

Electricity After the Energy Policy Act of 1992: The Regulatory Agenda

The recently passed Energy Policy Act has intensified the need to resolve long-standing problems between federal and state regulatory systems. Various means of coordination are open, but benefits will be lost if we don't get moving.

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The passage of the National Energy Policy Act of 1992, with its reform of the Public Utility Holding Company Act (PUHCA) and provision for mandatory transmission access, necessitates that the regulatory community redefine the electric regulatory agenda.

With the amendment of PUHCA and the Federal Power Act — the former removing the entry barriers for independent power producers to compete in electricity markets and the latter providing more assured access to the transmission grid — there will be significant new opportunities for capturing efficiencies and

stimulating innovation in bulk power markets. Doing so will enhance the overall competitiveness of the U.S. economy and provide real benefits to consumers.

But to take advantage of these opportunities, regulators at both the state and federal level must not only take the actions required by the new law (a subject beyond the scope of this article); more importantly, they should become proactive in spotting and clearing regulatory debris and potholes that threaten to impede the benefits of the new, more competitive order. They should reexamine existing regulatory practices, design new processes where appropriate,

and decide how to enhance existing processes that can be improved. Doing so requires no less than formulation of a regulatory agenda to meet the needs of the post-Energy Policy Act environment. What follows is an attempt to do so from several different perspectives: that of federal regulators, of state regulators, and from a joint federal/state perspective. While this last category is a new one, it is a most necessary one, as the new law poses new problems and opportunities for the never-easy federal-state relationship.

I. Federal Issues

A. Defining Competitive Markets

For several years, the Federal Energy Regulatory Commission has seen its role as cultivating and encouraging increased competition in the electricity industry. While its objective has been clear, the Commission has not articulated or formulated a predictable regulatory path along which a workably competitive bulk power market can progress and ultimately flourish. For example, FERC has yet to set forth any generic standards that would allow market participants to predict with a high degree of certainty when FERC will approve market-based rates, as opposed to requiring full cost justification for rates.

To its credit, FERC, unlike many other Reagan-Bush era federal regulatory agencies, has not confused competition with deregulation or regulatory abdication. The agency's approach has not been to

abandon regulation, but rather to actively intervene and seize opportunities to promote competition. It has vigorously employed its oversight authority to promote this ideological agenda. Once the added impetus of PUHCA reform makes itself felt in the marketplace, FERC will need to set forth its policies and processes more coherently and comprehensively. Even competitive markets appreciate predictability.

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B. Untying Transmission Knots

A second area demanding FERC's attention, in light of its new authority, is development of a fast-track mechanism for resolving transmission access disputes. FERC must move quickly to establish such a mechanism, while still affording fairness and due process to all litigants.

The Regional Transmission Group (RTG) proposal recently put out for comment by the Commission holds promise in that regard. So does the Interregional Transmission Coordination Forum (ITCF) application on trans-

mission, which would benefit from an expeditious ruling by the Commission.

A workably competitive, dynamic bulk power market will flourish only if rules are predictable and there is a mechanism for quick resolution of disputes over access. Competitive markets require sellers to be able to deliver their products to buyers readily on a timely and reliable basis. Conducting regulatory proceedings at the usual leisurely pace will not suffice.

For the competitive market to work there must be accurate, current information available to prospective participants. There must also be a way to resolve disputes efficiently and expeditiously. Examples of actions which could expedite transmission decisions include: (1) requiring standard periodic transmission filing requirements by transmission owners, (2) allowing prospective filings for seekers of transmission services in advance of actual need, and (3) developing transmission modeling capability at FERC.

FERC could also move the ball by conducting an updated national power survey, which the National Association of Regulatory Utility Commissioners (NARUC) has long been urging the Commission to do. Conducting such a survey would provide regulators and all interested parties with an invaluable data base which could be shared.

C. Transmission Pricing

Perhaps even more importantly, a workably competitive market requires a predictable transmission pricing regime. Such a regime might consist of requiring tariffs to be on file, consistent application of known criteria to establish price, and other means of providing clear price information to players.

Transmission prices should encourage needed expansion of the system, provide incentives for investment in new technology, promote efficient use of existing assets, and distribute costs equitably.

FERC, as well as the industry as a whole, also needs to move to a pricing regime that reflects the actual flow of energy and the real burdens borne by providers, rather than perpetuate the outdated contract-flow model. A number of utilities are actively trying to move toward a more equitable system. They should be encouraged to continue and FERC should work with them, as well as providing the leadership necessary to develop such a regime.

Pricing concepts which reflect the imposition of costs or afford savings (e.g., siting a generating facility in a location that increases the efficiency or stability of existing lines) should also be explored.

A number of critical pricing issues remain that are really joint, federal-state issues, such as developing a pricing regime that resolves the recurring conflict over the rights of native load customers. These issues are addressed below.

II. State Issues

A. Utility Specialization

Perhaps the first task for state regulators is to challenge utility management to identify precisely what business it wants to emphasize. Utilities should analyze discretely each of the services they currently provide, internally prioritize them, and decide which they want to emphasize. Does a company want to be in the distribution business? Does it want to

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be in the generation business? Does it want to be in the transmission business? Does it want to be in the demand-side business? Does it want to be in the factoring business?

Those companies that feel that they are most efficient as builders and/or operators of power plants may want to get out of the distribution service and vice versa. The broad purpose of such an exercise is, of course, to capture corporate strengths for the overall efficiency of the marketplace. A narrower purpose is to allow state regulators to focus more directly on those services that most impact retail customers. These serv-

ices would include distribution, demand-side management, wholesale power procurement, customer relations and planning. They might include generation and transmission as well, but the key is that regulators be able to focus and target rate treatment and price signals on an activity-specific basis.

B. The Regulatory Bargain

A second, related area requiring redefinition is the nature of a utility's obligation to serve. As need for new capacity arises in an increasingly competitive market, it can no longer be taken for granted that large consumers will continue as full service customers. The utilities' obligation to plan for such customers and put large amounts of capital at risk in order to serve them must be made symmetrical with customers' obligation to buy.

Simply stated, customers with market power will seek to exercise it. Whether they should have the ability to shop for power as a matter of policy is irrelevant; the market has already provided them with alternatives to traditional monopoly providers and will increasingly do so. Given that fact, it seems appropriate that a utility's obligation to serve reflect a customer's willingness to commit to buy from the utility; the obligation to serve should be symmetrical with the degree of monopoly power. Failure to find this symmetry will promote inefficient use of society's resources, as exemplified by excess capacity, and result in misallocating costs.

A good beginning might be to require special contracts, rather than tariffs, for customers whose load characteristics and other circumstances provide them with purchasing power.

C. Integrated Resource Planning

Perhaps the most effective forum for raising such questions as corporate self definition and clarifying the obligation to serve is through a systematic process in which some 35 states are already engaged: least-cost, or integrated resource planning (IRP). The IRP process, in addition to its other benefits, provides a useful way for states, customers and other nonutility parties to articulate their expectations of utilities. The clearer these expectations are stated at the outset, the less uncertainty everyone faces, and the more likely it is that society as a whole will capture the efficiency opportunities inherent in a competitive market.

The IRP process can provide answers to questions about the utility's mission and the nature of its service obligation. In addition, more specific questions can be raised, such as: how much reliance should there be on DSM, purchased power, and rate base construction; on particular energy sources; and what consideration should be given to externalities?

Through IRP processes, state regulators have the opportunity to take the initiative to examine and pursue various energy forms and energy policy options. If regulators take a passive, "in-box,

out-box" approach to regulation in the post-PUHCA world, we will almost certainly lose the benefits offered by a more competitive bulk power market.

The Energy Act requires states to consider IRP. The law provides little substantive guidance as to how that should take place, but really did not need to do so, in that IRP has been a creature of state initiative from its inception.

But passage of the Act, with its removal of former barriers to en-

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try into generating markets, does heighten the need for states to use the IRP process to help utilities to broaden their perspectives and view themselves as energy service providers, rather than simply vendors of kilowatt-hours.

Economically justified DSM and other efficiency measures, conservation, and encouragement of renewable energy sources should now become a central part of each utility's business perspective if they were not before.

Utilities that are already moving in that direction should be encouraged by regulators; those that are

defining their mission too narrowly should be prodded.

D. Inter-utility Coordination

One further planning challenge for states will result inevitably from the inherent tensions in maintaining inter-utility coordination in facility planning and construction, particularly in transmission. The historic benefits of that coordination — in terms of reliability, cost savings, and efficiency gains — cannot be underestimated. These efforts will be of equal or greater value in the future but will be made more difficult by the fact that the coordination will no longer be between vertically integrated utilities with monopoly service territories but, often, between competitors. State regulators will be well advised to use their planning authority assertively and diligently in order to make certain that coordinated planning does, in fact, continue. While RTGs may well prove to be of great benefit in maintaining coordination, the authority of the states both to prod such efforts and possibly to provide such groups some cover from antitrust attack, if appropriate, may well prove useful.

E. Regulatory Incentives

Structural changes in the marketplace make it advisable for state regulators to re-examine the traditional incentives provided utilities, which may well be counterproductive in an era of more resource alternatives, greater competition, and heightened environmental sensitivity. Indeed, tradi-

tional regulation may even act to undermine the agenda the state lays out in its IRP process. Healthy experimentation and debate is already occurring in state regulatory proceedings regarding the appropriate incentives for conservation and demand-side management. The debate should be broadened to include incentives for purchasing power.

The increasing competition in bulk power markets, with its inherent enhancement of supply side options, should lead states to reexamine whether purchased power ought to remain a flow-through, non-profit item for a utility. It is questionable public policy to provide financial incentives for a utility to build plants while providing it no profit potential for purchased power. Just as the incentives between demand- and supply-side should be neutral, so too should the incentives be among the various supply side options. There may be other areas, particularly in operations, where regulators should consider developing incentive systems that reward superior performance and penalize poor performance.

F. Transmission Cost Recovery

Examination of incentives is also desirable in state proceedings regarding transmission. While many have come to regard transmission pricing as a federal matter, in fact the bulk of transmission revenues in the U.S. come from retail rates set by state commissions. Nonetheless, not one state commission discretely prices retail transmission services. Such

unbundled pricing should not be seen as a call for retail wheeling, but simply as encouragement for efficiency in the use of transmission facilities.

States would be well advised to develop a system of incentives and disincentives that focus discretely on how well a company provides transmission services and how efficiently it uses its transmission assets. State commissions also need to develop their own transmission policies in order to interface meaningfully

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with FERC in that area, to promote economic development, and to make the most efficient and environmentally benign use of increasingly scarce rights-of-way.

Competitive bulk power markets are leading to greater demands for transmission access at the very same time that public concerns about electric and magnetic fields, aesthetics, and related environmental and health effect issues are making it more difficult to site transmission rights-of-way. Accordingly, it would be prudent for state regulators to consider incentives to maximize the efficient

use of existing rights-of-way. If there need to be new rights-of-way, there should be safeguards to ensure that they are used in the most efficient way.

G. Transmission Rights-of-Way

It may be anachronistic to see utilities as having a proprietary interest in rights-of-way, as opposed to having a fiduciary obligation to the public to use those rights-of-way in the most responsible way. The utility does, of course, have a proprietary interest in its investment in a right-of-way, but that translates into an economic or pricing question. State regulators should begin to fully explore their own authority in transmission not only to ensure capture of benefits in the bulk power market, but also — in an era of heightened environmental and public health consciousness — to assure that increasing demand for access to services is met by efficient use of these public assets.

III. State/Federal Issues

A. Confusion in Jurisdiction

Capturing the potential benefits of a more competitive bulk power market will put enormous strains on the already confused jurisdictional boundaries between state and federal regulation, and, to a lesser extent, between states. Despite some efforts in the Senate to clarify those boundaries during development of the Energy Policy Act, Congress ultimately decided to leave the issue to regulators and the courts to sort out. But the

costs of sorting through those issues are potentially enormous, both in terms of the actual costs of litigation and the opportunities lost by failing to capture the full benefits of competitive bulk power markets. *Therein lies the greatest single challenge to the regulatory community* — the development of institutional mechanisms for federal and state regulators to coordinate and cooperate in both policy and decision making. It is critical that the FERC and state regulators — through the National Association of Regulatory Utility Commissioners — take up that challenge.

The problem is not simply a turf fight among bureaucrats, nor is it a struggle between parochial interests and broader perspectives. Rather, the problem is one of fundamentally different regulatory focuses and missions, of jurisdictional boundaries that are not only unclear but which also were never explicitly designed to yield the level of predictability and coherence in policy now required, particularly in such areas as transmission, energy efficiency, and purchased power contracts.

State and federal regulation exist for quite different reasons.

State regulation was created to regulate the rates and service of monopoly service providers so as to protect customers who are largely captive. States have, over the years, also come to have authority over utility planning, facility siting, resource utilization and related matters.

Federal regulation, under Part II of the Federal Power Act, was created initially to regulate interstate commerce in electricity, but has evolved into oversight over wholesale markets — where market power may or may not exist — to determine the price and other conditions of power sales, transmission service, and related powers such as approval of mergers.

Thus, while state regulators approach the electric utility industry largely as a vertically integrated monopoly with captive customers

We need new institutional mechanisms to help federal and state regulators coordinate and cooperate.

to protect, bundled rates to determine and long-range plans to approve, federal regulators see the same industry as one where markets are sometimes monopolistic and sometimes competitive, but usually fragmented; where customers may or may not be captive; where rates and services may or may not be bundled; and where sellers are not always vertically integrated.

Another small, yet significant difference: state regulators must provide adequate safeguards for parties who may never appear before them as litigants, while at

FERC the affected parties are almost always well represented litigants.

It is in this diverse regulatory context that the industry has evolved.

B. Points of Contention

The tensions and strains inherent in such vastly different perspectives cannot help but become exacerbated in the new, more competitive environment that was already emerging before the passage of the Energy Policy Act, and will likely be accelerated by the new law. The critical pressure points are: (1) transmission, (2) prudence review of purchased power agreements, and (3) utility planning.

1. Transmission Access and Pricing. The new authority FERC has been given to order transmission access was in Congress' view an essential element toward enabling competitive bulk power markets. State regulators, through the NARUC, supported the idea that the voluntary transmission access regime was no longer adequate and that regulatory bodies needed to possess the authority to mandate access where appropriate. While there was a general consensus in the regulatory community on the concept of mandatory access, the fact of it raises a host of transmission-related issues that require resolution. Those issues fall into three broad categories: (a) pricing and cost allocation; (b) the nexus between FERC-mandated access and state siting and planning; and (c) reliability and service priority.

The pricing and cost allocation issues flow directly from the historic pricing regime. Utilities planned and built transmission to move power from generating stations to native load customers, most of whom are retail customers jurisdictional to state regulation. Transmission facilities were placed in rate base and their costs recovered as part of fully bundled electric rates. If sufficient transmission capacity was available, other utilities could obtain access to a utility's transmission facilities at a price set by the FERC on either a bundled or unbundled basis, depending on whether or not the transaction involved a power sale between the utilities or whether only wheeling services were to be provided. Revenues from such transactions were used by the transmitting utility to offset the residual revenue responsibility assumed by native load ratepayers.

As long as wholesale transactions were the exception, the regime worked reasonably well; little, if any, coherence was demanded of FERC's transmission pricing policy. As demand for wholesale transmission services grows — as it will inevitably do in the post-Energy Act environment — the old regime is no longer tolerable both in terms of equity to captive customers, and in terms of the economic signals it sends.

The equity issue has been particularly troublesome to relations between state and federal regulators. From the perspective of state regulation, existing transmission facilities

have been built for the benefit of native load customers who have, in exchange for receiving that benefit, assumed the fully allocated residual revenue responsibility for the facilities. Those who subsequently seek to obtain service from the same facilities on terms other than as native load customers may well, from time to time, contribute rent to the system, but they do not bear the responsibility assigned to native load customers of assuring recov-

Those who seek service may contribute rent to the system, but they do not assure recovery of its fully allocated costs.

ery of the fully allocated costs of the asset. Moreover, bulk power market users may have market alternatives that provide bargaining power on pricing that are rarely, if ever, available to native load customers.

In a voluntary access regime the equity aspect of the wholesale pricing issue was less pressing because both the utility and its state regulators were able to ascertain whether the economic benefits of providing access were worthwhile and could make their decisions accordingly. Under the provisions of the Energy Policy Act,

however, FERC can mandate access as well as determine the pricing of such transactions. Thus, while native load customers and retail regulators are essentially the guarantors of a utility recovering fully allocated costs, neither they nor the utility can assure that they get full value for undertaking that responsibility and are appropriately compensated for the loss of any of the value as tariff ratepayers.

While Congress has attempted to insert safeguards requiring that FERC hold harmless native load customers, it is not at all clear what that protection means. For example, if FERC sets a rate which it believes is fully compensatory to the utility, but which the relevant state commission does not believe to be so, the state could well impute revenues to the utility for the transaction for purposes of retail rate-making and leave the utility less than fully compensated for what appeared to have been a prudent investment at the time the costs were sunk. It is worth noting that while state regulators have, historically, been reluctant to conduct prudence or used-and-useful reviews of transmission facilities, the growth in the bulk power market with its potential benefits and losses seems certain to increase the likelihood of such reviews.

Both equity and used-and-useful concepts would inevitably be at issue when mandated access that requires the construction of new facilities creates enormous new potential for similar disjunctive results.

The FERC may believe that the customer being granted access should be assessed one-half of the costs of the new facility, for example; but because the enhancement provides benefits to the system as a whole, suppose FERC believes the other half of the costs should be borne by retail customers. State regulators may well conclude that retail customers were doing quite well without the mandated enhancement and that its benefits to both used and useful retail customers, on a stand-alone basis, were years away; therefore, as a matter of both used and useful analysis and equity, existing end users should bear little or no current revenue responsibility for the upgrade. Either way, the utility is less than fully compensated. Such scenarios are not unlikely. Once they arise, they are likely to cause utilities to resist access orders more vigorously, or at a minimum, provide disincentives for utilities to actively market wholesale transmission services.

The federal/state disjuncture on pricing is even clearer when examined from the perspective of economic signals. Native load customers have little or no control over the efficiency or effectiveness of utility management of transmission facilities, yet they bear the ultimate revenue responsibility and risk of the system's proper operation, in exchange for which they and state regulators demand reliable service and priority of access.

Historically, utilities were more at risk for unreliable service than they were for gross inefficiency in the use

of transmission facilities. In any event, inefficiency did not affect the bottom line of the utility as long as native load customers bore the ultimate revenue responsibility. On the other side of the equation, aggressive marketing of transmission service and maximizing revenues from the wholesale market resulted in larger offsets to native load revenue responsibility but provided little or no gain to the utility's bottom line. Perhaps most importantly, the fact that captive customers



would bear the ultimate financial responsibility for the existence and use of transmission assets provided little or no incentive for utilities to seek — or for FERC to pursue — optimal pricing arrangements or even coherent, predictable, and consistent pricing policy. It is little surprise that there is no system for compensation for loop flow, no requirement for utility transmission tariffs to be on file, no federal regulatory transmission modeling, and no effort to develop joint pricing arrangements between state and federal regulators.

The fundamentally different approaches to transmission rate-making at the state and federal level are almost certain to lead to conflict, particularly in the context of the more competitive market that will flow from the new Act. That conflict will inevitably be characterized by litigation, prolonged uncertainty, heightened risks for utilities and other actors in the bulk power market and, ultimately, in the diminution or deferral of the benefits offered by the Act.

FERC and state regulators must find joint mechanisms for pricing transmission, for allocating revenue responsibility in light of new uses of existing facilities or for new facilities, and for assuring coherent, consistent price signals. The use of joint pricing, jointly approved tariffs, and other collaborative mechanisms will be critical.

Both state and federal regulators have both enormous economic influence through their respective authorities to set retail and wholesale pricing. Each jurisdiction is capable of sending economic signals strong enough to drive policy in desired directions, but precious little effort has been expended to coordinate those signals or produce a consensus policy direction.

In light of the reforms in the Energy Policy Act, state and federal regulators must find ways to cooperate to send clear and coherent pricing signals to the owners and users of the transmission grid.

2. Facility Planning and Siting. The second transmission category

of issues is the nexus between FERC-ordered transmission access and state siting and planning. As noted above, most if not all existing transmission lines were built to serve native load customers. Over the years, the majority of states have provided their regulators with powers to oversee planning of transmission and other facilities designed to serve retail customers.

Similarly, many states have enacted statutes enabling designated state agencies to certificate and site transmission lines. Neither FERC nor any other federal agency has been provided with similar authority by Congress. Thus, despite having acquired the power to mandate access to the grid, FERC is without the authority to enforce such an order when to do so would require the construction of new facilities and the affected state(s) decline to approve them. Indeed, there is not even a requirement in federal law that states give any deference to a FERC order mandating access in determining need in a planning or siting proceeding.

While it might seem appropriate for a state to view such an order from the FERC as a determination of need, there is a powerful historic reason why they may not. Historically, determinations of need related to findings that facilities were required to serve retail customers, and were premised on the assumption that retail customers would eventually be required to bear the ultimate revenue responsibilities; need went hand in hand with revenue responsibility.

In that context, serving the needs of the bulk power market may, in the view of state regulators, be approving cost recovery from retail customers, despite the fact that there are no corollary benefits — a circumstance which imports an element of parochialism into siting and planning decisions.

The Energy Act does not require that parties who apply to FERC for an access order meaningfully participate in state planning and siting proceedings. Thus, a state may well complete a planning



proceeding only to have one of its utilities confronted by a FERC wheeling order after the closing of the record; and that order may be obtained by a party who opted out of the state proceeding. In such a situation the state may well feel "sandbagged."

It is apparent that without clear understanding between state and federal regulators as to cost allocations that allow state regulators to decouple retail revenue responsibility from planning and siting decisions, and without comity and mutual deference on both federal access orders and state planning

and siting decisions, mandatory access may be ineffective whenever the order requires the construction of new facilities.

While the decoupling of siting and cost assignment reduces the likelihood of parochialism in decision-making, it has the disadvantage of increasing the perception (if not the reality) of risk to the investor. That risk cannot be ignored if utilities or other investors are expected to build transmission needed to serve bulk power markets. For that reason it is essential that pricing be predictable and that allocation of responsibility for costs be known. But neither of those can be known without state and federal regulators consulting with one another. Such coordination, which could take place formally or informally, would inevitably have the positive effect of encouraging regional transmission planning, and perhaps siting as well.

There is another aspect of transmission planning that demands cooperation. Such planning is generally done on a utility-specific basis — not, with the possible exceptions of the Northwest and New England, on a regional basis. States such as Wisconsin conduct planning on a statewide basis. FERC itself, of course, does not involve itself at all in such planning.

Once again, more coordination, cooperation, and/or joint action between FERC and the states is necessary if we are to capture the full potential of a competitive bulk power market.

While regional transmission groups may facilitate the convening of such regional planning efforts, they cannot be a substitute for inter-governmental cooperation. As a consequence, FERC should convene regional forums involving itself and affected state commissions in considering transmission needs in the bulk power market. Such forums could be useful in making determinations of need that can be incorporated into state siting proceedings, and in specific setting such as utility mergers where regional market considerations are at issue. Competitive bulk power markets would be enhanced through such an approach.

3. Reliability of Service. The third category of transmission issues relates to reliability and priority of service. Native load consumers pay for and have every reason to expect a very high degree of reliability in the delivery of electricity. While there may be customers who would choose less reliable service in exchange for a lower price, increased competition that diminishes reliability or gives lower priority of access to native load customers who pay fully-allocated costs should not be permitted. It is essential, therefore, that state and federal regulators adopt a uniform set of reliability criteria in order to set the standard to which utilities should be held. Such a task might be expected to be performed by the regional reliability councils or by the North American Electric Reliability Council (NERC). The problem with NERC or its member set-

ting the standards is that some of them do not have membership policies that allow for input and authority for all of the potential actors on the grid. While some of the reliability councils have open membership policies, many do not allow meaningful participation by QFs, independent generators, or transmission-dependent utilities. Given the potential for NERC members to adopt standards that may be detrimental to non-member competitors, but recognizing that NERC and its mem-



bers should be afforded significant opportunity for input, the best solution may be for the reliability criteria to be formulated by some other body whose membership is broadly inclusive. Needless to say, it would be detrimental to the growth of the bulk power market for each regulatory jurisdiction to try to adopt its own distinct criteria. In any case, adoption of reliability standards must be done on a collaborative basis by regulators.

4. Reviewing Buyer Prudence. Another critical pressure point requiring regulatory action is filling the gap in consumer protection

left by Congress under the Energy Act. The gap is this: it is not certain, as a matter of law, what body — if any — has authority to review the prudence of wholesale power purchases by utilities for resale to captive customers.

Unfortunately, unlike the area of transmission, it is not certain that regulators possess authority to determine such a jurisdictional matter without a law or decision of a court. Nevertheless, there are two paramount policy reasons for the regulatory community to make the effort. The first is the obvious fact that prudence review of supply acquisition by utilities is an absolutely essential element of consumer protection. The second is that to have a truly competitive market, it is essential that purchasing decisions be made by diverse actors with varied perspectives and not part of some centralized decision-making. It only makes sense that prudence reviews of such purchases be done on a similar basis.

Both of those principles are served by the *Pike County* doctrine, which maintains that while FERC may set wholesale sales rates and tariffs, the actual choice of a specific option by a utility to purchase is subject to review by the state commission which sets the retail rates of that utility. There would seem to be no reason why the regulatory community could not issue a joint policy statement on these matters, or why such a statement could not be accorded substantial deference by the courts. This should be so at the very least for single-state utili-

ties and, for that matter, all utilities, except perhaps for registered holding companies subject to the integration requirements of the Public Utility Holding Company Act.

As to holding companies, the *Pike County* doctrine should apply on a regionally integrated basis, perhaps on a collaborative basis by the FERC and the affected states.

The mechanism for filling the gap should be negotiable, but it is imperative that it be filled, both for consumer protection and for functioning of workably competitive markets.

5. Deference to State Processes: Safe Harbor. FERC has indicated a willingness to move on the interface between state integrated resource planning and FERC's market-based pricing regime. What deference, if any, will FERC provide to state determinations of facilities or power contracts when it considers whether an arrangement is "just and reasonable"? Must it hold a full-bore rate case to establish a cost-based rate? FERC's deference to states in this area on some reasonable basis would provide greater comfort to buyer and sellers in the bulk power market.

It seems redundant to have a least-cost determination at the state level and then require a full rate case at the federal level to determine a just and reasonable rate. FERC has authority to provide some safe harbor mechanism that allows expedited market-based ratemaking where state processes have already determined that a

particular acquisition or transaction is consistent with a state IRP. The same would be true for multi-state transactions where each of the affected states has made a similar determination.

States obviously have an interest in such deference in order to protect the integrity of their IRP processes. FERC should be equally interested because the accelerated decision-making inherent in market-based pricing facilitates a more efficient and dynamic marketplace.



The states are going to do integrated resource planning. Why not capitalize on those proceedings and not duplicate them at the federal level?

This is not to say that there will not be some conflicts. A state may see something as being beneficial under its IRP that FERC, from a bulk power market perspective, might find unacceptable. Such conflicts can be minimized, however, if FERC would define the parameters of a regulatory safe harbor.

FERC and NARUC have had a discussion on safe harbor and, while FERC has indicated a will-

ingness to consider conducting a rulemaking on the matter, little has been done to date. Passage of the Energy Policy Act suggests the need to expedite this proceeding.

IV. Tools to Break the Impasse

Numerous tools are available to regulators to undertake the massive but essential task of cooperation needed to rationalize the jurisdictional jigsaw puzzle of electric utility regulation. They range, on a continuum of informal to formal actions: from joint policy statements to joint conferences, to uniform rules or guidelines, to joint hearings, to Federal Power Act Section 209(a) Joint Boards, to multi-state compacts, with many options in between. Under our flexible state-federal system the possibilities to use these tools or fashion variations thereon are limitless.

The stakes are immense: billions of dollars in savings annually; a more competitive, environmentally sensitive industry geared to profiting from the savings that greater efficiency can bring; and an enormous weight off the backs of all consumers that can only free the productivity of the rest of the American economy.

We cannot allow bureaucratic turf battles, communication breakdowns, or parochialism between regulators to impede the evolution of a competitive bulk power market. The challenge is there. The regulatory community must seize it. ■