

REPORT OF THE COMMITTEE ON INDEPENDENT POWER PRODUCTION 1995 - 1996

I. PROMOTING COMPETITIVE ELECTRICITY MARKETS

A. Order No. 888

The FERC's long awaited Final Rule mandating open access transmission service in the wholesale power markets, Order No. 888, issued April 24, 1996.¹ In order to remedy undue discrimination in the provision of wholesale transmission services, the Final Rule requires that public utilities² file with the Commission non-discriminatory transmission tariffs of general applicability that separately state rates for wholesale generation, transmission, and ancillary services and functionally unbundle wholesale generation and transmission services. Each public utility must take transmission service for its own new wholesale sales and purchases of electricity under the same terms and conditions as any other eligible customer who takes service under the open access tariff. The Final Rule also attempts to clarify the boundaries between FERC jurisdiction over transmission in interstate commerce and state jurisdiction over facilities used for local distribution and permits public utilities and transmitting utilities³ to seek recovery of legitimate, prudent and verifiable stranded costs associated with the provision of both open access and section 211⁴ transmission services.

1. *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities: Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 94 F.E.R.C. STAT. & REGS. Regulations Preambles (April 24, 1996) [hereinafter "Final Rule" or "Order No. 888"]. In most instances, the Final Rule closely tracks the Commission's Notice of Proposed Rulemaking, 60 Fed. Reg. 17,662 (1995) [hereinafter NOPR] was comprehensively summarized in the Spring 1996 report of the Committee on Electric Utility Regulation. *An Industry in Transition: Report of the Committee on Electric Utility Regulation*, 17 ENERGY L.J. 245 (1994).

2. Section 201(e) of the Federal Power Act [hereinafter FPA], 16 U.S.C. § 824(e), defines "public utility" as "any person who owns or operates facilities subject to the jurisdiction of the Commission under [Sections 201-14 of the FPA] (other than facilities subject to such jurisdiction solely by reason of section 210, 211, or 212)."

3. Section 3(23) of the STET, 16 U.S.C. § 796(23), defines "transmitting utility" as "any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale." The term "transmitting utility" is much broader in scope than the term "public utility" and includes various entities outside the Commission's regulatory jurisdiction, such as State agencies, municipalities and cooperatives."

4. Section 211 of the Federal Power Act, 16 U.S.C. § 824j, authorizes electric utilities, federal power marketing agencies, or any other person generating electric energy for sale or for resale, to apply to the Commission for an order requiring a transmitting utility to provide transmission services, generally referred to as "wheeling." The Commission will require such transmission service if it determines that it is in the public interest. Section 211 operates in tandem with section 212 of the FPA, 16 U.S.C. § 824k, which requires that the Commission, prior to ordering transmission service, find, *inter alia*, that the order will not impose certain costs upon or impair the reliability of service of the

In addition, pursuant to the requirements of a companion rule, Order No. 889, issued by the FERC simultaneously with Order No. 888, public utilities are required to create or participate in an electronic system, accessible via the Internet, which provides, by electronic means, information regarding available transmission capacity, prices and related information.⁵ Order No. 889 further requires that public utilities rely on the same electronic information as their customers when engaged in the purchase or sale of wholesale power and the implementation of standards of conduct intended to insure the functional separation of the transmission and wholesale power merchant functions.

Order No. 888 also contains a timetable for its implementation. Utilities that have filed open access tariffs (Group 1 utilities) must amend these tariff filings by July 9, 1996, to include the non-rate terms and conditions specified in the Final Rule (identifying any provisions that reflect regional practices) and to reflect any proposed rate changes caused by these non-rate terms and conditions. Utilities that have not yet filed proposed open access tariffs (Group 2 utilities) must file by July 9, 1996, proposed tariffs that conform to the non-rate terms and conditions specified in the Final Rule (identifying any provisions that reflect regional practices) and must propose rates for these services, including ancillary services. Any requests for waiver of these requirements must be submitted at this time. Once initial compliance tariffs and rates become effective, utilities may file pursuant to FPA section 205 proposed revisions to these initial tariffs. The initial OASIS requirements and the standards of conduct required for functional unbundling must be implemented by November 1, 1996.

1. Functional Unbundling

The Commission in Order No. 888 retained the functional unbundling approach set out in the NOPR, declining to mandate divestiture or other comparable corporate unbundling. The Commission concluded that functional unbundling, coupled with specific codes of conduct and the remedies available under section 206 of the FPA, is sufficient to ensure that public utilities provide non-discriminatory generation and transmission services.⁶ Further, the Final Rule does not require operational unbundling through the formation of Independent System Operators (ISOs).⁷ The Commission, however, wishes to promote the voluntary formation of ISOs. To that

transmitting utility. Section 212 also prohibits Commission-ordered wheeling directly to an ultimate consumer and so-called "sham wholesale transactions."

5. *Open Access Same-Time Information System (formerly Real-Time Information Networks) and Standards of Conduct*, III F.E.R.C. STATS. & REGS. ¶ 31,037 (1996) [hereinafter OASIS Rule or Order No. 889].

6. Order No. 888 at 31,654-55.

7. An ISO, an independent entity that does not own generation or transmission facilities, is responsible for operating a designated set of transmission facilities and administering access to transmission services for all users of the system. As an ISO operates facilities used for the transmission of electric energy in interstate commerce, it is a "public utility" independently subject to the open access and OASIS rules. Order No. 888 at 31,730, n.425.

end, Order No. 888 lists eleven "ISO principles" that the Commission will use to assess future ISO proposals.⁸

Effective July 9, 1996, public utilities must take unbundled transmission for all new wholesale sales, purchases and unbundled retail sales under their own open access tariffs.⁹ Existing requirements, service agreements, and bilateral non-economy energy coordination agreements need not be unbundled absent a separate Commission order.¹⁰ Existing economy energy coordination sales must be unbundled by December 31, 1996.¹¹

2. Retail Customer Eligibility

In the NOPR, the Commission proposed to define the entities eligible for non-discriminatory, open-access service as those entities eligible to request transmission service under FPA section 211, thereby limiting eligibility to wholesale customers.¹² The Final Rule expanded the eligibility criteria to include foreign entities that otherwise meet the eligibility criteria and, most significantly, retail customers receiving unbundled transmission services pursuant to a program voluntarily offered by a public utility or in accordance with a state retail access program. Although the FERC contends that retail customers can take unbundled transmission service under the wholesale open-access tariff, it agreed to accept separate retail transmission tariffs to accommodate unique requirements of state retail access programs, provided that the separate tariff is consistent with the Commission's open-access policies as reflected in the Final Rule and the Transmission Pricing Policy Statement.¹³

3. Reciprocity

Order No. 888 requires public utilities to file open-access tariffs in accordance with the *pro forma* tariffs contained in the Final Rule, providing for both point-to-point and network transmission service. In addition to transmission services, the Final Rule also specifies various ancillary services that must be offered as part of an open-access tariff.¹⁴

Although Order No. 888 limits the open-access tariff filing requirement to public utilities subject to FERC jurisdiction under FPA sections 205 and 206, the Commission is mindful that the failure of non-public utilities to file comparable tariffs would create a patchwork of open and closed transmission systems that could distort the operation of the wholesale electric market.¹⁵ Accordingly, the Commission required all public utilities

8. Order No. 888 at 31,730-32.

9. *Id.* at 31,665-66.

10. However, the Final Rule also requires that public utilities, by July 9, 1996, submit to the FERC an "informational" rate filing setting forth the unbundled power and transmission rates reflected in existing requirements contracts. *Id.* at 31,665.

11. *Id.* at 31,666.

12. NOPR at 17,682. *See supra* note 4, for a discussion of the entities subject to section 211.

13. Order No. 888 at 31,784-85.

14. *Id.* at 31,703-22.

15. *Id.* at 31,691.

open-access tariffs to include a reciprocity provision that would be applicable to all customers, including non-public utilities, that own, control or operate interstate transmission facilities and take service under the open-access tariffs.¹⁶ Under this provision, the user must agree to offer the transmission provider comparable access to the user's own transmission facilities.¹⁷ The Final Rule also establishes a "safe harbor" procedure whereby non-public utilities may submit their own transmission tariff to the FERC and obtain a declaratory order ruling that the tariff is an acceptable reciprocity tariff.¹⁸

4. Contract Abrogation

The Final Rule affirmed the Commission's determination in the Open Access NOPR that abrogating wholesale contracts was not necessary to remedy undue discrimination. Unlike the natural gas industry, which the Commission stated was experiencing a "market failure" at the time of its restructuring, the changes in the electric industry do not, in the Commission's view, compel generic abrogation of contracts.¹⁹

While generic contract changes were held to be unnecessary, the Commission explained that modification of certain contracts on a case-by-case basis may be appropriate. In the Open Access NOPR, the Commission stated that the public interest required that utilities be permitted to file to amend unilaterally existing wholesale requirements contracts that do not contain stranded cost recovery provisions to address stranded costs, even if such contracts contain *Mobile-Sierra* clauses.²⁰ This provision was widely criticized as one-sided because it allowed only public utilities—and not their customers—to seek to amend existing contracts. In the Final Rule, the Commission expanded its proposal to include comparable rights for utility customers, authorizing customers to challenge existing contracts under FPA section 206 notwithstanding a *Mobile-Sierra* clause, and indicating that it would address competing claims simultaneously in cases initiated by the public utility or by a utility customer.²¹

5. Allocation of Capacity

The Commission in Order No. 888 held that there is no limit on a customer's ability to reserve transmission capacity, and that reserved point-to-point capacity may be reassigned in the secondary market.²² Customers

16. *Id.* 31,691, 31,760-61.

17. *Id.* at 31,760.

18. *Id.* at 31,761. On May 29, 1996, the Commission granted the first petition for declaratory order under the safe harbor provision, concluding that the open-access tariff filed by a non-public utility met the Commission's comparability standards. *South Carolina Public Service Authority*, 75 F.E.R.C. ¶ 61,209 (1996).

19. Order No. 888 at 31,663-64.

20. NOPR at 33,113-14. *See* *United Gas Pipe Line Co. v. Mobile Gas Services Corp.*, 350 U.S. 332 (1956); *F.P.C. v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

21. Order No. 888 at 31,664-65, 31,812-14.

22. *Id.* at 31,693. The FERC, however, has refused to allow network customers to remarket capacity. *Id.* at 179.

that are required to pay firm reservation charges may be expected to determine their capacity needs and have an incentive to make unneeded capacity available to other customers. Any claims of anticompetitive conduct may be addressed under section 206.²³ With regard to capacity for future use, public utilities may reserve existing transmission capacity for reasonable native and network transmission customer load growth.²⁴

6. Jurisdictional Issues

In the Final Rule, the Commission held that it has exclusive jurisdiction over the rates, terms and conditions of unbundled retail transmission in interstate commerce, regardless of whether the transmission is made voluntarily or as a result of a state retail access program.²⁵ According to the Commission, when transmission is sold at retail as part of the delivered, bundled product called electric energy, the transaction is a state-regulated retail sale.²⁶

The Commission also determined that for virtually every retail wheeling transaction there would be a local distribution component that would be regulated by the state.²⁷ Once unbundled, the separate transmission service is "transmission within interstate commerce" subject to the Commission's FPA jurisdiction.²⁸ The Commission's jurisdiction over the transmission component of unbundled retail transmission, however, does not authorize the Commission to order retail transmission directly to an ultimate consumer—conduct which is barred by FPA section 212(h).²⁹ This jurisdictional determination also has no effect on state-established franchise areas or other state laws governing electric retail marketing areas, and the Final Rule expressly states that state commissions retain the ability to allow or disallow the costs of "electricity purchased at wholesale in retail rates."³⁰

The Commission found that there is no bright line that defines the appropriate jurisdictional boundaries between state and federal regulation of unbundled retail transmission service, and adopted a seven-part operational test, to be applied on a case-by-case basis to determine whether facilities are local distribution facilities.³¹ Further, even in circumstances where no local distribution facilities are identified, the FERC found that the states have authority over the *service* of delivering electricity to end-users, and may assess stranded costs as well as charges for stranded benefits.³² As a

23. Order No. 888 at 31,693.

24. *Id.* at 31,694.

25. *Id.* at 31,781.

26. *Id.*

27. Order No. 888 at 31,784-85.

28. *Id.* The Commission relies on this authority to regulate the interstate transmission component of buy/sell agreements, under which an end-user arranges for the purchase of generation from a third party. *Id.* at 31,785.

29. Order No. 888 at 31,781.

30. Order No. 888 at 31,781-82.

31. Order No. 888 at 31,783.

32. *Id.*

result, customers will have no incentive to structure a transaction to avoid local distribution facilities in order to bypass state jurisdiction and the assessment of stranded costs.³³ The Commission also indicated that it will defer to state jurisdictional determinations with respect to retail wheeling and to related decisions concerning how facilities' costs should be recovered through rates.³⁴ Alternatively, utilities, after consulting with state commissions, may file proposed jurisdictional facility classifications under section 205, provided that the proposal is consistent with the principles established in the Final Rule.³⁵

7. Stranded Cost Recovery

Order No. 888 reaffirmed the Commission's proposal to permit recovery of legitimate, prudent and verifiable stranded costs,³⁶ and rejected arguments that stranded cost recovery would be discriminatory or anticompetitive.³⁷ The Final Rule also reaffirmed the Commission's decision that direct assignment of stranded costs to departing customers is the appropriate method for cost recovery.³⁸ A utility seeking to recover stranded costs must demonstrate that it had a reasonable expectation of continuing to serve a departing customer.³⁹ The Final Rule contains a "revenues lost" formula for calculating stranded costs.⁴⁰

The Commission also upheld its decision not to allow stranded cost recovery for "new" contracts (contracts entered into after July 11, 1994) absent specific contractual authority.⁴¹ Requirements contracts that are renegotiated or extended for an effective date after July 11, 1994, will be considered "new."⁴² Utilities' obligation to serve wholesale customers will not extend beyond the term of existing contracts, absent unique circumstances.⁴³

With regard to stranded cost recovery from retail-turned-wholesale customers, the Commission held that it was the primary forum for addressing retail-turned-wholesale stranded costs, such costs, the Commission concluded, should be viewed as wholesale stranded costs because there is a clear nexus between FERC jurisdictional transmission access requirements and the incurrence of such costs.⁴⁴ With respect to stranded costs associated with retail wheeling, the Commission held that both the Commission and the states have jurisdiction to address such costs.⁴⁵ The Commission

33. *Id.*

34. Order No. 888 at 31,783-84.

35. *Id.* at 31,784.

36. *Id.* at 31,788-89.

37. *Id.* at 31,790-91, 31,793.

38. *Id.* at 31,797-803.

39. *Id.* at 31,831.

40. *Id.* at 31,839-42.

41. Order No. 888 at 31.804-805.

42. *Id.* at 31,805.

43. *Id.* at 31,805-806.

44. *Id.* at 31,818.

45. *Id.* at 31,824-25.

stated, however, that recovery of such costs is a matter that should be resolved by state commissions and that it will entertain requests to recover retail wheeling stranded costs only if the governing state regulatory authority is without the legal authority to provide a remedy.⁴⁶

B. FPA Section 211 and 212 Filings

1. Recent Commission Orders⁴⁷

The Commission reaffirmed its exclusive jurisdiction over section 211 applications in *Citizens Utilities Company*,⁴⁸ in which Citizens Utilities Company, an investor-owned utility, petitioned the Commission to order Swanton Village, Vermont, to provide unbundled transmission service to serve its customers in Highgate Springs, Vermont. In response to Citizen's request, Swanton offered to provide transmission and ancillary services to Citizens, but at a rate unacceptable to Citizens. In addition, the Vermont Public Service Board asserted that it had jurisdiction over the service and that the parties should negotiate a resolution in Vermont.

In its proposed order, the Commission made a preliminary determination that Swanton should provide transmission service to Citizens and provided preliminary guidance as to the rates, terms and conditions of service. Following its prior decision in *Zelienople*,⁴⁹ the Commission gave the parties forty-five (45) days to negotiate rates, terms and conditions and prescribed procedures for the Commission to establish final rates should the negotiations fail. The Commission also rejected the arguments that the matter should be decided by the Vermont Board, holding that FPA sections 211 and 212 provide the FERC with exclusive jurisdiction over Citizen's application.

In *American Municipal Power-Ohio, Inc. v. Ohio Edison Company*,⁵⁰ the Commission clarified the broad scope of a section 211 request. In *AMP-Ohio*, the Commission issued a proposed order directing Ohio Edison Company to establish additional delivery points, and to permit further delivery points to be added in the future, for its service to American Municipal Power-Ohio, Inc., an electric cooperative. The Commission thus concluded that a request for additional delivery points was within the scope of "transmission services" for purposes of section 211, even though the new delivery points would not alter the amount of electric energy transmitted to AMP-Ohio by Ohio Edison. The Commission gave the parties forty-five (45) days to negotiate rates, terms and conditions and prescribed procedures for the Commission to establish final rates should the negotiations fail.

46. *Id.* at 31,825.

47. The Spring 1996 report of the Committee on Electric Utility Regulation, 17 *ENERGY L.J.* 245, summarized the cases decided in 1995; this report updates that discussion.

48. 75 F.E.R.C. ¶ 61,240 (1996).

49. *Borough of Zelienople, Pennsylvania*, 70 F.E.R.C. ¶ 61,073, at 61,184-85 (1995), dismissed as moot 74 F.E.R.C. ¶ 61,231 (1996).

50. 74 F.E.R.C. ¶ 61,086 (1996).

The Commission decided a number of contested rate issues involving section 211 transmission services in *AES Power, Inc.*⁵¹ In *AES*, the Commission had previously issued a proposed order holding that the transmission service requested by AES Power, Inc., a power marketer, to be provided by the Tennessee Valley Authority (TVA) was in the public interest and directing the parties to resolve certain issues concerning rates and the terms and conditions of service.⁵² When the parties were unable to reach agreement, the Commission resolved the outstanding matters.

With regard to the applicable rate, the Commission rejected AES's request that TVA charge a rate based solely on the costs of TVA's bulk transmission facilities, holding that TVA's facilities formed an integrated grid and that transmission service should be priced using an average-cost, postage-stamp rate, inclusive of production-related costs. The Commission also held that revenue credits should be applied consistently to all transmission services, not just native load, and that TVA should apply the same priorities of service to AES as it applies to itself and to other parties. The Commission established an initial five-year service term, denying TVA's request that the agreement be for an indefinite term, subject to a ninety (90) day notice of termination provision. The Commission also resolved contested rate design issues, approving the use of annual system peak as a measure of system capacity and upholding a system of daily and weekly price caps for non-firm services.

2. Pending Section 211 Applications

In addition to these decisions, several applications filed under Section 211 of the Federal Power Act were pending before the FERC in mid-1996 that raise important legal issues. One of the most closely watched issues involves so-called "muni-lite" applications, in which either existing or recently-formed municipal entities seek to qualify for wheeling orders under section 211. Opponents argue that the requests constitute sham wholesale transactions prohibited by section 212(h). In addition, opponents, typically the host utilities, are concerned that such section 211 requests will result in avoidance of stranded costs. As a result, these cases are hotly contested.

For example, on March 1, 1996, the City of Palm Springs, California filed a Section 211 application requesting that the Commission order Southern California Edison to provide firm network transmission service to Palm Springs.⁵³ The city requested the service as part of a program to install separate, city-owned meters for each retail customer. Palm Springs contends that its request does not constitute a sham wholesale transaction because Palm Springs would deliver all of the wheeled electricity to ultimate consumers over meters and related equipment that it owns. The parties opposing Palm Springs' application argue, *inter alia*, that it is a "paper

51. 74 F.E.R.C. ¶ 61, 220 (1996).

52. *AES Power, Inc.*, 69 F.E.R.C. ¶ 61,345 (1994).

53. *City of Palm Springs, California*, Docket No. TX96-7-000 (FERC March 1, 1996).

municipal utility," that is ineligible for Section 211 transmission, and that the requested service violates the prohibition on wheeling directly to a retail customer. These parties also allege that the city does not own or control transmission or distribution facilities as required by section 212(h).

The Palm Springs application followed on the heels of the Freedom Energy L.L.C. application, in which Freedom, an aggregator granted "public utility" status by the New Hampshire Public Utilities Commission, requested the FERC to order Public Service Company of New Hampshire (PSCNH) to provide unbundled transmission service to enable Freedom to serve large industrial customers in New Hampshire presently served by PSCNH.⁵⁴ PSCNH and several other investor-owned utilities argue that Freedom is seeking to engage in sham wholesale wheeling transactions, asserting that Freedom is not eligible under Section 211 because it owns no facilities and presently has no customers. Freedom contends that it will acquire facilities and begin to serve customers once it receives approval from the New Hampshire PUC and the FERC.

A similar Section 211 wheeling request was filed January 17, 1996, by the Suffolk County Electrical Agency (SCEA), which requested that the Commission direct Long Island Lighting Company (LILCO) to provide firm network service.⁵⁵ SCEA, which has previously purchased power from the New York Power Authority, owns no generation, transmission or distribution facilities, and relies on LILCO to distribute this power to the ultimate consumer. Under New York law, SCEA has a partial leasehold interest in LILCO's distribution system that qualifies it as a "public body," and states that it may acquire additional facilities to permit wheeling. Parties opposing SCEA's request argue that Municipal Development Agencies, such as SCEA, are ineligible for Section 211 service. Opponents also allege that the service sought by SCEA would constitute a sham wholesale transaction because SCEA does not own or control the transmission or distribution facilities required by section 212(h) and that its request that the power be delivered "at the location of each residential customer" demonstrates that the service would violate section 212(h)'s prohibition against delivery of wholesale power directly to a retail customer.

On February 28, 1996, Pacific Gas & Electric Company (PG&E) filed a Petition for Declaratory Order requesting that the Commission hold that PG&E is not obligated to interconnect with and provide transmission service to Modesto Irrigation District and Destec Power Services, Inc.⁵⁶ Modesto proposed to purchase a substation located outside its service area from Praxair, a current PG&E industrial customer, and requested that PG&E wheel power to be purchased from Destec, a power marketer, and to be transmitted under Destec's transmission agreement with PG&E to Modesto at that interconnection. Modesto would sell the power purchased from Destec to Praxair and to other customers. Opponents of Modesto's proposal contend that it constitutes a sham wholesale transaction because

54. *Freedom Energy Company, L.L.C.*, Docket No. EL95-64-000 (FERC 1995).

55. *Suffolk County Electrical Agency*, Docket No. TX96-4-000 (FERC Jan. 17, 1996).

56. *Pacific Gas & Electric Company*, Docket No. EL96-37-000 (FERC Feb. 28, 1996).

the purchase of the substation does not satisfy the requirement that the utility receiving wheeling service own distribution facilities. These parties also charge that the transaction is intended to circumvent the assessment of stranded costs.

C. *State Administrative and Legislative Activity*

1. Restructuring Initiatives⁵⁷

(a) The Northeast - High electric rates have dampened economic growth in the Northeast, prompting several states to take the lead in restructuring the electric industry within their borders. In response to the vocal lobbying of industrials in New England, state legislatures, utilities, and state commissions have proposed innovative approaches toward deregulation, such as establishing independent system operators to operate regional transmission systems, functional unbundling of utilities, and exit fees imposed on large customers to recover stranded costs. Several states, including Massachusetts, New York, and New Hampshire, have implemented retail wheeling pilot programs.

Connecticut

The Connecticut Department of Public Utility Control (CTDPUC) conducted investigations on industry restructuring between February and June 1995, and issued a draft policy decision in July 1995⁵⁸, recommending, among other things, deregulation of electric generation and full retail access. The CTDPUC presented its recommendations to the state legislature, which established a Task Force⁵⁹ to review industry restructuring. On February 16, 1996, the Task Force released an interim report identifying the following areas of focus: (1) regulatory streamlining; (2) public policy requirements such as low-income protection, demand-side management, and purchased power agreements (including opportunities to reduce the impact of independent power producer contracts on electricity rates, incentives for renegotiating contracts, and methods to finance buy-downs and buy-outs); (3) siting guidelines; and (4) customer choice. The Task Force is expected to provide the legislature with a series of recommendations for the 1997 legislative year.

Maine

The Maine Public Utilities Commission (MEPUC) issued a proposal in March, 1995, that would allow state utilities to collect fifty percent (50%) of stranded investment costs from departing retail customers through an exit fee mechanism. The proposal was made in response to pressure from Central Maine Power Company, which has been concerned that several

57. This report updates the discussion of state initiatives on restructuring contained in the Spring 1996 report of the Committee on Electric Utility Regulation, 17 ENERGY L.J. 245 (1996).

58. CDPUC, *Investigation into the Restructuring of the Electric Industry*, No. 94-12-12 (1995).

59. See, An Act Concerning Restructuring the Electric Industry, Special Act 95-15 (June 28, 1995).

towns within its service territory may municipalize and take advantage of wholesale wheeling opportunities. Further, in July 1995, the state legislature passed a directive: (1) ordering the MEPUC to review retail wheeling options; (2) establishing the "Work Group on Electric Industry Restructuring;"⁶⁰ and (3) ordering the MEPUC to open an "Inquiry into the Electric Utility Industry Restructuring."⁶¹ The MEPUC will create two alternative plans to implement retail wheeling. One plan would implement full retail wheeling by the year 2000, while the other plan would implement partial competition by 2000 (in sectors in which effective competition is likely), maintaining appropriate regulation in necessary areas. The Work Group submitted its report on industry restructuring to the MEPUC and the legislature in December, 1995. Preliminary findings are expected from the MEPUC in August, 1996, and the MEPUC's final report should be presented to the legislature by January, 1997.

Massachusetts

The Massachusetts Department of Public Utilities (MADPU) opened its investigation into retail wheeling in February, 1995, and issued a unanimous decision on August 16, 1995, setting forth principles for a restructured electric industry and ordering the three largest IOUs in the state to file restructuring plans by February, 1996.⁶² The principles emphasized increased customer choice, increased competition, generation competition, functional unbundling, universal service, environmental protection and incentive regulation where a fully competitive market cannot or does not exist. Massachusetts Electric Company, Boston Edison Company, Western Massachusetts Electric Company, and Eastern Edison Company filed plans with the MADPU in February, 1996. The MADPU commenced a rulemaking to resolve general issues in the utility filings;⁶³ the utility-specific adjudications will be held after the rulemaking is complete, which is expected to be in the fall of 1996 and the winter of 1997. On May 1, 1996, the MADPU issued proposed restructuring rules which, among other things, would allow a reasonable opportunity to recover net, non-mitigable stranded costs, and establish performance based regulation for distribution companies. The MADPU also announced its vision of a restructured industry which would include: (1) an independent/unaffiliated ISO which would operate the regional transmission system reliably at comparable rates; (2) a power exchange to manage short-term power sales bids; (3) functional separation of electric companies; and (4) preservation of low-income customer discounts, universal services and other consumer protections. The MADPU will hold hearings on the proposed rules throughout the summer and final regulations are expected to be published on October 4, 1996.

60. The Work Group is made up of representatives of the MEPUC, the state legislature, the utility industry and electricity consumers.

61. MEPUC, *Inquiry into Electric Utility Industry Restructuring*, No. 95-462 (1995).

62. MADPU, *Electric Industry Restructuring*, No. 95-30 (1995).

63. MADPU, *Order Commencing Notice of Inquiry (NOI) Rulemaking and Setting a Procedural Schedule*, No. 96-100 (1996).

New Hampshire

The New Hampshire Public Utilities Commission (NHPUC) conducted an informal roundtable on electric industry restructuring beginning in January, 1995, and issued a draft report in August, 1995, that showed major differences on issues related to retail competition and stranded investment. A final roundtable report was issued in August, 1995. In June, 1995, the legislature adopted a bill⁶⁴ that: (1) created a special legislative committee to review restructuring issues and to submit legislation on electric industry restructuring; (2) mandated a two-year retail wheeling pilot program; and (3) required the NHPUC and utilities to develop economic development pricing proposals. New Hampshire's retail wheeling Pilot Program began on May 28, 1996.⁶⁵ Under the Pilot Program, at least three percent of each of New Hampshire's six utilities' peak load must be allocated to the Pilot Program, and suppliers may aggregate customers to supply them competitive retail service. All new customers in the industrial and large commercial categories may participate in the Pilot Program. The NH Restructuring Committee initiated what became H.B. 1392, which was enacted in late May, 1996.⁶⁶ This legislation requires the NHPUC, among other things, to prepare a final restructuring plan by February 28, 1997. The NHPUC is expected to have prepared a preliminary plan by August, 1996 and to hold hearings in October, 1996,⁶⁷ with public comments due in November, 1996. Finally, the NHPUC has conducted ad hoc negotiations on stranded cost recovery with each utility. The agreed-upon recovery rates range from thirty five percent to twenty percent, with the weighted average recovery at about thirty percent, much lower than the levels of other proposals.

New York

The New York Public Service Commission (NYPSC) issued a final draft of its "Principles to Guide Transition to Competition in the Electric Industry"⁶⁸ in June, 1995, which endorses increased competition (but not specifically retail competition), greater customer choice, and recovery of stranded investment costs. Eight utilities filing restructuring models in the Competitive Opportunities Proceeding⁶⁹ recommended switching to a poolco operation based on the existing New York Power Pool. Niagara Mohawk Power Corporation's (NIMO) proposed plan, "Energy and the

64. See N.H. REV. STAT. ANN. § 374:26-a (1995).

65. See NHPUC, *Retail Competition Pilot Program*, DR 95-250 (1995), enforcing N.H. REV. STAT. ANN. § 374:26-a (1995).

66. 1996 N.H. Laws Ch. 129 (H.B. 1392).

67. *Restructuring Plan*, DR 96-150 (NHPUC 1996).

68. *In the Matter of Competitive Opportunities Regarding Electric Service*, Case 94-E-0952 (NYPSC 1995) [hereinafter *Competitive Opportunities Proceeding*].

69. *Id.*

Power of Choice,"⁷⁰ would allow customers to buy electricity from a wholesale pool or to receive direct access to generation under a plan to be phased-in through 2000. The plan offered to divest NIMO's generating plants and create a holding company with two unregulated subsidiaries, one handling transmission and distribution and the other handling power marketing. In exchange, NIMO proposed to recover 100% of its stranded costs. NIMO's plan also proposed using eminent domain to condemn existing qualifying plants if contract renegotiations should fail.⁷¹

On December 21, 1995, the NYPSC issued a preliminary decision which concluded, among other things, that retail competition and direct access should be pursued after a wholesale market has been established.⁷² In May 1996, the NYPSC issued its final decision⁷³ regarding implementation of a retail electric market and requested six of New York's eight IOUs to file by October 1, 1996 plans that address: (1) corporate structure; (2) schedules for introducing retail access to all customers; (3) a rate plan effective for the transition; (4) public policy programs; (5) an examination of load pockets unique to each utility, identification of potential market power problems, and proposals to mitigate market power; and (6) provision of customer protections. The restructuring order suggests that utilities sell or spin off their generation assets.

On March 18, 1996, the state assembly introduced a legislative proposal called "Competitive Plus: Energy 2000" that would reduce electric rates by twenty five percent by allowing the New York Power Authority to sell its non-hydroelectric assets and requiring a transition to customer choice. The proposal presents guidelines to introduce wholesale competition and retail competition pilot programs throughout the state in 1997, and full customer choice by 2000. The legislature is expected to act on the proposal in 1996.

Rhode Island

In May, 1995, Rhode Island Electric Industry Restructuring Collaborative (Task Force) recommended a set of principles calling for retail wheeling, a spot market for power sales, and functional unbundling of generation

70. *Procedure on the Motion of Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation for Electric Service, Multi-Year Electricity Rate, Restructuring, and Retail Access Proposal*, Case 94-E-0098 (N.Y.P.S.C. October 6, 1995).

71. In opposition to the NYPSC's encouragement of the buy-out of existing IPP contracts, Independent Power Producers of New York proposed that there be no forced buy-outs or buy-downs of existing contracts. IPPNY and a group of lenders intervened in the Competitive Opportunities Proceeding and submitted a letter to the NYPSC expressing concern over its approach to IPP contract sanctity. The lenders warned that the NYPSC's approach undermined the trust and creditworthiness of New York's power market.

72. *In the Matter of Competitive Opportunities Regarding Electric Service*, Case 94-E-0952 (N.Y.P.S.C. December 21, 1995).

73. *In the Matter of Competitive Opportunities Regarding Electric Service, Opinion and Order Regarding Competitive Opportunities for Electric Service*, Cases 94-E-0952 et al, Opinion No. 96-12 (N.Y.P.S.C. May 20, 1996).

from transmission and distribution.⁷⁴ The Rhode Island Public Utilities Commission⁷⁵ rejected one of the principles, asked for clarification of others,⁷⁶ and made other suggestions. The Task Force, which has since disbanded, stated that its plan must be accepted without change before it would start a new round of negotiations on specific issues. In April, 1996, the Rhode Island Division of Public Utilities and Carriers (RIDPUC) filed a comprehensive restructuring plan.⁷⁷ Under the RIDPUC Plan: (1) all customer classes would access the competitive market at the same time; (2) utilities would continue to provide distribution service to all customers; and (3) utilities would be required to provide only basic generation service to all customers, obtaining the electricity not from affiliated resources but from the spot market or contracts with non-affiliated suppliers.

Vermont

In late 1994, the Vermont Public Service Board and Department of Public Service (VTPSB) sponsored a roundtable on competition and created a working group to focus on specific issues. In July, 1995, the working group set forth general principles supporting increased customer choice.⁷⁸ The working group, however, was divided on the stranded investment issue. In September, 1995, Governor Howard Dean urged retail choice in Vermont by the end of 1997 and called for the VTPSB to establish a restructuring investigation. The VTPSB issued recommendations in April, 1996. Governor Dean also asked the state legislature to pass a bill in 1996 that provides guidelines for restructuring. Based on these guidelines, the VTPSB required the twenty-two distribution utilities that provide electric service in the state to file plans by June 19, 1996.⁷⁹ Green Mountain Power Corporation and Central Vermont Public Service submitted restructuring proposals in January, 1996.⁸⁰ The VTPSB intends to review the plans and issue an order and report to the legislature by November, 1996.

Although not as pronounced as in the Northeast, the Mid-Atlantic region has high electric rates and potentially significant stranded costs

74. RIPUC, *Investigation into the Various Issues Surrounding Retail Competition*, No. D-94-9 (1995).

75. In February 1996, Representative Caruolo introduced a bill, the Utility Restructuring Act of 1996 (H-96-8123-8124), that would effectively place the General Assembly in control of the RIPUC by allowing the General Assembly to appoint (and dismiss at will) three of the (proposed) five Commissioners. The bill also includes a provision that would permit the Narragansett Electric Company (NEC) to recover \$930 million in stranded costs without selling its generation assets, through a \$.03 per kWh stranded cost recovery tariff charged on any customer who leaves NEC service.

76. RIPUC, in so doing, opened a new docket, *IN RE: ELECTRIC INDUSTRY RESTRUCTURING*, No. 2320 (1995), and issued the "Commission Report and Order on Interdependent Principles."

77. RIDPUC, *In Re: Electric Industry Restructuring, The Division Plan To Restructure the Electric Industry in Rhode Island*, No. 2320 (1996).

78. VTPSB, *Electric Industry Restructuring, Work Group Principles on Electric Industry Restructuring*, No. 5854 (1995).

79. *Electric Industry Restructuring, Interim Order Re: Scope of Filings and Procedural Schedule*, No. 5854 (V.P.S.B. May 24, 1996).

80. VTPSB, *Electric Industry Restructuring, CVPS Vision for a Restructured Electric Industry*, No. 5854 (1996).

which have prompted several states to begin industry restructuring investigations. Utilities have attempted to keep costs in check, with some targeting contracts with independents.

Delaware

In June, 1995, the governor approved a law that permits the Delaware Public Service Commission (DPSC) to adopt alternative regulation and promote competition in electric generation.⁸¹ Although the DPSC has not yet acted on this order, it planned to hold a conference in June, 1996, to discuss electric industry restructuring issues. Delmarva Power & Light Company, the state's only investor-owned utility, filed a motion⁸² in February, 1996, with the DPSC that was instrumental in prompting the DPSC action.

District of Columbia

On October 27, 1995, the District of Columbia Public Service Commission (DCPSC) ordered an inquiry into electric industry restructuring.⁸³ The DCPSC sought comments from interested parties on the: (1) economic, technological, institutional, and legal forces causing change in the industry, (2) the role the DCPSC should play in establishing and enforcing guidelines that encourage wholesale and/or retail competition, and (3) transitional problems that may occur, as well as possible solutions to those problems. A pre-hearing conference was held December 15, 1995, and written comments were filed. The DCPSC has delayed further action in the proceeding so that it may address the pending merger between Potomac Electric Power Company and Baltimore Gas and Electric.⁸⁴ The DCPSC heard the Merger Case in late May, 1996, and was scheduled to issue a pre-hearing conference order in its restructuring proceeding by July, 1996, delineating the specific issues to be addressed regarding the merger. The DCPSC also was expected to issue an order at that time addressing restructuring on an industry-wide basis.

New Jersey

In November, 1994, the New Jersey Board of Public Utilities (NJBPUB) issued a draft Energy Master Plan.⁸⁵ The draft Energy Master Plan approved increased wholesale competition but stated that no consensus

81. 70 Del. Laws Ch. 48 (June 12, 1995).

82. *In the Matter of the Motion of Delmarva Power & Light Company for the Establishment of a Docket for the Purpose of Discussing Issues Related to the Restructuring of Delmarva's Electric Business*, No. 96-83 (D.P.S.C. April 9, 1996).

83. *Re: Electric Services, Market Competition, and Regulatory Policies*, 165 Pub. Util. Rep. (PUR)4th 98 (D.C.P.S.C. October 27, 1995).

84. *In the Matter of the Joint Application of Baltimore Gas and Electric Company, Potomac Electric Power Company and Constellation Power, Inc. for Authorization and Approval of Merger and for Certificate Authorizing the Issuance of Securities*, No. 96-951 (D.C.P.S.C. April 8, 1996) (the "Merger Case").

85. NJBPUB, *New Jersey Energy Master Plan, Draft Phase 1 Report*, No. EX941205885Y (1994).

existed on retail wheeling and stranded investment issues, and recommended that the state proceed cautiously with restructuring. The draft Energy Master Plan also endorsed immediate steps to provide alternative ratemaking. The Master Plan Phase I, released in March, 1995,⁸⁶ received a favorable response from the major utilities in New Jersey. Further hearings on the plan took place at the end of 1995. In the fall of 1995, New Jersey utilities proposed moving to a wholesale poolco system within the Pennsylvania-New Jersey-Maryland Interconnection.⁸⁷

To address comments on restructuring issues, the NJBPU created four working groups: (1) The Industry Model; (2) Stranded Costs; (3) Regional Generation and Environment; and (4) Public Policies. A report documenting the findings and proposals of the working groups was delivered to the NJBPU in May, 1996. The NJBPU will soon begin another proceeding to address the recommendations of the working groups and finalize guidelines for restructuring. The state assembly passed a law⁸⁸ in 1995: (1) expanding the NJBPU from three to five members to provide more expertise on deregulation; and (2) ensuring small power producers and small power users equal access to the market under deregulation.

Pennsylvania

In April, 1994, the Pennsylvania Public Utility Commission (PAPUC) began an investigation of electric industry restructuring. Comments were submitted by January, 1995, and the PAPUC staff issued a preliminary report in August, 1995,⁸⁹ opposing retail wheeling. The report endorsed wholesale competition and performance-based ratemaking and stated that current state policy on stranded investment was ambiguous. The PAPUC offered the report and related questions for public comment, received initial comments in November, 1995, and completed hearings thereon in March, 1996.

The Pennsylvania General Assembly in April, 1996, introduced a bill, the Consumer Electric Utility Choice Act,⁹⁰ that calls for the PAPUC to allow customers to obtain electric energy and capacity from the supplier of their choice and to obtain transmission, distribution, and ancillary services separately. The bill permits purchasing cooperatives or other marketing mechanisms to be established to enhance customer choice. Under the bill,

86. NJBPU, *New Jersey Energy Master Plan, Phase I Report*, No. EX 941205885Y (1995).

87. FERC, *Supplemental Comments of the Supporting PJM Companies for Technical Conference on Comparability for Power Pools*, Nos. RM95-8-000 & RM94-7-001 (November 30, 1995). The utilities proposed that PJM expand to include other wholesale entities and evolve from an association of utilities to a non-profit, independent ISO structure. Under this configuration, all parties, including utilities, would bid into the pool and the ISO would choose supply sources based on their bid price, after taking transmission constraints, reliability and other factors into consideration. The utilities would maintain ownership of the transmission and distribution system, but the ISO would operate them. All parties taking advantage of this system would be subject to a transition charge, which would provide 100% stranded investment recovery.

88. 1995 N.J. Laws 180.

89. PPUC, *Investigation into Electric Power Competition*, No. I-940032 (P.P.U.C. August 4, 1995).

90. The Electric Utility Retail Customer Choice Act, H.B. 2537, Sess. 1996 (April 10, 1996).

utilities would be allowed to recover stranded costs, and the PAPUC would be required to adopt a plan within six months to introduce retail wheeling and customer choice, with implementation to take place within five years.

(c) The Southeast - Efforts to restructure the electric industry in the Southeast have trailed other parts of the country. A combination of lower than average energy prices, a generally favorable economic climate and a desire to wait and see how other restructuring efforts perform have led regulators to take a cautious approach. Most of the Southeastern states have not take steps toward restructuring or have only begun informal discussions between stakeholders and commission staff.

North Carolina

The North Carolina Utilities Commission (NCUC) opened a docket to investigate the appropriateness of retail electric generation competition in North Carolina,⁹¹ but, after review and public comment concluded that it should not convene an adversarial proceeding for purposes of further investigation.⁹² The NCUC expressed concerns regarding a number of jurisdictional uncertainties and whether the North Carolina service territory statute prohibited retail wheeling. The NCUC decided to monitor developments in other states and the FERC and to continue to solicit comments on other restructuring issues. Recently, the NCUC has focused on issues such as reliability of service, obligation to serve, stranded costs and the cost of ancillary services.⁹³

Virginia

The Virginia State Corporation Commission (SCC) opened a docket in 1995 to receive public comment on the issues associated with restructuring the electric utility industry.⁹⁴ The SCC directed interested parties to address, among other things, the need for change in Virginia, the benefits of competition, stranded cost exposure, necessary legislation for retail wheeling experiments, corporate restructuring and flexible pricing proposals. In April, 1996, the Virginia legislature passed two bills providing for stranded cost recovery in certain limited contexts. Senate Bill 224 provides that the rates to any federal government facility that is a retail customer of an electric utility as of January 1, 1996, and ceases to be a retail customer of that utility because of its purchase of electricity from another supplier shall be subject to the jurisdiction of the SCC for the limited purpose of determining the proper rate to be charged by the federal government for stranded costs.⁹⁵ House Bill 586 restricts the ability of certain entities to

91. See *Re Retail Electric Generation Competition*, 159 PUR4th 206 (N.C.U.C. 1995).

92. See *Re Investigation of Retail Electric Generation Competition*, 162 PUR4th 280 (N.C.U.C. 1995).

93. *Re Retail Electric Generation Competition in North Carolina*, Docket No. E-100, Sub. 77 (N.C.U.C. April 3, 1996).

94. *Re Restructuring and Competition in the Electric Utility Industry*, 164 PUR4th 145 (Va. S.C.C. 1995).

95. 1996 Va. Acts Ch. 466 (to be codified at VA. CODE ANN. § 56-235.6).

exercise their powers of eminent domain to acquire electric facilities and authorizes the payment of stranded costs for any such acquisition.⁹⁶

(d) The Midwest - Significant steps are being taken toward restructuring the electric industry in the Midwest.

Indiana

In April, 1995, Indiana passed legislation that authorized the Indiana Utility Regulatory Commission (IURC) to "flexibly regulate and control the provision of energy services to the public in an increasingly competitive environment" and to "commence an orderly process to decline to exercise, in whole or in part, its jurisdiction over either the electric utility or the retail energy service of the energy utility, or both."⁹⁷ The IURC has not opened a formal commission investigation but continues to hold informal roundtable discussions.

Iowa

The Iowa Utilities Board (IUB) initiated an inquiry into competition in the electric industry.⁹⁸ Roundtable discussions have been held and the IUB Staff have reported no consensus among the participants as to whether full retail competition would benefit Iowa's consumers. Further research on issues such as stranded costs, energy efficiency, alternative energy production, and regulatory options was recommended. Discussions and workshops are expected to continue.

Minnesota

The Minnesota Public Utilities Commission (MPUC) on December 19, 1995, issued draft principles to guide electric utility restructuring in that State,⁹⁹ including: the availability of benefits to all customer classes; competitively neutral laws and regulations that do not favor particular customer classes; the unbundling of generation, transmission and distribution services and the elimination of cross-subsidies. In addition, the MPUC established a Wholesale Competition Working Group to examine methods to bring about wholesale competition.

96. 1996 Va. Acts Ch. 619 (to be codified at VA. CODE ANN. § 25-233). The bill provides that no corporation or State authority shall take by condemnation proceedings any property belonging to another corporation possessing the power of eminent domain unless the SCC so authorizes. The bill specifically requires the SCC, in giving its permission to such acquisition, to establish whether any payment for stranded investment is appropriate and to set the amount and conditions and payment for such stranded costs.

97. 1995 Ind. Legis. Serv. 108-1995 (West) (to be codified at IND. CODE § 8-1-2.5-1(6) and IND. CODE § 8-1-2.5-5(a)).

98. *Re Emerging Competition in the Electric Utility Industry*, 165 PUR4th 101 (Iowa U.B. 1995).

99. MPUC, *In the Matter of an Investigation into Structural and Regulatory Issues in the Electric Utility Industry*, Docket No. E-999/CI-95-135 (Dec. 19, 1995).

North Dakota

The North Dakota Public Service Commission (PSC) in 1996 opened an investigation into electric utility restructuring.¹⁰⁰ The PSC noted that, in light of the sweeping changes in the wholesale electric industry proposed by the FERC and the restructuring activities of the neighboring States, the PSC should obtain information about the coming changes in the electric industry. The PSC was particularly interested in the impact of competition on residential customers, including low-income and elderly residential rate-payers; the effect of change on the utilities' traditional obligation to serve; and the PSC's role in monitoring and encouraging wholesale and retail competition. The PSC set out specific questions for participants to address in upcoming workshops.

Ohio

On February 15, 1996, the Ohio Public Utilities Commission (OPUC) issued an order adopting guidelines for the provision of interruptible electric service which include retail wheeling of replacement electricity.¹⁰¹ The guidelines grew out of the Ohio Energy Strategy, begun by the OPUC in 1994, to discuss issues concerning competition. The Commission established a Roundtable on Competition in the Electric Industry in October 1994, and the guidelines for interruptible electric service were negotiated as part of the Roundtable process.

(e) The West and Southwest - California has led the Western States in moving toward greater competition within the electric industry. Perhaps the most novel procedural approach is the steering committee recently empaneled jointly by the governors of Idaho, Montana, Oregon and Washington to complete a "Comprehensive Review of the Northwest Energy System." The four governors plan to evaluate the institutional structure of the electric utility industry throughout the four-state region, taking into account the very significant role played by the Federal government through the Bonneville Power Administration (BPA).¹⁰² The BPA sells about fifty percent of the power consumed in the Northwest and owns and operates about eighty percent of the high voltage transmission system. Therefore, any meaningful restructuring in the region must address the role of the BPA, and may require Federal legislation to implement.

California

In December 1995, the California Public Utilities Commission (CPUC) issued an order providing guidelines for the restructuring of the

100. NDPUC, *Re Restructuring of the Electric Industry*, 167 PUR4th 243 (1996).

101. OPUC, *Re Interruptible Electric Service Guidelines*, 167 PUR4th 593 (1996).

102. See Memorandum from Jim Middaugh to "Interested Parties" announcing the schedule and agenda for the Steering Committee's first organizational meeting on January 4, 1996.

electric industry in the State.¹⁰³ In that order, the CPUC called for the creation of an ISO to control and operate the State's transmission grid. Direct retail access to alternative energy suppliers will be available in phases beginning January 1, 1998. The CPUC also called for a voluntary wholesale power pool that will function as an electric power clearinghouse by providing a market for generation with hourly or half-hourly prices for immediate or long-term users.

Arizona

In 1995, the Arizona Corporation Commission (ACC) established a work group to evaluate various models for electric industry restructuring.¹⁰⁴ The work group's report considered four alternative structures to accommodate retail wheeling and several regulatory changes to implement if retail wheeling is not adopted. Three of the alternatives assumed that retail wheeling could be implemented without any change in the ownership of utility assets. In one model, consumers would contract with the generator of their choice and obtain transmission, distribution, and ancillary services separately (Bilateral Contracts Model). In the second model, an ISO would be formed to operate and dispatch all transmission and generation facilities and create a spot market for electricity (Exclusive Poolco Model). The third model is a combination of the first two and would allow for long-term or short-term bilateral transactions and spot market sales at poolco prices. Transmission and distribution would be regulated and a poolco would be established to create the spot market (Combined Model). As a separate alternative, the work group considered requiring utilities to divest their generation and transmission facilities, granting all end-users access to the transmission system. The work group concluded that there was not yet sufficient information for the Commission to make a decision on the restructuring models.

Colorado

In Colorado, the PUC Staff issued a report addressing the issues related to retail wheeling.¹⁰⁵ Staff reported that whether retail wheeling can enhance a particular state's economic competitiveness depends on the state's relative costs of electricity and whether cheaper power is available to be transmitted to the region. Since the report finds that the price of electricity in Colorado is low compared with the rest of the country, it appears to imply that retail wheeling may not be necessary for Colorado.

103. CPUC, *Draft Policy Decision on Restructuring of California's Elec. Serv. Indus. and Reforming Regulation*, 95-12-065 (1995). The December 20, 1995 CPUC was discussed in the Spring 1996 report of the Committee on Electric Utility Regulation, *supra* note 1.

104. ACC, *Report of the Working Group on Retail Electric Competition*, No. U-0000-094-165 (Oct. 5, 1995).

105. CPUC, *Changes in the Electric Industry*, (Oct. 1994).

Nevada

In 1995, the Nevada legislature passed a resolution directing a legislative committee to study the impact of competition and retail wheeling on the generation, sale and transmission of electric energy and to report its recommendations to the next legislature in 1997.¹⁰⁶ The Nevada Public Service Commission responded by opening a series of dockets to collect information on a broad range of issues.¹⁰⁷ In addition, Nevada is watching closely what California and other States are doing on retail wheeling as it continues its own study of the issues. In October 1995, the Nevada PSC called for comments in its electric restructuring investigation docket to discuss California's poolco and Direct Access proposals as well as orders of the Massachusetts Department of Public Utilities (which developed broad principles for implementing restructuring and discussed several market structures),¹⁰⁸ and the Maryland Public Service Commission (which rejected retail wheeling)¹⁰⁹ on electric industry restructuring. Workshops continue, and the Nevada PSC has not yet indicated which market structure elements it would favor.

Idaho and Montana

Both the Idaho Public Utilities Commission (IPUC) and the Montana Public Service Commission (MPSC) have opened dockets to take comments on restructuring of the electric industry in their States.¹¹⁰ In addition, these States are participating in the Comprehensive Review of the Northwest Energy System.

Washington

In Washington, the Washington Utilities and Transportation Commission (WUTC) issued a Policy Statement¹¹¹ adopting board principles for evaluating any proposed electric restructuring in that state, including that non-economic by-pass and the inappropriate shifting of costs between or among customers do not constitute fair and efficient competition and that, although traditional monopoly regulation serves to protect consumers and utility shareholders, regulation cannot guarantee that utilities will be made entirely whole for generation or other costs that are determined through fair competition to be stranded or uneconomic.

106. Nev. Ass. Concurrent Res. No. 49, 68th Sess. (1995).

107. NPSC, *Re Commission Investigation into Issues Regarding Electric Restructuring*, No. 95-9022 (Sep. 28, 1995); NPSC, *Re Investigation on Regional and Federal Electric Generation and Transmission Issues*, No. 94-6024 (Apr. 17, 1995); NPSC, *Re Retail Wheeling Issues*, No. 94-11030 (Jan. 30, 1995).

108. 163 PUR4th 97 (1995).

109. 163 P.U.R.4th 131 (1995).

110. IPUC, *In the Matter of the Commission's Investigation into Changes Occurring in the Electric Industry*, No. GNR-E-96-1, Order No. 26312 (Jan. 30, 1996); MPSC, *Inquiry into the Restructuring of Montana's Electric Utility Industry*, No. D95.7.96 (Aug. 18, 1995).

111. WUTC, *Guiding Principles for Regulation in an Evolving Electricity Industry*, No. UE-940932 (Dec. 11, 1995).

Texas

In 1995, the Texas Legislature declared wholesale electric markets to be open to competition with the passage of the Public Utility Regulatory Act of 1995.¹¹² Because most of Texas is served by the wholly intrastate Electric Reliability Council of Texas (ERCOT), the state has jurisdiction over most wholesale and transmission transactions. The revised statute requires all utilities with transmission to provide open access on comparable terms and conditions to those afforded native load.¹¹³ Market pricing down to marginal cost levels is permitted for both wholesale and retail sales at the discretion of regulatory authorities, but any discount cannot be passed along to other classes or customer.¹¹⁴ Finally, the Legislature mandated PUC reports by the end of 1996, on both the scope of competition in the electric industry and stranded investment.¹¹⁵ The new PURA also authorized exempt wholesale generators and power marketers (including utility affiliates) to operate within ERCOT, where they had been in limbo because of state rather than federal jurisdiction.¹¹⁶ All of these entities may compete in the competitive solicitation of demand-side and supply-side resources that is the centerpiece of the mandated integrated planning process.¹¹⁷

In Project No. 14045, the Texas PUC developed a rule on transmission access and pricing. All ERCOT transmission investment will be compensated from a common pool of transmission charges.¹¹⁸ Basic industry restructuring is the subject of PUC hearings in Project No. 15000 with subsidiary consideration of stranded investment in Project 15001 and the scope of competition in Project 15002. The initial focus has been stranded investment, which the PUC terms "excess cost over market" or "ECOM." To provide data for its report to the Legislature, the Commission has ordered each utility to compute its own ECOM under a model developed by PUC staff. More general restructuring proposals are being considered in a series of workshops that began in December 1995, and are scheduled to continue throughout 1996.

112. PURA, 74th Leg., R.S., ch. 765, 1995 Tex. ALS 765, 1995 Tex. Gen. Laws 765, TEX. REV. CIV. STAT. ANN. art. 1446c-0, § 2.001(a) (West 1995).

113. See PURA, § 2.057(a).

114. See PURA, §§ 2.053 and 2.054.

115. See PURA, §§ 2.003 and 2.057(e).

116. PURA, §§ 2.053 and 2.054.

117. See PURA, § 2.051.

118. 16 TAC § 23.67. Charges are to be computed for all load, including transmission utilities' own customers. Seventy percent of the charge of the costs are to be recovered through a postage stamp rate, with the remaining thirty percent allocated to a distance sensitive price. All transmission services must be unbundled and no system may discriminate against provision of any of the unbundled portions by another entity. Non-utilities are allowed to provide ancillary services that do not require ownership for operation of jurisdictional utility facilities. 16 TAC § 23.70.

Louisiana

The City of New Orleans, which exercises independent regulatory authority, initiated an investigation of competition for electric utility service for the city under resolution R-96-13, adopted January 19, 1996.

New Mexico

Before its adjournment in February 1996, both Houses of the New Mexico Legislature passed a resolution from an interim study committee stating that neither the implementation of retail wheeling nor the restructuring of electric power industry is justified or in the best interest of the state and its residents at this time, and that monitoring and evaluation of the industry should be continued at the PUC.

2. Selected Industry Actions and Administrative Decisions

In June 1995, Puget Sound Power & Light Company in Washington filed to revise its tariffs to enable it to recover stranded costs. *Washington Util. and Transp. Comm'n v. Puget Sound Power & Light Co.*¹¹⁹ The proposed tariff would have enabled the utility to collect from any departing customer the present value of the utility's estimate of the amount by which its net revenues would decrease as a result of the firm load being removed from the utility's system. The proposal drew criticisms from industrial and commercial customers, and the WUTC suspended the tariff and set it for a hearing. Later, Puget withdrew the tariff and the proceeding was terminated without any discussion of the issues raised by the proposal.¹²⁰

In Texas, self generators have been seeking transmission access to other sites of the same or affiliated companies. The PUC has declined to require such transmission service, so Gulf Coast Power Connect filed certificate applications to build lines connecting two sites of AMOCO (No. 13932) and Exxon (No. 13943), respectively. Power Connect would be a transmission-only utility, providing access to electric alternatives that were lawful, but which existing utilities were unwilling or unable to provide. Legal challenges by other utilities were rejected in a preliminary order.¹²¹ No. 13932 was withdrawn when the customer reached an accommodation with the local utility. In No. 13943, the Commissioners stated the open meeting considering the proposal for decision that they would not support a line connecting facilities of only a single company. They then allowed Power Connect to withdraw the application without prejudice to a further application involving more than one customer.

The Washington Water Power Company recently filed new tariffs before the Washington UTC and the Idaho PUC which would provide retail wheeling for large industrial customers. The experimental Direct Access and Delivery Service Tariffs would permit Water Power's largest

119. WUTC, No. UE-950570 (June 5, 1995).

120. WUTC, ORDER EFFECTING WITHDRAWAL OF TARIFF REVISIONS AND DISMISSING COMPLAINT AND ORDER SUSPENDING TARIFF REVISIONS, No. UE-950570 (Aug. 23, 1995).

121. 20 Tex. P.U.C. Bull. 1836, 164 PUR4th 286 (1995).

industrial customers to take as much as one-third of their load off of Water Power. Approximately 38 MW is available for service by alternative suppliers. Customers would still be required to pay approximately 16.2 mills/kWh for transmission, distribution and ancillary services, but would be able to seek alternative generation suppliers.

Last year the Massachusetts Institute of Technology (MIT), Cambridge Electric Light Company's largest customer, began generating its own electricity and left Cambridge Electric's system. On September 28, 1995, the MADPU issued a decision permitting Cambridge to recover seventy-five percent of its stranded costs associated with previously serving MIT's 20-MW load (amounting to \$1.3 million a year) for an indefinite period. *Re Cambridge Electric Light Company*¹²² The MADPU stated that allowing Cambridge Electric's stranded cost recovery would not set a precedent on recovery of stranded investments. Various interested parties, however, remain skeptical. MIT appealed the case to the FERC, which ruled that the customer transition charge, which applies only to MIT's cogeneration plant, is not discriminatory under the Public Utility Regulatory Policies Act of 1978. *Massachusetts Institute of Technology*¹²³ The FERC did not rule on whether the customer transition charge was properly calculated, leaving that issue to be resolved by the MADPU and the state courts. MIT has stated that it would appeal the decision to the Massachusetts Supreme Judicial Court. MIT is also appealing the level of stranded costs it is required to pay, claiming that Cambridge's estimate of stranded costs were based on inflated revenue figures that are at least three times what Cambridge now states in an affidavit to be its maximum revenue.

On August 1, 1994, Freedom Energy, L.L.C. (Freedom) sought permission from the NHPUC to compete on a limited basis with PSNH, New Hampshire's largest utility, by purchasing electric power at wholesale and reselling it at retail to end-users throughout the PSNH system. *Re Freedom Electric Power Company*,¹²⁴ The NHPUC ordered briefing and a hearing date on initial issues, and allowed seventeen parties to intervene.¹²⁵ The NHPUC stated that Freedom's proposed undertaking would qualify it as a public utility subject to the jurisdiction of the NHPUC, and that it would grant Freedom's petition only if it is in the public interest for Freedom to do business in the state. A threshold issue in deciding the public interest question was PSNH's rights, if any, to exclusivity within its franchise territory.¹²⁶ The NHPUC ruled that utilities in the state do not have exclusive franchises as a matter of law, and found on rehearing that the NHPUC may allow competitive providers of electric service if it is in the public interest.¹²⁷ The NHPUC will address, in the next phase of the proceeding, the details of Freedom's proposed operations and whether they are in the pub-

122. MADPU, 164 PUR4th 69 (September 28, 1995).

123. 74 F.E.R.C. ¶61,221 (1996).

124. 156 PUR4th 461 (1994).

125. NHPUC, *Re Freedom Electric Power Company*, No. 21,419, DE 94-163 (Nov. 8, 1994).

126. *See Id.*

127. NHPUC, *Re Freedom Electric Company*, No. 21,776, DE 94-163 (August 4, 1995).

lic interest.¹²⁸ PSNH appealed the NHPUC's ruling on franchise exclusivity to the New Hampshire Supreme Court on September 1, 1995. In its May 13, 1996 decision, the Court rejected PSNH's arguments and stated that the language of New Hampshire statute RSA 374:26 explicitly requires that the NHPUC permit competition among public utilities whenever it is in the public interest to do so, and that electricity utility franchises thus are not exclusive as a matter of law.¹²⁹ The Court did not rule on the desirability of retail competition or on the issue of whether utilities should recover stranded costs.

Sithe Energies recently prevailed over NIMO in its conflict over the provision of service to the Alca Rolled Products facility in upstate New York. *In the Matter of Niagara Mohawk Power Corporation*,¹³⁰ Sithe received a Certificate of Public Convenience and Necessity from the NYPSC, which NIMO challenged in the Appellate Division of the New York Supreme Court. The Court upheld the NYPSC's decision, but also endorsed its imposition of a "competitive equalization fee" of \$19.6 million which Sithe must pay to NIMO as compensation for NIMO's loss of its largest customer.¹³¹

D. Federal Legislative Proposals

As the 104th Congress headed into the 1996 Summer campaign season, no consensus had been developed for a federal legislative approach to restructuring the U.S. electric markets. However, the introduction during 1995 and 1996 of bills that include provisions to reform Section 210 of the Public Utility Regulatory Policies Act of 1978¹³² promote competition down to the retail level, assure full recovery of stranded costs and preserve a place for renewable power generation sources, as well as a bill to repeal the Public Utility Holding Company Act of 1935¹³³ raised the possibility that comprehensive legislation directly affecting participants in the independent power marketplace will be given serious Congressional consideration in the future.

1. S. 708 and H.R. 2562

In 1995, two bills were introduced calling for repeal of Section 210 of PURPA. The first, designated S. 708 and titled the Electric Utility Ratepayer Act, was introduced April 6, 1995 by Sen. Nickles (R-OK). S. 708 would repeal Section 210 and includes a savings clause that states that nothing in the bill abrogates any existing contract. S. 708 was referred to

128. NHPUC, *Re Freedom Electric Company*, No. 21,683, DE 94-163 (June 6, 1995). The NHPUC also required Freedom to obtain interpretation of certain issues related to whether Freedom could obtain a transmission order under § 211 and 212 of the Federal Power Act from the FERC. Freedom has petitioned the FERC for such a determination.

129. *See In re Public Service Company of New Hampshire*, 1996 LEXIS 41 (N.H. 1996).

130. 1996 N.Y. App. Div. LEXIS 1524.

131. *See Id.* at 14-15.

132. *See* 16 U.S.C. § 824a-3.

133. 15 U.S.C. § 79 *et seq.*, as amended.

the Subcommittee on Energy Production and Regulation of the Senate Committee on Energy and Natural Resources, which held hearings in June 1995.

The second bill was introduced as H.R. 2562 by Rep. Stearns (R-FL) on October 31, 1995 and is titled the Ratepayer Protection Act. H.R. 2562 was referred to the Subcommittee on Energy and Power of the House Committee on Commerce. To provide more protection for existing contracts, the Stearns bill would not repeal Section 210 outright but instead provides that Section 210 would not apply to any facility placed in service after enactment (except those for which a power purchase agreement entered into pursuant to Section 210 was in effect on the date of introduction) and further that, after the date of introduction, no electric utility would be required to enter into a new contract or obligation to purchase or sell electric energy pursuant to Section 210. This bill also provides that it would not affect the rights or remedies of any party to existing contracts to buy or sell power from qualifying facilities.

2. S. 1526

The Electricity Competition Act of 1996, introduced as S. 1526 by Sen Johnston (D-LA) on January 25, 1996, presents a more comprehensive approach than the Nickles and Stearns bills by combining PURPA reform with the promotion of effective competition at both the wholesale and retail levels. The Johnston bill contains provisions that effectively would repeal Section 210 on a prospective basis similar to the Stearns bill, although with a more comprehensive savings clause protecting existing contracts. The bill also contains a structure for implementing and enforcing retail customer choice in the states by January 1, 2010. It would require state regulatory authorities and unregulated retail electric utilities, within six months after enactment, to initiate proceedings to examine and consider the following competitive options:

- (a) requirements that establish a competitive market meeting certain minimum standards for utility procurement of new purchased power and new generation capacity;
- (b) a retail access plan requiring nondiscriminatory and unbundled local distribution service and retail customer choice by January 1, 2002; and
- (c) an alternative plan ensuring that: (i) any retail electric utility may not unduly discriminate in favor of its own or its affiliate's sources of generation supply or otherwise engage in self-dealing that could result in above market prices to consumers; and (ii) any above market costs of renewable electric generation are allocated on a nondiscriminatory basis that does not result in cross-subsidization among customer classes.

S. 1526 further would require each state regulatory authority and unregulated retail utility, within eighteen months after enactment, to select a competitive option based on such proceedings, render a decision by rule or order adopting the option, and begin implementation within sixty days

after such decision is rendered.¹³⁴ Judicial review and enforcement provisions for the competitive options selection process also are included in S. 1526. The bill also would amend the Federal Power Act to grant the FERC significant new regulatory jurisdiction over retail wheeling and stranded costs.¹³⁵ S. 1526 was referred to the Senate Subcommittee on Energy Production and Regulation, which held hearings in March 1996.

3. H.R. 2929

Another attempt at comprehensive restructuring legislation, titled the Electric Power Competition Act of 1996, was introduced by Rep. Markey (D-MA) on February 1, 1996. The Markey bill, designated H.R. 2929, would amend PURPA by adding new Sections 214 and 215 to Title II and a new subsection F — Standards of Competition for Electric Utilities — to Title I, containing new Sections 151, 152 and 153. The Markey bill also represents a significant federal effort to mandate competition (as well as divestiture) at the state level, but employs a structure that would condition relief from Section 210 upon certification by the state regulator that certain minimum standards for competition and preservation of opportunities for renewable resources have been met.

New Section 214 would suspend the mandatory purchase requirement of Section 210 for any electric utility that has received a Certification of Competition from a state regulatory authority and includes a savings clause for existing contracts similar to that in the Johnston bill. New section 151 would require the FERC to establish, by rule, criteria for such certification by a state regulatory authority that a state regulated electric utility has met:

- (a) specified minimum certification requirements (contained in new Section 153), and either
- (b) a retail competition standard (contained in new Section 152(a)) under which: (i) the utility must permit retail customer choice; (ii) the opportunity to build, own and operate new generation capacity approved by the state regulatory authority in the utility's service area is open to competition; and (iii) the utility does not gain an advantage over other competitors by virtue of its status as a regulated buyer or seller of electricity in its service area; or
- (c) a divestiture standard (contained in new Section 152(b)) under which a state regulated electric utility that is an integrated electric utility owning or

134. Exemptions from the competitive option selection process would be available for any state regulatory authority or unregulated retail electric utility that has adopted minimum requirements for competitive electricity procurement or a retail access plan requiring nondiscriminatory and unbundled local distribution services so that retail customer choice among competing electric energy suppliers would be available by January 1, 2004 and for any State regulated retail utility that has filed a tariff, approved by its state regulatory authority, for such services and for retail customer choice.

135. FPA Section 212(h) would be amended to authorize the FERC to order, or condition orders upon, the transmission of electric energy to an ultimate consumer if the delivery thereof would be accomplished through the provision of unbundled local distribution services. New FPA Section 215 would affirm states' authority to order retail wheeling. New FPA Section 216 would authorize the FERC to provide for recovery of stranded costs under specified circumstances and would expand Sections 205 and 206 to authorize the FERC to make rates for unbundled local distribution service solely as necessary to permit full recovery of stranded costs. New Section 217 would prohibit an electric utility from selling electric energy to an ultimate consumer by means of the unbundled local distribution service of another utility unless the selling utility itself provides such service.

controlling a monopoly distribution franchise, monopoly transmission franchise or both, has: (i) divested itself of all existing generation facilities and is prohibited by state law from owning or controlling any generation facilities so long as it has the monopoly distribution franchise or transmission facilities; and (ii) in the case of a utility that owns or controls transmission facilities, has adopted open access transmission tariffs that have been approved as just, reasonable and not unduly preferential.

The state regulatory authority could withdraw its certification that the retail competition standard has been met if it finds that a utility affiliate is competing unfairly by selling below market value or that the utility or an affiliate has discriminatory access to any asset, service or information that would be helpful to a competitor where the access is attributable to the utility's status as a regulated, integrated monopoly or the asset or information is an essential facility that is not economically duplicable by a competitor.

In order to encourage renewables, new FPA Section 215 would assure the states' authority to favor or disfavor particular types of generation for purposes of avoided cost determination and to segment competitive bidding by generation technology or groups of generation technologies. The bill also seeks to ensure that remedies for anti-competitive abuses would be available by providing that utilities exercising monopoly functions under state regulation may not use the "state action" doctrine of antitrust jurisprudence as a defense against charges of anti-competitive behavior in unregulated generation markets. H.R. 2929 was referred to the House Subcommittee on Energy and Power, in addition to the Committee on the Judiciary.

4. S. 1317

None of the bills discussed above address reforms of PUHCA, which had been the subject of a 1995 report by the SEC Staff¹³⁶ recommending that PUHCA be repealed and replaced by limited grants of ratemaking and investigative authority to the FERC and the states. On October 12, 1995, Sen. D'Amato (R-NY) introduced S. 1317, titled the Public Utility Holding Company Act of 1995, for that purpose. S. 1317 was referred to the Senate Committee on Banking, Housing and Urban Affairs. The D'Amato bill would repeal PUHCA one year after enactment of the bill. The FERC and the states are granted access to the books and records of all companies in a holding company system and the bill provides for federal oversight of affiliate transactions to the extent that such activities affect rates. Persons previously exempted from regulation under PUHCA, however, would be exempt from these new provisions, subject to termination of the exemption if the FERC determines that termination would be necessary for regulating the rates of a public utility company and for the protection of consumers. The FERC also would have authority to exempt other persons or transactions determined by the FERC, after consultation with affected state commissions, not to be relevant to the rates of a public utility company. The

136. *Id.*

bill also would transfer to the FERC all SEC resources that relate primarily to the functions vested in the FERC under the bill. Finally, the bill expresses the sense of the Congress that all personnel of the SEC's Office of Public Utility Regulation should be transferred to the FERC.

II. PURPA ENFORCEMENT¹³⁷ AND QF CONTRACT SANCTITY

A. FERC Action on QF Contract Challenges

Several principles have emerged from the FERC's seemingly disparate decisions in 1995 and early 1996 regarding PURPA-based challenges to existing QF contracts and state actions implementing PURPA or otherwise affecting QFs. The FERC declared states without authority to mandate above-avoided cost purchases and overturned as violative of PURPA a state procedure for administrative determination of avoided costs.¹³⁸ The Commission, however, staunchly upheld the sanctity of existing QF contracts and QFs' rights to rely upon avoided cost projections.¹³⁹ The FERC also made clear that it will turn back challenges to existing QF contracts if state administrative remedies have not been exhausted¹⁴⁰ or if QF contract rates purportedly exceed avoided costs as a result of a state law that is unrelated to ratemaking, e.g., a gas tax on QFs.¹⁴¹

1. Connecticut Light and Power Company

In *Connecticut Light and Power Company*,¹⁴² the FERC issued a declaratory order ruling that a Connecticut statute that regulated the rates to be paid by utilities to power sellers was preempted by PURPA as it applied to sales by a QF. The Connecticut DPUC had directed Connecticut Light and Power Company to purchase electricity generated by a municipally-owned QF at rates established under Connecticut Municipal Rate Statute. In granting the utility's petition for a declaratory order, the FERC asserted its jurisdiction over rates for QF sales at wholesale, noting that states may set the per unit charges only in accordance with the FERC's

137. For a discussion of *Industrial Cogenerators v. FERC*, 47 F.3d 1231 (D.C. Cir 1995) (the court lacks jurisdiction to review a FERC order vacating a declaratory order denying a QF petition for enforcement under PURPA). See Spring 1996 Report of the Committee on Electric Utility Regulation, 17 ENERGY L.J. 245.

138. See, e.g., *Connecticut Light & Power Company*, 70 F.E.R.C. ¶ 61,012, reconsideration denied, 71 F.E.R.C. ¶ 61,035 (1995), appeal docketed sub nom., *Niagara Mohawk Power Corp. v. FERC*, Docket No. 95-1222 (D.C. Cir. April 24, 1995); *Southern California Edison Company and San Diego Gas & Electric Company*, 70 F.E.R.C. ¶ 61,215 (1995), order on reconsideration, 71 F.E.R.C. ¶ 61,269 (1995).

139. See, e.g., *New York State Electric & Gas Corporation*, 71 F.E.R.C. ¶ 61,027, rehearing denied, 72 F.E.R.C. ¶ 61,067 (1995) *West Penn Power Company*, 71 F.E.R.C. ¶ 61,153 (1995); *Metropolitan Edison Company*, 72 F.E.R.C. ¶ 61,015 (1995), order granting clarification and denying reconsideration, 72 F.E.R.C. ¶ 61,268 (1995); *Jersey Central Power & Light Company*, 73 F.E.R.C. ¶ 61,092 (1995), rehearing denied, 73 F.E.R.C. ¶ 61,333 (1995).

140. See, e.g., *Metropolitan Edison Company*, 72 F.E.R.C. ¶ 61,015 (1995), order granting clarification and denying reconsideration, 72 F.E.R.C. ¶ 61,269 (1995).

141. See *Niagara Mohawk Power Corporation*, 74 F.E.R.C. ¶ 61,179 (1996).

142. 70 F.E.R.C. ¶ 61,012.

regulations. Reviewing Section 210(b) of PURPA, its implementing regulations, and the regulations preamble, the Commission found that states had no independent authority to set rates for QF sales in excess of avoided costs. Insofar as the Connecticut statute would require such rates, the statute was preempted.¹⁴³

In *Connecticut Light and Power Company*, the FERC also announced its refusal to abrogate existing QF contracts based on claims that the contract rate exceeds avoided costs, except in narrowly defined instances. Challenges to existing QF contracts will not be entertained unless the avoided cost issue was previously raised, stated the Commission. "The appropriate time to challenge a state-imposed rate is up to or at the time the contract is signed."¹⁴⁴

2. Southern California Edison Company and San Diego Gas Electric Company

In *Southern California Edison Company and San Diego Gas Electric Company*, Edison and San Diego sought review of orders of the California Public Utilities Commission directing the utilities to sign long-term contracts with QFs at rates the utilities claimed exceeded their avoided costs. The CPUC defended its avoided cost determination, arguing that it was a small component of a comprehensive integrated resource plan designed to favor particular generation technologies and as such, comported with PURPA's underlying goal of promoting a reasonably priced, diverse national energy system.¹⁴⁵ The FERC found that the CPUC's avoided cost determination violated PURPA. The FERC reasoned that Sections 210(b) and 210(d) of PURPA¹⁴⁶ require state determinations of avoided cost to take into account all potential sources of capacity and that the California program improperly limited itself to certain types of QFs.¹⁴⁷ While the FERC acknowledged California's prerogative under state law to diversify its generation mix to meet environmental goals, it emphasized that any such resource planning programs must comply with the avoided cost requirements of PURPA.¹⁴⁸

As relief, the FERC recommended that the CPUC stay its order directing Edison and San Diego to enter into QF contracts pending the outcome of further state administrative procedures in accordance with PURPA. Citing *Connecticut Light and Power*, the FERC stated it would refuse to entertain requests to invalidate existing contracts in which avoided costs were established pursuant to a state bidding procedure that did not allow all-source bidding unless such issue had been raised and is pending or is raised in a timely appeal of a state decision.¹⁴⁹

143. *Id.* at 61,027.

144. *Id.* at 61,029.

145. 70 F.E.R.C. ¶ 61,215 at 61,668, *order on reconsideration*, 71 F.E.R.C. ¶ 61,269 (1995).

146. 16 U.S.C. § 824a-3(b),(d) (1994).

147. 70 F.E.R.C. ¶ 61,215 at 61,677.

148. *Id.* at 61,676.

149. *Id.* at 61,678.

In contrast to its rulings in *Connecticut Light and Power* and *Southern California Edison*, in *CGE Fulton, LLC*,¹⁵⁰ the FERC determined that an Illinois statute establishing rates for utility purchases from solid waste QFs withstood scrutiny under PURPA. The Illinois statute at issue required utilities to pay the retail rate charged to local government agencies for power purchased from QF solid waste facilities. The statute further provided that utilities would receive a monthly tax credit designed to reduce the overall rate paid to the avoided cost. Because taxpayers rather than the utility or its ratepayers ultimately paid amounts in excess of avoided costs, the FERC found the Illinois scheme consistent with PURPA.

3. New York State Electric and Gas Corporation and Others

The FERC issued a series of decisions following its ruling in *Connecticut Light and Power* in which it declined to disturb existing QF contracts based on claims that contract rates exceeded avoided costs in violation of Section 210 of PURPA. In the first of these, *New York State Electric and Gas Corporation (NYSEG)*,¹⁵¹ the Commission denied NYSEG's petition for a declaratory order and request to modify the rates contained in contracts with two QFs. NYSEG argued that its payments to the QFs exceeded avoided costs over the life of the contract due to overstated projections of avoided costs, and therefore violate Section 210 of PURPA.

The FERC in *New York State Electric & Gas* ruled that its regulations implementing PURPA allow QF rates to be based on estimates of avoided costs calculated at the time its obligation was incurred, even if the resulting rates subsequently differ from the utility's avoided cost at the time of delivery. The Commission distinguished the case from *Connecticut Light and Power*, stating that the subject contracts reflected State implementation consistent with PURPA and its regulations, unlike the rates in *CL&P* which may have exceeded avoided costs at the time the rates were imposed. The Commission also found that its policy against invalidating contracts for which a PURPA-based challenge was not timely raised and is not still pending provided an independent basis for denying NYSEG's petition. Recognizing that the QFs and their investors proceeded under the reasonable belief that their contracts were lawful and binding under PURPA once the deadline for timely challenges had passed, the Commission analogized the situation to utilities' claims that "stranded costs" are the product of settled and reasonable investor expectations, and therefore should be recoverable. The Commission also noted that industry participants and investors will rely more heavily on contractual, rather than regulatory, protections as wholesale markets become more competitive, and that respecting contracts thus becomes increasingly important.

The FERC relied on its ruling in the *New York State Electric and Gas* in three subsequent proceedings. In *West Penn Power Company*,¹⁵² the

150. *CGE Fulton, L.L.C.*, 70 F.E.R.C. ¶ 61,290, *reh'g denied*, 71 F.E.R.C. ¶ 61,232 (1995).

151. 71 F.E.R.C. ¶ 61,027, *reh'g denied*, 72 F.E.R.C. ¶ 61,067 (1995).

152. *West Penn Power Co.*, 71 F.E.R.C. ¶ 61,153 (1995).

FERC denied the utility's request to abrogate an existing QF contract because the contract rates exceeded West Penn's avoided costs, even though the QF had neither been financed or built. The FERC emphasized that the only appropriate time to challenge QF contract rates was at the time of contract execution. Similarly, in *Jersey Central Power and Light Company*¹⁵³ and *Metropolitan Edison Company*,¹⁵⁴ the FERC upheld existing QF contracts containing rates that had not been timely challenged.¹⁵⁵

Despite its refusal to disturb existing QF contracts, the FERC has recognized "the concern of utilities that find themselves with legally binding QF contracts containing rates currently above avoided costs." Thus, the FERC has urged utilities to buy-out or buy-down unprofitable QF contracts, noting that the FERC would allow recovery of a *pro rata* share of prudently incurred buy-out or buy-down costs in the utility's wholesale rates.¹⁵⁶

The FERC has indicated that its enforcement authority under PURPA does not extend to non-ratemaking activity that may have the effect of raising QF contract rates above avoided cost. In *Niagara Mohawk Power Corporation*,¹⁵⁷ the FERC rejected Niagara Mohawk's claim that a New York state tax imposed on QFs for purchases of out-of-state natural gas and reimbursed through payments by electric utilities purchasing QF facility power violated PURPA because the reimbursement payments increased the cost of QF power above the utility's avoided costs. The FERC concluded that the state tax, "in design and practice, had no effect on the revenues ultimately received by QFs or the charges paid for QF power" because utilities were permitted to pass on reimbursement payments to non-residential customers through a fuel clause adjustment mechanism.¹⁵⁸ Moreover, the FERC emphasized that the New York tax "has nothing to do with the setting of QF rates," but rather, is a mechanism under which QFs and utilities pass along a tax on out of state natural gas purchases to non-residential electric consumers¹⁵⁹ and thus, was beyond the purview of the FERC's general enforcement authority under section 210(h) of PURPA.¹⁶⁰

153. *Jersey Central Power and Light Co.*, 73 F.E.R.C. ¶ 61,092, *rehearing denied*, 73 F.E.R.C. ¶ 61,333 (1995). The power purchase contract at issue in JCP&L was the subject of a ruling by the U.S. Court of Appeals for the Third Circuit in *Freehold Cogeneration Associates, L.P. v. New Jersey Board of Regulatory Commissions*, 44 F.3d 1178 (3d Cir. 1995), *cert denied*, *Jersey Central Power and Light Co. v. Freehold Cogeneration Assoc.*, 116 S.Ct. 68 (1995).

154. *Metropolitan Edison Co.*, 72 F.E.R.C. ¶ 61,015, *order granting clarification and denying reconsideration*, 72 F.E.R.C. ¶ 61,269 (1995).

155. In *Metropolitan Edison*, the Commission also declined to take action with respect to two other QF contracts that had been timely challenged before the Pennsylvania Public Commission and were the subject of pending state review. 72 F.E.R.C. ¶ 61,015 at 61,051.

156. See, *NYSEG, order denying reconsideration, Cal Ban Corporation*, 72 F.E.R.C. ¶ 61,068 at 61,341; *West Penn*, 71 F.E.R.C. ¶ 61,153; *Jersey Central Power and Light*, 73 F.E.R.C. ¶ 61,333.

157. 74 F.E.R.C. ¶ 61,179 (1996).

158. *Id.* at 61,629.

159. *Id.*

160. 16 U.S.C. § 824a-3(g).

B. Judicial Action on QF Contract Disputes

1. PURPA-Based Claims

The U.S. Court of Appeals for the Third Circuit in *Freehold Cogeneration Associates, L.P. v. Board of Regulatory Commissioners of the State of New Jersey*¹⁶¹ ruled that the New Jersey Board of Regulatory Commissions is preempted by PURPA from requiring the modification of a previously approved power purchase agreement. Pursuant to a BRC directive that utilities notify it of any power supply contracts that were no longer economically beneficial, JCP&L notified the BRC in May 1993, that its contract with Freehold fell into that category due to decreases in the cost of obtaining power. In January 1994, after JCP&L had tried unsuccessfully to buy out the contract, the BRC directed the parties to renegotiate the contract rates, or alternatively, to negotiate a buy-out of the contract. Freehold filed an action in district court seeking a judgment declaring that the BRC's order was preempted by PURPA and a court order enjoining the enforcement of the order. Freehold appealed the district court's grant of JCP&L's motion to dismiss. The Court of Appeals ruled that the BRC's attempt either to modify the contract or revoke its approval is utility-type regulation from which Freehold is exempted pursuant to Section 210(e) of PURPA.¹⁶² The court cited two recent cases in support of its conclusion, *Independent Energy Producers Ass'n. v. California Public Utilities Commission*¹⁶³ and *Smith Cogeneration, Inc. v. Oklahoma Corporation Commission*.¹⁶⁴

In *Independent Energy Producers Ass'n., Inc. v. California Public Utilities Commission*,¹⁶⁵ the U.S. Court of Appeals for the Ninth Circuit held that a CPUC order authorizing utilities to monitor QFs' compliance with the FERC's operating and efficiency standards was preempted by PURPA. Under the program adopted by the CPUC in 1991, if a utility determined that a QF was not in compliance with the federal standards, the utility was authorized to suspend payment of the avoided cost rate specified in the standard offer contract and to substitute an "alternative" avoided cost rate equal to 80% of the utility's avoided cost for short-term power. The program also provided for retroactive application of this alternative avoided cost rate scheme and permitted utilities to suspend parallel operation with any "non-complying" QF under certain circumstances. The Association

161. *Supra* note 153.

162. Section 210(e) requires the FERC to prescribe rules exempting QFs "from state laws and regulations respecting the rates, or respecting the financial or organizational regulation of electric utilities, or from any construction of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production."

163. *Independent Energy Producers Ass'n v. California Public Utilities Commission*, 36 F.3d 848 (N.D. Ca. 1995)(the FERC regulations "nowhere contemplate a role for the state in setting QF standards or determining QF status").

164. *Smith Cogeneration, Inc. v. Oklahoma Corporation Commission*, 863 P.2d 1227 (Okla. 1993) ("PURPA and FERC regulations seek to prevent reconsideration of [long-term contracts with established estimated costs]. The legislative history . . . confirms that Congress did not intend to impose traditional utility-type ratemaking concepts on sales by qualifying facilities to utilities")

165. *Supra* note 163.

brought an action in district court seeking to enjoin the CPUC from implementing the program. The Court of Appeals reversed the district court's grant of summary judgment for the CPUC, finding that the FERC regulations contemplate no role for the state in setting QF standards or determining QF status. Because the authority to make QF status determinations resides exclusively with the FERC, the Court concluded that the CPUC program was preempted by federal law. The Court also found that the CPUC program violated PURPA by substituting for any "non-complying" QF the specified "alternative" avoided cost, thus denying QFs the full avoided cost rate to which they are entitled.

2. Contract Law Claims

In *RW Power Partners, L.P. v. Virginia Electric and Power Company*,¹⁶⁶ a QF obtained a federal district court ruling that the utility had wrongfully terminated a power purchase agreement based on the QF's failure to maintain a letter of credit in accordance with the contract. The court ruled that under state law, the failure to have the letter of credit in place as required was not a material breach of contract. In addition, the court held that a provision in the agreement allowing cancellation if the QF failed to perform any of its obligations thereunder did not abrogate the common-law principle that termination of the contract for immaterial breach is improper. Thus, the QF's failure to maintain the letter of credit did not entitle the utility to terminate the Agreement.

The U. S. Court of Appeals for the Second Circuit in *Fulton Cogeneration Associates v. Niagara Mohawk Power Corp.*¹⁶⁷ affirmed a district court holding that the capacity and energy estimates contained in a power purchase agreement between the parties did not create absolute maximums limiting NIMO's obligation to purchase electricity. NIMO had taken the position that it was not obligated to pay the contract rate for electricity produced above the levels approximated in a whereas clause of the contract, and Fulton had commenced a breach of contract action. The Court of Appeals found that the interpretation of the estimates was controlled by *Philadelphia Corp. v. Niagara Mohawk Power Corp.*,¹⁶⁸ which the district court had relied upon in part in granting Fulton's motion for summary judgment, and affirmed the district court's holding that the contract obligates NiMo to purchase and Fulton to sell electricity in quantities not unreasonably disproportionate to the stated estimates.

166. *RW Power Partners, L.P. v. Virginia Electric and Power Co.*, 899 F. Supp. 1490 (E.D. Va. 1995).

167. *Fulton Cogeneration Associates v. Niagara Mohawk Power Corp.*, 1996 U. S. App. LEXIS 11351 (2d Cir. May 15, 1996) (the Court of Appeals reversed the district court's grant of summary judgment to Fulton and remanded for a factual determination whether the capacity variances of the Fulton plant were commercially reasonable, and affirmed all other aspects of the district court's decision).

168. *Philadelphia Corp. v. Niagara Mohawk Power Corp.*, 207 A.D.2d 176, 177 (3d Dept. 1995) (in a breach of contract action involving agreements defining the electricity to be sold "in terms of approximate capacity and approximate annual production," the court found the estimates stated in the contracts were targets, not maximums or minimums).

C. QF Certification Activity

1. Ownership Interest

In *General Electric Capital Corporation*,¹⁶⁹ the FERC, acting on GE Capital's request for a declaratory order, clarified that an entity with an ownership interest in a foreign utility holding company also could own or acquire an interest in a QF without violating the QF ownership requirements of the FPA, as amended by PURPA, or the FERC's regulations. The FERC explained that Sections 3(17)(C)(ii) and 3(18)(B)(ii) of the FPA, which preclude ownership of a QF by a person "primarily engaged in the generation or sale of electric power," did not apply to a FUCO's extraterritorial activities.¹⁷⁰

In *Brooklyn Navy Yard Cogeneration Partners, L.P.*,¹⁷¹ the FERC denied QF status to the 315-MW Brooklyn Navy Yard cogeneration project. The FERC agreed with Consolidated Edison that the facility's ownership arrangements failed to meet the ownership requirements of the FERC's regulations, which limit a utility's stake in a QF to no more than a fifty percent (50%) equity interest.¹⁷² Although SCE Corporation, a utility holding company, held only a fifty percent (50%) partnership interest in the Brooklyn facility, under the terms of its financing agreement with Brooklyn, SCE Corporation was entitled to control Brooklyn's management committee whenever the partnership had a minimum outstanding balance due on its loan from SCE Corporation. The FERC concluded this financing arrangement effectively gave SCE Corporation the ability to exercise more than fifty percent (50%) of the control over the facility, and thus, the facility failed to satisfy the FERC's QF ownership requirements.

2. Waiver Policy

In *New Charleston Power LLP v. FERC*,¹⁷³ the Court of Appeals for the D.C. Circuit upheld the FERC refusal to grant a cow manure burning small power production facility a waiver of its rule that no more than twenty-five percent of a QF's total energy input be fossil fuel. The owner sought a waiver while repairs, necessitated by heavy rains, were made to the facility. The FERC denied the waiver, finding that given the facility's troubled operational history, there was no assurance that it would begin operating after the waiver period. The court held that the FERC had acted within its discretion in denying the waiver, noting that "the Commission properly refused to bend its rules and shift the risk of the [facility's] non-performance" from its investors to ratepayers.¹⁷⁴

169. *General Electric Capital Corporation*, 70 F.E.R.C. ¶ 61,141 (1995).

170. *Id.* at 61,425.

171. 74 F.E.R.C. ¶ 61,015 (1996).

172. 18 C.F.R. § 292.206(b) (1996).

173. 56 F.3d 1430 (D.C. Cir. 1995).

174. 56 F.3d at 1433.

3. QF Rates Following Non-Compliance With Certification Requirements

*Medina Power Company*¹⁷⁵ involved a cogeneration facility that was self-certified as a QF, but admittedly did not meet the technical requirements for certification due to its failure to secure a steam host. The power sales contract between Niagara Mohawk and Medina Power provided that Medina was required to seek approval of rates set fifteen percent below contract rates (eighty-five percent default rate) if it failed to meet the FERC's QF requirements and that if the FERC authorized a higher rate, Niagara Mohawk could terminate the agreement. Acknowledging that it had not and would not be able to meet the requirements for QF status, Medina sought approval of the rate at fifteen percent below contract rates, as required by its contract with Niagara Mohawk, as a market-based rate. Niagara Mohawk protested, arguing that Medina could not meet the requirements for market-based rate authorization because there was no arms-length bargaining and thus, the agreement did not result from market forces. The FERC agreed, finding that since Medina's contract with Niagara Mohawk was executed under the mandatory purchase requirements of PURPA, "no aspect of the contract can be reasonably considered the product of market forces in the circumstances."¹⁷⁶ Accordingly, the FERC ordered Medina to submit cost-based data to support its rate and set the matter for hearing.

III. MARKET POWER ANALYSIS FOR MARKET-BASED RATE APPROVAL¹⁷⁷

A. Market-Based Rates and Order No. 888

The FERC requires that applicants for market-based rates for wholesale power sales, whether from new (unbuilt) generation capacity or existing capacity, must not have, or must have mitigated, market power in generation or transmission and must not control other barriers to entry. In reviewing market-based rate proposals, the Commission also considers whether there is evidence of affiliate abuse or reciprocal dealing. In Order No. 888, the FERC addressed several aspects of its market power analysis, as discussed below.

1. Transmission Dominance

Order No. 888 requires all public utilities owning, controlling or operating facilities used for the transmission of electric energy in interstate commerce to have on file with the FERC the pro forma tariff contained in Order No. 888, "or such other open access tariff as may be approved by the Commission consistent with Order No. 888. . ."¹⁷⁸ Compliance with the

175. 71 F.E.R.C. ¶ 61,264, *reh'g denied*, 72 F.E.R.C. ¶ 61,224 (1995)

176. 71 F.E.R.C. at 62,055.

177. This section updates the discussion of the FERC's changing market power analysis contained in the Spring 1996 report of the Committee on Electric Utility Regulation, 17 ENERGY L.J. 245 (1996).

178. 61 Fed. Reg. at 21,693-94, 18 C.F.R. § 35.28(c)(1) (1996).

mandatory open access requirement imposed by Order No. 888 should remove transmission dominance as an issue in market-based rate proceedings.

Prior to the issuance of Order No. 888, the Commission in *American Electric Power Service Corp.* held that it would no longer grant market-based rate approval to a public utility (or its affiliates) if the utility owned or controlled transmission facilities and did not have an open access tariff on file substantially in conformity with or superior to the pro forma tariffs contained in the Open Access NOPR, which preceded Order No. 888.¹⁷⁹ Accordingly, the FERC consistently refused requests for market-based rate authority until conforming transmission tariffs were filed.¹⁸⁰ Often applicants whose initial applications were denied promptly corrected the defects in the transmission tariffs and were then granted market-based rate authority.¹⁸¹

2. Generation Dominance — New Capacity

In Order No. 888 the FERC codified its holding in *Kansas City Power & Light Co.*,¹⁸² that it would no longer examine the generation dominance in evaluating market-based rate proposals for sales from new generation capacity. Newly enacted 18 C.F.R. section 35.27 reflects this ruling, and provides in pertinent part:

Notwithstanding any other requirements, any public utility seeking authorization to engage in sales for resale of electric energy at market-based rates shall not be required to demonstrate any lack of market power in generation with respect to sales from capacity for which construction has commenced on or after July 9, 1996.¹⁸³

Under the new rule, a public utility seeking market-based rates for sales from new capacity will not be required to demonstrate lack of generation dominance. If specific evidence of generation dominance with respect to its new capacity is presented by an intervenor, however, the utility will be required to offer "satisfactory" rebuttal evidence.¹⁸⁴ In addition, if an applicant has market-based rate authority for sales from existing generation, the FERC will consider whether the cumulative effect of the new capacity will result in the utility possessing generation dominance.¹⁸⁵ If, however, a utility's existing generation is subject to cost-of-service regulation, the existing generation will not be considered in determining whether to grant market-based rate authority for new capacity.¹⁸⁶

179. 72 F.E.R.C. ¶ 61,287 (1995); *reh'g denied*, 74 F.E.R.C. ¶ 61,013 (1996).

180. *See, e.g., Duke Energy Marketing Corp. et al.*, 73 F.E.R.C. ¶ 61,047 (1995); *Indeck Pepperell Power Associates, Inc.*; 74 F.E.R.C. 61,196 (1996); *PacifiCorp Power Marketing, Inc.*, 74 F.E.R.C. ¶ 61,093 (1996).

181. *See, e.g., Duke/Louis Dreyfus L.L.C.*, 73 F.E.R.C. ¶ 61,309 (1995); *Indeck Pepperell Power Associates*, 74 F.E.R.C. ¶ 61,304 (1996).

182. 67 F.E.R.C. ¶ 61,183 (1994).

183. Order No. 888, 61 Fed. Reg. at 21,693.

184. Order No. 888 at 31,657.

185. *Id.*

186. *Id.*

3. Generation Dominance — Existing Capacity

Despite the urging of investor-owned utilities and some state commissions,¹⁸⁷ the FERC in Order No. 888 declined to make a generic determination of the effect of mandatory open access on sellers' market power for sales from existing generation. Instead, it announced that it would continue to apply a case-by-case analysis of existing generation market power in first-and second-tier markets.¹⁸⁸ The FERC, however, invited applicants and intervenors to challenge its presumption that the relevant geographic market is bounded by second-tier utilities. For example, a utility could seek to broaden the geographic market by demonstrating a lack of transmission constraints in the proposed broader area and that cumulative transmission rates would not significantly affect the ability of distant suppliers to compete in the utility's market. Conversely, intervenors could demonstrate that existing transmission constraints in first-or second-tier markets required the use of a narrower geographic market. The FERC noted its intent to monitor the competitiveness of the market for existing generation and to modify its market-based rate criteria when circumstances warranted.¹⁸⁹

In *Wisconsin Public Service Corp.*¹⁹⁰ the FERC held that transmission constraints may affect the determination of whether an applicant for market-based rate lacks generation dominance. Wisconsin Public Service had asserted as part of its generation dominance analysis that 729 MWs of uncommitted capacity could be imported into its territory. An intervenor alleged that the uncommitted capacity could not in fact be imported due to transmission constraints. Although the FERC accepted the rates for filing, it set for hearing the issue of the effect of the alleged transmission constraints and said it would revoke the utility market-based rate authority if it was demonstrated that transmission constraints provided it with generation market power. The FERC took the same action in response to allegations of transmission constraints in *Southern Company Services, Inc.*¹⁹¹

B. Protection Against Affiliate Abuse

1. Operating Company Affiliates

In *Wholesale Power Services, Inc.*,¹⁹² the applicant proposed to broker the sale of power of affiliated entities, including affiliated investor owned utilities (operating companies). Consistent with its rulings in *LG&E Power Marketing Inc.*¹⁹³ and *Heartland Energy Services, Inc.*,¹⁹⁴ the FERC held that the power marketer, Power Services, could do so provided that: (1) it agree to first offer the operating companies' power for sale before attempt-

187. See *Id.* at 31,658.

188. See, e.g., *Southwestern Public Service Company*, 72 F.E.R.C. ¶ 61,208 at 61,968 (1995).

189. Order No. 888, at 660.

190. 75 F.E.R.C. ¶ 61,057 (1996).

191. 75 F.E.R.C. ¶ 61,130 (1996).

192. 72 F.E.R.C. ¶ 61,284 (1995).

193. 68 F.E.R.C. ¶ 61,247 (1994).

194. 68 F.E.R.C. ¶ 61,223 (1994).

ing to market its own power; (2) the affiliated operating companies agree that their arrangements with the power marketer are non-exclusive; and (3) the operating companies agree to simultaneously make publicly available to non-affiliated marketers and brokers any information provided to its affiliated power marketer.¹⁹⁵ The purpose of these restrictions was to prevent a power marketer from favoring transactions that benefit its (and the operating company's) shareholders to the detriment of the operating company's ratepayers. The applicant had not proposed an exclusive brokering arrangement, and had proposed to offer its affiliated operating companies' power first only if these offered power with the same degree of firmness at the same or a lower price. In addition to rejecting these elements of the proposal, the FERC refused the applicant's request to modify its information sharing requirements to cover only transmission-related information.

In *South Carolina Electric & Gas Co.*,¹⁹⁶ SCANA Energy Marketing Company requested that the FERC eliminate the "must offer first" requirement. SCANA argued that the non-exclusivity and information dissemination requirements offered sufficient protection against affiliate abuse. The FERC denied SCANA's request, noting that a power marketer seeking to broker its affiliated operating utility's power wore "two hats:" (1) agent of its shareholders and (2) representative of its operating companies' ratepayers. Between these constituencies, the FERC held that the power marketer must act with the ratepayers' interests in mind so that "shareholders cannot benefit until ratepayers first receive the gain from the sale of [the operating company's] power."¹⁹⁷

2. Other Affiliates

In its order in *Southern Company Services, Inc.*,¹⁹⁸ accepting market-based rates for filing, the FERC imposed the *Wholesale Power Services* restrictions on Southern Energy Marketing, Inc., a power marketer that intended to market or broker power of its affiliated EWG or QF but not that of its operating company affiliates. On rehearing,¹⁹⁹ the FERC removed these three conditions, citing its order in *USGen Power Services, L.P.*²⁰⁰ in which it concluded that the conditions were not necessary to protect against affiliate abuse when the power marketer does not propose to market or broker power to or from a franchised utility affiliate. The FERC agreed with USGen that the potential for the power marketer to favor power sales that benefit stockholders over those that benefit captive ratepayers did not exist when the marketer proposes to broker to or from non-traditional affiliates, and not to or from an affiliated franchised utility.

195. See also *Orange and Rockland Utilities, Inc.*, 75 F.E.R.C. ¶ 61,088 (1995).

196. 75 F.E.R.C. 61,151, (1996).

197. *Id.*, at 61,498.

198. 72 F.E.R.C. ¶ 61,324 (1995), *order on reh'g*, 74 F.E.R.C. ¶ 61,141 (1996), *appeal docketed sub nom. South Carolina Public Service Authority v. FERC*, No. 96-1115 (D.C. Cir. April 15, 1996).

199. *Order on reh'g*, 74 F.E.R.C. ¶ 61,141 (1996), *appeal docketed sub nom. South Carolina Public Service Authority v. FERC*, No. 96-1115 (D.C. Cir. April 15, 1996).

200. 73 F.E.R.C. ¶ 61,302 (1995).

C. Reporting and Filing Requirements, Annual Fees

In *Morgan Stanley Capital Group, Inc.*,²⁰¹ the FERC eliminated the requirement that power marketers report business and financial arrangements between the marketer (or its affiliates) and the entities that buy, sell or transmit power to, from or on behalf of the power marketer. The FERC had imposed the reporting requirements as a means of detecting reciprocal dealing, but agreed with Morgan Stanley that the burdens of the reporting requirements on both power marketers and the FERC outweighed the benefits. Instead, the FERC determined that it could rely on the complaint process to detect reciprocal dealing by power marketers. The FERC in *Morgan Stanley* reaffirmed its decision that power marketers would be required to pay the same annual charges required of other public utilities.

In *Southern Company Services, Inc.*,²⁰² the FERC held that it was no longer necessary for public utilities selling at market-based rates to document short-term transactions (transactions with a duration of one year or less) in separate service agreements. Instead utilities may file umbrella service agreements within thirty (30) days of commencement of service and file quarterly summaries with the FERC of the individual short-term transactions entered into under the umbrella service agreement.

D. Determination of Affiliation for Purposes of FPA, Part II

The FERC in *Morgan Stanley Capital Group*²⁰³ also provided guidance on the determination of affiliation for purposes of Part II of the FPA. The FERC held that all non-EWG public utilities should define affiliate as the term is used in the "Standards of Conduct for Interstate Pipelines with Marketing Affiliates."²⁰⁴ EWG public utilities were directed to use the definition contained in section 2(a) of the Public Utility Holding Company Act of 1935 which, in general, imposes a five percent ownership test for affiliation.²⁰⁵

IV. EXEMPT WHOLESALE GENERATORS AND FOREIGN UTILITY COMPANIES

A. FERC "EWG" Determinations

An EWG is defined under Section 32(a) of the PUHCA as a person "engaged directly, or indirectly through one or more affiliates as determined by the FERC to be defined in section 2(a)(11)(B) [of PUHCA], and *exclusively* in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electricity at wholesale" (emphasis supplied). In a series of rulings on applications filed under Section 32(a) of PUHCA for determination of EWG status, the FERC has addressed the extent to which an EWG may engage in various

201. 72 F.E.R.C. ¶ 61,082 (1995).

202. *Supra* note 198.

203. *Supra* note 201.

204. 18 C.F.R. § 161.2 (1995) (a voting interest of 10% creates a presumption of affiliation).

205. *See* 15 U.S.C.A. § 79b(11) (1935).

incidental activities consistent with the “exclusivity” requirement in the definition of an EWG.

On several occasions, the FERC has granted EWG status to an applicant who has stated that it intended to sell electric energy at wholesale from an “eligible facility” in which it had an ownership interest, as well as from other power sources that it did not own or operate.²⁰⁶ The FERC has also determined that an EWG may engage in a variety of incidental transactions with third parties, including making sales of gas supplies excess to the needs of an EWG’s own eligible facility,²⁰⁷ sales of steam or flyash produced by the eligible facility,²⁰⁸ and project development activities relating to future unidentified eligible facilities and/or EWGs.²⁰⁹

In *CNG Power Services Corporation (CNG Power II)*,²¹⁰ CNG Power proposed to expand the types of activities in which it would engage in connection with its overall power marketing business to include contracting for and reselling excess transmission capacity, contracting for delivery of fuel supplies to third-party generating facilities (i.e., fuel-for-electricity swaps, or “tolling” arrangements), and brokering. CNG Power asked the FERC to find that such transactions would be “incidental to CNG Power’s sales at wholesale of electric energy generated by others” and therefore would not violate the “exclusivity” requirement of Section 32(a)(1).²¹¹ CNG Power contended that the ability to engage in all of these related activities “is a prerequisite for any power marketer to compete effectively in the evolving wholesale power markets and meet customer service demands.”²¹²

The FERC granted CNG Power’s request as it related to entering into firm and interruptible transmission capacity, but only “to the extent necessary to effect its sales at wholesale of electric energy generated by it or others . . .,” as well as its reassignment (resale) of excess transmission capacity “solely to the extent that such excess transmission capacity originally was obtained for the purpose of effecting a specific wholesale sale of electric energy . . .,” whether from electricity generated by CNG Energy or purchased from others for resale. The FERC rejected CNG Energy’s request to engage in fuel-for-electricity swaps with third-party generators in transactions in which CNG Energy indicated that it would resell the

206. See *LG&E Power Marketing Inc.*, 67 F.E.R.C. ¶ 61,083 (1994); *CNG Power Services Corporation (CNG Power I)*, 69 F.E.R.C. ¶ 61,002 (1994); *Southern Energy Marketing, Inc.*, 71 F.E.R.C. ¶ 61,376 (1995). In *LG&E Power*, the FERC observed that the legislative history to Section 32 was clear that an EWG may sell power that it has not itself generated.

207. See *Selkirk Cogen Partners, L.P.*, 69 F.E.R.C. ¶ 61,037 (1994). See also *AEP Resources International, Limited*, 74 F.E.R.C. ¶ 61,203 (1996), in which the FERC held that the sale of a small amount of coal by the applicant from an adjacent coal mine to a charcoal briquette manufacturer pursuant to a preexisting contract between the previous owner of the eligible facility and the manufacturer would not violate the “exclusivity” requirement, where it appeared that continuation of the contract was required by the foreign government as a condition for the sale and privatization of the facility.

208. *Richmond Power Enterprises*, 62 F.E.R.C. ¶ 61,157 (1993).

209. See, e.g., *Southern Electric Wholesale Generators, Inc.*, 66 F.E.R.C. ¶ 61,264 (1994).

210. *CNG Power Services Corporation*, 71 F.E.R.C. ¶ 61,026 (1995) (*CNG Power II*).

211. *Id.* at 61,102.

212. *Id.*

resulting electricity at wholesale, as well as CNG Energy's request to provide non-jurisdictional power brokering services to third-party generators and purchasers, finding in each case that the proposed activity would constitute a "separate business" unrelated to the business of an EWG.

Subsequently, CNG Energy filed a new application containing a more complete description of the proposed fuel delivery and power brokering activities. On reconsideration, the FERC reversed itself and held that these activities were "[a] part of the business of selling at wholesale electric energy generated by sources not owned or operated by [an] EWG."²¹³ The FERC qualified its approval by stating that fuel deliveries to third-party generating facilities could only be in amounts necessary for the third-party generator to generate the electric power and energy that in turn would be delivered to CNG Energy for resale by CNG Energy at wholesale.²¹⁴

Although it is clear that an EWG may own ancillary facilities reasonably necessary for the operation of its business, such as a coal mine or fuel transportation, storage and handling facilities,²¹⁵ the FERC has ruled that such facilities are not themselves a part of the "eligible facility" for purposes of Section 32. Thus, the FERC has denied EWG status to a company that proposed to acquire and operate a coal handling complex which was integrated into the operations of a foreign generating station where the applicant would not have an ownership interest in the power plant itself.²¹⁶

B. SEC "Safe Harbor" Financing Rule

In August 1995, the D.C. Court of Appeals upheld the SEC's EWG financing "safe harbor" rule (Rule 53) against a challenge by the National Association of Regulatory Utility Commissioners and others. Rule 53 was promulgated in October 1993 in order to implement Section 32(h) of PUHCA.²¹⁷

Section 32(g) of PUHCA exempts from the pre-approval requirements under PUHCA any acquisition of an EWG by a registered holding company. Under Section 32(h), however, the SEC continues to have jurisdiction over the issuance of securities by any registered holding company in order to finance its investment in any EWG. To prevent the financing approval process from becoming a significant obstacle to the acquisition of

213. *CNG Power Services Corp.*, 71 F.E.R.C. ¶ 61,378 (1995) [hereinafter *CNG Power III*]. Concurrently, the FERC approved an EWG application by Southern Energy Marketing, Inc. which had also requested reconsideration of its holding in *CNG Power II* as it related to fuel delivery and power brokering activities. See *Southern Energy Marketing, Inc.*, 71 F.E.R.C. ¶ 61,376 (1995).

214. In a concurring opinion, Commissioner Hoecker complained that the majority's "part of" test lacked "definable limits" because it could be construed to permit an EWG to "engage in any activity associated with, or somehow logically connected to, the sale of electricity, however remote or non-essential that activity is to the business or technical requirements of selling power, . . ." *CNG Power III*, *supra* note 213.

215. See Comments of Sen. Johnston on Title VII of H.R. 776 (the "Energy Policy Act of 1992"), 138 CONG. REC. S17644 (daily ed. Oct. 8, 1992).

216. See *Desarrollo Petacalco, S. De R.L. De C. V.*, 67 F.E.R.C. ¶ 61,070 (1994), *reconsideration denied*, 67 F.E.R.C. ¶ 61,403 (1994).

217. 58 Fed. Reg. 51,488 (1993)(codified at 17 C.F.R. §250.53).

EWGs by registered holding companies, Congress provided in Section 32(h)(3) that the SEC, in determining whether to approve an EWG-related financing application, may not make certain adverse statutory determinations unless the Commission first finds that the financing proposal "would have a substantial adverse impact on the financial integrity of the registered holding company system . . ." Under Section 32(h)(6), the SEC was directed to promulgate rules with respect to "actions which would be considered . . . to have a substantial adverse impact on the financial integrity . . ." of a registered holding company. Further, Section 32(h)(6) provides that "such regulations shall ensure that the action has no adverse impact" on the holding company's utility subsidiaries or their customers or on the ability of State commissions to protect such companies and their customers.

The SEC adopted Rule 53, the so-called "safe-harbor" financing rule, in response to this Congressional mandate. Under Rule 53(a), if certain conditions or circumstances set forth in the rule are satisfied at the time an EWG-related financing application is acted upon, then it is presumed that approval of the application would not have a "substantial adverse impact" of the kind described in Section 32(h)(3). The heart of the "safe-harbor" test is the requirement that the amount of financing proceeds (including guaranties) used to make investments in EWGs cannot exceed fifty percent of the holding company's consolidated retained earnings.

In contrast, under Rule 53(c), if the "safe-harbor" conditions are not met, then the financing proposal will be approved only if the applicant "affirmatively demonstrates" that the transaction: (1) "[w]ill not have an adverse impact upon the financial integrity of the registered holding company system; and (2) [w]ill not have an adverse impact on any utility subsidiary of the registered holding company, or its customers, or on the ability of State commissions to protect such subsidiary or customers."

NARUC challenged the new rule, claiming that the SEC had simply ignored the express language of Section 32(h)(6), in that the rule applies the "no adverse impact" test only to those transactions which fail to satisfy the "safe-harbor" conditions, rather than to all financing requests. The SEC defended its action by urging that Section 32(h) is, at best, ambiguous and internally inconsistent, and that its approach under Rule 53 was a permissible construction of the statute. The Court of Appeals agreed with the SEC, holding that the SEC's construction of the statute was reasonable and had the effect of harmonizing the clear purpose of section 32(h)(3), namely, to streamline the financing approval process by precluding certain adverse determinations under PUHCA, with the purposes of Section 32(h)(6), namely, the protection of domestic utility companies and their effective State regulation.²¹⁸

Following adoption of Rule 53, several registered holding companies sought and obtained SEC authorization to issue securities and guaranties

218. *National Association of Regulatory Utility Commissioners v. SEC*, 63 F.3d 1123 (D.C. Cir. 1995).

for the purpose of financing investments in EWGs.²¹⁹ All of the initial round of applications met the "safe-harbor" conditions of Rule 53(a), including the fifty percent of consolidated retained earnings test. However, in April 1996, the SEC approved an application by The Southern Company to finance investments in EWGs (and FUCOs) in amounts which would exceed the fifty percent of consolidated retained earnings investment limitation. As required under Rule 53(c), Southern had to "affirmatively demonstrate" that its increased level of EWG financing activity would not have a "substantial adverse impact" on the financial integrity of the Southern system *and* would not have "an adverse impact" on any of its utility subsidiaries or their customers or on the ability of State commissions to protect those customers.²²⁰ Among other factors considered by the SEC was evidence indicating that Southern did not project the need to make any significant equity contribution to any of its domestic utility subsidiaries for at least the next ten years, thereby minimizing the possibility that Southern's increased level of EWG and FUCO financing could have an adverse impact on the cost and availability of equity capital needed by its domestic utility subsidiaries.

C. SEC Actions Concerning FUCOs

In a no-action letter dated September 13, 1995,²²¹ the SEC staff agreed not to recommend any action to the SEC if Central and South West Corporation, a registered holding company, were to proceed with its planned acquisition of NORWEB plc, one of the twelve regional electricity companies in the United Kingdom. Counsel for CSW sought assurances that NORWEB's status as a FUCO under Section 33(a) of PUHCA would be recognized, and hence, that CSW's acquisition of NORWEB's stock would be exempt from PUHCA pursuant to Section 33(c). At issue was whether NORWEB's ownership of an interest in an EWG (Gordonville Energy, L.P.) in the United States would preclude FUCO status.

Section 33(a) defines a FUCO as any company that "owns or operates facilities that are not located in any State and that are used for the generation, transmission, or distribution of electric energy . . ." if such company: (i) "derives no part of its income" from the generation, transmission or distribution of electricity for sale in the U.S.; and (ii) neither it nor any subsidiary is a "public utility company operating within the United States . . ."

On the facts presented, NORWEB clearly satisfied the second part of the definition of a FUCO, because neither it nor its EWG subsidiary is a "public utility company," as defined under PUHCA, in the U.S. Evidently

219. See, e.g., The Southern Company, Holding Co. Act Release No. 25980 (Jan. 25, 1994)(authorizing use of common stock proceeds and guarantees issued by registered holding company to invest in one or more EWGs or FUCOs).

220. The Southern Company, Holding Co. Act Release No. 26501 (Apr. 1, 1996) (authorizing Southern to use financing proceeds in an amount equal to 100% of Southern's consolidated retained earnings to invest in EWGs, as well as FUCOs).

221. See 1995 SEC No-Act. LEXIS 1028 (Sept. 13, 1995).

at issue was whether NORWEB satisfied the first part of the definition, since it arguably derived income from the generation and sale of electricity in the U.S., albeit indirectly from a subsidiary that is exempt from the definition of an "electric utility company" under PUHCA. Counsel for CSW argued that, since the clear purpose of Sections 32 and 33 was to allow a registered holding company, like CSW, to acquire and own interests in *both* EWGs and FUCOs, FUCO status should not be denied to NORWEB solely by reason of its ownership of an interest in an EWG in the U.S.

Subsequently, in a no-action letter dated February 22, 1996,²²² the SEC staff also agreed not to recommend any action if The Southern Company, also a registered holding company, were to acquire some or all of the outstanding shares of National Power PLC, the larger of the two principal generating companies in the United Kingdom, which indirectly holds interests in four "qualifying facilities" and one domestic EWG.

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222. See 1996 SEC No-Act. LEXIS 496 (May 10, 1996).