

HARVARD UNIVERSITY

JOHN F. KENNEDY SCHOOL OF GOVERNMENT

Harvard Electricity Policy Group



Center for Business and Government
79 John F. Kennedy Street
Cambridge, Massachusetts 02138

**HARVARD ELECTRICITY POLICY GROUP
SEMINAR: FEDERAL-STATE JURISDICTIONAL CONFLICTS**

Taubman Center, 5th floor
John F. Kennedy School of Government, Harvard University
December 16, 1993

MEETING SUMMARY

Homing session: Setting the Context

The session began at 9:30 with an introduction by Ashley Brown. The morning session was devoted to presentations on various areas of jurisdictional conflict between FERC and state regulatory bodies, and on their various objectives in regulation.

Areas of Federal-State Conflict in Regulating Electricity

Market Results.

Outline: *Rethinking Regulatory Jurisdiction for the Electricity Industry.*¹

Speaker:

The most important energy issue facing the nation today is the restructuring of the regulatory community and the electric industry it regulates. With the Energy Policy Act of 1992 (EPAct), Congress clearly intended to lay the groundwork for the evolution of a competitive electricity generating industry. Although the language of the EPAct gives the impression that Congress had in mind the restructuring of investor-owned utilities, in practice all publicly-owned and consumer-

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

owned utilities will also be affected.

Because generation and distribution companies in this new sector will have to interact across interconnected transmission networks, some new system of coordination of transmission activities will be necessary. Whether this should be handled by modification or coordination of existing regulatory bodies, by new regional institutions, or by some combination of the two, is not clear.

The current system of government regulation of the electric industry has been poorly defined for decades. When we began to develop high voltage transmission in the 1920s, and ran into problems dividing up regulation between states, we patched it up with the Federal Power Act and PUHCA. It began to fall apart again after World War II, and we patched it up again with a system of self-regulation of the industry, formalized in the North American Electric Reliability Council (NERC) and the regional reliability councils -- giving us an industry where perhaps the single most important set of regulators are not federal or state government regulators, but the industry itself. (For instance, transmission networks are operated by utilities acting cooperatively in reliability councils.) This system of regulation is particularly unsuited to adapting to changes created by the introduction of wholesale competition.

Since competitive pressure comes from forces outside of the regulatory system, what is there to gain from engaging in a debate about jurisdictional changes? This is not going to be a process where we will be able to clarify all the alternatives and make choices among them. It is also not going to be the case that the state commissions will agree to call on the Federal Energy Regulatory Commission (FERC) to take regulatory authority away from them. The most essential parts of the system to try to address coherently are the natural monopolies of the transmission network and control of dispatch. The quasi-judicial process regulators use to reach decisions makes it very difficult for them to make coherent policy. Needed jurisdictional changes must be guided into existence by the only two agencies capable of taking a national and international view -- the FERC

and the DOE -- although they will have to work with other organizations and regulators.

State commissions naturally tend to be parochial in their approach. The conflict between fairness to local, native-load customers and what makes sense regionally in planning and siting transmission lines is a deficiency of the current regulatory system that must be addressed -- the current state-based system has a parochial bias that can produce suboptimal siting decisions.

Objectives for restructuring regulatory jurisdictions:

Outcomes to be avoided:

- *Competition in transmission services should be avoided.* There is no way to realize more efficiency by offering competing transmission facilities. The public nature of transmission facilities mandates that transmission facility siting and use be made as efficient as possible. Because these facilities must interconnect, this is a national problem.
Competition in control services should be avoided.
- *Institutionalization of a system of bilateral trading should be avoided.* The objective of restructuring should be to promote efficient dispatch.
- *Institutionalization of an inefficient system of pricing transmission services should be avoided.*
- *Uneconomic physical bypass of distribution facilities should be avoided.*

Outcomes to be sought:

Regulators and industry leaders should affirm and protect the voluntary system of cooperation on which the reliability of the system depends, at least until some other system is developed. Some regional or national regulatory arrangement is necessary to regulate transmission and control.

- Pricing of transmission services should encourage the optimal location of plants, optimal sizing of transmission facilities, and optimal trading of power.

Strategies for restructuring jurisdiction:

- Impose non-discriminatory pricing standards on transmission-owning utilities for unbundled and currently bundled services. This would lay the groundwork for integration-by-contract rather than by-firm, and would highlight the need for defining and pricing transmission services and assets.
- Insist that each segment of the industry (e.g. transmission, generation, etc.). provide just and reasonable earnings estimates on the assets of that sector, to facilitate a re-conceptualization of the role of each sector.
- The DOE and REA could encourage open access on all federally-owned transmission facilities.
- Further, federally-owned transmission assets might be sold to incorporated transmission companies to facilitate the development of a transmission sector. This might be used as a means of easing the stranded investment problems of utilities.

The magnitude and complexity of the transformations initiated by the EPAct exceed those of any other industry which has undergone regulatory restructuring in the past. Electricity industry regulators must simultaneously deal with the restructuring of the industry and the reallocation and redefinition of jurisdictions among themselves. It may be necessary to create new regulatory entities to resolve these problems. An important step is to get all regulators intensely involved in the debate over their roles. Realistically, the federal government is the natural source of leadership on these

issues.

Response:

The impact of the EPAct has been somewhat overstated above, although the Act probably has accelerated issues on the transmission side. But this process has been underway for well over a decade -- the EPAct merely allowed the FERC to continue in the same direction it had been going, but under more "businesslike arrangements".

It is not clear that government intervention on the scale suggested by the speaker is going to be politically feasible. The process of adaptation by the industry may achieve the same results, without any such measures being explicitly taken. This has been true in other industries. Moreover, there are encouraging signs on the state level that states are willing to make changes to deal with these problems associated with restructuring the industry and modifying the regulatory system. In California, for instance, the governor has just proposed to abolish the California Energy Commission and make radical changes to the workings of the Public Utilities Commission. The FERC is seeing a greater degree of coordination with states as well, for instance in dealing with utility mergers, and in its increasing involvement in the transmission activities of municipal and cooperative systems.

It is clear that the cooperation between utilities which the speaker mentioned will become much more uncertain as the industry becomes more competitive. Utilities historically have coordinated their activities voluntarily because they were not competing with one another, and the benefits of this cooperation are large. How do we maintain a system of incentives for voluntary cooperation in a competitive industry?

The existing pattern of power transactions — both generation and transmission transactions -- is entirely based on existing property rights in the transmission system. Absent a transition scheme

which grandfathers those property rights and the transactual arrangements that go with them, there is going to be a major transfer of economic rents. A related issue is the role of secondary markets in transmission -- will they develop? Will they enhance competition? Finally, is transmission reform a meaningful objective, unless we first decide to mandate unbundled services? If the objective is to shift competition off the transmission price and onto the generation price, then can we really achieve much by reforming transmission pricing while still allowing utilities to bundle transmission and generation and selectively discount transmission prices for their own transactions, while charging a full rate to their competitors?

Finally, some observations about federal law. The issue comes down to a question of what is reasonable and practical to expect in our system of federal-state allocation of political authority. It is naive to assume that the states will willingly let the FERC or some other entity exercise a dominant role in order to achieve the market structure that economists dream about. Their models are rational and elegant -- why aren't we there? The answer is that, although we've been debating the creation of some federal authority to step in and change things for many years, the method we have used in the past is the slow adaptation of the existing regulatory system. This process will not only ultimately get us there more quickly, but has at least the same likelihood of achieving an efficient outcome as would some new federal entity.

Jurisdictional Confusion.

Speaker:

When FERC issued its series of questions about transmission policy recently, it asked a credible series of questions about everything they'd ever want to know about transmission, except for the question -- how does this all relate to the other regulators who have jurisdiction over the

grid? We're debating about transmission in a forum where FERC is responsible for less than half of the revenue that comes from transmission. The rest of that revenue comes from bundled retail rates set by state regulators who rarely, if ever, think about transmission. We have critical decisionmakers who make critical decisions who aren't thinking about what the other ones are doing -- what is the likelihood that we're going to come up with coherent transmission policies in the absence of a more formal system of cooperation?

Conflicts:

Let's start by looking at the four fundamental regulatory issues regarding the transmission: planning, siting, pricing, and access. All of these aspects of transmission regulation have areas that are under the jurisdiction of both the FERC and the states.

Planning and siting are fairly simple. Those are plenary state jurisdictional issues, with a few exceptions. For the most part there is no federal jurisdiction over siting and there is a minimal federal role in planning.

In pricing, it's not as clear where jurisdiction lies. Looked at from a distance, pricing is a FERC issue, and certainly all transactions between utilities are FERC jurisdictional, and the Federal Power Act says that FERC has the authority to price transmission. But the fact is that retail transmission rates, as little as state regulators may ever think about it, are set by state regulators. I don't think there is a state in the union that sets discrete transmission prices, but every single transmission line owned by a state-regulated utility in the United States is in the rate base of that utility. I had staff research that issue, and they found one case in California, where there had been disallowance for transmission investment and on rehearing the California Public Utility Commission reversed itself and put that line into rate base. Which means that federal regulators have essentially

put the retail regulators in the position of being the guarantors of the utility revenue requirements for transmission investment. What is the retail rate-payer entitled to as a result of bearing all the residual revenue responsibility for the grid?

There is some question about retail jurisdiction because there is some question that relates to the implications of the *Colton* case, a 1964 Supreme Court case which said that all electrons in the interconnected AC grid do in fact affect interstate commerce, and so as a result of that, all the transmission questions are subject to federal regulation, whether they were intrastate or interstate. The implications of that for retail wheeling are unclear, because Congress also said in the 1992 Energy Policy Act that retail wheeling is an issue left exclusively to the states, although wholesale access is FERC jurisdictional.

So a jurisdictional matrix is created which makes it difficult to make any kind of coherent decisions in the absence of some kind of coordination between what FERC does and what the states do. The Energy Policy Act of 1992 gives FERC the ability to mandate wholesale transmission access on a case by case basis when someone requests it. If the utility from whom the service is requested is able to demonstrate to the FERC's satisfaction that because of congestion or other factors it can't provide that service without building new transmission facilities, then the utility incurs a good faith obligation to obtain the authority to site a new facility in order to carry out the mandate of FERC's access order. If the FERC were to order access in a given case, and the state either says you can site it but we're not going to put it in the retail base, the investor will go back to FERC and say, "How am I going to recover my revenue?"

There lies the black hole of the 1992 act, because the utility then has to go to the* state commission or the state siting authority, depending on who has that authority in the state. (Actually only 28 states even exercise siting authority in a formal way -- in 22 states there is no siting law.

That may mean a variety of things -- that there's no problem siting a line, or that every municipal zoning authority has to be heard from on the question of whether or not the line gets built.) When the utility goes to the state for siting approval, and then the state's basically in a difficult situation. Historically lines have been planned and sited at the state level based on the notion that the beneficiaries of the new transmission line are the retail customers, because the state is planning the integrated transmission system to serve those customers. And so regulators have always made two decisions. They've made one decision that they're going to certify the need for the line. Two, in certifying the need for the line they have, in some cases explicitly, decided that the retail rate-payer will bear the residual revenue responsibility for that line. And there are revenues that are derived from other sources that may offset those revenues. If there aren't any of these revenues or the utility chooses to forego them for whatever reason, the transmission line owner will still be made whole by the residual revenue responsibility bearers, the retail rate-payers. So state regulators never looked at these two questions in a decoupled fashion -- they've always looked at those as essentially one issue.

The problem which you run into here is parochialism. On the one hand, in siting the line, should the state then say, well, FERC has already determined the need, we don't need to inquire into the need for the facility. FERC's issued an access order -- surely there's a need. So why should we go back and re-inquire into that question? On the other hand, the need is not necessarily the need of the local state ratepayers. If two companies in neighboring states on different sides of the state require a new line through my state, why should I site that line? In terms of siting the line, I think the proper public policy might say that the state siting authority ought not to be parochial about that. But on the second question, who should pay for it, is the state being unduly parochial when it says we don't see a need for our state's rate-payers to pick up the tab for that line? The

state's ratepayers won't need this facility by our calculations for another 15 or 20 years, so we're not going to bear that residual revenue responsibility. And so we expect that FERC will then price that line and it will be built in a way that will enable the investor in the line to get a reasonable expectation of recovery on that investment without ratebasing it. Is the state being parochial in this case? In this sense you might expect the state regulator to be parochial, because their job is to protect the ratepayer, most of whom are monopoly customers of the utility, but on the other hand, for physically siting the line you don't want them to be parochial. The state can say, "We're not even going to build it".

Probably the worst case of parochialism I've seen is a Mississippi Supreme Court decision which said that when Entergy built a line to interconnect with the system, the Mississippi Commission approved the line. The Mississippi Supreme Court ruled that the majority of the rate-payers who would benefit from this line were located in Louisiana, and so therefore Mississippi eminent domain statutes could not be used to condemn property and build the line. As a result of that, of course, the line cost a lot more because it didn't use eminent domain, but it's usually cited as the classic case of state parochialism in a siting decision. You can get a broad consensus that that's inappropriate parochialism, but if the Mississippi Commission had ordered Mississippi rate-payers to pay for the line without any adequate contribution from Louisiana rate-payers who were the real beneficiaries, then there is a case to be made for being a little parochial.

The next question, of course, is, how will FERC price that line? Historically, of course, no matter what FERC did, the utilities would be made whole by the retail rate-payers. And if FERC underpriced transmission assets, it didn't really matter to the utility bottom line. If the utility was very efficient and conscientious in providing transmission services to every one, it could, subject to the check of its native load responsibilities (which include some wholesale customers), make back

the investment. Does the utility gain by that? No. Because for the most part state regulators will then offset the revenue responsibility of retail rate-payers by attributing those revenues to block the utility from using those assets that are already rate-based. So in terms of price signals, the utility gets those signals to be efficient or inefficient in its use of transmission assets.

The flip side is that the state commissions, do not disallow transmission because the utilities have not used them efficiently. The only time I could find a state threatening that was my own commission in Ohio, where we raised the (rhetorical) question about why American Electric Power had this 765 KV system in retail rate base, when it was very clear when one looked at the parallel flows and the giant vacuum cleaner effect that it had on electrons in the midwest, that this line was being under-utilized for native load purposes. When we raised the possibility taking it out of rate base, we suddenly stimulated their interest in parallel flow pricing. What would happen if a state disallowed transmission assets of the rate base? We don't know what FERC's pricing regime is. If FERC chooses to use embedded rolled in average pricing, and by doing that they discourage investment in transmission or utilities, who may have already invested, may have existing assets and sunk costs, simply get whipsawed and lose some revenue.

The fact of the matter is that no state has ever done a very clear analysis of what the utilities -- of who's getting the benefit. They simply impose the residual revenue responsibilities on retail rate-payers.

Options for state regulators in dealing with these conflicts:

The questions then for state regulators might be: Isn't it time state regulators starting thinking about transmission and about transmission in very discrete terms? and; What do they do about the risk of pre-emption?

The options available to state regulators are interesting:

- They could do nothing at all.
- They could set discrete rates for transmission. The danger of this option is that under the *Colton* decision and under the provisions of the Federal Power Act, FERC has the jurisdiction to set rates for transmission services. FERC has never chosen to exercise (and we can argue about whether they can or can't exercise) this right in regard to retail transmission services. If states do choose to unbundle and set discrete rates for retail transmission (an independent question from whether or not states institute retail wheeling), do they run the risk, having discretely identified transmission cost, of having their rate-making authority preempted altogether by the FERC? While there's an attraction in pursuing this option from the standpoint of rate-payer equity, there's a negative side in that it may invite a move by FERC to preempt state regulators in regard to retail transmission rates. One could argue that it shouldn't really matter to state regulators whether or not they can set retail transmission rates, because what they really care about is to regulating the distribution company, but Congress (at the urging of a number of registered holding companies), has chosen never to legislate the Pike County doctrine, which says that states can review the prudence of purchases by retail utilities subject to their jurisdiction in the wholesale market. Having not done that, states are obviously going to be very nervous about losing transmission jurisdiction since they don't have any clear jurisdiction in regard to the wholesale purchasing activities of retail utilities. Clearly there's nothing to keep states from setting discrete rates under federal law, unless FERC chooses to try to preempt it, which means a battle in the courts. There is some question under different state laws whether or not state commissions can do that, but that varies from state to state.

- Another option for state regulators is to simply accept the FERC preemption — not one that they're likely to do rather quickly or with any enthusiasm.
- State regulators could still do the effective equivalent of setting discrete rates by starting to take a look at what transmission assets go into rate base. It would be very hard to argue that FERC has preemptive authority over deciding what portion of transmission is in fact legitimately being used for retail rate-payers in proportion to that dedicated to wholesale service, and simply removing that portion of transmission assets from retail ratebase for purposes of setting retail rates. Utilities facing this issue may argue that the transmission facility was built to serve the retail customers, and so therefore costs were prudently incurred, but state regulators can counter that the benefits of this line are not accruing to this ratebase -- you built it prudently, given the market considerations. We're responsible for setting retail rates and we're not going to recognize in the retail rate base assets being used for other customers.

Then you get into the question of whether FERC's rates are providing ample opportunity for cost recovery. If they aren't, is the utility likely to get whipsawed between the two? It might also be possible that the utility could run into a windfall by the same process, but of course, the state regulators are busy doing their job and are more likely to resolve it to the detriment of the utilities.

- A final option, which the states through NARUC have attempted to do recently is to institute some sort of collaborative exercise of jurisdiction. The native load issue looks very different to state regulators and to FERC regulators. For the FERC regulator it's a question of -- "Everybody is somebody's native load". And while that may be true, it doesn't answer the question of whether everybody is bearing their fair share of the rate for shipping the

electrons. Coherent public policy regarding transmission cannot be made by the FERC alone because it lacks sufficient authority over issues like planning and siting, and sufficient authority in retail transmission services. Similarly, states lack sufficient authority in wholesale access and pricing issues. So even though collectively public regulators do have enough authority and enough jurisdiction to regulate appropriately, neither federal or state regulators alone have enough to make coherent public policy. For the utility, that's good news-bad news. The good news is you can sometimes go shopping and try to find the most attractive option. The bad news is you may get whipsawed and lose a bunch of money in the process. In terms of public policy, however, it's hard to argue the go-it-alone applied to FERC and states makes a lot of sense.

What do cooperative mechanisms between FERC and the states look like? We can argue there are a number of options ranging from informal discussions to formal joint boards and various options in between -- these are discussed in more depth below.

Options for the FERC in dealing with these conflicts:

Leadership on the issues discussed above has got to come from the FERC. What should FERC do? One is continue to do what it's been doing, which is treat state regulators as parties before it as opposed to treating them as the federal court with the state courts, as being in comity with them. But if FERC continues to see states as parties as opposed to recognizing some level of comity and some deference where appropriate to state decisions, or alternatively, some joint decision-making process, I think the opportunity for litigants before FERC and the state commissions to get whipsawed increases.

- An area where FERC could be looking is this black hole question of the Energy Policy Act.

Why not have some sort of understanding between FERC and the states, where, for example, access orders from the FERC are essentially preempted by state siting determinations in regard to need. The states would still have to do the siting reviews for environmental, public health, aesthetic purposes and so forth, but they don't have to do a brand new inquiry into the question of whether or not there's a need for the facility.

Another area where there's opportunity for deference is the question of what happens in states like Wisconsin that have very detailed and comprehensive planning processes for transmission where everybody with any conceivable need to access the system, access the planning decisions that lead to building transmission facilities can do so. What happens in those states if they issue an elaborate planning order and an IPP that wants access says "That's too expensive, it's too much of a pain -- I'll just wait and when it's over I'll go to FERC and get myself an access order, and then we'll throw the state's planning process out the window." Why not some sort of system where FERC recognizes that process, and indeed, in exchange, within some reasonable time frame, basically says that it will not order access in those circumstances if somebody tries to forego the state's own planning process?

- There are opportunities for joint boards in two different areas. One is on regional issues.

The classic example is when FERC is so deeply involved in pricing transmission transactions or approving pool arrangements, why not on a regional basis, so that when states go to make their own decisions in regard to the retail rate implications, or alternatively siting or planning decisions that they do that with the full knowledge of FERC's likely pricing policy, with jurisdiction exercised in ways that are coherent. And nobody else outside those regions are generally affected by it.

- The second area for joint boards is on generic issues, for example, transmission pricing. Making the assumption that we're best off with some sort of unitary pricing system, that can just as easily be done by some sort of state-federal mechanism as by FERC preempting the field. Politically, it is probably easier done through some sort of joint mechanism. It would make less work for the courts of appeals because there would be less litigation, likely to be less litigation, at least on the jurisdictional issues.
- Another area where FERC would be helpful is on this question of native load. What does it mean? What does it mean in terms of FERC policy that the retail ratepayers and the native load customers have to pick up the residual revenue responsibility for the grid? Does it mean what states would assert it means, that they have priority of access? Or does it mean something else? It's no answer to say everyone is somebody's native load customer. That's an important public policy question that really has to be answered.
- Defining capacity rights -- what does it mean when somebody causes new transmissions to be built? If they get charged marginal cost for that, do they acquire some sort of capacity rights that allow them to some future use of that line? Those are public policy areas that really cry out for some definition and that raise questions that are relevant to those state and federal jurisdictions.
- Of course the fifth option for FERC is to do nothing at all. Probably the option most likely to be selected.

Response:

For many years we have had a policy of "mutual assured frustration" between state regulators and FERC, who all share authority over transmission. We have had a series of cases over the years

that have defined industry structure and industry regulation. Regional Transmission Groups (RTGs) can be another step in this process, and an adaptation that will help us solve these jurisdictional conflicts. The FERC has already taken the first step of asking, "What are the principles that an RTG should follow?"

Assuming that RTGs come about, what do the states see as their role in interacting with RTGs? The FERC has said that it would give deference to the pricing and access decisions of an RTG. If the state commissions were to agree to give deference to the siting and planning authority decisions of RTGs, the process of creating them might move further along. More discussion of these options would be good.

RTGs can be a way of addressing the operational and reliability issues that will come up in a competitive industry, as well as possibly unbundling and pricing issues, if it comes to that.

Perspectives on the Public Interests in a Federal System

Overall Public Policy Interests in Electricity Regulation

Speaker:

The changes to electricity regulation being contemplated here are big changes -- beyond simply modifying a few rules, we're talking about a change in paradigm. It took fifty years to develop cost-of- service rate-making. It's never worked well, but it started out being terrible. In building a competitive system, we had better be prepared to build one that will last 100 years, and we obviously won't be able to change it overnight. In setting out to change the current system are we making a judgment that, 30 years from now, the following won't happen: natural gas prices go

way up; people become accepting of nuclear power; demand for electricity suddenly shoots up; or no one wants to build anywhere so existing plants can charge enormous prices? Are we deciding that monopoly power, at either the plant level or the regional level, is not going to be a problem for the next 30 years?

Once we've made that judgment, solutions to certain problems fall into place. The big problem of how to compensate firms for stranded investment, for instance, is simply going to be worked out through the political process. It is the political process, not economists, who will determine, for instance, what interest or compensation utilities will be allowed from transmission assets. A further problem is the risk that, in changing the institutional structure through which electricity is delivered, we may lose the economies associated with central dispatch. The risk is that we won't start putting plants online in ascending order of production cost, but according to some contract that someone signed with someone else in 1982, because they're first in line, or something like that. This is a big problem, and calls for a decision, either to break utilities apart so that the companies who make electricity don't have control over transmission, or not do anything.

Restructuring the industry is going to take a long time -- the last restructuring case from PUHCA was settled thirty years after PUHCA was passed, and that was only the holding companies. But not doing anything at all is going to be even more complicated, because the current system of dispatch is controlled by the traditional investor-owned utilities, and some day a customer or a small independent company is going to claim they are being discriminated against because the IOU won't give them access to the cheapest power -- and that will be the first of 50,000 law suits.

Finally, if the decision is made to de-integrate the industry, the jurisdictional problems will go away, because regulation will have to follow the resulting industry structure. The FERC might have to say, "We control transmission", and the states will complain about it.

Public Policy Interests: Perspective from the States

Speaker:

Federal policies are at cross purposes with state policies on some issues. This tension is only going to get worse with increasing competition, and it's in the states' interest to resolve some of these problems.

There are problems we can only resolve through amendments to the Federal Power Act. The most important problem is the uncertainty over how much authority state commissions have to review power supply options. We know that, if the FERC approves an allocation of costs among operating companies of a registered holding company, states are precluded from doing anything but passing through the cost. Although this supposedly only applies to holding companies, if I were a utility lawyer I could make a good argument that it applies to any two affiliated operating companies. This might also be applied to non-power supply costs, like distribution. The natural gas experience suggests that it is important that the state commission be assured the authority to regulate supply options, but that is not currently the case in electricity. Another area of jurisdictional uncertainty is the "Ohio Power issue", where the FERC is precluded from regulating the pass through of non-power supply costs (in the case of Ohio Power, coal costs). In the near term, those costs need to be regulated by *somebody*.

Transmission pricing and cost allocation is another area of concern -- some day a state commission is going to be confronted by a FERC price imposition that they believe is unfair, and they will fight the decision. As was mentioned earlier, it may not be the FERC that decides these transmission issues, but a court somewhere. A regional transmission agreement could be an agreement to allocate costs approved by the FERC.

Public Policy Interests: Perspective from the FERC

Speaker:

We have four new Commissioners and each one of them thinks that Congress gave them a clear message that wholesale competition in power markets where possible should be the key note of the nation's electricity policy. So the Commission has a strong interest in making wholesale competition happen, and in seeing how it's going to play out at the state level in terms of retail consumer prices. The wholesale competition that the Commission's interested in needs to work well not only in long-term purchased power arrangements, but we also need to start thinking about how it works in terms of the short-term market operations of the sort that have been discussed by this group.

Transmission access and pricing is the key to making this all happen, and the Commission would ultimately like to see seamless open wholesale transmission access. Network service is definitely a possibility, or even some sort of spot trading arrangement, if it's possible. We need to have transmission pricing that is sensitive to the location of generators or in some way that appropriately disaggregates the grid.

Afternoon Session: Optima

The seminar continued after lunch with a discussion of options for dealing with the problems explored in the morning session. General recommendations were made for the continued work of the group on this subject.

Discussion: Optimizing Jurisdictional Arrangements

A draft report of a survey of state commission staff was distributed by a participant.² The goal of the survey was to assess what needed to be done at the state level to get RTGs going. The survey found a lack of coordination of methodological approaches to assessing transmission restrictions, and a lack of coordination in transmission planning and operational analysis in general. The survey also documented a lack of technical competence due to lack of resources at the state commission level. This analytical capability is vital to the success of RTGs. Another participant noted the difference between the FERC, which characterizes RTGs as a viable solution to several problems, and the comments of state commissioners, several of whom questioned where the resources for RTGs would come from.

In the opinion of one participant, utilities and the financial markets are looking for a greater degree of certainty in jurisdictional direction. A voluntary forum between the FERC and states, with agreements to defer to the decisions of that forum, could be a role for RTGs or some other entity. Options like FERC preemption of state authority or use of joint boards have been discussed for years, without being found politically feasible. Nor is further federal energy legislation likely in the next years. Another participant suggested that one of the benefits of RTGs from the state perspective, especially for a place like New England, would be the recognition that regions did differ in the types of decisions they faced. What might be of benefit to one region may offer nothing to

² The writeup of this survey will be distributed as soon as it is available.

others.

Another participant noted that economic development was a major obstacle to states cooperating in RTGs. States compete with other states for jobs -- participating in a body that is going to make wheeling to New Jersey easier is not a high priority for New York, for instance. A participant noted that RTGs might become useful as a replacement for regional reliability councils, whose function, because they are voluntary, is threatened by increased competition between utilities. Their functions can then be expanded as they are found to be useful for other things. He also urged that a mechanism for merging RTGs be considered, since it is unlikely that we will get the initial model right.

A participant called on the DOE to help formulate clear-cut objectives for dealing with some of these state-federal issues.

Handouts at 12/16/93 seminar on Federal-State Jurisdictional Conflicts

Brown, Ashley, *State Power Over Transmission Access and Pricing. The Giant Will Not Sleep Forever* Public Utilities Fortnightly November 9, 1989.

Brown, Ashley and Terrence L Barnich, *Transmission and Ratebase. A Match Not Made in Heaven* Public Utilities Fortnightly June 1, 1991.

Gray, Charles and Scott Hempling. *Options for Jurisdiction Over Transmission Facility Siting* Draft, November 1993

Gray, Charles and Scott Hempling. *Transmission Cost Recovery. Does the Split Jurisdiction Between FERC and States Create Uncertainty or Inefficiency?* Draft, November 1993

NARUC Electricity Committee, *NAR UC Proposal to the FERC for Consultative Process on Electricity Transmission Issues* November 1992 (?)

Stalon, Charles, *Rethinking Regulatory Jurisdiction for the Electricity Industry*. Draft, December, 1993.

Visnesky, Tony/Illinois Commerce Commission Staff, *RTG Survey. Initial Glimpses* December 1993