

HARVARD UNIVERSITY

JOHN F. KENNEDY SCHOOL OF GOVERNMENT

Harvard Electricity Policy Group



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HARVARD ELECTRICITY POLICY GROUP SEMINAR: STATE AND FEDERAL JURISDICTIONAL ISSUES IN ELECTRICITY

Hyatt Regency Crystal City, Arlington, Virginia
February 11th, 1994

MEETING SUMMARY

In previous sessions the HEPG has discussed the issue of conflicts, gaps, and overlaps between federal and state regulation of electricity. Two specific topics emerged as being of immediate importance to several imminent regulatory proceedings: the usefulness and limitations of regional transmission groups (RTGs) in resolving some of these jurisdictional issues in a more competitive industry; and the treatment of stranded assets issues between federal and state jurisdictions. At the request of several key groups involved in these discussions, this HEPG seminar was organized to continue the discussion focused on state and federal jurisdictional issues.

Morning Session: Regional Transmission Groups as They Relate to State and Federal Jurisdiction

There are differing views as to whether RTGs will help resolve potential federal-state jurisdictional conflicts. Some believe they will prove helpful in that regard, others believe that, while RTGs may have merit, their existence means little in regard to resolving jurisdictional issues. The object of this session was to explore the jurisdictional problems that RTGs solve and don't solve.

Papers: *Transition to Competition: Federal Initiatives and Industry Opportunities* and *FERC vs. State Jurisdiction Over Transmission Lines, Transactions, and Rates*¹

First Speaker

The FERC currently has approximately 211 cases before it for provision of transmission

¹ Papers and outlines handed out for this seminar are listed at the end of this summary.

access. The Energy Policy Act did not go as far as it might have in developing the concept of RTGs, and the FERC has taken on the task fairly quickly, in hopes that they can handle some of these transmission decisions. The FERC put out a policy statement on RTGs, including provisions for size, membership, and emphasizing the role of state commissions.

Several points have been important to date in the development of RTGs. The North American Electricity Reliability Council has proposed certain organizational changes, in order to be able to make a contribution to the development of RTGs. Quite a few efforts are underway in various parts of the country to develop RTG bylaws -- the FERC expects one or two petitions from organizations in the western U.S. in the first half of this year.

A regional focus on grid issues in particular will be much more productive in the long run. If people don't support RTGs, the industry may end up saturating the FERC with transmission requests, and federal decisions will not be able to take into account regional differences in the electric system.

With a few exceptions, there has not yet been a great deal of participation by state commissions in the process of setting up RTGs. The FERC urges greater state involvement, to make sure that the state commissions are comfortable with the decisions RTGs will be making. Ultimately, of course, the decisions that RTGs will be making, especially those with respect to expansion of the transmission system, are going to require state commission approvals.

Second Speaker

RTGs are based on three premises: that competitive markets will evolve regionally without regard to state boundaries; that regional solutions reached in consultation with state commissions will be better than solutions imposed nationally; and that the process of discussing and developing

RTGs is itself an important part of the final product. We're faced with the jurisdictional reality that state commissions and the FERC have statutory roles to play, and RTGs offer a way to work within that framework to solve some of these difficult inter-jurisdictional problems. The FERC believed that there has been a lack of regional communication on transmission planning issues, and rather than mandate a forum with some nationally-determined structure, the FERC felt that it would be better to encourage each region to come up with its own RTG, within the seven minimum standards the FERC provided. One of the reasons the FERC chose this path was that it wanted to encourage experimentation within regions on how they plan, how they communicate with state regulators, and how they deal with issues specific to the region.

The most important RTG standard that the FERC set was a requirement for an appropriate consultation mechanism with state commissions. The FERC has stated that the measure of deference it will accord to RTG decisions depends critically on the manner in which the RTG dealt with its state commissions. The FERC did not, however, define appropriate state involvement, because it felt that it would be more productive approach to encourage each emerging RTG work out its own level of comfort with each state with which it dealt. The models for state involvement could range all the way from state assent to the formation of an RTG and separate state assent to each RTG decision, to simply reporting to state regulators what actions the RTG has taken. The relationship that seems to be taking shape in the emerging RTGs is ex-officio voting membership in the RTG for state commissions, as well as the opportunity to observe planning and decisionmaking sessions. These mechanisms, rather than full voting membership, were preferred by the state regulators. They did not want a more active role, because they felt that proposals should be made to them as state regulators, and they did not want to compromise that by voting on proposals as part of an RTG.

The emergence of RTGs will not resolve all federal-state conflicts, but they could provide a means of federal-state communication that make some of these conflicts less likely. RTGs give the FERC a much more comfortable means of solving transmission problems with the input of state regulators than is currently possible. Finally, the RTG process itself will be valuable in opening up regional communication.

First Respondent

As the speaker stated, there are currently four western RTGs that are preparing by-laws, and all of them decided early on that ex-officio membership for state commissions was the best approach. At a recent meeting of the West-wide group, there was some discussion of additional state involvement. My concern is that, at this point, all information flow is embodied in the RTG's by-laws, so that when the FERC approves the by-laws, it will be approving whatever deference to the RTG process is embodied in the by-laws. State commissions have made no similar commitment. We need to pay attention to this issue: What approval, acknowledgement, recognition, or endorsement of the RTG approach is needed from state commissions? Should a state commission recognize that RTG output should be considered in its proceedings? It's important to go through that range of possible outcomes, and determine how we want to approach these issues. So far, we've had general agreement among western regulators in support of the RTG concept, and that is why we've seen the amount of development that we have.

Some specifics about the emerging western RTGs:

- Membership is open to anyone who is subject to or can apply for a FERC 211 [transmission access] order.

Two of the RTGs in the West are about to go to the WSCC, the reliability council, with a proposal that the executive committee be restructured to be one third transmission owners, one third transmission dependents, and one third independent power producers. The future of these RTGs is dependent on this.

Dispute resolution is handled through a modified version of the baseball arbitration process, with the ability to appeal to the FERC if decisions are considered unjust or unduly discriminatory, etc.

One of the major concerns has been rules for planning and access requests. Some members think that there ought to be one set of rules for everyone in the interconnected grid, while others want to do all the planning in their own back yard and everyone else should go by their rules. This issue is going to come up everywhere you try to start an RTG -- what is the appropriate region, and whose rules do you go by within that region? This process had been two steps forward and one step back, but there has still been progress.

Second Respondent

New England, through NEEPOOL, has always enjoyed good cooperation and communication among its utilities and regulatory bodies, but it has usually occurred on a need-to-know, specific issues basis. The commissions have tried to be more proactive and forceful in coming up with a regional transmission agreement that enunciates five or six principles that we would like to see in an RTG.

Membership is a major issue -- who is going to be part of this RTG? Consumer groups are very important, and the New England approach should include these groups to some degree. (In response to a question about how these groups might participate, the respondent said that

associations might be formed over a period of time to facilitate their involvement. Massachusetts has recently seen a transit authority turn into a utility, for instance. The question is really what role the region needs them to play, not what the mechanism is for including them. Another participant noted that the WSCC is forming an outreach subcommittee to include input from consumer groups, federal land agencies, native American tribes, and other groups.)

Another issue is the concept of collaboration and appropriate deference. The concept is good, but how it would work in practice has not been adequately described. Even though we in New England have a good relationship with our pool members, at what level would our decisions trigger a FERC response? If our dispute resolution doesn't work at the local level, at what point can the parties go to the FERC? This is an important issue that needs to be looked at.

A final interesting issue is stranded investment. One of the reasons our regional transmission agreement is hung up right now is that one of our big utilities is in court. This is a failure of the region to work together on transmission.

Commenter

The FERC has no power to order retail wheeling and no power to authorize construction of transmission lines. The second of these is going to end up being much more important than the first. The natural gas experience would have been a mess if not for the FERC's preemptive power to authorize the construction of gas pipelines -- not just with respect to half a dozen large projects that were necessary to enhance capacity, but also with respect to hundreds of little projects that were necessary to the development of a competitive environment in the industry. Given NIMBY and EMF concerns, states are going to be incapable of authorizing new transmission capacity, and the FERC is going to have to help them by establishing policies that send a message that if any state

chooses not to authorize a needed transmission system enhancement, that virtually all of the costs of that decision will fall on that state. States that have the option to make costless decisions not to site lines will fold in the face of EMF and NIMBY-based opposition -- they have to be given something that pushes on them in the other direction.

Even if the FERC decides it cannot or will not assert direct jurisdiction over all transmission issues, it is still the only institution that has any ability to be the architect of a workable transition regime. But the jurisdictional situation is so messy that the FERC is going to have to rely on creating rules that indirectly shape the incentives of other actors, including both private market participants and state commissions -- rules that encourage the kinds of restructuring that will create an industry that functions well. Rules that in effect say, "You have one hundred percent freedom to do whatever you want, but understand that these are the consequences of taking this alternative rather than that one."

Eventually, the courts are going to hold that the FERC has plenary exclusive power over transmission rates over all high-voltage lines in the continental U.S. "I won't try and tell you that there is case law to support this -- there isn't." Transmission has always been bundled with other services, and those services were provided by a small group of IOUs operating subject to cost-of-service regulation. This is all gone with respect to wholesale transactions, and the courts are going to have to resolve these issues for this new world.

How will state regulation change? Once the generation market is on a competitive basis, the state commissions are going to be left regulating the distribution system, and they won't have nearly the leverage they have now. Generation is where the big money is, and when that goes, the ability of state commissions to put in conservation programs, externality adders, low income rates, etc. will be less than it is now.

Discussion

- A participant noted that the NARUC Electricity Committee is trying to put together a resolution which encourages state regulators to become involved in the development of RTGs, and provides a discussion of issues the second speaker raised, with respect to the role of state regulators.
- A participant from New England noted that, while NEEPOOL has been the most tightly integrated pool for some time, locking in pricing mechanisms at this point is not a good idea. The voting structure of NEEPOOL, where any two entities can veto, makes it inadvisable to use at a time when policy is evolving -- decisions will be impossible to get. NEEPOOL negotiations on a regional transmission agreement capture most of the things the FERC is looking for in an RTG -- everyone will have a transmission tariff, along with a mechanism for planning new transmission, and as one of the respondents said, NEEPOOL already has a good cooperative relationship with the state commissions. The big issue is the pricing issue -- we need to link the resolution of the stranded asset issue to the RTG issue. This would solve both pricing and some access issues. Is this a direction the FERC would take? (The first speaker responded that the FERC would be prepared to give a properly constructed RTG a great deal of flexibility on deciding pricing issues within its region.)

In response to a question about the relationship between transmission pricing and siting, a participant stated that all RTG bylaws now being developed punt on pricing -- they state that pricing will be consistent with the Federal Power Act and FERC policies. One of the speakers stated that the FERC's likely direction in pricing will be to construct a box in which regional experimentation with pricing can take place. This is a good approach -- state regulators will be reluctant to site transmission, so care will have to be taken that the pricing is equitable, but states recognize the benefits of increased competition in terms of regional efficiency.

- A participant pointed out that a New England state had justified a siting decision based on

regional, rather than state, needs, and the courts had thrown it back, saying, "The siting statute says you have to find benefits for the state, not the region. Whether or not the FERC can figure out how to work the leverage the commenter talked about, these statutes may be a constraint on the ability of many states to approve the decisions of the FERC or RTGs. (The commenter agreed that changes to state statute might be necessary.)

- Another participant asked what is to be done about pricing in the case where the line is justified on the basis of regional need, not local need -- how can the state commission turn around and justify passing through some of the costs of that facility to the retail ratepayers in the state? A participant said that the answer to that is to create a contractual commitment for the party outside the state to pay those costs, and there's no reason why that can't happen immediately. This might be a very constructive step for states to take -- to say that we are no longer going to make our retail ratepayers bear the residual revenue responsibility for transmission costs without justification.

Moot transactions where a customer wants to switch utilities to get cheaper power occur intrastate, so the question of FERC involvement is much more complicated. Has the FERC given any thought to what its reaction would be if a state tells one utility in its jurisdiction to wheel power from another utility in its jurisdiction to provide lower cost power? This has been under consideration in one way or another in Pennsylvania, Florida, New York and Michigan. Does the FERC consider this an invasion of federal jurisdiction?

Afternoon Session: Federal-State Jurisdiction and Cost Recovery of Stranded Assets

Increased competition raises the spectre of significant risk of stranded assets to utilities and other existing generators. Whose responsibility is it to address these issues (L e. which regulatory jurisdiction) ? When it results from wholesale competition? From retail competition? Does the answer vary depending on the nature of the competition? This session explored the constraints and possibilities for exercise of jurisdiction over stranded investment.

Paper: *Federal-State Jurisdiction and Cost Recovery of Stranded Assets*

Speaker

A quick summary of how the FERC has addressed stranded investment is instructive to some of the jurisdictional issues we face. This includes the question of who has jurisdiction of transmission, and how to apply this jurisdictional mix to some of the stranded investment scenarios that are now before us.

The first case is the Entergy open access transmission case, where the FERC approved a provision providing for recovery of stranded assets under a variety of scenarios and on a case-by-case basis. In subsequent orders the FERC established some standards as to what kind of recovery would be appropriate.²

There are now two cases before the FERC where stranded investment is an issue. Philadelphia Electric has proposed a termination charge to its power supply contract with its wholly-owned subsidiary, Conowingo. The other case is a Massachusetts Electric Company case involving a wheeling rate by Massachusetts Electric for a former retail customer, the Massachusetts Bay Transit Authority (MBTA). Several years ago the Massachusetts legislature declared the MBTA to be a domestic electric utility, and then this year the MBTA became a wholesale customer of Boston Edison (BECO). Mass Electric is seeking to recover stranded investment costs as part of its transmission service from BECO to the MBTA.

² These are outlined in more detail in the paper referenced above.

Who has jurisdiction over stranded investment may depend on who has jurisdiction over transmission. Section 201 of the Federal Power Act states that the FERC has jurisdiction over all facilities for transmission or wholesale sale of electric energy, but not over local distribution facilities. Clearly the states are not entirely preempted from jurisdiction with regard to transmission service. They have siting authority. The FERC has asserted authority over most transmission pricing -- the Commission has accepted retail wheeling rates for filing, such as the arrangement in New York where Niagara Mohawk and ConEd wheel power from the New York Power Authority to certain customers in their territories. These arrangements have been called different things, but no one has ever challenged the FERC's jurisdiction.

It is less clear who has jurisdiction over transmission access. The clause in the Energy Policy Act that prohibited the FERC from ordering retail wheeling added that nothing in the Act shall affect any authority of any state government concerning the transmission of electricity to a consumer. What does that mean? Does it mean that states have authority to require retail transmission access, or does it simply leave states with jurisdiction over direct transmission of a utility's own power to a retail customer within the state? Until this kind of question is resolved, it is going to be hard to say definitively who should deal with stranded investment in many situations.

Transmission access and pricing when a wholesale customer simply switches suppliers is definitely FERC jurisdictional. If a retail customer switches suppliers, the FERC clearly cannot compel access -- whether or not the states can is an open question. What about if a retail customer becomes another supplier's wholesale customer? Probably the FERC has jurisdiction over access and pricing because the customer is can now demand access under Section 211.

Respondent

There is a good legal case to be made that states can't order retail transmission access. States in these cases are afraid of litigating the access issue because they are afraid that they'll lose, and it will turn out they don't have the authority to order a utility to provide retail transmission service. A major court decision will eventually have to resolve that issue.

Is there an obligation to buy? Is there any legal doctrine that is imposed on a consumer in the absence of a contract -- I don't know of any cases where the customer has an obligation to defray the cost of the purchase that the utility had planned over the life of having that customer on the system.

It is not clear whether by law the FERC can direct a utility to recover costs that aren't transmission related in a transmission pricing docket.

Discussion

- Could the FERC impose its own pricing scheme for retail transmission services and effectively unbundle retail rates? It's hard to say, although there are some individual rates on file to federal facilities, etc. that are essentially retail transactions. In establishing a transmission rate the FERC could certainly divide it between retail and wholesale, but it would not be able to require state commissions to then reset retail rates to reflect this analysis.
- A participant disagreed with the statement that transmission access was the mechanism that caused stranded investment. Plenty of customers are encouraging or threatening municipalization, or self-generation, or getting discounts, all of which cause stranded costs to be passed on to the remaining customers or allocated to the stockholders, without anyone formally adopting a stranded investment policy. If, on the other hand, the FERC were to come up with a stranded asset policy,

this changes the decisionmaking by the utility, which _{might} prefer to lose its customer and recover some of its stranded costs through the FERC mechanism rather than facing its state commission and possibly get some of those costs disallowed in the next rate case. The incentives are tricky.

- A participant noted that, if stranded asset fees were recovered as part of a transmission charge, it would be important to apply the fee as close to the customer as possible, to prevent incentives to bypass transmission and avoid paying the charge. In New Zealand, stranded costs are being recovered through the transmission system, creating an incentive for people to build "embedded" power generation in the distribution system, because it doesn't count as using the transmission system under one version of the proposed rules.
- In a brief discussion about exit fees, the danger of creating an incentive to self-generate was mentioned, as well as a question about whether exit fees posed a "right to travel" problem. In the opinion of one participant, customers seeking to leave a utility would not be constrained from doing so -- they might have to pay something to leave, but that's another issue. Several utilities have tried notice requirements and termination provisions recently, but to date there isn't a great deal of experience with exit fees.
- Options were discussed for ordering the recovery of stranded assets through transmission in the event of a customer leaving its franchise utility. The utility could file a tariff amendment or a transmission service filing with the FERC seeking some form of stranded asset surcharge. The state commission, in allowing the customer to leave the utility, could impose some kind of exit fee, or tell the utility that the issue of who bears the stranded costs -- the remaining ratepayers or the utility's shareholders, or both, will be resolved in some rate proceeding. All of these approaches have been proposed in various cases. Even if no one has the authority to order retail wheeling, it was noted that these stranded assets issues would need to be resolved in the increasing numbers of cases where

retail customers become wholesale customers, or leave the system in some other way.

How do we sort out the policy question about what kinds of stranded assets can be recovered and what kinds can't? Should assets stranded through a customer self-generating be treated the same in terms of cost recovery as assets stranded by an access order from the state commission or legislation allowing retail wheeling?

- A participant reported that the president of the Sierra Club has suggested that the state of California sell bonds to pay off the fixed costs of the Diablo Canyon and San Onofre nuclear plants so the plants could be shut down and taken out of the rate base. This is a new option for dealing with stranded assets -- there may be others that have not yet been explored.

Handouts for 2/11/94 Harvard Electricity Policy Group seminar in Washington

Some of the materials listed below were prepared specifically for the seminar. Please do not cite any materials marked "Draft"

Massey, William L., "RTGs: State-Federal Cooperation" Draft remarks, 2/11/94

- Massey, William L., "Transition to Competition: Federal Initiatives and Industry Opportunities" *Electricity Journal* December 1993/January 1994 p.26-32
- Norton, Floyd L. and William M. Dudley, "Federal-State Jurisdiction and Cost Recovery of Stranded Assets" Draft outline, February 1994
- Ostrom, Elinor, "Design Principles Illustrated by Long-Enduring Common Property Resource Limitations" *Governing the Commons. The Evolution of Institutions for Collective Action* Cambridge, U.K.: Cambridge University Press, 1990, table 3.1, p.90
- Pierce, Richard "FERC vs. State Jurisdiction Over Transmission Lines, Transactions, and Rates" Draft outline, February, 1994