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The trinity of transmission issues: Siting, access and pricing

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by Ashley Brown, Commissioner Public Utilities Commission of Ohio

Ashley Brown is not only a commissioner of the Public Utilities Commission of Ohio, he is also one of the most widely-respected authorities in the U.S. today on the regulation of electric utilities. He is particularly known for his vocal efforts to forge a more cooperative state-federal relationship in electrical regulation. The following is an edited excerpt from his keynote address at the PURE '93 Conference.

Today, we must formulate the electricity agenda in the aftermath of National Energy Policy Act of 1992 ("Energy Act"). The Energy Act is really just a beginning in which Congress sets certain broad policy directions. But, clearly, the hard work ahead for regulators, managers, investors in the industry, and consumer advocates is to determine where the industry will go.

What are the challenges that we will face? Through my regulatory prism (although these challenges are not just regulatory), I would identify three broad areas: the key federal issues, the key issues at the state level, and, perhaps most importantly, the issues on which state and federal regulators must work together to develop coherent policies.

Federal issues

Several issues are important at the federal level. The Federal Energy Regulatory Commission (FERC) has recognized some, but perhaps not all, of these challenges. These issues include: creation of a workable, competitive bulk power market; transmission access rules to accommodate this bulk power market; loop-flow pricing; and coordination of federal energy policy and environmental policy.

Under the Energy Act, transmission access can be mandated, but only on a case-by-case basis. FERC has made some initial steps in transmission access by offering the regional transmission group agreement. There are benefits to a regional transmission agreement. For example, it provides for informal mechanisms to resolve disputes among actors in the industry. On the positive side, FERC has proposed to broaden the membership far beyond the current membership of the Reliability Councils across the country. On the other hand, the agreement does not resolve the regulatory morass. I do not think that FERC has begun to explore the legal implications of how it might indirectly and inappropriately pre-empt state regulation and how it could reduce the ability of state regulators to protect consumers. These multi-fold problems of the proposal are not addressed adequately.

But it is critical to understand that there is no quick fix here. By putting out the regional transmission group proposal in unexpurgated, unedited form, FERC, perhaps inadvertently, seemed to say, "We are looking for the quick fix that will resolve these transmission disputes very rapidly." There is no quick fix; there is only hard work. The debate stimulated by this

proposal is beneficial, but the adoption of a regional transmission group proposal may create more problems in the long run, even though parts of it ought to be incorporated in some ultimate solution.

FERC must clearly articulate standards for transmission access. Standard transmission filing requirements for utilities on load flow information could facilitate that objective. FERC itself ought to develop transmission modeling capabilities. Neither FERC nor most state commissions have such capability. This is unfortunate and rather astonishing. We need to develop that modeling capability. Among other things, the availability of transmission modeling would encourage more informal resolution of transmission access disputes. Where informal resolution does not occur, then regulators would have the information necessary to move more quickly to develop resolutions.

FERC also has not provided the leadership necessary to develop pricing for loop flows. There has been embryonic leadership in the industry on it. In New England, NEPOOL (the New England Power Pool) creates a much different situation than exists in most of the rest of the country. The absence of loop-flow pricing in most of the country makes it almost impossible for regulators (or the industry) to send the correct price signals. Utilities that bear transmission burdens must be adequately and appropriately compensated. Those that cause burdens must pay the costs imposed by those burdens. The current regime of transmission pricing is too uncoordinated and too unarticulated to achieve the economic benefits that we seek from a competitive bulk power market.

Finally, FERC has been restrained in its efforts to coordinate the direction of the electric utility industry with a sound environmental policy. FERC must engage in a dialogue with its sister agencies in the federal government. FERC, like many other agencies, has not engaged in much meaningful dialogue with the Environmental Protection Agency on the implementation of the Clean Air Act. FERC must lead the effort to coordinate, on the national level at least, the direction of environmental regulation with the direction of energy policy. FERC has almost completely ignored this question. FERC has been rather single-minded in its pursuit of competition in bulk power markets. There are real benefits to that competition. But this single objective is rather unambitious, in light of the agenda set forth by the Congress in the Energy Act.

State issues

There also are enormous challenges facing the state regulatory community. One is to expand and improve integrated resource planning (IRP) efforts. While IRP is well established in New England and elsewhere, it requires constant effort, and there are still many states where IRP is barely established, if it exists at all. Integrated resource planning must develop the appropriate incentives for supply of various energy services. There are questions about what kinds of incentives states should provide. There has been a vigorous debate - and Maine has certainly been in the forefront of that debate - over the appropriate incentives for demand-side management and for efficiency improvements. With more options in the wholesale power market, appropriate incentives must be created for utilities that choose to purchase power rather than generate it. When creating incentives, however, we must be very careful that incentives

generate efficiencies that benefit customers, as opposed simply to increasing rates to finance incentives.

Two clear trends in the Energy Act very much reflect the trends at the national level. One is toward state-level integrated resource planning. This necessitates more government involvement in the planning activities of investor-owned utilities and, in some cases, in publicly-owned utilities. At the federal level, on the other hand, the movement is towards less regulation (if not deregulation) of generation and more competitive bulk power markets. These two trends may seem philosophically incompatible. As a matter of practicality, however, these two trends work together quite well. The federal trend toward competitive power markets creates more opportunities and more options, so the state regulators can expect utilities to pick among those options to minimize costs to consumers. Thus, a competitive bulk power market is very compatible with strong integrated resource planning at the state level. However, this underscores the fundamental question for the utilities under the Energy Act: Regulators must force utilities to ask themselves, "What business do we want to be in?" For example, are utilities efficient producers of power? Can they compete in the bulk power market? Should utilities continue to be vertically-integrated monopolies, as they have been in the past?

To some extent, Maine has already answered these questions. But other states are not as far along in answering those questions. For example, in Ohio, we have a company that almost every year has the fewest number of consumer complaints. They are doing a reasonably good job with customer services. On the other hand, if you look at the price of the power that they sell, and if you look at the productivity of their power plants, it is hard to imagine a worse performer anywhere. This is a company that should ask itself, "Should we continue to be in the generating business?" Competition in the bulk power market will allow the option of changing the business of utilities. We need no longer assume the vertically-integrated monopoly; we can think of utility activities in an unbundled way. Efficiency demands, and consumer protection demands, that utilities provide services in areas where they perform best and that they buy from others where others can perform better.

Adapting to these new realities will cause some fundamental change in utility culture. At the Ohio commission, we are prepared to deal with these changes. We have hired three Ph.D. anthropologists, one of whom wrote his dissertation on utility culture. State regulators must encourage utilities to engage in self-examination of their business attitudes.

Quite frankly, state regulators, including myself, have been negligent about transmission pricing and transmission policy. We have ignored this as a federal issue. But most of the revenues for transmission services come from retail rates. Until very recently, no state commission thought discretely about transmission pricing, or how it relates to other services. That must change. This change will be driven in part by preemption at the federal level and in part by the need to encourage utilities to provide transmission service efficiently. Many transitional and long-term issues must be resolved for states to accomplish this objective. But states can no longer bundle electric rates to the end user and not worry about the discrete elements of providing that service.

States must design appropriate incentives for each of these activities. These include appropriate transmission incentives and the appropriate demand side management incentives. Pricing regimes that send correct economic signals may encourage the activities and results we want.

Finally, state regulators face the same problem as FERC in trying to coordinate energy policy and environmental policy. Some state commissions are already addressing this issue. Ohio has been thinking strategically as we undertake Clean Air Act implementation. We are planning for potential impacts of global warming legislation (or international treaty obligations) on utilities. This strategic planning can occur on different levels: either because of the intrinsic environmental benefits or in terms of prudent economic planning.

The industrial customers in Ohio have insisted that the commission should never consider an environmental externality. On the other hand, they urge us to consider the steelworkers in the state, a consideration which, after all, represents a socio-economic externality. And, if you ask an industrial customer, "When you site a steel plant, are you indifferent to the potential environmental regulations?" their answer would be, "Of course not, that would be imprudent" Yet, they demand exactly that level of imprudence from a utility and its regulators. It is clear that state regulators must think not only about current environmental externalities, but also about environmental challenges that may well be future "internalities."

Issues in state/federal relations

The most critical challenge before us, and the one that absolutely demands leadership from FERC and the Department of Energy, is to find ways that federal and state regulators can work together. The current jurisdictional mix - particularly when the state and federal levels proceed independently of one another, frequently in conflict with one another - can only produce policy incoherence. It can only whipsaw utilities and others trying to act rationally in the marketplace. The unwillingness, to date, by FERC to provide constructive leadership is part of this mix. Some examples of policy incoherence are:

- *Transmission pricing:* Is this a federal or state issue? It is both. Retail prices are set by state utility commissions; wholesale transmission prices are set by FERC. And we do it very differently. FERC sets rates on a per-kilowatt basis; states make retail ratepayers assume all the residual revenue responsibilities for the grid. The result is obvious. There are conflicts over native-load priority. We have conflicts over whether we ought to have marginal-cost pricing or embedded cost pricing and over what the impact of pricing is on native-load customers as opposed to incremental customers. These conflicts can be avoided if FERC and the states can work rationally together.
- *Transmission access:* FERC has now acquired direct authority over transmission access on a case-by-case basis. States have always had indirect authority, and in some cases direct authority, to demand transmission access. And states still have it under the Energy Act, because the retail wheeling issue was quite appropriately left up to the states.
- *Transmission siting and transmission planning:* These have been exclusively within state jurisdiction. There is no FERC jurisdiction on planning and, unlike natural gas, there is no FERC jurisdiction over the siting of transmission lines. The question has been raised about what would happen if FERC mandates access from a utility and that utility does not

have the capacity to provide such access. Does the utility have the obligation to make a good faith effort to build new capacity? If the state refuses to order the utility to build, what happens? In the law, this seems to be a black hole. It would appear that the access order would be null and void. On the other hand, the argument might be made that the state is pre-empted from making its own siting decisions.

On this issue, FERC and the states should strive to find comity. On the one hand, FERC access requirements could be reflected in state need determinations in siting proceedings. On the other hand, FERC, in mandating access, should consider what processes states have used to plan transmission. In some states, most notably Wisconsin, there are extensive transmission planning phases and all interested parties are invited to participate. FERC ought to avail itself of the benefits of that process, because this process provides real opportunity to provide access without upsetting the state planning process. The process may even obviate the short-term, transitional issues that are so difficult in the development of transmission policy. We need to look to joint boards as a mechanism to develop policies that coherently address the trinity of transmission issues: siting, access, and pricing.

I do not mean to say that we have not made progress. We have had some very civil discussions. But we have not gone beyond simple, civil discussions that merely touch the surface of these issues. Kenneth Gordon, when he was president of NARUC, and I worked closely trying to push FERC toward development of more coherent policy.

FERC deserves credit as the only agency in the federal government over the last twelve years that has believed that there are still anti-trust laws. FERC's movement toward market-based pricing, where workably competitive markets exist, and its attempts to safeguard against abusive monopoly power are commendable. At the same time, there are state integrated resource planning proceedings that engage in similar activities. There should be a "safe harbor" where FERC acknowledges state integrated resource plans and allows market-based pricing where the result is consistent with the state-mandated plan. That would provide much greater predictability to states as they engage in integrated resource planning. It would probably provide more opportunities for competition in the long run, because the states are, after all, looking for least-cost alternatives. New opportunities for both demand-side providers and supply-side providers may make FERC's job easier. Unfortunately, the discussion of safe harbors at FERC has moved ahead rather slowly.

We also should actively consider regional forums for transmission planning. The dispute over the Northeast Utilities-Public Service Company of New Hampshire merger might have been a perfect case for a joint board. Each of the states that was affected by that merger had its own proceeding, in addition to FERC's proceedings. FERC and state objectives often seemed inconsistent. It should have been possible for the FERC and the affected states to come up with an effective compromise. Such a compromise could have reduced the costs of litigation in multiple forums. The powers held by the states, individually and collectively, and by FERC, could have brought a coherent resolution. In fact, we have created a regulatory maze that cannot produce coherent results.

On Clean Air Act implementation, there has been some consultation between FERC and the states, but it has been modest.¹ We must get on with implementation. For example, the allowance trading system has not been as liquid as some would like, although that may ultimately change. Part of the problem is the jurisdictional uncertainty. What part of the initial allocation of allowances belongs to federally-regulated transactions and what part belongs to state-regulated transactions? A number of multi-state companies are absolutely confused over how to allocate these rights. The accounting rules proposed over a year ago by FERC have yet to be enacted. Although Congress, the environmental community, and the executive branch of the government have all decided that market-based implementation of environmental regulation would result in least-cost compliance, FERC's failure to adopt accounting rules has held up the entire process. And still waiting for action is the question of what allowances should be allocated to wholesale customers (if any), and what part should be allocated to retail. Those issues must be resolved, because they stand in the way of achieving the flexibility that can be provided under the Clean Air Act.

Finally, there must be on-going dialogue between environmental and energy agencies at both the state and federal level. Coordination of energy policy with long-term environmental policy is essential. These are the areas of state/federal cooperation that I think are critical. What benefits flow out of the Energy Act, as well as the Clean Air Act, will depend on how successful state and federal regulators are at working together. '

1. Editor's note: See the following article by Susan Dudley on the Clean Air Act Amendments of 1990.

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