

REPORT OF THE COMMITTEE ON INDEPENDENT POWER

I. FERC DECISIONS IMPLEMENTING OPEN-ACCESS TO TRANSMISSION

In 1994, the Federal Energy Regulatory Commission (FERC or the Commission) began to resolve many of the questions regarding access to transmission service that were not resolved by the Energy Policy Act of 1992 (EPAAct).¹ The FERC created a comparability requirement in the context of a voluntary open-access transmission tariff in *American Electric Power Service Corp.*² In addition, the FERC implemented section 211 transmission orders in 1994,³ issuing its first final orders and refining some of the requirements of good faith requests left undefined in its 1993 policy statement on good faith transmission requests.⁴

A. FERC Comparability Decisions

In *American Electric Power Services Corp. (AEP)*, the FERC found that any open-access tariff that failed to offer “third parties access on the same or comparable basis, and under the same or comparable terms and conditions as the transmission provider’s uses of its system” constitutes an unduly discriminatory tariff under section 205 of the Federal Power Act (FPA).⁵ One month earlier, in *New England Power Pool*,⁶ the FERC had announced its intention to apply the section 205 test for “unduly discriminatory” rates in a new context. In *New England Power Pool*, the FERC stated that competitive changes in the bulk power market required a change in the traditional undue discrimination analysis. The traditional approach involved examining discriminatory treatment of similarly situated customers. The new approach involves analyzing differences in treatment of third party customers and owners of transmission systems. The FERC had previously approved American Electric Power Services’ (AEP’s) open-access tariff without a hearing on the intervenors’ claims of undue discrimination.⁷ On rehearing, the FERC agreed with intervenors’ contention that the tariff’s limitation of transmission service customers to firm, point-to-point service on a minimum one month contract basis, while allowing AEP substantial flexibility of use, gave AEP a competitive advantage in the sale of off-system power.⁸ To implement comparability, the FERC instructed

1. Pub. L. No. 102-486, 106 Stat. 2776 (1992).

2. 67 F.E.R.C. ¶ 61,068 (1994).

3. 16 U.S.C. § 824j(a) (1988 & Supp. V 1993).

4. See *Policy Statement Regarding Good Faith Requests for Transmission Services and Responses by Transmitting Utilities under Sections 211(a) and 213(a) of the Federal Power Act, as Amended by the Energy Policy Act of 1992*, 58 Fed. Reg. 38,964 (1993) (codified at 18 C.F.R. § 2.20 (1994)).

5. 67 F.E.R.C. ¶ 61,068, at 61,490.

6. 67 F.E.R.C. ¶ 61,042 (1994).

7. *American Elec. Power Serv. Corp.*, 64 F.E.R.C. ¶ 61,279 (1993).

8. *Id.* at 61,490.

each utility seeking an open-access transmission tariff to perform an analysis to determine the actual uses made of its transmission system and the costs associated with those uses, and to identify any constraints to providing comparable services to third parties.⁹ The FERC was unable to determine the answers to these questions based on AEP's open-access tariff filing. Accordingly, the FERC ordered an evidentiary hearing on comparability before an administrative law judge (ALJ). The FERC later stated that the purpose of the hearing was to "focus on what may constitute the same or comparable service and what is the cost of providing the same or comparable service."¹⁰ The FERC underscored however that the ALJ was only to develop the evidentiary record and not to determine the rates for comparable services.¹¹ Similarly, evidentiary hearings have been required in connection with subsequent open-access tariff filings.¹²

In *LG&E Power Marketing, Inc.*, the FERC held that proposed comparability open-access transmission tariffs must establish specific rates, terms, and conditions for offering comparable services, and cannot be negotiated with customers on an as-needed basis.¹³ In *Kentucky Utilities Co.*, the FERC required a utility to offer a network services tariff regardless of whether current customers' needs are limited to point-to-point transmission.¹⁴

In *El Paso Electric Co. and Central and South West Services, Inc.*, the FERC conditioned approval of a proposed merger on the adoption of comparable services open-access tariff to mitigate any transmission market power increase that might result from the merger.¹⁵ *El Paso* extended the comparable services requirement to cover all future mergers, whether or not the merger produced an increase in transmission market power.¹⁶ The FERC found that a transmission tariff that fails to offer comparability is unduly discriminatory, and that comparable access to transmission must be maintained in a competitive wholesale marketplace. The FERC also adopted comparability as a means to mitigate transmission market power of power generators and their affiliates charging market based rates,¹⁷ as a part of its policy on regional transmission groups,¹⁸ and as part of its transmission pricing policy adopted in October.¹⁹

9. *Id.* at 61,491.

10. *American Elec. Power Serv. Corp.*, 67 F.E.R.C. ¶ 61,317 (1994) (clarification order).

11. *Id.*

12. *See, e.g., Kansas City Power & Light Co.*, 67 F.E.R.C. ¶ 61,183 (1994); *Northern States Power Co.*, 67 F.E.R.C. ¶ 61,240 (1994); *Commonwealth Elec. Co.*, 68 F.E.R.C. ¶ 61,400 (1994).

13. 68 F.E.R.C. ¶ 61,247, at 62,120-21 (1994).

14. 69 F.E.R.C. ¶ 61,260 (1994).

15. 68 F.E.R.C. ¶ 61,181 (1994).

16. *Id.* at 61,914-15.

17. *See* Part II, *infra*.

18. *See* Part III, *infra*.

19. *See Policy Statement on the Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act*, 59 Fed. Reg. 55,031 (1994).

B. Section 211 Transmission Orders

In *Florida Municipal Power Agency*, the FERC issued its first final order under section 211, establishing the terms and pricing for network service rendered by Florida Power & Light Co. (FP&L) for the Florida Municipal Power Agency (FMPA).²⁰ Because the parties could not negotiate acceptable network service terms during the 60 day negotiating period imposed by FPA section 212(c)(1) after the issuance of the proposed order, the FERC set the pricing policy, adopting FP&L's proposal to incorporate FMPA's native load as part of FP&L's native load to assign a pro-rata share of system fixed costs.

In *Minnesota Municipal Power Agency v. Southern Minnesota Power Agency*, the FERC issued its first final transmission order asserting rate jurisdiction over a transmitting utility that was not a public utility subject to FERC rate jurisdiction under sections 205 and 206 of the FPA.²¹ The FERC stated that future transmission rate changes by Southern Minnesota would have to be filed at least 60 days notice going into effect to allow Minnesota Municipal Power Agency an opportunity to comment. The FERC also ruled that Minnesota Municipal Power Agency would be entitled to file complaints with the FERC in the transmission docket concerning any problems with the transmission service under existing rates, similar to the complaint procedures under section 206.

In *Old Dominion Electric Cooperative, Inc. v. Delmarva Power & Light Co.*, the FERC held that proposed and final transmission orders under section 211(a) would be limited to requiring the transmitting utility to provide only the transmission services initially requested in the requesting party's initial good faith request.²² Old Dominion initially requested firm network service from only one point of interconnection, with use of all other interconnections limited to an as available basis. Consequently, the FERC limited its proposed order to that request, rather than require the full network service Old Dominion subsequently requested.²³ In *Tex-La Electric Cooperative*, the FERC held that transmission pricing cannot be based on a pricing methodology calculated in a way that differs from the way in which the transmitting utility charges itself for use of its system.²⁴

In *American Electric Services Power, Inc.*, the FERC directed the Tennessee Valley Authority (TVA) to provide transmission services under an umbrella agreement on an as needed basis for AES Power, Inc., a power marketer.²⁵ The FERC held that requests for service under umbrella agreements conformed with the requirements for a good faith request. The FERC rejected TVA's contention that it was immune from FERC jurisdic-

20. 65 F.E.R.C. ¶ 61,125, *reh'g dismissed*, 65 F.E.R.C. ¶ 61,372 (1993), *final order*, 67 F.E.R.C. ¶ 61,167 (1994).

21. 66 F.E.R.C. ¶ 61,223, *reh'g dismissed*, 67 F.E.R.C. ¶ 61,075, *final order*, 68 F.E.R.C. ¶ 61,060 (1994).

22. 68 F.E.R.C. ¶ 61,169 (1994).

23. *Id.* at 61,766.

24. 67 F.E.R.C. ¶ 61,019, *final order*, 69 F.E.R.C. ¶ 61,269 (1994).

25. 69 F.E.R.C. ¶ 61,345 (1994).

tion pursuant to the Tennessee Valley Authority Act. The FERC also rejected AES Power Inc.'s contention that comparability principles require that TVA give its non-firm transmission services customers the same priority in curtailment situations as TVA's own off-system economy purchases to serve native load. The FERC held that native load customers were firm service customers and were entitled to a higher priority because they pay for the fixed costs of the transmission system regardless of how much energy they schedule. In contrast, non-firm transmission customers pay only for services they schedule. In this context, comparability requires only that TVA offer transmission customers the ability to upgrade their service to a firm level by paying for fixed costs no matter how much service is actually scheduled, thus sharing the costs of the system in the same way as native load customers. The FERC also approved TVA's proposal to allow AES Power, Inc. to upgrade its service to firm transmission status in curtailment situations by paying TVA's lost opportunity costs.

II. FERC POLICIES ON BLANKET APPROVAL OF MARKET-BASED RATES

In 1994, the FERC also dealt with a significant number of requests by power marketers, non-utility generators, brokers, and public utilities to obtain blanket approval to sell power at market-based rates. In response, the FERC reconsidered its approach to market-based rates for sales from unbuilt generation, developed a uniform rule adopting comparability to mitigate transmission market power, and tightened and clarified its rules on affiliate abuse and reciprocal dealing.

A. Sales from Unbuilt Generation

In *Kansas City Power & Light Co.*,²⁶ the FERC held that requests for market-based rates to be sold from unbuilt generation would no longer be tested for generation market dominance. Instead, entities seeking to charge market-based rates for power from new generation need only prove that their transmission market power has been mitigated and that they have no power to erect any barriers to entry. The FERC made this change in policy out of recognition that the wholesale competition resulting from the EPAct would ensure that no utility could obtain generation market dominance in the long-term bulk market if it does not already possess such dominance. Accordingly, the FERC abandoned examination of long-term generation market dominance, but maintained its policy of examining short-term market dominance resulting from existing generation.

B. Affiliate Sales

In *Heartland Energy Services, Inc.*, the FERC: (1) clarified the previously adopted tests for blanket approval to charge market-based rates; (2) incorporated comparability tariffs as a requirement for mitigating the trans-

26. 67 F.E.R.C. ¶ 61,183 (1994).

mission power of all entities, or their affiliates, who own or control transmission facilities and seek to charge market-based rates; and (3) restructured the rules for affiliate abuse and reciprocal dealing.²⁷ Heartland Energy Services, Inc. is a wholly-owned power marketing affiliate of Wisconsin Power & Light Co. (WP&L), and was the first affiliate of a major transmission-owning utility seeking such approval.

The FERC summarized its general standards for reviewing applications by affiliated power marketers for Commission authorization to transact at market-based prices in *Heartland*:

(1) The affiliated marketer must demonstrate that any affiliates that own or control generation have no market power in generation or have mitigated such market power. The affiliated marketer can make such a demonstration by: (a) showing that the entire output of such generating units is committed under long-term contract; (b) showing that its affiliates already are authorized to sell at market-based rates; or (c) submitting a market analysis that indicates that neither it nor any of its affiliates has market power in generation in the relevant markets;

(2) The affiliated marketer's affiliated public utility must have a transmission tariff on file that provides for comparable services;

(3) The affiliated marketer must agree not to sell power to or buy power from its affiliated public utility unless the Commission approves the transaction in a separate rate filing under section 205 of the FPA. If the affiliated marketer intends to use the transmission facilities of its affiliated public utility, it must commit to obtain any such transmission services under the affiliated utility's transmission tariff;

(4) The affiliated marketer must notify the Commission if it sells to, purchases from, or obtains transmission from a utility that has any business relationship with any affiliates, including the affiliated public utility;

(5) The affiliated marketer must not obtain non-sales services from the affiliated public utility unless it can demonstrate that its payment is not below market value for such services;

(6) The affiliated marketer must demonstrate that there are adequate procedures in place to ensure that market information is not shared between it and the affiliated public utility, or is shared on a comparable basis with non-affiliates;

(7) The affiliated marketer must notify the Commission of any change in the characteristics or information upon which the Commission relied in granting market rate authority.²⁸

WP&L had anticipated comparability and had made a comparability tariff filing analyzing its own system uses according to the standards of *AEP*. The FERC accepted WP&L's proposed comparability tariff for filing, subject to refund, and remanded it for a *AEP* type evidentiary hearing before an ALJ.²⁹ The FERC also authorized Heartland to charge market-based rates, subject to refund down to cost-based rates, starting on the day WP&L's revised comparability tariffs were submitted for filing.³⁰

27. 68 F.E.R.C. ¶ 61,223 (1994).

28. *Id.* at 62,060-66.

29. *Id.* at 62,063-64.

30. *Id.*

Because WP&L owned natural gas distribution facilities, the FERC made Heartland's market-based rates subject to rescission upon any complaint of discriminatory natural gas distribution service by a competitor of Heartland out of FERC's concern that WP&L could raise a barrier to entry in the generation market by refusing to provide gas services to any new entity proposing to generate electricity from natural gas to compete with Heartland or WP&L.³¹ Although power brokering activities are non-jurisdictional, the FERC applied affiliate abuse standards and prohibited Heartland from engaging in brokering activities for WP&L unless it did so without charge to prevent WP&L's ratepayers from wrongfully subsidizing Heartland's brokering activities.³²

In *LG&E Power Marketing, Inc.*, the FERC considered market-based rates proposed by a power marketer that was affiliated with a major transmission owning utility (Louisville Gas & Electric or LG&E) and several entities owning interests in qualifying facilities (QFs), and that itself owned a 25% interest in a QF.³³ The FERC applied the *Heartland* test and found that LG&E did not have generation market dominance and that all affiliated QF facilities were tied into long-term contracts. However, because the comparable open-access tariff filed by the affiliated utility was unacceptable, the FERC held that LG&E could not charge market-based rates anywhere in the country until the tariff was resubmitted to mitigate its transmission market power.³⁴ The FERC authorized LG&E to broker its affiliate's power at no cost, but required the affiliate to give other power marketers and brokers equal access to all shared marketing information.³⁵ In addition, the FERC rejected LG&E Power Marketing's request for a six month delay on quarterly transactional reports, holding that the reports were necessary to ensure reasonableness of charges, to monitor market power, and to prevent affiliate abuse.³⁶ Similarly, in the FERC letter order involving *Louis Dreyfus Electric Power* rejected a power marketer's attempts to claim confidentiality of market information as grounds for delaying quarterly reports of all transactions.³⁷

In *Intercoast Power Marketing Co.*, the FERC rejected Iowa-Illinois Power Co.'s (Iowa-Illinois) attempt to avoid the requirement that affiliates file comparable open-access tariffs by proposing that its affiliate, Intercoast, would engage in sales activities only in areas in which Intercoast could demonstrate that its competitors would not require the use of Iowa-Illinois' transmission system. Intercoast contended that it would not sell or buy power from any utility having direct interconnections with Iowa-Illinois' transmission system, or, in the alternative, that it would limit such activities to customers three transmission interconnections removed from

31. *Id.* at 62,064.

32. *Id.* at 62,065.

33. 68 F.E.R.C. ¶ 61,247 (1994).

34. *Id.* at 62,122.

35. *Id.* at 62,123.

36. *Id.*

37. *Louis Dreyfus Elec. Power Co.*, 68 F.E.R.C. ¶ 61,029 (1994).

Iowa-Illinois. The FERC held that the transmission market power of affiliates could not be mitigated except through a comparable services open-access tariff.³⁸ In rejecting the proposed approaches, the FERC stated that “attempting to determine the areas in which Intercoast’s competitors would not need comparable access to Iowa-Illinois’ system would be an administrative quagmire.”³⁹

In *Hermiston Generating Company, L.P.*,⁴⁰ the FERC extended the applicability of the *Heartland* comparability tariff to affiliates of generating entities charging market-based rates to specific customers under negotiated sales contracts. Hermiston Generating Company, L.P., owner of a 474 MW electric generating facility proposed to be located in Oregon, was indirectly owned in part by Pacific Gas & Electric Company (PG&E), a public utility owning generation and transmission facilities. Hermiston had obtained a contract with Pacificorp, a first tier competitor of PG&E, under which Hermiston would sell the entire output of its facility to Pacificorp at market-based rates for twenty years, with no power transmitted through PG&E’s grid. The FERC held that Hermiston’s affiliate, PG&E, possessed transmission market power that could have affected the bidding that resulted in the Pacificorp contract, and that this transmission market power was not mitigated through a comparable services open-access tariff. Although no disappointed bidders intervened to complain that PG&E’s transmission market power had prevented them from winning the Pacificorp contract, the FERC found that PG&E’s size might have enabled it to prevent other generators from competing with Hermiston. In that regard, the FERC stated, “while we cannot know whether PG&E’s market power did, in fact, preclude potential competitors from competing for this transaction, we believe the most effective way to assure that PG&E cannot foreclose potential competitors in situations such as this is to require it to file an open access transmission tariff.”⁴¹ The FERC also rejected Hermiston’s contention that the presence of section 211 transmission requests offered a better guarantee that transmission market power would be mitigated. The FERC denied Hermiston’s application for market-based rates without prejudice to a refiling in the event that PG&E adopted a new comparability tariff and Pacificorp issued a new procurement process for its power needs.

In *Morgan Stanley Capital Group Inc.*,⁴² the FERC gave blanket approval to charge market-based rates to a power marketer affiliated with a large international banking company that held various public utilities securities. The FERC held that the ownership of securities held for investment purposes created no market power issue. Because Morgan Stanley was affiliated with several QFs, the FERC ordered its power marketing affiliate, MS Capital, to make sales to and purchases from the QFs at cost-

38. *Id.* at 62,129.

39. *Id.* at 62,133.

40. 69 F.E.R.C. ¶ 61,035 (1994).

41. *Id.*

42. 69 F.E.R.C. ¶ 61,175 (1994).

based rates. The FERC also required MS Capital to report all of Morgan Stanley's transactions with entities that buy and sell power from MS Capital, despite MS Capital's contention that this requirement would be practically impossible to meet. The FERC announced that it would conduct a "generic proceeding" in the "near future" to consider the reporting requirements applicable to all public utilities selling power at market-based rates, including marketers. Finally, the FERC held that MS Capital did not have to include in its quarterly report electricity price risk management transactions such as options and futures in which no actual electric energy changes hands.

In *Electric Exchange Co.*,⁴³ the FERC rejected market-based rates for a power marketer which stated that limited partners in the company may eventually include subsidiaries or affiliates of investor owned utilities. The FERC also rejected a proposed 10% threshold interest for imposing its comparability tariff requirement for affiliates of entities seeking market-based rates.

C. Power Brokers

The FERC has held that it has no jurisdiction over power brokering activities because power brokers do not take title to power and thus are not wholesale sellers of power under the FPA.⁴⁴ Power brokers thus need not file rates with the FERC, and the FERC has taken no position favoring one form of brokering activity over another. In *Continental Power Exchange, Inc.*,⁴⁵ the FERC disclaimed jurisdiction over Central Illinois Public Service Company's computerized brokerage service that allowed buyers, sellers, and transmitters of electric power to communicate offers to provide or receive jurisdictional services. The FERC declined to endorse the service or make any determination regarding its effects on operational or reliability issues.

III. REGIONAL TRANSMISSION GROUP

In 1994, the FERC extended the requirements of comparability to all regional transmission group (RTG) filings. In two RTG filings approved by the FERC on the same day, *PacifiCorp* (on behalf of the Western Regional Transmission Association) (WRTA)⁴⁶ and *Southwest Regional Transmission Association (SWRTA)*,⁴⁷ the FERC elaborated on the requirements for a successful RTG agreement filing beyond those requirements contained in FERC's 1993 *Policy Statement on Regional Transmission Groups*.⁴⁸ In *SWRTA*, the FERC interpreted the RTG Policy Statement's requirement that an RTG agreement should impose on members an obligation to provide transmission services for other members on a basis consis-

43. 69 F.E.R.C. ¶ 61,435 (1994).

44. See *Chicago Energy Exch.*, 51 F.E.R.C. ¶ 61,054 (1990).

45. 68 F.E.R.C. ¶ 61,234 (1994).

46. 69 F.E.R.C. ¶ 61,099 (1994).

47. 69 F.E.R.C. ¶ 61,100 (1994).

48. III F.E.R.C. STATS. & REGS. ¶ 30,976 (1993).

tent with FPA sections 205, 206, 211, 212, and 213 as a requirement to offer a comparable services transmission tariff to all other members. The FERC reiterated that, under *AEP*, a transmission tariff must offer comparable services to avoid being unduly discriminatory or anti-competitive. The FERC stated that bilateral agreements for comparable services would give RTG member utilities the ability to discriminate against similarly situated transmission customers, and would be less efficient than a tariff.

The FERC stated that comparability tariffs must include specific terms, rates, and conditions for comparable services. The FERC allowed some flexibility, noting that the requirements could be met either by individual tariffs filed by RTG members or by a generic regional comparability transmission tariff filed by the RTG on behalf of all RTG members. While the FERC stated that such comparable services tariffs could also be extended to non-RTG members seeking transmission services, it imposed no general comparable services open access tariff requirement for them.

In *WRTA*, the FERC clarified the RTG policy statement requirement that an RTG must provide coordinated transmission planning to mean a requirement that the RTG develop one coordinated master transmission plan that members are unified behind. *WRTA* had proposed a planning committee to perform coordination functions and had instructed all members to make planning information available to it. The FERC held that this was not sufficient coordination, absent the adoption of an actual uniform transmission plan by members for proposal to various state siting and oversight authorities. The FERC also required non-RTG members to be allowed to attend planning meetings to air their future transmission needs.

Although the FERC conditionally approved the RTG filings of both the *WRTA* and the *SWRTA*, neither filing was allowed to go into effect until after comparability tariffs are filed and the single regional transmission plan is adopted as part of the RTG bylaws.

IV. ALTERNATIVE POWER POOLING INSTITUTION INQUIRY

On October 26, 1994, the FERC issued a *Notice of Inquiry Concerning Alternative Power Pooling Institutions Under the Federal Power Act* (Pooling Inquiry),⁴⁹ seeking public comment on issues related to alternative power pooling institutions and the role of traditional power pools in an era of increased competition due to increasing access to transmission services. FERC's decision to pursue this effort was based upon its interest in fostering the development of the existing bulk power market in the wake of EPAct and various state and industry proposals to develop alternative mechanisms for implementing these competitive changes.

In particular, the Commission seeks to determine what changes in regulation may be necessary to allow existing or newly created power pooling institutions to capture the benefits of competition in bulk power markets without unnecessarily sacrificing the coordination benefits of current pooling systems. Issues to be discussed in the inquiry include: (1) several Cali-

49. 59 Fed. Reg. 54,851 (1994).

ifornia utilities' responses to the California Blue Book Proposal⁵⁰ for retail access that call for restructuring the state electric industry by creating an entity known as a "poolco" to operate a short-term spot market for power by centrally dispatching all in-state generation according prices bid by generators; (2) more radical alternatives calling for the complete dis-integration of the electric industry into generation, transmission, and distribution companies that would possibly work in tandem with a poolco to increase competition and system reliability while eliminating the conflict of interest between utilities as producers of power and consumers of power; and (3) revisions to current power pooling regulations to facilitate competitive changes while retaining system coordination. The Commission invited public comment on the strengths and weaknesses of the above approaches.

V. STRANDED COST RECOVERY

A. Market Power Mitigation and Stranded Cost Recovery

In *Entergy Services Inc.*⁵¹ in 1992, the FERC approved the recovery of legitimate and verifiable stranded cost recovery as part of an open-access tariff for a utility seeking to charge market-based rates. Under the original tariff, wholesale customers that decided to stop purchasing electricity from Entergy and purchase transmission services for power purchased elsewhere, were to be assigned a stranded cost charge to account for idled generation.

In June 1994, in *Cajun Electric Cooperative, Inc. v. FERC*, the United States Court of Appeals for the District of Columbia remanded the *Entergy Services* tariff to the FERC for an evidentiary hearing to determine whether Entergy's transmission market power had been sufficiently mitigated to allow Entergy to charge market-based rates.⁵² The D.C. Circuit found FERC's failure to hold a hearing on mitigation of transmission market power to be "arbitrary and capricious" in the face of legitimate questions raised by intervenors concerning the stranded cost recovery provision's impact on competition.⁵³ The D.C. Circuit agreed with intervenors' contention that the incorporation of stranded generation investment costs in the transmission rates of departing wholesale customers could constitute a distortion of the market and might fail to mitigate Entergy's transmission market dominance.⁵⁴ The court used anti-trust principles to find that Entergy's control over the transmission system amounted to a "bottleneck monopoly," and that incorporation of a stranded generation investment cost as part of the transmission charge amounted to an illegal "tying" situation between Entergy's transmission and generation services.⁵⁵

50. See *Proposed Policies Governing Restructuring of California's Electric Services Industry and Reforming Existing Regulation*, 151 Pub. Util. Rep. 4th (PUR) 73 (1994).

51. 58 F.E.R.C. ¶ 61,234 (1992), *order on reh'g*, 60 F.E.R.C. ¶ 61,168, at 61,629-32 (1992), *rev'd and remanded sub nom. Cajun Elec. Coop. Inc. v. FERC*, 28 F.3d 173 (D.C. Cir. 1994).

52. 28 F.3d 173, at 175-77 (D.C. Cir. 1994).

53. *Id.*

54. *Id.* at 176.

55. *Id.* at 177-78.

The court also agreed with intervenors' contention that the concept of stranded investment could have "no meaning in a competitive market; since a surplus of productive capacity can always be readily eliminated simply by lowering the price."⁵⁶ The court also tacitly agreed that Entergy should use its market-based rates to lower the cost of its energy to a point low enough to make sufficient new off-system sales to recover generation investment costs without need of stranded cost recovery in transmission rates.⁵⁷ Finally, the court expressed concern that allowing Entergy to determine how much capacity was available on its transmission system could result in little available open-access service and could fail to mitigate transmission market power sufficiently to allow market-based rates.⁵⁸

B. *Stranded Assets and NOPR*

On June 29, 1994, the Commission issued a Notice of Proposed Rulemaking (NOPR) on *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*.⁵⁹ In the NOPR, the FERC discussed both wholesale and retail stranded costs. For wholesale stranded cost recovery, the Commission proposed allowing recovery of "any legitimate, prudent and verifiable costs incurred by a public utility or a transmitting utility to provide service to a wholesale requirements customer that subsequently becomes, in whole or in part, an unbundled transmission services customer."⁶⁰ For retail stranded recovery the Commission proposed either no recovery or intervention only when states fail to develop a policy, with the Commission expressing no preference for either alternative.⁶¹ In general, the Commission noted that it was appropriate to consider stranded investment costs (whether wholesale or retail) broadly to include not only generating capacity, but also fuel supply costs, purchased power costs, nuclear plant decommissioning costs, and regulatory assets.⁶²

FERC's proposal distinguished between old requirements contracts (contracts entered into prior to the publication date of the proposed rule) and new requirements contracts (contracts entered into after the publication date). New requirements contracts would not be affected by for the Commission's policy. Instead, parties would be required to negotiate explicit contractual provisions creating exit fees for stranded cost recovery, if desired. If no exit fee is negotiated, no stranded costs can be recovered for new contracts.

For existing requirements contracts, stranded costs would be recoverable only during a three-year transition period when all electric utilities would be encouraged to renegotiate existing contracts to include reasonable exit fees for stranded cost recovery. Where existing requirements con-

56. *Id.* at 179.

57. *Id.*

58. *Id.* at 180.

59. IV F.E.R.C. STATS. & REGS. ¶ 32,507 (1994).

60. *Id.* at 32,860.

61. *Id.* at 32,861-62.

62. *Id.* at 32,867.

tracts already contain exit fees, their terms would be controlling. Where existing contracts have no exit fees and none can be successfully bargained for between the parties during the three year period, the Commission's proposal authorizes utilities unilaterally to file proposed transition costs as proposed amendments for Commission approval under section 205 or 206. Where a given customer's contract expires during this three year transition period and a customer seeks to begin purchasing only unbundled transmission services under section 205 or section 211 of the FPA, the Commission's proposal authorizes the selling utility to apply for recovery of stranded costs through jurisdictional transmission rates.⁶³

In allowing recovery of stranded costs, FERC's proposed policy requires that: (1) the utility prove it incurred stranded costs based on a reasonable expectation that the wholesale contract would be extended;⁶⁴ (2) the utility must show that the stranded costs to be incurred are no more than the customer would have contributed to the utility had it remained a wholesale requirements customer of the utility; and (3) the utility must show that it has taken or will take reasonable and prudent measures to mitigate the impact of stranded costs (i.e. attempt to market and wheel power off-system). Because no public utility or transmitting utility has sought recovery of any specific stranded costs, the effect of such proposals upon independent power producers cannot be determined.

VI. RETAIL WHEELING

In 1994, a number of states began to consider authorizing retail wheeling due to pressure from industrial customers and some independent power producers seeking greater competition. Significant national attention was focused on retail wheeling proposals made in Michigan and California, while other states announced less-extensive inquiries into restructuring their state competitive environments.

A. California Public Utilities Commission

On April 20, 1994, the California Public Utilities Commission (CPUC) issued its "Blue Book Proposal" announcing its intention to restructure the regulation of the electric utility industry in California by allowing all consumers direct access to the competitive power market by 2002.⁶⁵ Under the initial proposal, open access to transmission would be provided to all customers under a program to be phased in for transmission level customers in 1996, for primary level distribution customers in 1997, for secondary level distribution customers in 1998, for commercial customers in 1999, and for all remaining customers by 2002. The CPUC proposal retains two tracks of

63. *Id.* at 32,861.

64. *Id.* at 32,873. Where a contract provides for a notice period for terminating service there should be a rebuttable presumption that there was no reasonable expectation that the contract would be renewed. *See Maine Pub. Serv. Co.*, 61 F.E.R.C. ¶ 61,319 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,226 (1993).

65. *Proposed Policies Governing Restructuring of California's Electric Services Industry and Reforming Regulation*, 151 Pub. Util. Rep. 4th (PUR) 73 (1994) (Blue Book Proposal).

service for all retail customers: under the first track customers would receive bundled transmission and generation service at cost-based rates from their current supplier just as they do now, but under the second track, customers could opt for retail wheeled power purchased elsewhere at market-based rates plus a retail transmission charge and a transition surcharge to recover the stranded costs of their former supplier. Customers choosing retail wheeling would be required to notify their current supplier within one year of leaving the supplier's system and could not later return to that supplier under the first track without giving one year's notice. The CPUC invited comments from all interested participants regarding these goals and methods to most effectively implement them.

The CPUC's proposal for industry restructuring has sparked competing proposals from Pacific Gas & Electric, San Diego Gas & Electric, Southern California Edison, and a ratepayer group known as Toward Utility Rate Normalization (TURN), all calling for various restructurings ranging from no retail access to a complete unbundling of integrated utility systems. The CPUC's proposal also led to intervention by the California State Legislature, which has created an Assembly-Senate Joint Oversight Committee on Lowering the Cost of Electric Service to assess the CPUC Blue Book Proposal and to obtain an overview of the competing proposals and their respective effects on various existing state legislative initiatives. Current timetables call for CPUC adoption of a final restructuring proposal for public comment by March 22, 1995, with such policy to become final in September of 1995 after allowing at least 100 days to coordinate the final restructuring plan with any required state legislative action. Many non-utility generators have advocated unbundling of utility generation and distribution functions in the restructured marketplace to prevent conflict of interest for public utilities, but this is only one possibility being considered.

B. Michigan Public Service Commission

On April 11, 1994, the Michigan Public Service Commission (MPSC) approved an interim order authorizing a limited five-year experimental retail wheeling program to be conducted to determine whether retail wheeling is in the public interest for Michigan retail customers. To implement the experiment, MPSC instructed Detroit Edison Co. and Consumers Power Co. to make 1% of their capacity available for retail wheeling to be implemented through retail transmission-only tariffs. Under the proposal, individual customers with greater than 5 MW demands will be able to receive retail transmission service using this capacity provided they arrange to purchase power elsewhere. Although MPSC has approved the limited retail wheeling proposal in principle, it remanded the case to an ALJ to determine the rates and charges for the required retail transmission service.⁶⁶ Detroit Edison appealed MPSC's interim order requiring them to provide retail transmission to a Michigan state court which dismissed the

⁶⁶ See *Re Association of Businesses Advocating Tariff Equity*, 150 Pub. Util. Rep. 4th (PUR) 409 (1994).

case as premature because MPSC had not issued an order fixing a rate. Detroit Edison then sought a declaratory order from the United States District Court for the Western District of Michigan stating that MPSC is preempted by the FERC through the power granted to it by the Federal Power Act from ordering retail wheeling.

C. Retail Wheeling Activity in Other States

The Connecticut Department of Public Utility Control has found that retail wheeling is not in the public interest at the present time and that it should not be introduced in Connecticut until utilities in the state require new capacity, which at current estimates will not be until 2005.⁶⁷

The Wisconsin Public Service Commission announced its intention to consider fundamental structural and regulatory changes aimed at encouraging Wisconsin electric utilities to function more efficiently in a market driven economy.⁶⁸ Retail wheeling is anticipated to be discussed in this proceeding and Wisconsin Electric Power Company has already made a proposal calling for the unbundling of all integrated utility services.⁶⁹

In July, 1994, the New York Public Service Commission (NYPSC) opened the second phase of its competitive opportunities proceeding in which it seeks to adopt principles to assist in the transition to a more competitive industry structure designed to increase efficiency in the provision of electricity while maintaining safety, environmental and service quality goals.⁷⁰ In December, the NYPSC issued for public comment a set of regulatory principles designed to guide the transition to greater competition. Among the nine principles was: (1) a commitment to provide "increased consumer choice of service and pricing options"; (2) a statement that more competition should bring less regulation; (3) a recognition that "the current industry structure, in which most power plants are vertically integrated with natural monopoly transmission and distribution, is incompatible with effective wholesale or retail competition"; and (4) a statement that utilities and IPPs "should have a reasonable opportunity to recover prudent and verifiable expenditures and commitments made pursuant to their legal obligations, as long as they are cooperating in furthering all of these principles" and "taking all practicable measures to mitigate transition costs."⁷¹

In 1994, the New Jersey Board of Public Utilities issued a draft New Jersey Energy Master Plan that declines to adopt retail wheeling for the

67. See *Re Investigation into Retail Electric Transmission Service*, 155 Pub. Util. Rep. 4th (PUR) 209 (1994).

68. See *Re Electric Utility Company Structure and Regulation*, 154 Pub. Util. Rep. 4th (PUR) 509 (1994).

69. See *Wisconsin Electric Urges Vigorous Steps in Restructuring of Industry*, ELEC. UTIL. WK., Nov. 7, 1994, at 1.

70. See *Re Competitive Opportunities Available to Customers of Electric and Gas Service*, 154 Pub. Util. Rep. 4th (PUR) 35 (N.Y.P.S.C. 1994).

71. See Press Release of State of New York Public Service Commission, *PSC to Seek Comment on Competitive Guidelines for Electric Industry*, Dec. 22, 1994.

moment given uncertainty about stranded cost recovery and the danger of having small ratepayers' rates increase.⁷²

The Maryland Public Service Commission has released an issue paper discussing four alternatives for future competition: (1) current wholesale competition only; (2) selective retail access for large customers; (3) common-carrier status for utilities requiring them to divest themselves of generation; and (4) full retail competition for generation, transmission and distribution.⁷³ No final position has been advocated however.

VII. IPP STATE, PROJECT, AND LITIGATION SPECIFIC ISSUES

A. *Federal Court Decisions Affecting QF Facilities*

In *Independent Energy Producers, Inc. v. California Public Utilities Commission*,⁷⁴ the United States Court of Appeals for the Ninth Circuit held that the CPUC was preempted by PURPA from authorizing a 1991 program in which electric utilities in California with QF contracts were allowed to monitor QF compliance with federal operating and efficiency standards and to use a lower "alternative" avoided cost rate whenever the utility determined a QF facility to be no longer in compliance with the Federal standards. Under the CPUC program, lower "alternative" avoided cost rates for non-complying QF facilities were set at 80% of the utility's current short-term avoided costs and utilities were authorized to retroactively apply alternative rates as far back as three years. The Ninth Circuit held that the CPUC's 1991 program represented an improper usurpation of FERC's exclusive jurisdiction under PURPA to determine whether a QF is in compliance with federal efficiency standards and that the program violated PURPA by denying QFs the benefit of receiving the full avoided cost rates to which they are statutorily entitled by PURPA. The court noted that while States have broad authority to implement the requirements of avoided cost rates, these requirements must focus on the individual utility's avoided costs and not on the degree of compliance with federal efficiency requirements by the QFs. The court rejected the CPUC's contention that states have the right to alter existing QF contracts where avoided costs were incorrectly estimated at the time of contracting, noting that federal regulations entitle QFs to deliver energy at an avoided cost rate calculated at the time the contract is signed, and States should only correct avoided cost imbalances prospectively through more flexible avoided cost rate proposals. If a utility is paying inflated avoided cost rates under an existing contract and wishes to challenge a QF's compliance with federal efficiency standards, it can either petition the FERC to decertify the QF (if the QF was ever certified by the FERC) or seek a declaratory order that the facility is no longer a QF (if it self-certified). As a final matter, the Ninth Cir-

72. See *N.J. Plan Urges 'Evolutionary' Course to Competition; No Retail Wheeling*, ELEC. UTIL. WEEK, Nov. 28, 1994, at 8.

73. See *MD. PSC Staff Sees Need For Electric Competition Despite Low Power Rates*, ELEC. UTIL. WEEK, Nov. 28, 1994, at 9.

74. 36 F.3d 848 (9th Cir. 1994).

cuit upheld the provisions of the CPUC program requiring QFs to submit compliance monitoring data to the affected utility purchasers of QF power to enable them to make decisions whether to pursue a non-compliance order with the FERC, so long as the reporting requirements do not impose a substantial burden on the QFs subject to them.

In *Liquid Carbonic Industries Corp. v. FERC*,⁷⁵ the United States Court of Appeals for the District of Columbia held that a competitor of a FERC-approved QF cogenerator's thermal host did not have standing to challenge FERC's certification of QF status for the cogenerator despite potential economic injury to the thermal host's competitor. The court found that the FPA's limited provisions for review require use of a standing test based on a zone of interest analysis that seeks to determine if the party making the challenge is an intended beneficiary of the regulation being administered. Under such an analysis second-tier competitors cannot be found to be intended beneficiaries of PURPA and they thus have no standing to challenge QF certification.

In *Bristol Energy Corp. v. State of New Hampshire Public Utilities Commission*, the United States Court of Appeals for the First Circuit upheld the New Hampshire Public Utilities Commission's (NH-PUC's) authority to apply EPAAct wholesale market business and financial disclosure requirements on QFs in the state.⁷⁶ The First Circuit Court rejected the QFs' contention that they were exempt from these requirements imposed by section 712 of EPAAct by virtue of section 292.602(c)(1)(ii) of the FERC's Rules⁷⁷ which exempts QFs from state laws or regulations respecting the financial and organizational regulation of electric utilities. The court held that the NH-PUC was seeking information on a one-time basis to complete a federally mandated study of wholesale power supplies and held that there was no reason to exclude QF's from the study.

B. FERC Decisions Affecting QF Facilities

In *Western Systems Power Pool*,⁷⁸ the FERC held that recent changes to EPAAct require the Western Systems Power Pool (WSPP) Agreement to be amended to provide that a QF may become a member of the pool without having to waive its PURPA rights to require a WSPP member utility to purchase electricity at that utility's avoided cost.⁷⁹ Although the WSPP members maintained for years that allowing QF membership without such a waiver would chill the competitive process in the pool and would require member utilities to make unwanted or unneeded purchases, the FERC held that there was no statutory or regulatory basis to discriminate against QFs regarding membership and participation in the WSPP, explicitly

75. 29 F.3d 697 (D.C. Cir. 1994).

76. 13 F.3d 471 (1st Cir. 1994).

77. 18 C.F.R. § 292.602(c)(1)(ii) (1994).

78. 55 F.E.R.C. ¶ 61,099, *order on reh'g*, 55 F.E.R.C. ¶ 61,495, *remanded in part and rev'd in part*, *Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991), *order on remand*, 66 F.E.R.C. ¶ 61,201 (1994).

79. 66 F.E.R.C. at 61,457.

reversing its prior position.⁸⁰ The FERC stated that there was no legitimate reason for requiring QFs to give up their statutorily created rights in exchange for membership. The FERC rejected a proposed unilateral settlement offered by certain QF intervenors that sought to set avoided cost rates for WSPP pool members at the purchase price that would otherwise be made on the pool according to the lowest offered price on the pool electronic bulletin board for comparable energy and/or capacity at the time of offer.⁸¹ The FERC found that this price could, at times, be higher than a member utility's actual avoided costs and might allow QFs "to pick and choose the most favorable rate".⁸² Accordingly, the FERC ordered the WSPP to amend its agreement to allow QFs full and nondiscriminatory access to membership and authorized QFs to charge standard state-regulated avoided cost rates to other WSPP members.

In *LG&E—Westmoreland Southampton*, the FERC rejected a QF facility's application for a second waiver of compliance standards, holding that a major reason for the facility's non-compliance was due to circumstances within the operator's control.⁸³ The FERC stated that the Commission should not, through its waiver authority, insulate a QF from the risks of non-performance due to operator error or poor management oversight. In *United States Department of the Navy*,⁸⁴ the FERC rejected a QF waiver where a metering defect had been undiscovered by QF operators for over five years on the theory that unintentional management errors or oversights do not justify a waiver.

In *UNIGAS Corp.*,⁸⁵ the FERC disclaimed authority to grant requests to revoke QF status for QF facilities that self-certified themselves by filing a notice of self-certification with the Commission under section 292.207(a)(2) of the FERC's Rules.⁸⁶ The FERC explained that it has authority to revoke certification only for QF facilities that are certified by it under section 292.207(b) of the Federal Rules.⁸⁷ Utilities wishing to challenge a self-certified QF facility must instead file a petition for a declaratory order that such a facility no longer is operating in accord with all QF requirements.⁸⁸ In *Syracuse Power Co.*⁸⁹ and *Medina Power Co.*,⁹⁰ the FERC applied this rule to dismiss two other requests for revocation of QF status in instances involving petitions for revocation of QF status.

80. See *Western Sys. Power Pool*, 55 F.E.R.C. ¶ 61,099, at 61,322-23, *order on reh'g*, 55 F.E.R.C. ¶ 61,495, at 62,715-16 (1991).

81. 55 F.E.R.C. ¶ 61,099, at 61,322-23.

82. *Id.* at 61,459.

83. 68 F.E.R.C. ¶ 61,034 (1994).

84. 69 F.E.R.C. ¶ 61,304 (1994).

85. 67 F.E.R.C. ¶ 61,142 (1994).

86. See 18 C.F.R. § 292.207(a)(2) (1994).

87. See 18 C.F.R. § 292.207(d)(1), § 292.207(b) (1994).

88. See 18 C.F.R. § 385.207(a)(2) (1994) (petition for declaratory order).

89. 67 F.E.R.C. ¶ 61,195 (1994).

90. 67 F.E.R.C. ¶ 61,357 (1994).

C. *Project Specific State Precedent*

In *Re Sithe/Independence Power Partners, L.P.*,⁹¹ the New York PSC (NY-PSC) authorized a QF facility owned by Sithe/Independence Power, L.P. to sell electricity at retail to its would be steam hosts, Alcan Rolled Products Corp. and Liberty Paperboard. The grant of the certificate of public convenience to allow the retail sales was conditioned on the payment of an "equalization fee" by Sithe/Independence to Niagara Mohawk to reimburse it for lost contributions to fixed costs associated with its loss of Alcan as a retail customer. The "equalization fee" would also mitigate the extent to which investment undertaken to serve Alcan and other local growth now falls on Niagara Mohawk's other customers, and cover as well contributions to demand side management and other programs made by Niagara Mohawk that would otherwise be lost as a result of Sithe/Independence retail sales. The NY-PSC also rejected Niagara Mohawk's claims of anti-competitive practices by Sithe/Independence in taking the retail service of Alcan.

VIII. SECURITY EXCHANGE COMMISSION ISSUES

In January of 1994, the Securities and Exchange Commission (SEC) Office of Public Utility Regulation issued a no-action letter that indicated that the SEC will not recommend Public Utilities Holding Company Act⁹² enforcement action against Enron Power Marketing, Inc., an affiliate of a natural gas pipeline that received authorization from the FERC to engage in wholesale electric power marketing in late 1993.⁹³ The SEC believes that power marketers are not "electric utilities" as defined in the Act.

In November, 1994, the SEC voted to solicit comments on reforming PUHCA in a "concept paper" release that called for comments to "address the overall regulatory structure for public utility holding companies, and to consider the appropriate role of a federal holding company statute, particularly in view of the work of the Federal Energy Regulatory Commission and state and local regulators."⁹⁴ Topics addressed in the concept paper include: adjusting regulatory responsibility among current regulators for transaction approvals; the possibility of increasing state regulatory oversight as SEC oversight is reduced; reforms of financing, intrasystem transactions, and utility acquisitions; reforming exemptions from the act; and altering reporting and accounting requirements.

91. 155 Pub. Util. Rep. 4th (PUR) 149 (1994).

92. 15 U.S.C. § 79z (1988 & Supp. VI 1994).

93. *Enron Power Marketing, Inc.*, 1994 SEC No-Act. LEXIS 42, at *1 (Jan. 5, 1994).

94. *SEC Issues 'Concept' Paper Setting Stem-To-Stern Review of PUHCA*, INSIDE FERC, Nov. 7, 1994, at 1.

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