

# State Power Over Transmission Access and Pricing: The Giant Will Not Sleep Forever

By The Honorable ASHLEY C. BROWN

This article examines the nature and extent of authority which state utility commissions have to regulate access to electric power transmission lines and pricing for such access. Somewhat surprisingly, since there has been a common assumption that this is the domain of federal regulators, the author is able to point out numerous bases for the exercise of jurisdiction by state regulators, by direct grants of authority, or indirectly in the discharge of other responsibilities and duties.

The debate over electric transmission pricing and access has largely focused on the Federal Energy Regulatory Commission and its powers. That focus is a logical result of the fact that both the suppliers and buyers seeking to use the transmission grid are active participants in the federally regulated wholesale market. While the FERC's transmission activities over the years have been less than dramatic, its recent actions, the formation of the Transmission Task Force at the commission and, of course, the broad use of conditioning powers by the commission in its recent decision in the Pacific Power and Light Company and Utah Power and Light Company merger case have tended to strengthen that focus. While certainly understandable, the concentration on national policy has served to obscure the fact that greater powers, both *de jure* and *de facto*, to mandate access, and even to set pricing signals, exist at the state level. Those powers, while largely overlooked and ignored, merit close study in an era where transmission have-nots on both the supply and demand side of the grid are seeking access to and equitable prices for transmis-

sion services. Moreover, as the dynamics of the industry change both in terms of new actors and increased competition, state regulators are likely to be pressed to explore and use their powers by parties who see their interests served accordingly. Those powers, and the dynamics driving their use, merit discussion.

Some states, most notably Texas, mandate transmission access by law. Since much of Texas is in the Electric Reliability Council of Texas, the only reliability council in the United States which is largely unconnected with the rest of the country, the impact of mandating access is geographically confined within the state, thereby rendering all transactions, both wholesale and retail, intrastate and therefore solely subject to state jurisdiction. While Texas is certainly not typical in regard to the physical structure of its bulk power market or the breadth of the statutory empowerment of the commission, the degree to which the consolidation of transmission jurisdiction in a single regulatory body has created a workable, competitive bulk power market is instructive in pointing out the benefits that can be derived from effectively utilizing state authority over transmission. The Wisconsin Public Service Commission, with a perhaps less explicit statutory mandate, has also moved recently, pursuant to its planning and siting authority, toward a more comprehensive and more open transmission policy for the state as a whole. (Order 05-EP-5, April 1989).



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## *Bases of State Authority*

While most states lack the direct and broad authority that the Texas commission possesses, it is clear in looking at retail jurisdiction alone that most, if not all states,

using retail rate making and siting jurisdiction, could mandate whatever public policy they deem appropriate on access. The first, most obvious, *de facto* power of states over transmission relates to the attachment of conditions for siting and certification of transmission lines or corridors. For example, a state commission, in certifying a corridor for a transmission line, might choose to impose a condition on certification that would require the applicant to provide access to all generators or transmission-dependent utilities (or both) which can be physically accommodated or whose needs can be reasonably anticipated at the time of certification. Indeed, the very planning process for those lines could require the builder of new transmission to plan for all reasonable and foreseeable uses of the line, not only for their retail load but for wholesale markets as well. The public policy reasons for a state to undertake that kind of approach are obvious. Transmission corridors are scarce resources, and their environmental and aesthetic impacts are often subject to intense controversy. Once the effort is undertaken to site a line, it makes sense politically, economically, and environmentally to ensure that the use to which it is put is the most efficient possible, and that the incremental need for new transmission will be deferred as long as possible.

Another power of the states over transmission relates to siting of generating plants. States could condition the siting of utility generating facilities upon certain transmission access policies such as those Congress empowered the Nuclear Regulatory Commission to impose in the certification process of nuclear power plants. If competition fully emerges in the generation sector, that type of conditioning may well become commonplace.

State jurisdiction over retail rate making provides for considerable influence over transmission policy. The bulk of transmission pricing is already done by the states in the course of retail ratemaking. Since the bulk of rates are bundled, little if any effort is made to specifically identify specific costs, revenue requirements, or risks associated with transmission services. Nevertheless, state rate making has an enormous direct and indirect impact on wheeling rates that utilities charge wholesale customers. A state could choose to send policy signals by unbundling retail rate making to specifically identify transmission-related costs and allocate revenue accordingly. Indeed, it could evaluate risks specifically associated with transmission and set a different rate of return for transmission investments different than that for other assets. A state doing so would not necessarily be unbundling in order to accommodate or encourage retail wheeling, but could do so in order to send appropriate price signals to wholesale markets and to make appropriate cost allocations between retail and wholesale markets. In fact, utilities might find that the unbundling of transmission rates at the state level could provide them with some relief from price squeeze complaints from wholesale customers at the FERC.

The power to review the management practices of

utilities allows state regulators to audit the use of transmission assets. Thus, if it could be shown in a state proceeding that the facilities were not being optimally employed a state commission would have considerable power to remedy that circumstance. For example, if a wholesale customer wanted to wheel on a utility's system, but the utility chose not to accommodate the transmission even though it had the ability to accommodate the transaction, a state commission which was not persuaded as to the prudence of a utility's explanation for forgoing the revenue from the proposed deal could deduct that amount from the company's overall revenue requirement in a rate proceeding. Similarly, it could disallow the costs in rate base of that portion of the company's transmission system that it viewed as being underutilized as a result of refusing to accommodate wheeling for which it had capacity. Moreover, a state commission unhappy over the transmission policy of a regulated utility could express that displeasure through its rate of return determination.

A significant source of authority for states to effect transmission policy relates to eminent domain. State legislative policies in determining who should be authorized to condemn property have enormous implications for transmission policy. If, for example, eminent domain flows from certification and anyone who obtains certification acquires condemnation powers, then opportunities are opened for new entrants in the transmission business, a circumstance which is likely to lead to more open access.

Conversely, if a state decides that eminent domain is derived from utility status, states could define the transmission policy they wanted, in order for a utility to maintain its monopoly provider status. That could impose a fiduciary obligation on the possessor of that authority to utilize the system as efficiently and with the least adverse environmental impact possible. States could determine that the possessor of a transmission corridor does not have a proprietary interest in the corridor, but only in its investment therein, which is, of course, a pricing rather than an access issue. Similarly, an obligation to build transmission to serve the needs of nonutility generators or other utilities could be imposed.

A further source of state power to determine transmission policy derives from the state's ability to engage in least-cost planning. Transmission planning is an integral part of overall least-cost planning. Its existence or potential is determinative of the supply options available to a utility. Moreover, the more revenue derived from wholesale markets by sale of transmission service, the lower the retail revenue requirement will become. To some extent, Wisconsin has already followed this model in its proposed transmission planning policy.

#### *Historic Reasons for Inaction*

Having delineated, although certainly not exhausted, an array of readily available state powers to effectively determine transmission policy, the question naturally

arises as to why the states' powers have not been utilized or sought to be used more often than they have been to date. There are a number of reasons. The first is that the initiative for planning in most states has resided with the utilities, who have traditionally tended to view electric markets as insular in nature, and have viewed transmission as moving their generation to their retail load centers rather than accommodating a broad array of transactions. Moreover, the importance of transmission to utilities has paled in comparison to the importance of generation. This is clearly illustrated by the fact that, nationally, transmission amounts to less than 10 percent of investor-owned utility investment in the United States. Transmission has rarely been viewed as a profit center of its own and the bundling of retail rates tends to reinforce that mindset. Thus, utilities viewed raising transmission access issues as not only irrelevant to the initiation of transmission planning, but in some senses as contrary to their interest.

The second reason why states' powers have never been utilized to a full extent relates to the political and perceptual dynamics flowing from the wholesale-retail dichotomy in rate making. In 1964, the United States Supreme Court in *City of Colton, California v. Southern California Edison Company et al.* (No. 73) 376 U.S. 205 established that as the bright line between state and federal pricing jurisdiction. While the increasing market presence of nonutility generators may create a somewhat different dynamic, the historic battle over transmission access has been between the transmission haves and have-nots among utilities. Generally speaking, with some notable exceptions, the transmission haves are investor-owned utilities, while the have-nots are cooperatives and municipal companies without sufficient generating capacity to meet their own retail requirements, and who, typically, do not own transmission.

Since the *Colton* decision, transmission-dependent utilities, who, for the most part, are not subject to state rate-making jurisdiction and may not even be subject to state planning jurisdiction, have seen little reason to make their presence felt before state regulatory bodies. Thus, the transmission haves tend to be more involved in state regulatory proceedings than transmission have-nots. This inevitably creates a dynamic where the general absence of transmission have-nots in state regulatory forums has led to a belief, or sometimes, perhaps, a self-fulfilling prophecy, that state regulators are more sensitive to investor-owned utilities than to other actors in the marketplace. Whether the perception is true or untrue, the absence of transmission have-nots has made it less likely that transmission issues will be dealt with by state regulators. The result of those dynamics is that those most in need of transmission access and services have tended to absent themselves from those regulatory bodies vested with the greatest authority to meet their needs.

It should be noted, of course, that with a few recent exceptions, investor-owned utilities have shown little ini-

tiative in transmission access and pricing policy. Indeed, they have had little incentive to do so. The predominance of their assets are in generation, which could, in their view, suffer adverse impact from a more open transmission regime. Utility legal obligations to serve are explicit at the retail and not the wholesale level. Moreover, full service retail customers, unlike transmission-only customers, are unlikely to emerge as competitors in the future. Finally, the nature of electron flows is such that a more open grid could lead to increased load flow burdens for utilities for which, if the flow is inadvertent, the utility may not even be compensated. Thus, the interest group with the greatest presence in state regulatory proceedings historically has been that with the least incentive for opening up the topic of transmission.

#### *Interest Perceptions May Change*

Given the history that we have noted, it seems unlikely that transmission-dependent utilities will want to forever remain outside the state regulatory proceedings. Even if they do, however, the growth of competitive bulk power markets and the increasing importance of nonutility generators in the market will inevitably compel state regulatory bodies to examine and exercise their powers in transmission matters, thereby changing the scope and dynamics of state regulatory deliberations. Indeed, given the inherent power of state regulators to deal with transmission issues, increased state involvement by transmission have-nots seems inevitable.

That, in turn, may well lead to wider participation in the planning and siting of new transmission facilities because wholesale buyers and sellers will be seeking access, while regulators and the utilities themselves may well find the sharing of costs and risks associated with new investment between wholesale and retail markets a desirable result. In any event, the enormous growth of bulk power markets alone will inevitably lead regulators to seek a more efficient use of the transmission system.

Finally, what will lead states to a more active role in transmission, apart from direct pricing of wholesale transmission, is the growing recognition that the bulk of effective jurisdiction of transmission siting, access, or pricing lies with the states. Inevitably, those concerned with transmission services will seek to persuade the states to use those powers in ways that are most advantageous to their interests. As long as states do not become overly parochial, a possibility that both state and federal regulators need to guard carefully against, the increased use of state powers would seem in the long run to be in the best interest of an effective national energy policy. It seems likely that state powers over transmission access will not be allowed the luxury of continuing the slumber that has marked the past. □