

COMMENT

ELECTRIC DEREGULATION IN OKLAHOMA: A COMPARISON OF DIFFERING APPROACHES

I. INTRODUCTION

Across the United States, legislatures and regulatory bodies are looking to the possibility of deregulating electric generation to decrease rates to residential customers and decrease the cost of doing business for energy-dependent industries through competitive pricing, including those in the State of Oklahoma. Twenty-four states have passed restructuring legislation, one state has restructured through its regulatory body, and eighteen states have performed studies on the issue.¹ Some states have been fairly successful, like Pennsylvania, though not without problems. However, developments in San Diego, California beginning in June 2000 and the now-famous electricity shortages, price spikes, and near bankruptcies of the utilities across that state in the past year have attracted attention from legislators and regulators still considering deregulation, leaving them wondering about the asserted benefits of deregulation.

Some states, such as New Mexico and Arkansas are delaying, or are considering a delay, of their current restructuring plans.² Others, like Iowa, have determined that restructuring is not in their best interests at this time and will defer legislation.³ Oklahoma regulators and legislators, noting the events in California, passed legislation during Oklahoma's Spring 2001 session that delayed restructuring,⁴ pending a second study on deregulation by a legislative-directed advisory committee authorized to examine the issue (for the second time) and report by December 31, 2002.⁵

Fears of consequences from deregulation similar to those in California prompt a more careful approach to deregulation than initially anticipated. While events in this fast-moving area do not stand still, and circumstances may be expected to have substantially altered the California and Pennsyl-

1. Energy Information Association, Status of Electric Industry Restructuring as of September 2001, available at www.eia.doe.gov/cneaf/electricity/CHG_STR/REGMAP.HTML (Sept. 2001).

2. The governor of Arkansas signed a bill on February 21, 2001 that will delay electric restructuring in Arkansas from January 1, 2002 until no sooner than October 1, 2003, but no later than October 1, 2005. DEPARTMENT OF ENERGY, *Electric Utility Restructuring Weekly Update*, (Feb. 23, 2001), available at www.eren.doe.gov/electricity/restructuring/weekly/feb23_01.html. The New Mexico Senate also passed a bill in February 2001 that, if passed by the House, would delay deregulation in that state from its current start date of 2002 (already delayed from 2001 by the Public Utilities Commission) until January 1, 2007 for residential and small commercials and until 2008 for all other customers. *New Mexico Could Push Back Dereg Five Years*, MEGAWATT DAILY (Feb. 20, 2001).

3. *Electric Deregulation Unlikely Any Time Soon*, ENERGY ONLINE, (Aug. 16, 2000), available at <http://www.energyonline.com/Restructuring/news-reports/news/0816ia.html>.

4. See generally S.B. 440, 48th Leg., 1st Reg. Sess. (Okla. 2001)[hereinafter *Okla S.B. 440*].

5. *Id.*

vania situations during the process of publication, the varied results among these leaders of the restructuring trend is still very much in the minds of Oklahoma legislators and regulators. This comment offers an analysis of several salient issues surrounding electric restructuring within the framework of the Oklahoma, California, and Pennsylvania efforts.

A. Current Efforts in Oklahoma

Oklahoma law, approved in 1997, mandated that restructuring occur in July 2002,⁶ but implementing was deferred. Draft implementing legislation was introduced on the last day of session in June 2000, passed by the Senate, but defeated in the House of Representatives.⁷ The Senate Bill (SB 220) was already a concern to regulators and customer groups because of certain features that some argued could hinder the development of a competitive, unregulated market.⁸ However, the contents of the bill, which some suggested might resurface in subsequent legislative sessions,⁹ caused even greater concern to involved parties after regulators removed rate freezes in San Diego and the rates there skyrocketed.¹⁰

Concerns arose regarding SB 220 partly because the Oklahoma Corporation Commission (OCC) Staff demonstrated that the bill was, in some respects, similar to California's deregulation legislation, Assembly Bill 1890 (AB 1890).¹¹ Certain provisions of AB 1890 may have discouraged the development of a competitive market, creating problems once generation rates in San Diego were deregulated.¹² Unless a truly competitive market is developed during a state's transition period and unless proper controls are present, an unregulated monopoly could result. This is the situation that appears to have occurred during Summer 2000 in San Diego, and this is what opponents of SB 220 argued could happen in Oklahoma if a similar bill is passed in that state.

A number of electric restructuring bills were introduced in the Oklahoma State Legislature in fall of proposing to delay the date of restructuring to as late as 2004, or would have removed the deadline posed by Oklahoma's previous restructuring law altogether.¹³ In addition, some of the

6. S.B. 500, 46th Leg., 1st Reg. Sess. (Okla. 1997)[hereinafter *Okla. S.B. 500*].

7. William O. Pitts, *Electric restructuring: politics, turf, and turmoil*, THE JOURNAL RECORD, September 18, 2000, at 2.

8. S.B. 220, 47th Leg., 2nd Reg. Sess. (Okla. 2000)(2nd Conference Committee Substitute) [hereinafter *Okla. S.B. 220*].

9. Pitts, *supra* note 7, at 2.

10. William Amurgis, *Law Urges Consumers Not to Pay Their Electric Bills*, ENERGY.COM, July 14, 2000, at 1.

11. A.B. 1890, 1995-96 Portion of 1995-96 Reg. Sess. (Cal. 1996)[hereinafter *Cal. A.B. 1890*].

12. OKLAHOMA CORPORATION COMMISSION STAFF, *Staff's Electric Restructuring Status Report No. 9*, at <ftp://204.87.70.98/OCCFILES/related.ppt> (Sept. 2000) [hereinafter *Staff's Electric Restructuring Status*].

13. See generally S.B. 888, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 176, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 436, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 448, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1026, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1157, 48th Leg., 1st Reg. Sess. (Okla. 2001);

bills proposed would have removed a prohibition from Oklahoma law preventing the OCC from promulgating rules related to electric restructuring. In the Spring 2001 session, delaying legislation was finally passed in the form of Senate Bill 440 (SB 440), leaving Oklahoma without implementing legislation for its deregulation effort. The interest in delaying the restructuring deadline may have reflected a concern that suitable implementing legislation could not have been passed during the 2000-2001 sessions. Also, because the current deadline was fast approaching, it may reflect a cautious attitude by legislators, who may not want to rush into passing implementing legislation without careful consideration, especially considering the level of concern SB 220 raised when it was introduced, and the haste with which they were forced to make their decision on that bill.

At this time, a bill similar SB 220 has not been reintroduced at the legislature, but it is not unreasonable to expect that the benefits or drawbacks of provisions contained in that bill, which was one of the most-publicized of proposed implementation drafts, will be in the minds of the next Oklahoma advisory committee as it studies restructuring, especially considering that the author of both SB 220 and SB 440 will be involved in the advisory committee studies, and may therefore take part in guiding the focus of the study or shaping future implementing legislation. Whether another form of SB 220 is passed, or something altogether different, looking at the provisions of that bill and concerns raised may give one an idea of what to expect or what not to expect from Oklahoma legislators and regulators in the coming months.

II. RESTRUCTURING PROGRESS IN OKLAHOMA, CALIFORNIA AND PENNSYLVANIA

Though oversimplified, when legislators and regulators consider electric restructuring, they typically consider separating the generation, or *supply* segment of the electric industry from *transmission* and the local *distribution* systems owned by the utility.¹⁴ For years, transmission, distribution and generation have been owned by vertically integrated utilities, natural monopolies serving customers at regulated prices.¹⁵ However, new ideas about competition in the electric industry have emerged in the last decade, making retail wheeling possible at the national level by requiring utilities to offer open access tariffs to their interstate transmission lines for third-party generators.¹⁶ Along similar lines, in hopes of decreasing the

H.B. 1336, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1445, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1474, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1598, 48th Leg., 1st Reg. Sess. (Okla. 2001).

14. JOINT ELECTRIC UTILITY TASK FORCE, *Report on Electric Restructuring Issues*, available at <http://www.restructureok.net/lpaden/dac/folders/Task%20Force%20Report/Report.pdf>, at 17 (Oct. 1, 1999).

15. Navarro, Peter, *A Guidebook and Research for Restructuring the Electricity Industry*, 16 ENERGY L.J. 347, 348 (1995).

16. *Id.* at 352. See generally Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting*

cost of electricity through competition, policy makers at the state level began to consider breaking generation off from regulated transmission and distribution, and allowing non-utility generators to compete and serve the utility's customers with electric supply.¹⁷

While methods vary between states, when the states unbundle generation from regulated services offered by the utility, they generally either require the utility to separate its generation into a separate affiliate company owned by the same corporation as the regulated utility, a separate affiliate division within the utility, or in some cases, they force the utility to sell, or 'divest' its generation to an unrelated entity.¹⁸ Policy makers are often concerned that the relationship between the utility and its affiliates could be abused, creating an unfair competitive advantage that would hinder new suppliers from being able to, for example, offer competitive rates, attract customers, or serve customers they gain by having open access to a utility's transmission and distribution lines.¹⁹ Divestiture raises fewer concerns in this area, but can still be problematic to a competitive market if all of a utility's generation assets are sold to one person or a very small group, preventing a competitive market from developing.²⁰

In order for policymakers' goals of deregulating and reducing electricity costs to be successful, a competitive market must be developed.²¹ This means that multiple suppliers must be lured into the market, encouraged to buy or build generating plants, and given a fair chance to attract customers formerly served by the utility. Restructuring legislation is usually written so as to reduce or remove market entry barriers that may exist or could be erected by the utilities to favor their affiliates or by other new competitors, hopefully creating a "level playing field" between all competitors, new and established.²² The idea is to deregulate generation after a sufficient level of competition exists to produce reasonable market-based prices.²³ The danger of restructuring is that if competition is not sufficiently established before deregulation, unregulated monopolies will result, trapping customers who would have no choice but to pay whatever rates their electric supplier chooses.

Utilities, I.V. F.E.R.C. STATS. & REGS. ¶ 32,514 (1995).

17. REGULATORY ASSISTANCE PROJECT, *Consumer Choice Making It Work for All Customers*, ISSUELETTERS, available at <http://www.rapmainc.org/consumer.html>, at 1 (1996).

18. Navarro, *supra* note 15, 355-356 (1995). Divestiture raises issues of proper valuation outside the scope of this comment. For a general discussion of such issues, see generally ELCON, *The First States: The Learning Curve on Stranded Cost Recovery Policies*, (Oct. 1998), available at <http://www.elcon.org/First%20States.pdf>.

19. *Id.* at 362 (1995).

20. Navarro, *supra* note 15, at 358.

21. REGULATORY ASSISTANCE PROJECT, *Best Practices Guide: Implementing Power Sector Reform*, at 1484 (2000), available at <http://www.rapmainc.org/bpiicfnl.doc>.

22. REGULATORY ASSISTANCE PROJECT, *supra* note 17, at 5.

23. Navarro, *supra* note 15, at 355.

A. *Developments in California*

Problems related to restructuring developed first in San Diego, California, where utility customers were subjected to hefty rate increases after deregulation, starting in June 2000.²⁴ California approved deregulation in 1996,²⁵ earlier than many states that have since passed legislation. This legislation, AB 1890, was to take effect in 1998, allowing a transition period until 2002 to pay off stranded costs.²⁶

Discussed *infra* in greater detail, AB 1890 basically required separation of generation assets from regulated transmission functions by valuation methods approved by the regulatory body,²⁷ a five-year rate freeze,²⁸ and a mandatory 10% rate reduction for residential and small commercial customers.²⁹ AB 1890 also provided that recovery of stranded costs be accelerated and allowed for the rate freeze to be removed once stranded costs were fully recovered, before the end the transition period.³⁰

AB 1890 established a power exchange (PX), through which generators must purchase their power, and required membership in an Independent System Operator (ISO).³¹ The Bill did not contain provisions to monitor or mitigate excessive market power.³² Also, the Bill contained no requirement that sufficient competition be found to exist before deregulation, nor did it require market power studies or the analysis of effects of generating and transmission capacity restraints on deregulated rates.³³ In short, AB 1890 does not appear to have provided for effective regulatory control to assure the development of a competitive market.³⁴

The effects of a deregulated but uncompetitive market have been felt strongly in San Diego since June 2000 (and throughout California). In that city, the first to experience faltering deregulation in the state, generation owned by San Diego Gas and Electric (SDG&E) was divested to only one entity,³⁵ which also owned the only transmission lines into town.³⁶ Addi-

24. Amurgis, *supra* note 10.

25. *Cal. A.B. 1890*.

26. The legislative history of AB 1890 defined stranded costs as operating, construction, or maintenance costs prudently incurred by the utility's generation assets in accordance with being a regulated entity that is allowed to recover from ratepayers; *Cal. A.B. 1890*, § 330(1)(4); see generally JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 20.

27. *Cal. A.B. 1890*, § 330(d). In the case of San Diego, all of the utility (SDG&E) generation was divested to another entity, Sempra. (Nor did the legislation contain a provision to allow recall of generation to regulation in an emergency). *Staff's Electric Restructuring Status*, *supra* note 12, at 4.

28. *Id.* § 368(a).

29. *Cal. A.B. 1890*, § 368(a).

30. *Id.* § 368(a).

31. *Cal. A.B. 1890*, § 330(1)(1).

32. *Staff's Electric Restructuring Status*, *supra* note 12, at 6-11.

33. *Id.*

34. *Staff's Electric Restructuring Status*, *supra* note 12, at 6-11.

35. Paul English, *Blocked Deregulation Similar to California Law*, DAILY OKLAHOMAN, Sept. 7, 2000, at B1.

36. Chuck Ervin, *Oklahoma, California power plans similar*, TULSA WORLD, Sept. 7, 2000, at 1.

tional suppliers chose not to enter the San Diego market,³⁷ possibly due to a fear of being unable to compete with the mandated rate reductions that were to be offered during the transition period.³⁸ However, despite the absence of a variety of competitors, generation was deregulated early, after SDG&E finished recovering its stranded costs in May 2000.³⁹

The month following deregulation in San Diego, customers saw their monthly bill double.⁴⁰ Wholesale rates for power at the end of June 2000 were seven times the rates one year earlier, despite only a 3% increase in usage.⁴¹ Prices continued to rise throughout the summer months. The average price of electricity throughout the year prior to June 2000 was four cents/kWh; prices increased to 9.2 cents/kWh for July, 14.3 cents in early August, and 17.6 cents by the end of the month.⁴² The rapid increase caused a ratepayer uproar and caused businesses to struggle due to the increase in operating costs, leading some California legislators and policy makers to urge citizens in San Diego to pay their bills only up to the amount they paid at the same time of year in 1999. Over the summer, California Governor Gray Davis vetoed a bill for 150 million dollars in rate relief for San Diego residents, but did approve bills to cap summer rates and accelerate the approval process for power plant building permits.⁴³

Events in San Diego foreshadowed greater problems statewide in Summer 2000 and months following, leaving lawmakers scrambling to rescue both the consumer and the utilities. Legislators and regulators searched for a solution for paying the difference between the cost of wholesale power, which was not capped despite a Federal Energy Regulatory Commission (FERC) finding that rates were unjust and unreasonable in November, and capped utility rates in order to prevent bankruptcy of the operating division of the utilities.⁴⁴ Governor Davis signed an order in February 2001 to further shorten approval time for generating plant construction in hopes of eventually alleviating capacity shortages.

Despite officials' efforts, difficulties in California continued into 2001. One of the state's major utilities declared bankruptcy in April 2001, citing the cause as huge losses resulting from the discrepancy between the

37. Some areas of California, not yet deregulated, have had alternate suppliers enter the market, but still in low numbers. The number of customers switching to an alternate supplier across the state has only reached around 2%. OKLAHOMA CORPORATION COMMISSION STAFF, *California Case Study Focusing On San Diego*, (Sept. 6, 2000), available at <ftp://204.87.70.98/OCCFILES/sandiego.doc>, at 1 [hereinafter *California Case Study*].

38. *Id.* at 3.

39. *California Case Study*, *supra* note 37, at 3.

40. Amurgis, *supra* note 10.

41. *Staff's Electric Restructuring Status*, *supra* note 12, at 1.

42. *Id.*

43. Daniel M. Weintraub, *Davis Vetoes Cash Aid For Electricity Bills Utilities: The Governor Says Appropriating \$150 Million to Help South O.C. and San Diego Consumers Was a Bad Precedent*, THE ORANGE COUNTY REGISTER, Sept. 30, 2000, at A 21.

44. Patrice Hill, *Experts Say California is Moving Toward Reregulation of Power Industry*, KNIGHT-RIDDER TRIBUNE BUS. NEWS, Feb. 16, 2001.

amount at which it purchased wholesale power and the amount it could charge ratepayers for service.⁴⁵

Parties outside California have also made efforts to alleviate power problems in California since June 2000. For example, for the months of January and February 2001, the Secretary of Energy required power suppliers in Western states that were doing business with the California Independent System Operator (Cal ISO) to sell any excess power not needed to serve firm load to the Cal ISO when reserves reached below a certain amount.⁴⁶ In April, the FERC also promulgated a price mitigation plan applicable to those in California, and the other states in the Western System Coordination Council, which required mitigation of rates when reserves fall below 7.5% by requiring the ISO to set up a market clearing auction for real-time markets and make weekly reports to the FERC.⁴⁷ Despite these efforts, the FERC was forced in March to approve a substantial rate increase, effective in June. Depending on average usage by consumers, rates for residential customers were to increase from zero to 80% (excluding low income customers); commercial consumer rates were to increase by 34% and 45%, industrial rates by 50%, and agricultural rates by 15% to 20%.⁴⁸

B. Developments in Pennsylvania

With the benefit of hindsight, it is evident that poorly designed deregulation can do more harm than good. However, deregulation is not a losing proposition for those states that have chosen a different approach. Pennsylvania's restructuring efforts have been more successful, although not without its problems. In 2000, following the implementation of Pennsylvania 1997 restructuring legislation, House Bill 1509 (HB 1509),⁴⁹ one thousand alternate suppliers are operating across the state, making the market more competitive than that in California.⁵⁰ At that time, Pennsylvania's customer switching rate was much greater than California's for all types of customers. Also, though only 8% of residential customers had switched as of August 2000, 35% of commercial customers and 42% of industrial users had also switched,⁵¹ compared to California's overall average of 2% for all combined groups.⁵²

45. Vincent J. Schodolski, *Utility Company Files for Bankruptcy; California Firm Says Discussions 'Going Nowhere'*, CHICAGO TRIBUNE, Apr. 7, 2001, at 6.

46. Energy Information Association, Status of Electric Industry Restructuring as of September 2001, available at www.cia.doc.gov/cneaf/electricity/CHG_STR/tab5rev.html (Sept. 2001)

47. *Id.* See also FEDERAL ENERGY REGULATORY COMMISSION, Press Release, *Commission Establishes Prospective Mitigation and Monitoring Plan for California Wholesale Electric Markets*, Docket No. EL00-95-012 (Apr. 25, 2001) [hereinafter *FERC Press Release*].

48. *FERC Press Release*, *supra* note 48.

49. H.B. 1509, 180th Leg., 1st Reg. Sess. (Pa. 1996)[hereinafter *Pa. H.B. 1509*].

50. *Power Play: Pennsylvania PUC can learn from California's deregulation mistakes*, HARRISBURG PATRIOT, Aug. 22, 2000, at A6. [hereinafter *Power Play*]

51. *Id.*

52. *Power Play*, *supra* note 50, at A6.

The foregoing factors have been noted as signs of Pennsylvania's success in electric restructuring. However, it is important to note recent difficulties in Pennsylvania caused by hefty increases in rates for wholesale power, which have almost doubled, and increases in rates for natural gas.⁵³ Some customers seeking protection of regulated, below-market rates have returned to the utility, causing the number of Pennsylvania customers using an alternate supplier to decline by 25% between April and July 2001.⁵⁴ Loss of customers is causing a decline in the number of alternate suppliers willing to serve in the state.⁵⁵ Industrial customers, traditionally the strongest proponents of deregulation, have returned to the utility, causing the number of commercial and industrial customers using an alternate supplier to fall by 78% and 81% respectively between April and July 2001.⁵⁶ Nevertheless, Pennsylvania officials still cite current figure showing \$3 billion in savings and a decrease in electric rates from 15% above the national average to 1% below the national average of proof of its success.⁵⁷

Despite its problems, two points emerge from the Pennsylvania experience. First, these problems do not appear to result from flaws in the fundamental structure of the state's deregulation program, but rather might be solved by adjustments to the shopping credit or other changes. Indeed, they may resolve themselves by the introduction of more competition by the end of the transition period. Second, Pennsylvania's legislation, unlike California's, was structured so that during a transitional period, such as customer switchbacks, ratepayers were protected from unexpected price increases, and also allowed regulators flexibility to make changes as needed. For example, in light of recent problems, the Pennsylvania Public Utilities Commission was able to reach a settlement in August with GPU, Inc. and First Energy Corp. to allow GPU to defer wholesale power losses and extend distribution rate caps until 2005, in order to pro-

53. DEPARTMENT OF ENERGY, *Electric Restructuring Weekly*, available at www.eren.doc.gov/electricity_restructuring/wckly/aug17_01.html (Aug. 17, 2001).

54. DEPARTMENT OF ENERGY, *Electric Restructuring Weekly*, available at www.eren.doc.gov/electricity_restructuring/weekly/jul6_01.html (July 6, 2001).

55. *Id.*

56. DEPARTMENT OF ENERGY, *supra* note 53. In Pennsylvania, customers operate on a shopping credit system, where they receive a credit as an incentive to switch to an alternate supplier, and where there is a set rate that the utility offers for regulated generation, that competitors try to beat. Charlotte Le Gates, *Faulty State "Choice" Programs Lead to Customer Switchbacks*, ENERGY.COM, June 13, 2000, at 2. Due to warmer than average summer temperature in 2000 and a marked increase in natural gas costs, electric commodity prices increased so much that some alternate suppliers could not beat the utilities' artificially low rates, causing at least two suppliers, Connectiv and Peoples Plus, to ask their customers to switch back to utility supplies in June 2000. *Id.* This problem appears to have continued throughout the year due to high wholesale electric rates. In addition, because competition is still developing in Pennsylvania, market prices have not yet naturally fallen as low as the rate the utility can offer. Some suppliers of electricity chose, beginning in Summer 2000, to sell more of their power in the wholesale market where they could sell at summer price spikes, leaving their more expensive power for residential customers. These types of problems have led customers to switch back to the utility, either on their own or sometimes at the request of the alternate supplier. Le Gates, *supra* note 48, at 1-2.

57. DEPARTMENT OF ENERGY, *Electric Restructuring Weekly*, available at www.eren.doc.gov/electricity_restructuring/weekly/jul20_01.html (July 20, 2001).

tect consumers and the utility from losses incurred by buying wholesale power at high rates and selling at lower capped rates.⁵⁸

Pennsylvania's legislation contains several provisions, discussed *infra* in greater detail, that help facilitate building a competitive market and protecting the consumers from an unregulated monopoly. In short, Pennsylvania appears to have given its regulatory body the necessary power to oversee unbundling, to remedy and mitigate excessive market power,⁵⁹ and seek punishment for abuses.⁶⁰ HB 1509 mandated a lengthy transition period of nine years⁶¹ and a rate cap for five-and-one-half years.⁶² Prior to full implementation, Pennsylvania conducted pilot programs to test deregulation's feasibility.⁶³ Significantly, Pennsylvania's legislation empowers regulators to delay competition for a period of six months for a number of considerations, including the interest of Pennsylvania consumers and businesses, detrimental effects on reliability, systems that are not yet operational, or if generators would be disadvantaged.⁶⁴

The results of Pennsylvania and California's differing types of legislation are now becoming visible as each state moves closer to full deregulation. However, Oklahoma has not yet reached a point where its future under deregulation can be predicted with certainty. Controversy surrounding the contents of the last proposed restructuring legislation, especially in light of the past years' events in California has resulted in careful consideration of the future of restructuring by Oklahoma legislators this session.

A. *Deregulation Statutes in Oklahoma*

Oklahoma took its first steps to deregulating its electric industry with the passage of SB 500⁶⁵ in April 1997. SB 500 mandated electric deregulation by July 1, 2002.⁶⁶ Stated goals were to reduce the costs of electricity, develop a competitive market, and ensure continued safety and reliability in generation, transmission and distribution.⁶⁷ SB 500 also required that the following principles guide any restructuring effort in Oklahoma: (1) preservation of reliable and safe service; (2) establishment and encouragement of a competitive market; (3) open-access by July 1, 2002; (4) prohibition of vertically integrated utilities from abusing their monopoly positions and requiring generation be functionally separated from transmission

58. EIA Page Energy Information Association, Status of Electric Industry Restructuring as of September 2001, available at www.eia.doc.gov/cneal/electricity/CHG_STR/tab5rev.html (Sept. 2001)

59. *Pa. H.B. 1509*, § 2811.

60. *Id.* § 2811.

61. *Pa. H.B. 1509*, § 2804(4)(ii).

62. *Id.* § 2804 (4)(i).

63. *Pa. H.B. 1509*, § 2805(G).

64. *Id.* § 2806(C)(i)-(vi).

65. *Okla. S.B. 500*.

66. *Id.* § 190.2(4).

67. *Okla. S.B. 500*, § 190.2 (1)-(5).

and distribution and subject to minimal regulation;⁶⁸ (5) unbundled rates; (6) assurance to suppliers of open access to transmission and distribution; (7) establishment of service territories and requirement that distribution utilities provide service to all those in such territories; (8) evaluation of benefits to joining an Independent System Operator (ISO); (9) establishment of consumer protections; (10) establishment of a suitable transition period, (11) maintenance of current rates under transition period; (12) establishment of an access fee for distribution; (13) establishment of procedures to recover stranded costs; and (14) establish of a mechanism to recover transition costs.⁶⁹

Though SB 500 established general standards for electric restructuring implementation in Oklahoma, the act did not indicate what specific steps would be taken in furtherance of its goals, except to state "the [previous] principles and directives be adhered to by the Commission in developing a framework for a restructured industry and . . . the Commission is expressly prohibited from promulgating any rules without the express authorization of the Oklahoma State Legislature."⁷⁰

The legislature followed SB 500 by Senate Bill 888 (SB 888),⁷¹ which reiterated these goals and required, as did SB 500, that a number of studies be done under the direction of the legislature's Joint Electric Utility Task Force (JEUTF)⁷² on subjects such as market power, consumer issues, financial issues and technical issues by October 1999.⁷³ These studies were partially undertaken under the direction of the JEUTF Electric Restructuring Working Group, which met during the spring and summer of 1999. The JEUTF issued a final working report in October 1999 that consisted of varying, but generally non-consensus viewpoints on multiple issues solicited from the utilities, electric cooperatives, municipal electric systems, commercial and industrial groups, and consumer groups.⁷⁴

The most publicized implementing legislation introduced in the Oklahoma State Legislature was the final version of the Second Conference Committee Substitute of Senate Bill 220. The Bill was introduced on the last day of the session in May 2000, where it was passed by the Senate, but

68. Functional separation entails adopting separate accounting procedures for the generation segment, possibly removing employees used for the generation function into a separate division or department, and adopting certain codes of conduct in an effort to prevent preferential treatment of the unregulated generation affiliate by the utility. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 17.

69. *Okla. S.B. 500*, § (1)-(14).

70. *Id.* § 190.4(B)(1)-(14). Several pieces of legislation introduced this session would remove this restriction.

71. S.B. 888, 46th Leg., 2nd Reg. Sess. (Okla. 1998) § (190.4)(B)[hereinafter *Okla. S.B. 888*].

72. The JEUTF consisted of members from the Oklahoma Legislature: Senators Kevin Easley (Chair), Brooks Douglass, Sam Helton, Cal Hobson, Lewis Long, Jerry Smith, Dick Wilkerson and Representatives Larry Rice (Vice Chair), Larry Adair, Larry Ferguson, Jim Glover, Danny Hilliard, Chris Hastings, and Clay Pope.

73. *Okla. S.B. 888*, § 5(C).

74. Pitts, *supra* note 7, at 2. See also JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14.

failed in the house.⁷⁵ Some speculate that the lack of votes could be partially attributed to Governor Keating's indication that he was considering vetoing the SB 220, and that legislators had only a brief time to review the lengthy bill prior to the vote.⁷⁶ SB 220 also lacked certain provisions that the working report had recommended. For example, the report contained a recommendation that utilities be required to join a Regional Transmission Organization,⁷⁷ recommended further study and recovery of stranded costs,⁷⁸ and recommended the Commission investigate market power.⁷⁹

Following the events of Summer 2000 in San Diego, regulators and legislators expressed concerns that a similar situation might arise in Oklahoma, particularly if restructuring legislation was not carefully crafted. The OCC Staff issued a comparison report in Summer 2000 regarding SB 220 and California's restructuring legislation, around which this comment is structured, noting several similarities between the California legislation and SB 220, as well as noting other shortcomings of the Oklahoma bill that could be detrimental to the development of a competitive market.

Concerns due to the events in California and Oklahoma's lack of implementing legislation in the face of a 2002 deadline led legislators to consider two options in the legislative session of Fall 2000. First, several bills were proposed containing implementing legislation which differed from SB 220 in that they basically left deregulation to the control of the Oklahoma Corporation Commission, though no implementing legislation of any kind was passed. Second, several bills were introduced that would delay deregulation for a number of years, until implementing legislation could be passed.⁸⁰ Ultimately, legislation delaying restructuring was passed in June 2001.

Senate Bill 440, authored by Senator Kevin Easley, the author of the failed SB 220, was enacted June 4, 2001.⁸¹ This legislation had the effect of

75. Pitts, *supra* note 7.

76. *Id.*

77. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 8.

78. *Id.* at 20.

79. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 45. However, legislators' reluctance to vote for the bill might also have been attributed to the dearth of impact studies on this particular bill and concerns voiced not only by the OCC Staff, but also consumer groups and prominent industries. For example, the Williams Companies and Conoco commented that, although they support deregulation, SB 220 failed to address important issues, such as market power abuse. In addition, the president of Energetix, a company manufacturing power plants in Oklahoma, has commented that if a bill such as SB 220 passed, new power coming on-line would have to be sold out of state because it would be too difficult to compete with utility affiliates, and has been quoted as saying that SB 220 should be called "the utility company windfall profit bill" because of the advantages it would have given public utilities already in the market. Ervin, *supra* note 36, at 1.

80. See generally S.B. 88, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 176, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 436, 48th Leg., 1st Reg. Sess. (Okla. 2001); S.B. 448, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1026, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1157, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1336, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1445, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1474, 48th Leg., 1st Reg. Sess. (Okla. 2001); H.B. 1598, 48th Leg., 1st Reg. Sess. (Okla. 2001).

81. Okla. S.B. 440.

not only delaying electric restructuring in Oklahoma, but also creating a new group to oversee further study of the effect of deregulation in Oklahoma. Specifically, SB 440 establishes the Electric Restructuring Advisory Committee to advise both the legislature and the governor.⁸² The bill requires that this group: (1) study transmission congestion and the potential for upgrades and expansion; (2) examine the previous Joint Utility Task Force on electric restructuring from October 1999; (3) analyze operations and control issues; (4) seek input from Oklahoma consumers; (5) review any proposed electric restructuring legislation, if any; (6) consider possible development of zero-emission electric generation facilities; (7) study other states' restructuring and recommend any beneficial practices from those states; (8) and study other issues as needed.⁸³

The Advisory Committee is also required by SB 440 to submit an interim report focusing on transmission issues by December 31, 2001, while the Committee's final report is due one year later, December 31, 2002.⁸⁴ While the report states no date certain when restructuring must take place, the SB 440 prohibits electric restructuring in Oklahoma until the final report of the Advisory Committee has been issued and implementing legislation is adopted.⁸⁵ Because the Committee is permitted to remain in existence until January 1, 2005, it appears that enabling legislation could be passed sometime between December 2002 and January 2005.

While further legislation may not be passed, the language of SB 440 suggests that legislators still contemplate going forward with retail choice at some point in the future, once the Advisory Committee study is complete.⁸⁶ During the study, committee members will be looking at provisions of the first restructuring study report, discussed *infra*, and it is also not unreasonable to think they will closely examine provisions of SB 220. It was this legislation that engendered controversy and close scrutiny of its contents by regulators and consumer groups throughout the Spring 2000 legislative session and into Summer and Fall 2000.

III. ANALYSIS OF SB 220

California's experience over the past year has attracted the attention of regulators and legislators across the country, concerned that their own states could meet with a similar fate. The OCC Staff addressed this issue

82. *Id.* § (4)(A). The Advisory Committee is composed of the Chair of the Senate Energy, Environmental Resources and Regulatory Affairs Committee, Chair of the House Energy and Utility Regulation Committee, a minority party member of the Senate and the House, appointed by the respective Minority Floor leaders, the Governor, the Attorney General, a Corporation Commissioner, the Superintendent of Public Instruction, and the Vice Chair of the Oklahoma Tax Commission. *Id.* § (4)(A)(1)-(9).

83. *Okla. S.B. 440*, § (4)(D)(1)-(8).

84. *Id.* § (4)(E)-(F).

85. *Okla. S.B. 440*, § (4)(G).

86. *Id.* § (4)(G). The bill does not appear override provisions by SB 500 and SB 888, which mandated a move toward electric restructuring.

in Summer 2000 in its Electric Restructuring Issue Report Number 9,⁸⁷ which compares California's electric restructuring legislation, AB 1890⁸⁸ and SB 220. The Staff noted that California's legislation lacked certain provisions necessary to build a competitive market before deregulation, which probably played an important part in the price hikes in San Diego. SB 220 appeared to be missing many of these same provisions.

A. California's A.B. 1890

To evaluate whether a bill like SB 220 could lead to price increases, as in San Diego, it is necessary to look at California's deregulation plan. California approved its restructuring legislation, AB 1890,⁸⁹ in 1996, to be implemented in January 1998.⁹⁰ While the legislation allowed for a four-year transition period, in which rates for those continuing to receive supply from the utility would be frozen, the utility in San Diego was able to remove the rate freeze early because it recovered its stranded costs sooner than expected.⁹¹ However, no competitive market developed during the shortened transition period. Once the rate freeze was lifted, SDG&E customers were subjected to an unregulated monopoly, with no competitive forces present in the marketplace to restrain prices.

The structure of AB 1890 itself may have been largely responsible for discouraging development of a competitive market in San Diego. First, the Bill did not require that the regulatory body find that adequate competition in an area exists before permitting the removal of rate freezes. Second, though noting the need to prevent abuse of market power,⁹² AB 1890 contained no provision empowering regulators to monitor, remedy, or sanction such abuses. The only sanctions and enforcement provisions in the Bill were reserved for violations of reliability standards.⁹³

In hindsight, AB 1890 contained an insufficiently detailed outline of the provisions and preparation necessary to develop a competitive market. The Bill not only mandated a rate freeze for a transition period of four years, but also required an immediate 10% rate reduction, to continue until 2002.⁹⁴ As a result, competitors avoided markets such as San Diego, where they could not compete with the artificially low rate.⁹⁵ AB 1890 did require that transmission lines be placed under the control of an ISO but required utilities receive their power through a PX, leaving utilities unable to enter into long-term contracts for power.⁹⁶ Finally, the Bill did not re-

87. Staff's *Electric Restructuring Status*, *supra* note 12, at 9.

88. *Cal. A.B. 1890*.

89. *Id.*

90. *Cal. A.B. 1890*, § 330(1)(4).

91. English, *supra* note 35, at B1.

92. *Cal. A.B. 1890*, § 333(1)(3).

93. *Id.* § 364 (c).

94. *Cal. A.B. 1890*, § 368(a).

95. *California Case Study*, *supra* note 37, at 2.

96. *Cal. A.B. 1890*, § 330 (1)(1).

quire that detailed studies on transmission or generation constraints, market structure or market power be performed prior to implementation of electric restructuring. Detailed studies would possibly have revealed that demand for electricity in the state is greater than generating capacity and that transmission is severely congested.⁹⁷

While the details of California's electric restructuring legislation are further described here in comparison with Oklahoma's legislation, two points deserve emphasis. First, while California's problems have been partially attributed to the sudden creation of an unregulated monopoly under the terms of AB 1890, the FERC also found that price spikes in Summer 2000 were at least partially caused by the charging of unjust and unreasonable rates of marketers, not only by natural market forces.⁹⁸ Second, rates in California in Summer 2000 were affected by the requirement that utilities purchase all supply through the CalPX power exchange, and through short-term contracts.⁹⁹ Without long-term forward contracts, utilities were forced to acquire power on the spot market, leaving them susceptible to price spikes that began appearing after the rate freeze on SDG&E was removed. Though the issue of a power exchange is not currently relevant to Oklahoma, the potential for anti-competitive practices could be a very real consequence of legislation that not only creates a potential monopoly situation, but also creates a market where competition exists, but where there is no adequate protection from anti-competitive behavior.

B. Pennsylvania's H.B. 1509

As previously discussed, not all states that have undergone electric restructuring have met with the problems of California. Pennsylvania's efforts have been fairly successful (despite the aforementioned difficulties), probably due to legislation that was better written. Pennsylvania's law was more careful to protect the developing competitive market than either AB 1890 or Oklahoma's failed SB 220, particularly in the areas of giving the regulatory body adequate power to oversee and facilitate the transition period, preventing the abuse of market power, and allowing time for a competitive market to develop before deregulation. In addition to provisions that the OCC Staff has recommended for Oklahoma, Pennsylvania's legislation offers certain alternatives that might be useful in fostering a competitive market. Here, in the discussion of SB 220, are comparisons of both California's AB 1890 and certain features of Pennsylvania's HB 1509 that might have contributed to Pennsylvania's more successful experience in restructuring.

97. *Staff's Electric Restructuring Status*, *supra* note 12, at 9.

98. Patrice Hill, *Experts Say California is Moving Toward Reregulation of Power Industry*, KNIGHT-RIDDER TRIBUNE BUS. NEWS, Feb. 16, 2001.

99. Ric Teague, *Regulators Cap San Diego Electric Rates*, ENERGY ONLINE, available at http://energyonline.com/restructuring/news_reports/0822ca.html, at 1 (Aug. 22, 2000).

C. Oklahoma's Senate Bill 220

1. Market Readiness

Before restructuring is undertaken, policy-makers and regulators should determine whether or not the market is capable of becoming competitive. If not, deregulation might only result in an unregulated monopoly.¹⁰⁰ For example, studies in the San Diego area might have revealed two important clues that deregulation could be problematic without careful supervision. First, throughout the transition period and up to the time the rate freeze was removed in San Diego, no alternate suppliers of energy had established themselves in the area.¹⁰¹ Supply was provided solely by one entity.¹⁰² Second, no new generation or transmission had come on line in California in ten years, and no studies had been done on how such constraints and future load growth could affect prices once deregulated.¹⁰³ Similarly, generation in Oklahoma is in the hands of only two utilities and one electric cooperative.¹⁰⁴ The last complete report of any kind on generation in Oklahoma was in 1995, covering the 1994 period,¹⁰⁵ meaning no comprehensive study has been done on whether generation capacity constraints currently exist and how this may effect rates in Oklahoma, though as previously noted, SB 440 now requires a study and report on transmission constraints by the end of 2001.¹⁰⁶

In addition to the lack of studies on generating capacity and transmission constraints, the OCC Staff asserted that regulators and legislators in California appeared not to have performed studies on issues such as load growth, market structure, and market power prior to restructuring, and noted adequate studies on these subjects have also not been done in Oklahoma.¹⁰⁷ The Staff urged these issues be addressed before deregulation, and noted, "such restructuring could actually cause rates for Oklahoma customers to increase. Because of this high level risk, comprehensive research and analysis regarding the likely impacts of restructuring in Oklahoma is essential before restructuring is allowed to go forward."¹⁰⁸

If Oklahoma studies generation and determines that it is in no danger of demand exceeding supply, as it did in California, some concerns about deregulation might be allayed. For instance, Pennsylvania's success may

100. Navarro, *supra* note 15, at 355.

101. Staff's *Electric Restructuring Status*, *supra* note 12, at 3.

102. *Id.* at 3.

103. Staff's *Electric Restructuring Status*, *supra* note 12, at 6.

104. OKLAHOMA CORPORATION COMMISSION STAFF, *Staff's Analysis of Final Version of SB 220*, available at <ftp://204.87.70.98/OCCFILES/sb220fin.doc>, at 2 (June 23, 2000) [hereinafter *Staff's Analysis*].

105. English, *supra* note 35. Though no official study exists, some utility executives note that fourteen new plants are being built in Oklahoma at this time and that the state will have a power surplus of over 30%. *The Debate: Deregulation*, DAILY OKLAHOMAN, Feb. 11, 2001, at 6A.

106. *Okla. S.B. 440*, § (4)(E)-(F).

107. Staff's *Electric Restructuring Status*, *supra* note 12, at 9.

108. *Staff's Analysis*, *supra* note 104, at 5

be attributed in part to it being an exporter of power.¹⁰⁹ The state will have capacity to meet demand for electricity when the rate caps are removed, hopefully saving them from rapid price spikes.¹¹⁰

a. Pilot Programs

In addition to such assurances, prior to full implementation, Pennsylvania's legislation required pilot programs to test if retail access could succeed in smaller areas before opening it to the entire state.¹¹¹ Pilot programs may be an option Oklahoma should consider before full-scale restructuring, especially since there are unknown variables, such as generation capacity and market concentration, in the market in Oklahoma, just as there were in California. Also of note, SB 220 barred recovery of stranded costs,¹¹² though the JEUTF report recommended further study, and so potential costs to the utility may be unknown.¹¹³ A trial run on a smaller scale could help work out kinks in the restructuring method or indicate whether statewide deregulation is feasible and perhaps eliminate some surprises before going to the effort and expense of restructuring the entire state.

2. Unbundling

When a state restructures its electric industry, it determines how generation assets will be separated from the regulated transmission and distribution segments of the utility. Legislatures and regulators usually choose between structural and functional separation and forced divestiture of generation assets.¹¹⁴ Structural separation means removing generation assets to a separate, though still affiliated company.¹¹⁵ Functional separation, as discussed *infra*, entails separation of accounting procedures for different divisions, without actually breaking generation off into a separate company.¹¹⁶ Divestiture requires the sale of generating assets to a non-affiliated entity.¹¹⁷

SB 220 required the filing of a functional or structural unbundling plan by September 30, 2001, under the supervision of the "appropriate oversight committee . . . developed *solely* at the discretion of the entity."¹¹⁸ This provision would give the utility a choice of whether it will separate its generation assets into a separate, affiliated company or simply separate the

109. *Power Play: Pennsylvania PUC can learn from California's deregulation mistakes*, HARRISBURG PATRIOT, Aug. 22, 2000, at A6.

110. *Id.*

111. *P.A. H.B. 1509*, § 2806(G).

112. *Okla. S.B. 220*, § 707 (B)(5).

113. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 20.

114. Navarro, *supra* note 15, at 355.

115. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 17.

116. *Id.*

117. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 17.

118. *Okla. S.B. 220*, § 706(A)(emphasis added).

generating function into a separate division.

Several concerns arise from allowing a utility in any state to choose functional unbundling. First, functional unbundling is less conducive to the development of a competitive market because it creates greater opportunities for discriminatory behavior by a utility in favor of its affiliate, for sharing of information, or cross-subsidization, all of which would give an affiliate an unfair competitive advantage over alternate suppliers of electricity.¹¹⁹ Where little competition exists or is struggling to develop, it would seem that anti-competitive conduct between a utility and its affiliate would be especially detrimental. Also, because of the need to monitor utility and affiliate conduct, functional unbundling requires more ongoing regulatory oversight than structural unbundling.¹²⁰

a. Affiliate-Supplier Relationships and Anti-Competitive Conduct

In Oklahoma, allowing the utility to choose functional unbundling may be of particular concern. First, the state's competitive market in generation is currently non-existent.¹²¹ Any risk of abuse created by the continued association contact of the affiliate also risks that development of adequate competition will be hindered. Second, under SB 220, the risk of abuse seemed especially great because there appeared to be no significant monitoring or enforcement provisions included in the bill to allow the OCC to monitor or remedy anti-competitive behavior.

SB 220 did expressly forbid anti-competitive behavior or self-dealing¹²² and discriminatory behavior in favor of one's affiliate.¹²³ In addition, SB 220 instructed regulated utilities with unregulated business segments to ensure that employees and divisions are separate and that there will be no preferential use of the distribution system or confidential information.¹²⁴ However, while anti-competitive behavior was forbidden, consumers and competitors were left little recourse in the event that these mandates are breached. Section 12 of the SB 220 required *the utility* and not the OCC or any other regulatory body to establish a complaint procedure for violations.¹²⁵ It seemed this provision would have not have required that any complaints by consumers to be reported to the OCC once they were received by the utility, and there was no mention in the Bill of remedies or sanctions. This provision appeared to allow self-monitoring, by letting the

119. REGULATORY ASSISTANCE PROJECT, *supra* note 21, at 2084.

120. NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, CODES OF CONDUCT GOVERNING COMPETITIVE MARKET DEVELOPMENTS IN THE ENERGY INDUSTRY: AN ANALYSIS OF REGULATORY ACTIONS, available at <http://www.naruc.org/Committees/Finance&Tech/Accounts/codesdraft.htm>, at 6 (2000). [hereinafter *NARUC CODE OF CONDUCT*].

121. As mentioned, two utilities and one electric cooperative owned all in-state supply at the time of the OCC's report. *STAFF'S ANALYSIS*, *supra* note 105, at 2.

122. *Okla. S.B. 220*, § 706(B)(2).

123. *Id.* § 706(B)(3).

124. *Okla. S.B. 220*, § 712(B)(1)-(8).

125. *Id.* § 712(B).

utility to determine whether or not to report that its affiliate may be acting in a discriminatory or anti-competitive manner toward other generation suppliers.

A later provision, section 21(A), required all generators, transmission entitles, suppliers, aggregators, and "oversight and supervisory" authorities to establish complaint procedures, including a toll-free hotline, and provide a written report of complaints to the Electric Consumer Complaint Division, to be established.¹²⁶ However, it was unclear whether the OCC or any other body would have the authority to spot-check whether complaints to utilities and suppliers were actually reported or how this provision should be enforced. However, assuming the OCC did not have supervisory power over complaint programs, there could have been a danger that complaints would not reach the appropriate authorities.

Even in the best of situations, anti-competitive and discriminatory conduct could be dangers when utilities are functionally unbundled. SB 220's loose enforcement provisions seemed as if they would increase that danger exponentially. Even if a utility chose structural over functional unbundling (which might be less likely because of the greater initial expense and difficulty), these complaint procedures could be inadequate. Allowing the utility to make the sole decision of how it will unbundle may not provide the regulator with the opportunity to choose the method most appropriate to the public interest. The regulator could consider the utility's past behavior, current business structure, the current market structure, or any number of factors, as some states, like New Jersey, have done and choose an unbundling method that would not be detrimental to the market or to the utility.¹²⁷

If legislation lacks adequate provisions for regulatory oversight of the restructuring process, as did SB 220, a requirement of structural unbundling of generation, to prevent cross-subsidization, anti-competitive conduct and preferential treatment between utilities and their affiliates would seem especially prudent.¹²⁸ Pennsylvania's approach did not to specify whether assets must be functionally or structurally unbundled but rather required that the regulatory body review each restructuring plan and gave that body the ability to accept, modify or reject the plan after notice and hearing.¹²⁹ This seems to give the regulator the ability to do what is best on a case-by-case basis, whereas SB 220 left all discretion as to method with the utility, with no express power for the OCC to modify or reject their plan.¹³⁰

126. *Okla. S.B. 220*, § 721(A).

127. A.B. 16, 204th Leg., 1st Reg. Sess. (N.J. 1999) (allows functional unbundling, but allows the regulatory body to require divestiture if it finds an entity possesses a level of market power having an adverse affect on the competitive market).

128. *NARUC CODE OF CONDUCT*, *supra* note 121, at 6.

129. *P.A. H.B. 1509*, § 2805(F).

130. *Okla. S.B. 220*, § 706 (A)-(B).

3. Market Power

When an entity owns all or a significant portion of assets (in this case generation) in an area, there is a possibility that the entity can manipulate prices or prevent others' entry into the market. When this happens, the entity is exercising market power.¹³¹ Market dominance could also arise when one entity controls non-owned assets. In the utilities' case, market dominance is legal, and until recently monopolies were encouraged by state regulators as the best way to provide electric service.¹³² However, even though the utility has done nothing wrong by dominating the market prior to deregulation, in order for a competitive market to develop, sometimes this market power must be broken up and prevented from redeveloping.¹³³ For example, if a utility or its affiliate owns or controls all or a significant portion of generation in an area, competitive suppliers cannot enter the market until they build a new plant. In addition, even after some alternate suppliers are able to enter the market, if too much of the market remains concentrated in one supplier, that supplier could use that power to an unfair advantage by controlling prices or preventing others from entering the market.

Prevention of market dominance, like discriminatory behavior, requires regulatory oversight. California's deregulation legislation appears not to have established a structure or means to adequately monitor or mitigate market power.¹³⁴ AB 1890 recognized the need to prevent an entity from exercising market power,¹³⁵ but did not contain provisions allowing the regulatory body to monitor, investigate, or mitigate that power. This may have created problems in San Diego, where generation was owned by only one provider, creating the potential for market manipulation and leaving the regulatory body without tools to prevent it.¹³⁶

Without proper controls, the same potential for market manipulation could be created in Oklahoma. There have been reports in Oklahoma, as in California, of some utilities withholding generation from the market (in addition to restrictions on transmission access).¹³⁷ However, SB 220 did not contain provisions for monitoring or mitigating market power.

Unlike SB 220 and AB 1890, Pennsylvania law gave its regulatory body power to monitor market power and prevent anti-competitive and discriminatory conduct.¹³⁸ The Pennsylvania Public Utilities Commission (PUC) can initiate an investigation on its own, or on another's complaint, and is directed to study the effects of "mergers, consolidations, acquisitions

131. Harry M. Trebing, *Concentration and the Sustainability of Market Power in Public Utility Industries*, ISSUELETTERS, available at <http://www.rapmainc.org/concentration.html> (1998).

132. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 5.

133. Trebing, *supra* note 132.

134. *Staff's Electric Restructuring Status*, *supra* note 12, at 8.

135. *Cal. A.B. 1890*, § 330(1)(3).

136. Ervin, *supra* note 36.

137. *Staff's Electric Restructuring Status*, *supra* note 12, at 11.

138. *P.A. H.B. 1509*, § 2811(a).

or disposition of assets or securities of electricity suppliers, transmission congestion and anticompetitive or discriminatory conduct affecting retail distribution of electricity.¹³⁹ Upon finding misconduct, the PUC has the option of referring its findings to the State Attorney General, the United States Department of Justice, the Securities and Exchange Commission or the FERC for enforcement,¹⁴⁰ where it may intervene in the proceedings.¹⁴¹ Such a provision would seem to give the regulatory body considerable power to monitor and mitigate market power and seek real enforcement of abuses, thereby protecting the consumers and the development of a competitive market.

4. Transfer of Assets

When a utility unbundles generation, it transfers its assets to an unregulated affiliate, if it does not completely divest the assets by selling them to a non-affiliated entity.¹⁴² The transfer of assets to what will become its unregulated affiliate (whether structurally or functionally separated) is in a sense a kind of sale in itself, involving pricing. Often, states, such as Pennsylvania, require regulatory approval of such transfers, though SB 220 did not.

SB 220 mandated that transferred assets would be transferred at book value, rather than at market value.¹⁴³ The OCC Staff argued that assets should be transferred at market value, to prevent cross-subsidization of the affiliate by the utility, thereby discriminating against potential competitors.¹⁴⁴ In Oklahoma, generating assets are older, and have already been depreciated, making their book value lower than the market value of generation.¹⁴⁵ The Energy Information Administration (EIA) estimates that average selling price for generation ranges from 1.5 to over 2.5 times book value, despite variations in price dependant on fuel.¹⁴⁶

139. *Id.* § 2811(b).

140. *P.A. H.B. 1509*, § 2811(d)(1).

141. *Id.* § 2811 (d)(3).

142. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 17.

143. *Okla. S.B. 220*, § 706 (2). Book value is the cost of the plant less accumulated depreciation. ENERGY INFORMATION ADMINISTRATION, THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 1999: MERGERS AND OTHER CORPORATE COMBINATIONS, *available at* http://www.eia.doe.gov/cneaf/corp_str/chapter6.html, at 8 (1999).

144. *STAFF'S ANALYSIS*, *supra* note 105. However, SB 220, as discussed *infra*, disallowed recovery of stranded costs for reasons that are unclear. Similarly, transferring assets at book value, if less than market value, raises the issue of whether allowing such a transfer is a disservice to ratepayers, after they have in a sense funded the construction and purchase of such assets, but have no hope of benefiting in any way from their sale, and if stranded costs are allowed to be recovered in relation to a transfer at book value, they might even be forced to compensate the utility, even as its holding company benefits from the transfer.

145. *Id.*

146. ENERGY INFORMATION ADMINISTRATION, THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 1999: MERGERS AND OTHER CORPORATE COMBINATIONS, *available at* http://www.eia.doe.gov/cneaf/corp_str/chapter6.html, at 8 (1999). The EIA notes that there is a large variation in the selling price of generation assets, depending on the type of fuel used. Coal-fired plants

Transferring assets to an affiliate for book value provides the affiliates with assets at a much lower cost than for which it could buy them on the open market. A non-affiliated competitor wishing to enter the market would have no choice but to buy assets at the higher market value, which would then be reflected in its rates. This results in an unfair competitive advantage for the affiliate.¹⁴⁷ The requirement that assets be transferred at book value appears inconsistent with SB 220's direction that there be no discriminatory behavior towards a non-affiliate.¹⁴⁸

Some restructuring legislation has not specified a value for transfer of assets, but left these determinations to the regulatory body. Pennsylvania's legislation did not indicate how assets should be transferred when unbundled, but did require the regulatory body to approve such transfers,¹⁴⁹ allowing evaluation of the fairness of the transaction to all involved. California's legislation also made no provisions for how assets should be valued if transferred to an affiliate, but what effects this provision would have had on San Diego are uncertain, since SDG&E divested all of its assets.¹⁵⁰

5. Commission Finding that Competition Exists

SB 220 did not allow for any mechanism for delay of deregulation in the event of unforeseen problems nor did it require the OCC or any other regulatory body to determine that sufficient competition exists before deregulation would go forward in July 2002. The OCC Staff argued in its report that legislation should require an official finding by the OCC that competition exists before full deregulation is allowed to proceed.¹⁵¹ With such a provision, the OCC would only completely deregulate generation in an area if it found that sufficient competition was present, in order to prevent creation of an unregulated monopoly or a market where competition was not sufficiently controlling prices.

The OCC Staff's concerns over the absence of this provision from SB 220 could be warranted. San Diego is an example of where a similar provision might have been helpful, but California's AB 1890 contained no provision that the regulatory body find competition existed before rate freezes were removed. Thus, the California Public Utilities Commission (CPUC) had no choice but to remove the rate freeze in San Diego once SDG&E's stranded costs were fully recovered. A requirement in Oklahoma's bill for an OCC finding might prevent the same situation from occurring in that state.

usually sell for more than gas-fired plants (the two main types used in Oklahoma), but the EIA notes that despite these variations, selling prices for all types of plants, except nuclear, are still "relatively high." *Id.*

147. *Staff's Analysis, supra* note 104, at 4-5.

148. *Okla. S.B. 220*, § 706(c).

149. *P.A. H.B. 1509*, § 2805(F).

150. *Staff's Electric Restructuring Status, supra* note 12, at 4.

151. *Staff's Analysis, supra* note 105, at 5.

a. Commission Ability to Delay Deregulation

While Pennsylvania's legislation also did not contain a requirement for such a finding, it did allow its regulators to delay restructuring under certain criteria, which appears to serve a similar function of preventing deregulation before the market is ready. Pennsylvania's restructuring act, HB 1509, granted the Pennsylvania PUC the power to delay implementation of the restructuring act six months in the event that: (a) immediate implementation would affect reliability; (b) information systems were not yet functional and up to standards; (c) generators would be put at a disadvantage, or (d) if immediate implementation was found to be against the interest of the Pennsylvania consumer, business' competitive position would be affected, or "other considerations that would materially affect implementation."¹⁵²

Pennsylvania's delay provision also seems helpful because any newly discovered dangers to consumers can be forestalled immediately and possibly remedied, while giving legislators a chance to act within the six months if they think necessary. This provision might be especially helpful to Oklahoma, where many unexpected problems could occur, due to the lack of studies on generation capacity and market power in the state. Also, another unexpected problem could arise if new legislation contained a Regional Transmission Organization (RTO) provision, as recommended by the OCC Staff and JEUTF Working group that might require a delay. While discussion of an RTO for Oklahoma is beyond the scope of this article, it should be noted that there is currently not an operational RTO in the region, and any in the works could potentially experience a delay in becoming operational by the time restructuring is implemented.¹⁵³ A delay provision would allow implementation to wait until transmission could be handled by the RTO. Finally, such a provision might be helpful for states such as Oklahoma that are deregulating after others, because they would be able to consider a delay if they notice that deregulation is a failing for some reason in another state, such as in California. In short, a delay provision would allow the regulator to protect consumers and the development of the market without having to wade through a legislative quagmire.

6. Rate Freezes

California's AB 1890 originally established a rate freeze during the transition period between January 1, 1998, and March 3, 2002.¹⁵⁴ Included in this rate freeze was also a mandated rate cut of 10% throughout the transition period.¹⁵⁵ This rate freeze was initially removed in San Diego in

152. P.A. H.B. 1509, § 2806(C)(1)(i)-(iv).

153. As discussed *infra*, the entity seeking to form an RTO that would include Oklahoma, Southwest Power Pool (SPP), has faced difficulties in getting approval by the FERC.

154. Cal. A.B. 1890, § 330(1)(1)(b)

155. Staff's *Electric Restructuring Status*, *supra* note 12, at 8.

June 2000, after SDG&E finished paying off its stranded costs earlier than anticipated.¹⁵⁶

SB 220 mandated that rates be frozen at current levels for two-and-one-half years for residential and small commercial customers and one-and-one-half years for large customers.¹⁵⁷ Two concerns arose from this provision: (1) the possibility that a rate freeze could deter competitors from entering the marketplace, and (2) the transition period in which control on rates would be effective was too short.¹⁵⁸

Criticism of SB 220's rate freeze provisions may have merit.¹⁵⁹ In San Diego, a rate freeze and mandated 10% reduction may have convinced potential new suppliers that they would be unable to beat the regulated rate, causing them to stay out of the market. In addition, the transition period in which the rate freeze was effective was too short to allow competition to develop.¹⁶⁰

a. Transition Period

A short transition period in which competitors are expected to enter the market may be an additional concern. Transition periods and rate freezes control prices long enough for competition to develop to a sufficient level to reduce prices through market forces. San Diego's rate freeze lasted only for a shortened transition period of only two-and-one-half years, allowing very little time for new entities to become interested in the market, purchase generation, and establish themselves with the public.¹⁶¹

Oklahoma's SB 220 mandated a rate freeze for a period from July 2002 to March 2005 for residential customers and smaller commercial customers with 200 kW or less peak demand, and a rate freeze for larger commercial customers for a period between July 2002 and January 2004.¹⁶² If the Bill had been passed with these parameters, potential generation owners in Oklahoma would have had to purchase or build facilities, bring them on-line, and establish themselves with large commercial customers in less than two years. In less than three years, generators would have to do the same thing for residential and small commercial customers, who might take longer than an industrial consumer to convince to switch to an alternate supplier. While some generators might have become established under this time line, there was a danger that a sufficient number of generators would not have been established to create a competitive market before price freezes were removed.

In contrast, Pennsylvania's HB 1509 contains two provisions that differ greatly from California's AB 1890 and SB 220: (1) rate caps, instead of

156. English, *supra* note 35.

157. *Okla. S.B. 220*, § 708(A)(2).

158. *California Case Study*, *supra* note 37, at 2.

159. *Id.*

160. *California Case Study*, *supra* note 37, at 2.

161. *Id.*

162. *Okla. S.B. 220*, § 708 (A)(1).

a rate freeze, and (2) a lengthy transition period. Pennsylvania's transition period and rate caps actually contain two components: (1) rates for non-generation services provided by the utility to both those purchasing generation from the utility and those choosing an alternate supplier are capped for a period of fifty-four months;¹⁶³ and (2) the generation component of a utility's charges are capped at current levels for nine years.¹⁶⁴ This means that customers have the option to buy generation at current rates for almost a decade, while the competitive market develops and is able to undercut the utility's price.

As previously discussed, the market in Pennsylvania has reached a point where suppliers cannot undercut the utility's price, and many customers have returned to the utility.¹⁶⁵ The competitive market has not yet sufficiently developed in Pennsylvania to lower prices below the regulated rate, despite the fact that restructuring was implemented almost five years ago. However, because of the lengthy transition period, customers are protected for at least five more years. Considering that four years has not been long enough in Pennsylvania to develop a competitive market, SB 220's two and three-year freeze and transition period seem inadequate.

7. Default provider

When electric restructuring is implemented, and consumers are allowed to choose an alternate supplier, there will be customers who fail to make a choice of supplier, or who do choose, but later want to return to the utility.¹⁶⁶ Legislation must direct who will serve these customers. Depending on what option customers are given, this could result in a windfall to the utility's affiliate. Three choices that legislators often choose are the utility itself, an affiliate, or a bidding process by all alternate suppliers for the right to serve these default customers.¹⁶⁷ Because San Diego's SDG&E divested its assets to only one provider, nothing in that city's experience is relevant to Oklahoma on this issue.

Oklahoma's SB 220 contained two provisions regarding service for customers who chose not to switch to an alternate supplier. First, during the transition period, a utility *or its affiliate* would have been obligated to provide service to eligible residential and small commercial retail consumers between July 2002 and March 2005, and large customers between July 2002 and January 2004.¹⁶⁸ After these periods, the utility *or its affiliate* would have obtained the supply by competitive bidding.¹⁶⁹ Second, residential and small commercial customers who had switched to an alternate

163. P.A. H.B. 1509, § 2804(4)(9)(a)-(b).

164. *Id.* § 2804(4)(ii).

165. DEPARTMENT OF ENERGY, *Electric Restructuring Weekly*, available at www.crcn.doc.gov/electricity_restructuring/weekly/jul6_01.html (July 6, 2001).

166. *Id.* at 8.

167. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 57-59.

168. Okla. S.B. 220, § 708(A)(1).

169. *Id.*

supplier could return to the utility *or its affiliate* after one month's notice,¹⁷⁰ though large customers were excluded from this option.¹⁷¹

Such provisions may be problematic. They would give the utility the option of shifting captive customers they over to an affiliate to the detriment of its competitors. During the transition period when the utility and affiliate would not be required to use competitive bidding to supply must-serve customers, the affiliate could serve them, build up its goodwill with the customers, who might then never venture into the competitive market. Unlike a non-affiliated supplier, that must work to attract every single customer, the affiliate would be starting up its business with a guaranteed customer base.¹⁷² This would appear to be preferential treatment for the affiliate and would not create the environment necessary to building a truly competitive market.

Instead of requiring an affiliate to serve default customers, legislation requiring the utility itself to serve these customers on a cost-of-service basis (recommended by the JEUTF Working Group Report),¹⁷³ or using competitive bidding among all suppliers could prevent the affiliate from gaining unfair advantage. Pennsylvania's HB 1509, for instance, requires the distribution utility to remain the provider of supply for those customers not being served by an alternate supplier.¹⁷⁴ This inhibits the affiliate from gaining an unfair advantage, while at the same time, assures legislators and regulators that these customers will be served by a reliable entity.

8. Regional Transmission Organizations or Independent System Operator

Well-designed RTO's or ISO's may facilitate deregulation because they remove functions such as scheduling on the transmission system from the utility's control, thereby curbing potential collusive action or preferential treatment by the utility over the use of its transmission system and can aid in regional coordination and planning. Both California's AB 1890 and Pennsylvania's HB 1509 require their utilities to join an ISO.¹⁷⁵

Oklahoma's JEUTF working group studied the potential benefits and feasibility of requiring Oklahoma utilities to join an RTO or an ISO, and recommended such a requirement.¹⁷⁶ In addition, an entity in the Oklahoma area, SPP filed with the FERC to become an RTO under Order No. 2000 in October 2000.¹⁷⁷ The FERC rejected SPP's filing for RTO status in

170. *Okla. S.B. 220*, § 708(B)(2).

171. *Id.* § 708 (C).

172. REGULATORY ASSISTANCE PROJECT, *supra* note 17, at 4.

173. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 57.

174. *P.A. H.B. 1509*, § 2802(16).

175. *Cal. A.B. 1890*, § 330(l)(1); *P.A. H.B. 1509*, § 2805(A)

176. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 8.

177. Southwest Power Pool, *RTO Proposal of SPP, Inc.*, Docket No. RTO1-34-000 (Oct. 13, 2000); *See also* Order No. 2000, *Regional Transmission Organizations*, F.E.R.C. STATS. & REGS. ¶ 31,089 (2000) [hereinafter *Order No. 2000*].

July 2001 for failure to comply with the scope and regional configuration requirements of Order No. 2000, and directed SPP to enter into mediation with Southeastern groups seeking RTO status in an effort to create on large Southeastern RTO, which is pending.¹⁷⁸ Therefore, it is reasonable to assume that Oklahoma utilities would be able to join an RTO in the near future.¹⁷⁹ However, despite JEUTF recommendations and OCC Staff recommendations and the feasibility,¹⁸⁰ SB 220 did not require utilities to join an RTO or an ISO, which may cause issues to arise over control and access to the transmission system after restructuring.

IV. CONCLUSION

Electric restructuring success depends on legislation that facilitates the development of a competitive market. For legislation to accomplish this goal, it should contain basic provisions to prevent anti-competitive practices, unfair advantages to utility affiliates, adequate monitoring and control provisions allocated to the regulatory body, and mechanisms to prevent the re-creation of an unregulated monopoly. Looking at the example of California, suggestions of the OCC Staff, and provisions of a more successful effort, such as Pennsylvania, former SB 220 may have been inadequate to foster competition.

From the examples presented here, it follows that future legislation in Oklahoma as well as other states might need provisions for controlled implementation of restructuring to market abuses and creation of an unfair advantage for the affiliate. Such provisions include designating the regulator to oversee deregulation. Such oversight would mean investing the OCC with the power to facilitate restructuring through the transition period and monitor abuses of the system afterward. For Oklahoma, the OCC should have the power to monitor, remedy, and sanction market-power abuses, cross-subsidization, discriminatory practices of the utility, and preferential treatment and transactions between a utility and an affiliate. In addition, the Commission would need the ability to modify the utilities' restructuring plans, so that unbundling will be done in such a way that will not create a disadvantage to the consumer or other competitors. Legislation could perhaps allow the regulator the authority to briefly delay competition in case of certain circumstances. Above all, the regulator should be able to control the transition to a competitive market if a required precondition was a finding.

Legislative controls, in addition to regulatory oversight, have a strong role in ensuring the creation of a competitive market. Legislation should probably require structural unbundling, to limit problems arising from close contact between the utility and its affiliate, or at least provide for

178. Order Rejecting RTO Filings, *RTO Proposal of SPP, Inc.*, Docket No. RT01-34-000 (July 12, 2001.)

179. *Order No. 2000*, *supra* note 160, at 31,227.

180. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 8; *Staff's Electric Restructuring Status*, *supra* note 12, at 14.

strict monitoring of affiliate relationships if functional unbundling is permitted. Generation assets should be transferred to the affiliate at market value to prevent it from gaining a competitive advantage over alternate suppliers.

Comparison of California's and Pennsylvania's experience teaches that the transition period to full deregulation, a legislative provision, is important in allowing alternate suppliers to establish themselves, and should be sufficient to accommodate that objective. Also, rate reductions, freezes or caps must be thoughtout carefully, and not set so low that they block market entry. Additionally, the default provider should not be the affiliate, to prevent unearned acquisition of a guaranteed market over nonaffiliated generators. To prevent utilities from blocking alternate suppliers transmission system access, legislation should require utilities to join ISOs or RTOs to discourage discriminatory access to the transmission system. Finally, before restructuring is implemented, it seems imperative that legislation direct studies to be done in areas such as generation capacity, transmission capacity, and market power to ensure that Oklahoma's current market structure is suitable for restructuring.

In conclusion, a successful restructuring effort in Oklahoma will require legislation that contains the appropriate safeguards for creating a competitive environment. Where states' legislation contains those controls, such as Pennsylvania, restructuring can be successful and result in savings for the consumer. A bill such as SB 220 may lack provisions designed to foster the success of deregulation. If legislation lacks such protections, typified by California's AB 1890, restructuring can resulting in price increases and even shortages, placing the consumer in a worse position then where they started.

Electric restructuring and factors needed in implementing legislation are being studied once again by legislators in Oklahoma. These legislators may be looking to past measures, such as SB 220, and the experience of states such as California and Pennsylvania in order to chart their course for deregulation. How and when deregulation occurs in Oklahoma will depend on careful study of successes an dfailures in deregulation, as well as Oklahoma's own unique attirubtes. Hopefully, additional studies now occurring in that state will prevent Oklahoma consumers already enjoying relatively low-cost electricity¹⁸¹ from experiencing the hefty rate increases and reliability problems experienced in California.

Stacie Hayes

181. JOINT ELECTRIC UTILITY TASK FORCE, *supra* note 14, at 5.

