue orders that effectively require a utility to expand its facilities. However, states can just as effectively veto those orders by withholding the authority to build. This raises at least two problems: either the FERC's orders may be inconsistent with state planning priorities, or the state's veto may be based on state-specific concerns alone, to the exclusion of regional benefits. This is of course a problem mostly in the case of siting facilities meant for interstate use. We need to find a method of resolving these competing interests.

In some ways, legislation may be the only long-term solution to this problem, in order to avoid litigation under the Commerce Clause. There might be a PURPA-type approach, where federal standards are set but the states retain the authority, with FERC or some other entity available for dispute resolution. There is the very simple approach of establishing an antidiscrimination process based in the federal courts, to keep states from treating interstate transmission siting questions differently than they would treat questions

within their own jurisdictions. Another option would be to use Section 209 to create a joint regional body of some sort, be it under the auspices of the FERC or under some other organizing body, where a common decision could be made. Finally, we could use the natural gas model, where the states retain some jurisdiction over land use and environmental decisions -- a distinction which they would probably find preferable to total federal preemption authority over interstate siting.

Third Speaker:

Basically five distinct streams of thought have emerged around these state-federal jurisdictional issues:

- The first constituency, the "no-problem" group, believes that the present system works reasonably well and does not need an overhaul.
- The second group feels that the federal government should have a dominant role on all key issues in regulation.
- The third constituency takes the opposite view, believing that states' rights should prevail over the interference of federal regulation.
- The fourth group favors the least amount of regulation as soon as possible.
- Finally, the fifth "reform" group feels that balanced state-federal jurisdiction is a worthy concept, but the present structure is poorly balanced at best: there is no structure in place to superintend the current transition, and

there is too much confusion regarding state-federal jurisdictional boundaries.

Especially where multi-state companies are concerned, I side with the reform constituency. The current structure *is* poorly balanced, and has been so for a long time. This is not the regulators' fault; the FERC and the states have been more than willing to tackle tough issues together. The problem is a structural one -- no one has planned for the transition period itself. The argument that the free market will cure all ills does not become persuasive until full retail competition is at hand, and with 50 states looking at this problem in addition to federal regulators, the transitional period may be longer and more disjointed than some analysts anticipate.

Integrated resource planning is a questionable solution to any of these problems, because federal regulators have jurisdiction over the supply side, while states have jurisdiction over the demand issues--but only within their own borders. There is no mechanism for solving disputes over a multi-state company system. Allocation questions, purchasing decisions, transmission pricing, stranded investment, RTG jurisdictional problems, emissions trading, and allocation of credits all remain unresolved. If Section 11 integration requirements are repealed before the transition is complete, there will be no one to protect captive customers. Finally, the regulatory structures for handling mergers are insufficient, especially where multi-state companies are concerned. Some states can end up with 80 to 90 percent of all the merger benefits just because they have local control over the facilities of the merging companies. We need to find a way to referee a balanced sharing of the benefits as well as the costs.

Fourth Speaker:

There are a number of problems that will arise as states move toward retail wheeling. First of all, the unbundling of services raises the question of jurisdiction over transmission assets. Somewhere between state and federal jurisdiction over transmission, utilities are probably going to be forced to absorb the responsibility for revenue requirements once set by regulators.

Is jurisdiction over transmission based on the asset or on the service? The statutes, unfortunately, have nothing to say on either subject, and the definition of jurisdiction remains highly subjective. So if we're going to assert some sort of preemption, it will have to be based in some collective or collaborative exercise of state and federal jurisdiction. Neither one or the other has enough authority to do it alone. FERC may at some point argue that its jurisdiction extends right up to the customer, but that would take a long time to resolve in the courts.

One *could* argue that giving up authority over transmission may leave states with *more* authority in retail markets. The Detroit Edison suit against the Michigan Commission is a good example. Under the nondiscrimination provision of the Federal Power Act, once a discrete unbundled rate is set, it may mean that *anyone* can take unbundled service. So while FERC cannot order retail wheeling under the 1992 EPAct, it also cannot prevent it from happening once it sets a retail transmission rate, since it can't discriminate. If Detroit Edison wins its suit, it may end up with retail wheeling even faster.

What happens on the generation side is equally interesting. Without transmission

included in retail rates, jurisdiction over in-state sales from heretofore wholesale generators moves from the FERC to the states because it is a retail transaction, and the state can decide who it wants end-users to buy from. So while the state of Michigan could not order the use of the grid for purposes of ordering retail wheeling, it could encourage customers to shop around—this also enhances the likelihood of getting retail wheeling very quickly. This is a confusing game of federal-state jurisdictional hopscotch.

In the California proposal there is a statement that utilities should be compensated for prudently incurred costs that would be stranded by the new more competitive regime. It is not clear, however, how the CPUC can do this within the scope of its jurisdiction. If this is true, what responsibility does the FERC have to deal with the problem? If a regulatory body assumes responsibility for certain changes which turn out to be beyond its jurisdiction, should it go back and try to revise its original program, or should it try to work with the agency that *does* have jurisdiction over the problem? And should the agency that has jurisdiction over the problem necessarily defer to the agency that created the situation in the first place? It is very difficult to resolve this type of jurisdictional conflict without resorting to some kind of collaboration.

Discussion:

_: There are really two models of this industry that are floating around. The "continental" model emphasizes power flows, understanding the industry today as one in which generators insert power into the grid, distribution companies take power out of the grid, and the grid itself is a sort of "black box" that takes care of itself. The second model is

the "island" model, in which a utility generates its own power, transmits over its own lines and distributes over its own lines. Regulation and government grew up around this second model, even though it was starting to become irrelevant as early as the 1920s.

Regional transmission groups were begun as an attempt to deal with the increasing need for coordination under regional reliability councils, where government regulators were continuing to treat utilities as independent and vertically integrated entities long after that model had ceased to be a reality. I think it is important in this restructuring process that we recognize that a gap has existed for a long time between the actual nature of the industry and the way it was originally conceived by federal and state regulators. The regional groups, functioning as a "third set" of regulators, has served as the bridge across that gap. We should not ignore the importance of their role in the midst of this whole restructuring process.

_: There is a *fourth* set of regulators -- the federal courts -- that are going to determine what all the others can and can't do. The people with the least expertise in this matter are going to be making some of the most fundamental decisions on stranded investment, etc.

_ Part of the success of the regional reliability councils is that they operate within the NERC, which is a continental organization. Federal-state cooperation or regional regulation is still not going to solve issues raised with multi-state companies. Electricity has to be treated as a continental industry. Canadians, not surprisingly, are a little upset over the U.S. debate, which frames the problem in national terms alone, when they

feel that it is a North American issue.

_: We have to see the current three-tier system as a sort of transitional model. It is fundamentally impossible to develop a long-term collaborative model of regulation which will produce a coherent pricing scheme. We can't even agree on what exactly it is we're trying to price. The services are changing as we try to price them. In the end, we're going to end up with some sort of market-based model and we should look for a process to get us there with the least pain, the greatest equity and the least inefficiency.

_: The argument that retail customers should be the guarantors of transmission costs doesn't really hold water unless they are granted a firm entitlement to the use of the system. For some transition period, it might be possible to use some sort of revenue crediting mechanism, but it would not be viable for the long-term.

_: One thing you get rid of if you move toward a more competitive market is the whole idea of entitlement. If we get stuck talking about entitlements, how I protect my native load customer or how I protect my shareholders, we're just moving back toward that island model of the industry. We need to be moving ahead instead.

_: Let me put it in a somewhat different light. At any given time, 45% of the transactions between Ontario and New York come across Ohio. Ohio electricity customers derive no benefit from this transmission, but they pay all the freight. Why do we continue to support this economic fiction, that somehow Ohio ratepayers are the beneficiaries of this system? And why don't we compensate for loop flow as a rule? This is where the substantial questions of equity exist.

_ : There are some parallels between the telephone and the electric industries that have not been acknowledged in terms of federal-state comity. Like the electricity industry, the telecommunications industry followed the "island" model. In the telephone industry, until a Supreme Court case in about 1984 or 1985, the FCC had total preemptive power over state and local telephone companies. From 1984 onward there was a series of cases in which the federal courts forced the FCC to measure its interests against the state interests. Those of you who are arguing for FERC preemption should read this series of cases, because you'll see that the federal courts today do not entertain the kind of blanket preemption that we were used to prior to 1984.

: One of the key themes of that line of cases was that the very nature of the service had changed. The same thing is true in electricity. What they argued was that the service that was considered in the 1934 Act was not the same service they were dealing with today.

_ : Didn't the FCC and the states have joint boards, though, with clearly laid-out allocation principles?

_ : Well, they have a long history of obscure separations rules. Those rules were very helpful with some issues, but on the whole they were highly arbitrary -- for instance, one rule said, "If 10% of a line is used for interstate calls, it automatically becomes federally regulated."

Session II. Mechanisms For State-Federal Collaboration

For a long time, the discussion of possible mechanisms for state-federal collaboration has stalled on the subject of joint boards. It is important to consider the entire range of alternative approaches are possible under current statutes, be they formal or informal arrangements, local, regional, or national approaches.

First Speaker:

A more overarching, rational approach to public policy can be reached through the concept of deference. Jurisdictional issues are at the intersection of law and public policy -- the challenge is to develop an approach that is both legally sound and limits bureaucratic transaction costs. The marketplace will provide long-term solutions to some of these problems, but if we don't deal with jurisdictional issues now, during the transition, the resulting problems may overwhelm any long-term solutions. Moreover, since regulation itself is also in transition, this is an appropriate time to make some changes. If we don't seize the opportunity now, we may find ourselves locked into positions that only years of complex litigation will resolve.

Any changes should be based on the concept of mutual deference between the states and the federal regulators. On one level, the FERC NOPR on stranded costs could be seen as a timely attempt to solve problems in a balanced way, by setting guidelines and then leaving it up to the states to develop compatible local solutions. But it also suggests that the FERC has the authority to determine the adequacy of a state's response in dealing with stranded investment. Because the line between policy changes and legal authority is likely to be blurred in this way on any number of issues, it is best to deal with jurisdictional issues in the spirit of comity rather than adversity.

There are two approaches: one involves enhancing federal jurisdiction, and the other is what we're loosely calling comity. Federal jurisdiction makes a certain amount of sense given the increasingly continental nature of the industry. But remaining questions about retail wheeling and state jurisdiction over siting force us to explore the potential offered by a loose comity approach. The benefits to states are obvious in terms of being able to design situation-specific solutions to problems. But there is also some potential benefit to the FERC, in terms of lessening the burden on an overloaded agency.

A less adversarial approach will probably bring both sides closer to policy goals more quickly and more thoroughly than would litigation, but if each state has to hold 50 hearings on the changing structure and regulation of the power market before they can set their own objectives, the process will still be slow. We need to find a less formalistic, less legalistic approach, and to avoid situations in which jurisdictional battles become an attractive mechanism through which aggrieved parties pursue their interest. Innovative solutions to difficult problems should not be invalidated on a jurisdictional basis alone.

There is the danger that, in figuring out how to arrive at some sort of comity, we lose sight of the fact that comity is a tool for policymaking, not an end in itself. To that end, what is needed is a set of agreed-on principles of decisionmaking to reduce

jurisdictional conflict.

Second Speaker:

There are several options for joint proceedings allowed under Section 209. A joint deliberative body, with representatives from each interested party, could be convened in an effort to render a joint decision. (There is, of course, some question of what this would do to existing sunshine laws.)

Alternatively, a joint proceeding could maintain a common record, while each jurisdiction retained the ability to make its own decisions. Where an actual joint decisionmaking body is not practicable, a common record would still provide some cross-pollination of ideas, and perhaps prevent litigation as well. Why not, for example, have common pretrial conferences between FERC and the states that are conducting their own proceedings on these subjects, so that each jurisdiction is kept informed as to what the others are planning?

A third possibility is common policymaking, most appropriate to regional transmission groups. This is the kind of third level of informal non-governmental regulation that was mentioned earlier. Of course, it is unlikely that all the parties with differing interests in a given region are suddenly going to find common ground. It would require some sort of regulatory intervention, either from the RTGs or some external regulatory body. This sort of cooperation would also reduce the opportunity for heavy litigation, because it would not involve a question of delegating authority. For example, the FERC could choose to assert its jurisdiction by collaborating with the state.

Another, somewhat less formal option, is a system of "contracts" governing how jurisdiction would be exercised between two regulatory bodies. For instance, if a state has a planning process to meet the FERC's objectives in transmission access and comparability, then the FERC might agree not to grant any 211 orders within the relevant time period.

Finally, there could be joint fact-finding conferences between FERC and the states on very specific topics, along with joint policymaking proceedings that the states and FERC could enter into. Where there was contention over who had jurisdiction, such a joint proceeding could simply decide to exercise it jointly.

All of these mechanisms provide legal and viable solutions. The important thing they share is that they all involve *exercising* jurisdiction, rather than preempting it or just delegating it to another body.

Third Speaker:

The California Public Utilities Commission (CPUC) is very interested in cooperating not only with FERC but also with other states in the region, at the very least as a means of avoiding litigation. The "regulatory alliance" is a concept that could provide a forum for coordination, not only under current regulation, but also under future restructuring proposals. This concept could be thought of as the regulatory counterpart of industry alliances like the Western Regional Transmission Association. Its membership would be voluntary, consisting of FERC, state regulators in the region, and members from regional reliability councils. Alliance members could enter into mutual agreements to the

extent that they saw mutual benefits. FERC could convene joint hearings or joint conferences, either under its own 209 authority or on petition by a state commission or group of commissions. It is a bare bones approach, but one which does represent a starting point. The RTG all by itself is just not sufficient in terms of cooperation.

Fourth Speaker:

It was mentioned earlier that, under the present FERC, we have achieved better state-federal relations than for some time previously; however, I think that an important and contentious case like *Middle South* still has the ability to break that comity very quickly. We need to lower the barriers to candid dialogue between the FERC and the states. There is a great deal that can be done currently between individuals through informal conversation, but sunshine laws tend to hamper any kind of formal joint meeting. Can we find a model for the relationship between the state regulator and the federal regulator?

There are a number of ways of thinking about the position of state commissions with respect to the FERC, ranging from the state regulator as a party in interest in a given case to the state commission as a sort of co-equal arm of government. Perhaps the ultimate model is international diplomacy between nations, where we are freed from the procedural restraints that we have imposed in our domestic regulatory institutions. There are two complications when you apply this kind of informal approach to regulators. One is the concept that the regulator is independent of other parts of government. Related to that is the lack of legitimacy of the regulator, who doesn't fit neatly into any of the accepted arms of government. This sort of preconception is

the source of the Sunshine Act, the Federal Advisory Committee Act, and so on, all of which constrain the ability of the commissions to work together on a direct and informal basis.

I think the courts, as the "fourth level" of regulator, potentially present a significant challenge to federal-state interaction through the application of the antitrust laws. There is very little precedent for the type of case which might arise if federal and state regulators were to start talking informally to one another. For this reason it is vitally important to identify some mechanism for regulatory comity quickly and define it clearly. We need to carve out a very clear and cohesive policy that the courts can recognize and therefore give deference to.

Fifth Speaker:

It has long been recognized that the concept of the interstate compact operates between the limits of what Congress may do and what the states may not do. Therein lies its power for forging regional solutions to the gaps between federal and state regulation. Under the Commerce Clause of the Constitution, this applies not merely to the interstate compact device, which is really an interstate agreement, but also to other joint exercises of authority between the states and the federal government. Furthermore, Section 202A of the Federal Power Act states that, for the purpose of assuring an abundant supply of electric energy with the greatest possible economy and with regard to the proper utilization and conservation of natural resources, the commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy.

Further, it is admonished that in doing so, it must first give notice to the state or states affected. In other words, the Federal Power Act anticipates the increasingly regional nature of the business.

In 1978 or so, as part of the DOE organizational act, the coordination authority arising from section 202A was handed off to the DOE. The first step for the FERC is to get its 202A authority back and exercise it in conjunction with a group of states where there is a common interest and a common need for cooperation, be it a merger or a regional transmission group or whatever.

Discussion:

_: We have been talking about some of these solutions for the past ten years without much progress. Joint boards, for instance: a lot of mergers work just as well or even better without joint boards. These things have theoretical appeal, but as a practical matter it is sufficient for the FERC simply to define what it believes its jurisdictional authority to be. Perhaps we've reached a time where the FERC could develop a policy statement with regard to what the generally applicable jurisdictional policy positions are which implicate federal jurisdiction.

To begin this process, it would be helpful to have a thoughtful review of all the models that are now being proposed--the Hogan model, the California model, the Wisconsin model, the NEES model and so on--and try to understand how they implicate federal jurisdiction. Such a review could take the form of a proposed policy statement, to which the states and the industry could respond. That would be another way of making everything clear and well-defined.

The point about the uncertainty associated with judicial review is a good one. The FERC has fared better in the courts when it has made a declaration of its judicial purview on the basis of some broad consideration rather than by just going before the judges case by case. But that is something that has to be done separately. None of these joint mechanisms in and of themselves are going to provide the general overall policy certainty as to what's federal jurisdiction and how it may play out.

_: I agree that it is essential for FERC to clarify the extent of its jurisdiction. In the case of stranded investment, the FERC may not have a lot to say about the assets in question. This is a cardinal example of how some sort of informal meeting, cobbled together under Section 209B, might lead to a better understanding among the parties involved. The piecemeal use of some or all of the devices mentioned here this morning will be the most useful in the long run.

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: Some of the comments we have heard here today were more negative than the western experience would indicate they need to be, but I agree with many of the concepts that were put forward. Multi-state cooperation has already taken place in a number of mergers and projects that are still ongoing. These efforts were successful because they involved the explicit appreciation and understanding that the states are free to assert whatever individual jurisdiction they need; that is, that the individual state commissions are not asked to give up anything as part of the process. Pacificorp is a good real-life example of such an endeavor.

I like the comment that was made earlier about a sort of regulatory "hold harmless" clause, which to my mind is exactly what we need: a basis for collegial respect and appreciation between regulators for the job that they all have to do. That is what we are doing in the West. There is a good deal of federally owned land in the West, which is perhaps responsible for the culture of cooperation and deference in siting and transmission that we have had for a long time.

As far as the continental model of the industry is concerned, the Western Reliability Council has always included British Columbia and Alberta as well as the eleven interconnected western states. We meet twice a year in an extremely informal way, and try our best to invite FERC commissioners and staff and DOE folks as well. It is a mistake to say that RTGs have come and gone and served their usefulness already; the three most active RTGs have not even been fully implemented yet. We think that they hold great promise. Hopefully these things will be allowed to grow and mature so we can see where changes might need to be made and where things can go on as they are.

: It is no coincidence that the most active progress on regional RTG efforts has occurred in the West. We have a long history of cooperation between and among the states, and recent changes have also increased the equity of voting arrangements in even the oldest of the reliability councils. We still have some problems with loop flow issues; a number of initial attempts at providing for compensation schemes have failed because, in most of the situations, someone was winning and someone was losing. But recently the reliability council took a vote to impose the

costs of PacifiCorp's phase shifters on all of the entities within the region. The proposal passed, even though not everyone in the region supported it. It is the first time I know that the industry has imposed a solution on the region for the benefit of the region, and it represents a big step toward revising how the industry handles transmission issues across regions.

Similarly, the merger that was just mentioned presented us with the need for major restructuring, since of the seven states that PacifiCorp now serves, three or four were low-cost states and the rest were high-cost states. But since no one tried to impose an instant solution at the start of the merger, but rather left it to a later, collaborative effort by the states and the FERC to work out the very difficult issues of allocation, there was a continuing effort to make sure that all the states benefitted from that merger. And I think we have.

\_: In the Synergy merger, the Indiana Commission took the position that it would not, under any circumstances, talk to any other regulator anywhere. The result was a nearly unworkable solution, which was later overturned by the Indiana Supreme Court.

\_: The lesson here is fairly simple. Where there exists a way and a political and economic rationale for cooperation, it will happen, and where that does not exist, whether we structure it in terms of a permissive or a prescriptive model, it is not going to happen. In the Synergy case the procedural circumstances were very unusual, and gave rise to a situation where the incentives for mutual cooperation were not there. Where there are states that want to come together on a particular issue, they will find a way of doing so. There are no particular impediments to

having that happen. The problems arise when no one wants to cooperate, and it is then that we need a FERC or a federal court or some other body to make the hard decisions.

Moderator: Let's take two or three circumstances that fall into the gray areas of jurisdiction, and focus on them in the context of this discussion of mechanisms. These are: RTGs, the gap between Section 211 orders and state siting laws, and the jurisdictional ramifications of a state ordering retail wheeling. Starting with RTGs, where can we go from the example of the Western states, with their history of cooperation?

\_: It actually took ten years for them to figure out how to allocate the cost of the phase shifters. Is this a record of success or a record of failure?

\_: Admittedly, the rate of progress on the phase shifters was slow, but on the other hand, the industry is moving in the direction of solving these problems by itself, which is inevitably faster. This is a process of evolution, not revolution.

\_: The success of the Western merger lay in the fact that, even before the FERC decision on the merger, the state commissions were clearly defining what they viewed as their own regulatory interests and what they saw as FERC's regulatory interest, and the FERC was able to build on that. There is our lesson--to try to get each side to define very clearly where the regulatory nexus should lie.

\_: Speaking of RTGs, New England thought it was going to be first at one time in getting an RTG in place. After all, we have the New

England Conference of Public Utility Commissioners, which has a very close working relationship. Then there is the New England Governors' Conference, which has a power planning committee specifically for these issues. And NEPOOL has been around for a long time in a very cooperative role. And yet even in a region with all that comity, the first attempt at an RTG failed. Now we're back at the drawing board.

\_: What role, if any, did the regulatory community play in the failure of that first effort?

\_: What happened in particular was that one key company's interest began to diverge sharply, and that alone was able to bring the whole process to its knees. It failed because the terms that were evolving weren't in the interest of one major negotiator.

This time there is much more regulatory oversight. Regulators are going to the organizational and technical discussion meetings. The regulators also said, "No, we won't object if you have discussions about how handling stranded costs might be tied to transmission pricing." There are a number of procedural discussions going on, such as voting procedures and dispute settlement, but pricing is also on the table for discussion. This is important, because discussing RTGs without talking about price is like Hamlet without the Prince. There is a reasonable possibility of success this time.

\_: This is an example of where the FERC and the states worked well together. The FERC came out with a statement in the RTG document that said, "We care very much what state regulators think." That is a very positive basis of negotiation for the state regulators and

the other players as well. That document established a legitimacy for the state role which made it much more attractive for the utilities and the non-utility parties to come in. It became something that was worth participating in.

\_: In light of this struggle to bring the RTGs to fruition, and the significant costs of coordination, planning, and working together, and in light of what FERC is doing on full comparability and replying comparability for RTGs, what will be the comparability with respect to those who do not want to be members, but want to use the facilities of the RTG? Is two-tier comparability possible?

\_: Currently, negotiations are going forward on the presumption that everybody will be a member. If that fails, then we will have to address those issues.

\_: Some IPPs say, "We don't have the time, money, or resources to go join every RTG and sit down and plan with them, because our plants are spread out over the country. We just want to use the RTG services."

\_: In the West, the IPPs are participating actively, but still we have a number of multiple organizations where the RTGs use the reliability council for its planning function, and so on. The industry ought to work in the direction of consolidating and coordinating these functions so that we can minimize the cost.

\_: In terms of redundancy of operations, I'd like to reiterate what was said earlier: that the day of the RTG has really come and gone. The first thing that should be done is to get

them out of generation, so they can focus on transmission and its control. And they need to create a decisionmaking structure that does not require involvement of a hundred different parties! I understand that the current situation was a reaction to the overabundance of "good old boys" in the regional reliability councils; the FERC came along and tried to make them more truly representative of all parties. And now we have a group that can't make *any* decisions. If we're going to salvage any usefulness from these organizations, we'd better focus on transmission: what needs to be planned; what needs to be controlled.

\_: I agree. The standardization role of the regional reliability councils needs to be separated from the planning role.

\_: The assumption has been that regional reliability councils will eventually evolve into RTGs. I'm not sure that is really the case, but I don't see a problem of generation and RTGs being in any way correlated with each other.

\_: One of the problems we have seen in the Western RTGs is that of separating out the functions. I don't know whether vertical disintegration is the solution, or whether there is some other mechanism that would accomplish the same thing.

\_: I have a lot of sympathy with the temptation to disintegrate vertically, but ownership in New England, at least, cuts across six states and twenty or thirty utilities. Viewed from this perspective, the RTG is simply an aggregation device, to pull things together into one system with an overall set of rules. It is a useful way to cut across the protocol problems of multiple ownership.

\_: How does the FERC see the relationship between the regional reliability councils, the emerging RTGs, and the power pools as evolving?

\_: Clearly there is a blurring of the lines between these types of organizations. The best way to approach these issues is to let the various regions try out different things, perhaps start down some failed roads, perhaps down some successful ones, rather than trying at this point to look for a solution that probably won't fit any of us.

\_: I would recommend taking a look at the Michigan proposals for some inspiration here. They are describing an organization that looks a lot like what we're talking about -- an umbrella group with subgroups on reliability, trading, planning, and dispute resolution. Membership is not exactly the same in each one of these subgroups, but there's probably an 80 percent overlap. They seem to be reasonably far along in establishing these groups and talking about the various issues. Maybe eventually not everyone needs to be concerned about, say, reserve margins; instead you have a reserve margin group.

\_: It might be useful for the FERC to issue a policy statement on industry restructuring, covering issues like the process by which the issues will be addressed or the circumstances under which it would be deferred to organizations like the RTGs. This could include clear articulation that one size does not necessarily fit all in this case, and there can be regional solutions that can be quite different in the East and the West and the Midwest and so on. That might be a way to give some thrust and orientation to the whole process.

: How do we coordinate Section 211 decisions at the FERC with state planning and siting processes? We still have prices in place that are going to induce independent generators to locate plants in places that are probably not economically optimal. In the past we assumed that generators would be sited by utilities without reference to the price of transmission services, but that's not the way independent generators are going to behave. They will locate in response to existing transmission rates, and we have to be prepared for that to happen fairly soon.

\_: Is FERC going to order somebody to build a line to provide a service that otherwise cannot be accommodated under existing transmission capacity? The answer is probably no. Once the system is opened up and more flexibility is introduced, there will be more capacity available. Reserve margins are also going to drop as a result of changes in the industry. No one is building transmission anyway except in very select circumstances. Most utilities I know have no interest in building anything domestically in the near term, so this issue is not a problem.

: The effect of such a FERC order would be to assign financial rights to compensation for transmission differentials across locations. Those financial rights could be handled in a number of ways, including leaving it up to the state to compensate the people who have been assigned those financial rights. That way, the person who was ordered to get access would get access. The cost of building or not building the line could then be absorbed by the people making the decision to build or not to build. So it might actually turn out to be easier to deal with this way.

: Except that if I were a state siter, I would

never agree to site a line that was serving people outside the state when the cost was being imposed on the ratepayers in my state, which under the current regime is exactly what would happen.

\_: The way the policy on comparability works today is that you would not impose the cost of building that line on native load if it was dedicated to third party service.

A major problem with all models for federal-state comity under the Federal Power Act is that they are very difficult to apply to real situations. It is nearly impossible to define the limits and boundaries of just who constitutes a party of interest in a discussion of, say, the CPUC Blue Book proceeding.

\_: Why not just issue a statement on what you think the jurisdictional boundaries are? What prevents any parties that consider themselves interested from being heard on that?

\_: That's why we do rule makings, because they're very open. But I don't believe that the results of the deliberations of approximately 250 federal and state regulators are a practical way to go about solving problems.

\_: So should the various groups of states come to FERC with a proposed resolution of the issue or a proposal for a process that would solve the problem?

\_: We would have to come up with some sort of a process first. Rather than having a massive joint hearing with FERC, the states could come to a joint conclusion amongst themselves and propose it to them, perhaps

cross-checking along the way that they're not out in left field someplace. Present them with a solution, but keep them informed as to what's going on while you're in the process.

\_: We haven't really defined which model we're using, be it direct access or something else -- from that perspective, it makes more sense to deal with issues of process as opposed to outcome.

\_: The idea of a joint board in a scenario like that of the Western states is just wholly unworkable because of its size and scope. The scheduling problems alone could cause the whole thing to balloon out of control. The idea of presenting FERC with a regional solution makes a lot of sense in this context.

\_: The comity we have seen so far in the formation of the RTG hasn't really been tested yet at the practical level. To propose it as a solution to the procedural problems we have been talking about is just too big a leap, with all of the uncertainties that remain. We need to take some smaller steps, practical steps, in some smaller forum, before proposing this as a national solution. Work some specific problems through on a more informal level and see what happens when the process issues become less of a concern.

\_: From time to time regulation is really a legislative activity. When we *do* come to an issue that we think is important, maybe it is just time to make a rule and pass it, and then move on so that people can make their decisions around it. You can listen to everybody and try to balance what you've heard in the making of the rule. Not everyone is going to be happy, of course, but it may be that we will just have to do it from time to time rather than adjudicate everything on a

small scale, an approach which runs the risk of being driven by special circumstances rather than overall principles.

\_: It is important that whatever process we use yields an expeditious and efficient end result. There are two important initiatives out there now: the NOI on alternative industry structures, and the stranded cost issue, both of which we hope to move on soon. Those large issues will take time, but they will solve a lot of the uncertainty and flux that is out there now.

\_: The FERC actually made a lot of progress with the RTG policy statement by setting out general principles against which people could work and then deciding cases in response to that. If there were some general guidelines they could agree upon and make available to the nation at large, it would facilitate the development of restructuring proposals. Such general principles wouldn't have to be binding as a matter of law, but they would give people confidence that there would be a generally positive response if they were within certain parameters. Beyond that, the only alternative is case-by-case judgments, which could be very time-consuming.

\_: The basic point I hear is that, if FERC can announce some rules that include policies of deference, that will go a long way to resolving a lot of the questions that are up in the air. I would like to underscore that. Much of American federalism that has been successful has been something you might call "informal federalism", or an attitude of cooperation in which rules of deference and so on are made clear. All these ways we have discussed are ways in which state authority and state flexibility can be enhanced by an articulation of rules by FERC within which states are free to

make their own decisions. It is that attitude and that structuring of rules that leaves enough flexibility open to take us down this path without necessarily creating new joint structures to do so.



Handouts for January 12, 1995, Harvard Electricity Policy Group seminar on Federal-State agency cooperation:

- . Gray, Charles. *Memorandum and paper: Options for Jurisdiction over Transmission Facility Siting*. Paper, 1991; memo, January 1995.
- . Kates-Gamick, Barbara. *State/Federal Interaction: The Appeal of "Comity" during the Transition*. Draft, January 1995.
- . Marritz, Robert. *Materials on Mechanisms for Joint State-Federal Decision Making in Electricity Policy*. Various materials assembled January 1995.
- . Bums, Robert, and Mark Eifert. *A Cooperative Approach Toward Resolving Electric Transmission Jurisdictional Disputes*. National Regulatory Research Institute Report NRRI 94-06, March 1994. Excerpt, *The Regulatory Alliances*.