A DECLARATION OF INDEPENDENCE

Why Transmission and System Operation Must Be Truly Independent from the Ownership of Generation

Efforts to restructure the electric power industry are based on the conviction that open competition in power supply will advance consumer interests better than traditional economic regulation. The objective of restructuring must be to create conditions that will allow genuine competition to thrive. The ultimate measure of success is whether competition delivers benefits to consumers, not just to those in the electricity business, either competitive electricity suppliers or providers of monopoly wire services.

To succeed, the restructuring process must address the inherent market power problems caused by ownership or control of the monopoly transmission system that connects competitive generators with their customers. The divergent interests of suppliers and customers are clear:

* In competitive electricity markets, all generators will benefit from high prices while customers benefit from low prices;

* In competitive markets, higher prices achieved through any action, including control of the transmission system, by any generator or group of generators, will benefit all generators;

* Decisions regarding transmission pricing, dispatch rules, and new investment in the transmission system can add value to generation. An unnecessarily constrained transmission system will lead to overpriced electricity and excess profits for suppliers;

* Many techniques for leveraging transmission and system operation to add value to generation assets are complex, subtle, and difficult to control through regulatory oversight.

This means that steps taken to deregulate supply could harm rather than advance consumer interests, if not paired with measures to sever suppliers' control over transmission services.

To ensure that the transmission system is operated and expanded to suit the needs of society at large rather than the narrower interest of generators, most nations implementing

competition in generation have chosen to completely separate the ownership of power plants from ownership or control of transmission lines. Such separation provides a clear, workable and effective means of protection against the potential for many types of abuse.

However, many US utilities oppose divestiture of either generation or transmission assets. They offer instead to separate ownership from control, by placing control of the transmission system in an "Independent System Operator" or ISO. Unfortunately, most ISO proposals put forth to date have been seriously deficient in one or both of two key areas: (1) the scope of functions entrusted to the ISO is too limited, so it does not effectively control transmission pricing and system operation, and (2) the ISO is not truly independent.

Each ISO should have a mandate to manage and expand the portion of the nation's grid under its control so as to ensure reliability while minimizing costs. The management of the transmission system involves the exercise of hundreds of small and large decisions, many of them subjective judgment calls, involving such matters as the pricing of transmission service, construction of new lines, and operation and maintenance of the existing system. All of these decisions should be made by the ISO, subject to regulatory oversight. The transmission system should be operated and expanded so as to encourage rather than limit competitive challenges among suppliers.

Most ISO proposals fall short by giving suppliers substantial, or in some cases, majority control of the system. Independence is not achieved by simply sharing control of the transmission system among different types of suppliers. To achieve independence, ISOs should be responsible to boards that are completely independent of suppliers. In the absence of a clear structural solution such as divestiture, we must create solutions equivalent to a non-voting "transmission trust": generating companies must cede all control of their transmission lines to the ISO; they will be entitled to fair compensation on their investment, but afforded no opportunity to influence the use of those lines.

The ISO should, in turn, be subject to appropriate regulatory oversight. This regulatory framework should strive to harmonize the interests of the ISO with those of the public: reliability and stability, low generation and transmission prices, and minimum environmental impact. Such regulation must reflect both federal and state interests, ensuring the development of regional markets while recognizing states' interests in siting, and in shaping regulatory reform to suit local concerns.

Effective regulation of regional markets and transmission systems may require creation of new regional governance mechanisms, such as regional joint boards or councils under existing or new enabling legislation. However this is accomplished, FERC, the States, and Congress must insist upon creation of ISOs that have authority to operate and improve regional transmission systems, and that are truly independent from the owners of generation resources. Only when transmission constraints cannot be used to leverage above-market value from generation assets will the public's interests in genuine competition be well served.

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