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**FEDERAL ELECTRICITY RESTRUCTURING:**  
*A Northeast Perspective*

A Report to the Coalition of Northeastern Governors  
Prepared by the CONEG Energy Working Group

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This report was prepared by the CONEG Policy Research Center, Inc., under the guidance of the CONEG Energy Working Group. The findings do not represent the views or opinions of the Coalition of Northeastern Governors (CONEG) or its individual member Governors.

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# EXECUTIVE SUMMARY

The Northeast states are leading the way to competitive retail electricity markets. Most Northeast states have implemented legislative and regulatory actions to increase consumer choice and reduce the region's historically high electricity costs. The region's rapid progress towards competitive electricity markets offers a prism through which to consider the relationship of state and federal roles in this still evolving industry.

The 105<sup>th</sup> Congress helped generate awareness of the complex issues involved in industry restructuring through numerous hearings and consideration of various targeted and comprehensive legislative proposals. With this foundation, the 106<sup>th</sup> Congress is expected to give federal restructuring legislation a higher priority.

While final action on restructuring legislation may not be possible this Congress, a number of federal proposals are being discussed, some of which may be detrimental to the states. This report provides a short background on each issue and presents the unique interests and concerns of the Northeast states as Congress moves forward to address federal restructuring legislation.

## **Conclusion: in Brief**

These issues, addressed in federal legislative proposals, touch directly on the issue of state and federal roles, authorities and responsibilities. The resolution of these issues will bear directly on the Northeast states' ongoing progress in creating competitive retail electricity markets. It is essential that any federal legislation to address electric industry restructuring support and enhance **C** not impede or reverse **C** the progress of the Northeast states in creating competitive electricity markets. The Energy Working Group has proposed the following policy directions which should guide the development of any federal restructuring legislation.

- C**     **Reliability** - The federal government and the states must act in partnership to develop an appropriate mechanism to ensure adequate reliability standards. The states must also maintain authority over the reliability of the local distribution system and the right to set additional standards for their bulk power systems.
  
- C**     **Market Power** - States must be permitted to continue to work with Federal Energy Regulatory Commission (FERC) to pursue mitigation strategies where potential market power abuses are perceived. States must retain authority over market power at the distribution and retail level.
  
- C**     **Siting** - States must retain decision making authority for siting of all generation, distribution and transmission facilities.

- C **Disclosure** - Consistent standards for the disclosure by suppliers should be encouraged, and states and markets should be given adequate time to continue cooperation in developing consistent disclosure requirements. Therefore, a national mandate for uniform standards or a specific reporting format is not needed at this time.
- C **Stranded Costs** - States must retain the right to calculate stranded costs, and to determine the appropriate recovery method for these stranded costs.
- C **Renewable Energy** - States' authority to incorporate renewable energy into state-approved restructuring plans must be retained, with clear authority over net metering programs.
- C **Public Benefits** - States must have authority to provide the particular package of public benefits programs and protections that they determine appropriate; this includes the right to impose charges to fund these initiatives.
- C **Transmission** - The states' process of converting their long-established power pools into FERC-approved independent system operators (ISO) C and the resulting ISOs C must be protected.
- C **Air Quality** - Competition in the electric industry must coexist with environmental quality goals, with evenhanded application of equitable and comparable environmental provisions to all market participants. This objective is enhanced with clear legal authority for the Environmental Protection Agency to require an interstate trading system for NO<sub>x</sub>.

# THE NORTHEAST LEADS THE COUNTRY IN RESTRUCTURING

The electric industry has been restructured in the Northeast, opening the way for competition both for generation and for energy services. Most Northeast states have implemented legislative and regulatory actions to increase consumer choice and reduce the region's historically high electricity costs. The Northeast is in the vanguard of efforts to create competitive electricity markets. Competitive wholesale markets are being established throughout the region. At the same time, individual state actions to bring choice of electricity suppliers to their businesses and citizens lay the foundation for competitive retail markets. These developments are the beginning of the creation of truly competitive markets.

This industry restructuring is occurring on many fronts. At the wholesale level, ownership of generation facilities is changing and new merchant plants are proposed. The region's power pools are being transformed into independent operators of the transmission systems and power exchange organizations are being formed. At the retail level, consumer choice of suppliers is being phased in, and new marketing entities are offering a variety of products to consumers. Consumers are becoming more educated about retail electricity markets, and are combining into aggregated buying groups to negotiate for favorable terms from suppliers.

In an industry which has traditionally been vertically integrated **C** with a utility owning/controlling generation, transmission and distribution **C** the change is happening first in the generation of electricity. Many existing utilities in the Northeast have divested, or will divest themselves, of their generation units, including nuclear units in some cases. Independently-owned power units are also being sold. The new owners of generation facilities include major independent power producers as well as subsidiaries of utilities from both inside and outside the region. In addition, the number of proposals for new generation in the region is startling. The total generation capacity of proposed non-utility merchant plants in New England exceeds the current capacity of those six states. Major merchant plants are being proposed in New York as well. Clearly the region is entering a new era in electricity, led by changes in the generation market.

With the exception of California, the rest of the U.S. has moved more slowly on electricity competition than the Northeast. The desire for a speedy, more comprehensive approach encompassing the entire nation has prompted some proponents of electricity competition to advocate federal legislation. The 105<sup>th</sup> Congress helped generate awareness of the complex issues involved in industry restructuring through numerous hearings and consideration of various targeted and comprehensive legislative proposals. With this foundation, the 106<sup>th</sup> Congress is expected to give national restructuring legislation a higher priority; and the Secretary of Energy has vowed to take an active role in the legislative process.

The Northeast states, with their rapid progress towards competitive electricity markets, offer a prism through which to consider the relationship of state and federal roles in this still evolving industry. It is essential that any federal legislation to address electric industry restructuring support and enhance **C** not impede or reverse **C** the progress of the Northeast states in creating competitive electricity markets.

The Northeast states, through the Coalition of Northeastern Governors, can help ensure that the states' concerns, interests, and rights are adequately addressed as the federal legislative process moves forward. Through thoughtful engagement, the Northeast states can provide experienced insights on those aspects of the restructured industry that require federal action, and those elements of the new system that are appropriately regulated by the states.

Many issues likely to be addressed by federal legislation touch directly on this issue of state and federal roles, authorities, and responsibilities. The resolution of the following issues being debated in federal legislative proposals will bear directly on the Northeast states' ongoing progress in creating competitive markets.

# RELIABILITY

## *What does reliability include?*

Electric system reliability usually refers to the reliability of both the bulk power system (transmission and generation) and the distribution system. Distribution system reliability falls in the jurisdiction of the state since outages in the distribution system tend to be localized. On the other hand, bulk power outages can have significant regional and national implications. Because of the interconnectivity of the bulk power system, bulk power disruptions in one region can have consequences to the interconnected transmission facilities across the country.

Reliability of the bulk power system is achieved by ensuring adequate capacity of the bulk power system within regions and by operating the transmission system within limits so as to avoid system collapse for credible outages and equipment failures. The West Coast blackouts of 1996 and the Midwest summer power shortages in 1998 have raised both state and federal interest in electric reliability.

Some have expressed concern that commercial pressures in a restructured electricity market to operate the system beyond its design capability will increase the risk of system collapse. It is also unclear that the current voluntary system for adhering to system reliability rules (described below) would be sufficient in a competitive marketplace.

## *How is reliability currently promoted?*

The reliability of the regulated electric utility industry is promoted mainly by the North American Electric Reliability Council (NERC) and its 10 regional councils through a system of peer-reviewed standards and voluntary adherence to reliability rules. In some instances, states have also ordered utility compliance with NERC standards and state-initiated standards.

NERC was established in 1968 as a response to the 1965 East Coast blackout. NERC monitors compliance with guidelines and standards and assesses the future reliability of the bulk electric systems. The regional councils adapt the standards and rules to meet the needs of their region. Individual control areas (each with its own system operator) communicate and work together to maintain system reliability. Individual states, such as New York, have set unique operating criteria at the control area level to ensure reliability. Historically, NERC has been quite successful in maintaining a high degree of transmission grid reliability.

## *How will the system change in a competitive marketplace?*

There is a tension between reliable operation of the bulk system and the increased commercial traffic resulting from competition. Reliability requirements can have the effect of limiting commercial transactions. On the other hand, rules to encourage and increase commercial activity can decrease reliability margins. The promotion of a robust competitive market therefore, introduces the need to strike a balance between commercial and reliability interests.

In 1997, NERC formed a blue-ribbon panel to chart the course for ensuring the reliability of the bulk power system in a competitive electricity market. In December 1997, the panel made several recommendations (approved in July 1998) to the NERC Board to convert NERC into a self-regulating organization **C** the North American Electric Reliability Organization (NAERO). The establishment of

this organization may require federal legislation to make adherence to its national reliability rules mandatory and enforceable.

On September 29, 1998, the U.S. Secretary of Energy Advisory Board (SEAB) Task Force on Electric System Reliability issued a final report, *Maintaining Reliability in a Competitive U.S. Electricity Industry*. The Task Force recommended that Congress clarify the Federal Energy Regulatory Commission's (FERC) authority to oversee an electric industry private, self-regulating reliability organization (such as NAERO) and expand the FERC's jurisdiction for reliability over the bulk power system, including the authority to coordinate North American reliability with the appropriate regulatory agencies in Canada and Mexico. The Task Force also recommended that reliability standards must be enforceable for all entities using the bulk power system.

The Task Force also recommended that action must be taken now, as "the task force believes the primary challenges to bulk power system reliability are presented by the transition itself, rather than at the end state of competition."

### ***Federal legislative proposals***

Several federal restructuring proposals recently introduced in Congress permit states to impose reliability requirements on those seeking to sell electricity in the state and permits states to impose charges to fund reliability programs for the distribution system. However, there are also legislative proposals to establish a national reliability organization to enforce reliability standards. In particular, the Administration's proposal calls for the establishment of an organization based on the Task Force's model for bulk power reliability. Unfortunately, the Administration's and NERC's legislative proposals do not provide for any state role in transmission reliability beyond an advisory status.

### ***What are CONEG's interests and concerns?***

Reliability remains of the utmost concern to the Northeast Governors. An appropriate level of reliability must be ensured throughout the system. States must maintain authority over the reliability of local distribution systems. As for the transmission system, the federal government and the states must act as partners to provide leadership and oversight in developing an appropriate mechanism to ensure adequate reliability standards and enforcement. However, any national reliability standards, enforced by a national reliability organization such as NAERO, should be set by the organization itself, not the FERC or Congress.

Furthermore, the Northeast states believe strongly that any federal legislation must retain the states' right to set additional standards appropriate to their bulk power systems. This authority to allow states to set more stringent standards is very important. States believe that they are in the best position to use their knowledge of local or regional reliability concerns to determine the need for additional measures. New York, for example, has developed a customized reliability operating criteria, known as "Stormwatch" for a transmission corridor leading to the Consolidated Edison service territory (New York metropolitan area). This corridor, located in the Hudson Valley, is notorious for lightning strikes. When possible thunderstorm conditions exist, the Stormwatch contingencies are put into effect, thereby significantly minimizing the chance of outages in the New York City area due to lightning strikes in the transmission corridor.

# MARKET POWER

## *What is market power?*

Market power is the ability of a particular seller or group of sellers to influence significantly the price or availability of electricity to their advantage, through actions such as raising prices by withholding capacity or creating barriers to entry of new market participants. Abuse of market power limits competition and can result in a decline in innovation in electric transmission and generation and inefficient cost shifting among buyers. Governmental agencies with the authority to require actions to mitigate market power include FERC, state public utility commissions (PUCs), the Securities Exchange Commission (SEC), and the Department of Justice (through anti-trust litigation).

## *Mega-mergers*

Lately there has been a trend in the electric industry toward mega-mergers C mergers of two or more utilities that result in giant companies that span several states. For instance, the pending American Electric Power/Central and Southwest (AEP/CSW) merger will result in a company serving 4.6 million consumers in 11 states, spanning four regional power grids. FERC has ordered a hearing to investigate the effect of the merger on retail competition in Missouri. There have been 29 mergers in the past two years. Mergers of transmission and distribution (T&D) companies should not exacerbate market power (as the T&D system will continue to be a regulated monopoly). In the Northeast, most utilities are divesting generation; but where utilities are integrated, owning both generation and distribution, mergers raise market power issues. Although such mergers can provide significant efficiencies in operations and consumer savings, market power concerns have led the American Public Power Association and the National Rural Electric Cooperative Association to consider opposing the AEP/CSW merger and call for a moratorium on large mergers.

## *Federal legislative proposals*

Concerned that mega-mergers would give a few companies control over power generation as well as transmission, many federal proposals include provisions to curb the potential for market power abuses. Key proposals include providing FERC and the states greater access to books and records of holding companies and affiliates; expanding FERC jurisdiction over mergers of electricity utility holding companies and generation-only companies; expanding FERC authority to remedy existing or future market power problems if the state has insufficient authority to do so; and authorizing FERC to order divestiture in order to mitigate market power abuses.

Stand-alone legislation to repeal the Public Utility Holding Company Act (PUHCA) ignited significant debate between those who want to repeal what they consider an outdated law, and those who would repeal the law only in the context of broader, comprehensive restructuring legislation. When PUHCA was enacted in 1935, 13 holding companies controlled 75 percent of the nation's electric

utilities. PUHCA was designed to let the SEC get control over those holding companies to end the abusive practices. However, PUHCA also provides protection for competition and consumers in the electric industry by prohibiting utility acquisitions which could monopolize territories or power sources. Opponents of PUHCA repeal separate from comprehensive restructuring legislation believe that the absence of the law's protections will allow companies to grow exponentially by eliminating competitors through mergers.

***What are CONEG's interests and concerns?***

Identifying and mitigating market power abuses is an important element for the emergence of fair and equitable competitive markets. The challenge lies in balancing the need to prevent and mitigate market power abuses without imposing federal dictates which might hinder the market's development and innovation. Protections include encouraging the divestiture or spin-off of generation from transmission and distribution operations and ensuring non-discriminatory access to the transmission system. Federal legislation should allow states to continue to work constructively with FERC to craft mitigation strategies where potential market power problems are perceived. States must also retain authority over market power at the distribution and retail level as well as full authority for siting of facilities.

# DISCLOSURE

## *What does a consumer need to know?*

Many consumers, in order to make informed decisions on the purchase of electricity, desire basic information on competing product offerings presented in an easily understandable format. This information need lies at the heart of the vigorous debate over disclosure. Meeting this need is challenging as the electricity consumer faces competing suppliers for the first time; as marketers offer innovative, not easily comparable, products and services to distinguish themselves from competitors; and as marketers attempt to operate in a multistate regional market.

According to the Administration, uniformity in disclosure requirements will give the consumer the information needed to compare suppliers' efforts by standardizing the format for certain claims. It will also simplify the task facing governmental agencies verifying the claims made by suppliers regarding "green" power.

Parallels can be drawn to the Food and Drug Administration's guidelines for a food labeling program which determines what kind of information a consumer should be provided concerning the nutritional value of packaged foods. The Federal Trade Commission has also issued mandatory guidelines for food manufacturers who claim their products are "light" or "low fat," prompting some groups to argue that similar guidelines are needed for "green" power claims.

In Fall 1997, after a spring-summer series of workshops, a report entitled "Uniform Consumer Disclosure Standards for New England," was issued by the Regulatory Assistance Project (RAP). It recommends, as does the Administration, a standardized label format to facilitate consumer comparison and regional operation of marketers. RAP proposed a label to include information on price, contract terms, generation mix, and emissions characteristics, to be distributed to all consumers by all retail marketers, with governmental verification based on the Independent System Operators financial settlements data base (with some trading for the spot market).

In 1998, Massachusetts enacted a more limited disclosure system under legislation, but the New England states are together working toward a comprehensive, regional system under the auspices of the New England Council of Public Utility Commissions (NECPUC) and the New England Governors' Conference. On December 15, 1998, the New York State Public Service Commission issued Opinion No. 98-19 establishing a comprehensive system of disclosure of generation mix and emissions levels, with a verification system broadly comparable to RAP's proposal. The New England states are considering plans based on their regional circumstances as well as elements of the New York system.

## *What has Congress proposed?*

Many federal legislative proposals that address this issue require the Department of Energy, often in consultation with the Environmental Protection Agency and the Federal Trade Commission, to

develop rules for disclosure. Generally, information on generating source, emissions, price, reliability, and environmental compliance are included in the requirement.

***What are CONEG's interests and concerns?***

The CONEG Governors believe strongly that disclosure is essential for both informed consumers and effective market operations. At a minimum, consumers need information on fuel source, emissions generation, and price to make an informed decision regarding their electricity provider. Disclosure of fuel sources can be an important means to encourage inclusion of renewables into a diverse fuel mix. Any federal action should encourage consistent standards for disclosure, but a federal mandate for uniform standards or a specific reporting format is not needed at this early stage of market development. States and markets should be given adequate time to cooperatively develop consistent disclosure requirements.

# STRANDED COSTS

## *What are stranded costs?*

In a regulated market, a utility makes capital-intensive investments, such as constructing power plants and entering into long-term purchased power and fuel contracts, in order to meet the needs of the consumers in its service territory or to be in compliance with federal or state mandates. The cost of these investments are recovered through rates, approved by the state public utility commissions, generally spreading out the cost over long periods of time. In a restructured market, these assets or contracts may be above the current wholesale market price even if some consumers are permitted to take electricity from another supplier. However, utilities must still pay for these investments **C** thus the costs are "stranded." The total amount of stranded costs is unclear and can vary with changes in the wholesale market price, although it has been estimated to be anywhere between \$100 billion and \$200 billion.

## *Who will pay for them?*

There are strong differences of opinion regarding not only how to calculate these costs, but who should pay them.

Some argue that "the market will take care of itself," and there should not be a "bail out" for those utilities with stranded costs. Some argue that state restructuring laws and regulations are too generous to utilities **C** recovery of billions of dollars in stranded costs, through charges added on to electric bills, could reduce the actual savings to consumers in a restructured market. Others argue that the states (and the federal government) are responsible for "stranding" these costs because of government's role in encouraging utilities to enter into long-term contracts and in energy planning at times when the economic basis for utility capital investment decisions were radically different than they are today. Some propose significant, but not total, stranded cost recovery by utilities, allowing for modest rate relief for consumers.

There are several proposed methods for recovery: exit fees paid by departing consumers for whom the costs were originally incurred (exit fees are not typically required in a full monopoly structure); a surcharge on transmission and distribution on departing consumers if they still use the system for transmission access; entrance fees for new consumers; and securitization whereby a utility or the state issues low cost bonds to be repaid through competitive transition charges imposed on all consumers. Currently, all states with retail competition plans have provided for some level of stranded cost recovery. Utilities are often required to divest, or sell off, their generation assets as a means of lowering these stranded costs and promoting the competitive generation market. From state to state the method of recovery varies, as does the "transition" period during which utilities have the opportunity to recover these costs.

### ***Proposed federal legislation***

State public utilities commissions have traditionally overseen the recovery of investment in generating capacity. Federal legislative proposals have generally left the stranded cost issue up to the states, with some proposals providing for a FERC backstop if the state lacks the authority to impose recovery charges. Other federal legislative proposals have sought to inject a federal solution to this local issue C which range from one extreme to the other C a federal mandate for recovery, or prohibition of any stranded cost recovery.

### ***What are CONEG's interests and concerns?***

Any federal legislation should reaffirm the states' right to calculate and determine the appropriate recovery mechanism for stranded costs including non-bypassable charges to generate monies for recovery. All CONEG states with restructuring plans in place provide for recovery, and in several states, the process of divestiture of generation assets is well underway. Therefore, the states' authority to mitigate stranded costs as well as provide for the recovery mechanisms provided in state restructuring programs must not be pre-empted by federal legislation.

## *What are renewable energy sources and how might competition affect the renewable energy markets?*

Renewable energy is generally defined in various federal legislative proposals as wind, solar, geothermal, biomass, organic waste, and dedicated energy crops. Generally, hydropower is not considered a renewable resource for the purpose of federal restructuring proposals. In the generation of electricity, renewable energy can contribute to sustainability, environmental soundness and development of local resources.

How renewables will fare in a competitive market is an area of great debate. Some believe that competitive market forces should be allowed to operate, that there will be a demand for renewables and that the market will respond to the demand and offer renewables to consumers. Proponents of special consideration for renewables believe that in a still-maturing competitive retail electricity market, higher-priced renewables will not survive without some sort of mandate that they be purchased.

## *What are states doing to promote renewable energy?*

States have several mechanisms in place to ensure that high-priced renewable energy does not get squeezed out of the competitive market. These include net metering, renewable portfolio standards, and support for research and development.

Net metering, sometimes referred to as net billing, is an arrangement designed to promote renewable technologies by allowing a consumer who has small renewable generation on-site to offset his electricity consumption. If the consumer consumes less energy than he/she generates, the excess is delivered to the utility and the consumer is credited with the retail cost of that electricity. MidAmerican Energy Company, an Iowa-based utility, has filed a petition with FERC arguing that the state's net metering program violates FERC rulings that prohibit utilities from being required to purchase power from renewable generators in excess of avoided cost. (Avoided cost is the wholesale cost of the electricity or the utility's cost of producing that electricity themselves.) The Maine Public Utilities Commission, as well as several other PUCs, have ruled that net metering is considered a "utility metering and billing practice" and therefore falls within a state's authority over utility retail activities. FERC's final ruling on this will have a profound impact, as more than 20 states currently have net metering programs.

A renewable portfolio standard (RPS) is a minimum purchase requirement for electricity generated from renewable resources, whereby a minimum percentage of electricity sold by all retail suppliers must be generated from renewable resources. The system is designed to ensure increased development of renewable energy in a restructured market without administrative selection of which renewable project is developed. Retail sellers could meet the requirement by generating renewable power or by purchasing tradable credits ultimately from renewable generation owners a system modeled after the SO<sub>2</sub> credit-trading program under the federal Clean Air Act. When the price of renewables becomes competitive with conventional electricity, the RPS usually self-sunsets.

Some states such as New York are promoting renewables through research and development programs funded by ratepayers through system benefits charges (see below) or by independent state authorities (in New York, the New York Power Authority, the Energy Research and Development Authority, and the Long Island Power Authority).

### ***Federal legislative proposals***

Several federal legislative proposals contain a renewable portfolio standard and statutorily set the definition of "renewable energy" and the minimum annual percentages. Minimum annual percentages vary widely, but the authority to administer a renewable energy credit trading program is, for most of the proposals, given to the Department of Energy. The definition of renewable energy does not differ drastically among proposals, although only a few proposals include hydropower in the definition. Several proposals included a net metering provision.

### ***What are CONEG's interests and concerns?***

The CONEG states recognize the benefits of renewable energy, including biomass, and its role in the diversification of fuels. The Northeast states, in their restructuring programs, have embraced a variety of means to encourage renewable energy in the fuel mix. The federal government should maintain its presence in research and development for renewable energy. Any federal legislation should recognize states' authority, and encourage state action to support renewable energy, and should also clarify states' authority over net metering programs.

# PUBLIC BENEFITS

## *What are Public Benefits?*

Public benefits are programs to promote public policy objectives such as energy efficiency or conservation, renewable energy technologies, low-income services, universal service, and research and development. In a regulated electric industry, state public utility commissions, as guided by state law, determine which of these public benefits programs will be provided as a matter of public policy; and the programs are funded by the utility ratepayers and implemented by utilities or other providers. In a restructured industry, states retain their authority over the regulated distribution system, including the authority to maintain an array of public benefits programs and to require consumers to fund them through charges placed on the distribution system. In the restructured industry, public benefits programs may include a number of additional programs, such as consumer education about the competitive market.

## *How will competition affect public benefit programs?*

Utilities already have scaled back their existing public benefits programs. If, in a competitive market, the emphasis is placed on cutting prices, there will be less or no incentive for power providers to promote energy conservation programs or to spend money on low-income or R&D programs. On the other hand, some believe that the market will meet the demand for these programs; that many marketers will need to offer commodity sales packaged with other services, such as energy management in order to compete and that many consumers will be interested in these "value-added services." A middle view holds that markets will work in many cases, but that barriers to some cost-effective energy efficiency programs will remain indefinitely, requiring intervention to overcome.

## *Federal legislative proposals*

Most federal proposals have left this issue up to the states by clarifying the states' authority to impose charges to support public benefits programs. However, the Administration's proposal, as well as other legislative proposals, would establish a national Public Benefits Trust Fund to encourage and supplement state public benefits programs. As proposed, the Public Benefits Trust Fund would provide matching funds to states for their public benefits programs, generally defined as programs to promote energy efficiency, renewable energy, energy research and development, and low-income assistance. Monies for the fund are generated by a national "system benefits charge" on transmission or generation. For example, in the Administration's restructuring proposal, this charge is capped at 1 mill per kWh. An independent agent (usually a Public Benefits Trust Fund Board) would collect and administer the funds to the states to augment public benefits programs.

The Administration has asserted that a national Public Benefits Trust Fund will not lead to increased rates. The proposed matching fund amount of \$3 billion will encourage states to preserve the current

level of utility-funded support for public purpose programs, estimated to have been about \$6 billion in 1996. However, others oppose the fund as a federal mandate or argue that it is equivalent to a federal tax. The National Rural Electric Cooperative Association has suggested that the trust fund may be unconstitutional because Congress would delegate its taxing authority to the Secretary of Energy and a Joint Federal-State Board. However, the program would be constitutional if Congress imposed a fixed charge.

***What are CONEG's interests and concerns?***

The CONEG states believe that public benefits programs remain an important tool of public policy in a restructured electric industry. The Northeast states' restructuring programs incorporate a variety of public benefits programs and funding approaches C each appropriate to a state's particular situation and public policy objectives. While a national public benefits trust fund is one means for the federal government to encourage or enhance state-designed and implemented programs, such a federal fund should not preempt states' authority to design or set the appropriate funding level for such programs. Any federal restructuring legislation must reaffirm and protect/respect the states' authority to provide the particular package of public benefits programs that it determines appropriate; including the right to impose non-bypassable charges to fund public benefits programs.

## *Who will operate the transmission system?*

A well-maintained and operated transmission system is essential to the reliability of the electricity system. Open access to the transmission system and efficient pricing of transmission services is essential to the functioning of competitive electricity markets. Ensuring that the goals of system reliability and fair competitive markets are met is the function of the system operators. The system operators, in order to ensure nondiscriminatory open access, must not be allowed to favor one set of market participants, such as generation owners, marketers, or large consumers, over any others.

The use of an existing system and its future expansion must be based on the availability of proper price signals through the administration of the transmission tariffs by the system operator. Also, the system operator should have a direct role in decisions to increase transmission capacity to ensure orderly expansion of the system.

A system operator, independent of the generation and transmission owners, is a concept promoted by FERC. FERC included its principles for the Independent System Operator (ISO) in Order 888 which began open access implementation. Another concept being advocated is the transmission company (transco) which would own the transmission system and operate it to maximize its value to the owners. Proponents of this concept believe maximizing the value of the transmission system will ensure the delivery of electricity at its minimum cost, including both generation and transmission costs.

## *Who has the authority to create ISOs?*

FERC is overseeing the establishment of several ISOs which would be approved and largely regulated by the Commission. Two of the ISOs under development are in the region; these ISOs are based upon the geographic boundaries of the long-established power pools.

In September 1998, the Department of Energy re-delegated authority to FERC under the Federal Power Act to establish boundaries for ISOs or other appropriate transmission entities. FERC was given the authority to divide the country into regional districts to interconnect and coordinate facilities to generate, transmit, and sell electricity. FERC has issued a notice of intent to consult with state commissions regarding how the country should be divided into these regional districts.

## *Federal legislative proposals*

The Administration's proposal clarifies FERC's authority to order the establishment of an independent operator of interconnected transmission facilities and to order a transmitting utility to relinquish control over operation of its transmission facilities to the operator. Most federal legislative proposals include provisions that clarify FERC's authority to order formation of ISOs in a region and to require utilities to relinquish control of transmission facilities to an ISO.

***What are CONEG's interests and concerns?***

The CONEG states recognize the importance of entities that can provide independent control of transmission operations and planning. The CONEG states are well underway in the process of converting their long-established power pools into FERC-approved ISOs. Any federal legislation must respect this process and the resulting ISOs. Regional entities should adopt a broad perspective when developing plans in an open market environment, but such planning and related siting should not be federalized.

Congressional consideration of national restructuring legislation occurs against a backdrop of related national policy initiatives in air quality and in energy resources/emissions information development. The prospect of national restructuring legislation is an opportunity to coordinate and reinforce policy initiatives originating in the FERC Order 888 regarding emissions tracking and in U.S. Environmental Protection Agency (EPA) efforts to encourage effective regional strategies to reduce the transport of ozone.

### *Need for timely, credible information*

State and federal actions to address electric industry restructuring occur even as competitive markets are emerging. This dynamic transition comes with uncertainty about the implications and impact of these changes on the electric industry and the environment. The industry, consumer, policymakers, and regulators require timely, meaningful and credible information about changes underway in industry and their impacts if both the emerging market and policymakers are to understand, assess, and adapt effectively.

The federal government has initiated a number of efforts to obtain timely and objective information about the implications of restructuring on both the electric industry and the environment. FERC Order 888 included a commitment to track and report on emissions associated with open access to the wholesale market. Therefore, the Administration, working through the Council on Environmental Quality, is overseeing an EPA-led initiative to track and report on industry-wide emissions and resource generation data. The Northeast states welcome this initiative as an important first step, and look forward to its continuing development as a useful policy and implementation tool.

A similar need exists for timely and ongoing information on the impact of wholesale and retail competition on the electric industry. One approach is the Administration's legislative proposal that directs the Department of Energy, through the Energy Information Administration, to collect and publish information in such areas as the changing structure of the industry; price and associated factors for both competitive and regulated services; electricity consumption and demand; reliability; efficiency and renewable programs; and research and development.

### *Restructuring and environmental quality must coexist*

The CONEG Governors believe strongly that competition in the electric industry must coexist with environmental quality goals. The adoption of equitable and comparable environmental emissions provisions applied evenhandedly to all market participants is an important foundation for effective and successful competition in electric markets. National legislation presents an ideal opportunity to ensure that restructuring initiatives incorporate those mechanisms in existing law to improve air quality across all states.

Extensive and costly emissions controls have been installed on generators in the Northeast to improve air quality, but no individual state can tackle upwind emissions that threaten to overwhelm in-state emissions reductions efforts. EPA's recent Final Rule to reduce nitrogen oxide (NO<sub>x</sub>) emissions and solve air pollution problems on a regional basis is a welcome step toward equitable and cost-effective measures to reduce smog-causing emissions that move across state boundaries.

An important component of the recent Final Rule is development of a market-based emissions-trading or "cap and trade" system for utilities that allows industries greater flexibility in choosing appropriate and cost-effective pollution control measures. While EPA has provided a model emissions trading program to states as part of the Final Rule, questions have been raised about EPA's legal authority to require such an interstate trading system for NO<sub>x</sub>. Any national restructuring legislation offers an opportunity to provide EPA with clear legal authority to require a cost-effective interstate trading system to address regional transport of pollutants.

EPA's Final Rule has also generated some concerns that its implementation could affect electricity reliability as generators undertake the necessary steps to reduce ozone-related emissions. The Northeast states believe that the Final Rule contains specific measures and sufficient flexibility to ensure that reliability will not be jeopardized when such control measures are designed and implemented in a well planned and efficient manner. To ensure maximum cost effectiveness, such measures should be coordinated with EPA programs designed to address other pollutants produced by electricity generators.