

Competing Industry Visions

Electricity Transmission in Deregulated Markets:
Challenges, Opportunities and Necessary R&D
Agenda



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Standard Disclaimer

- This presentation represents the views of the poor shmo in front of you, and does not represent the views of NRECA or its members



Who Are The Co-ops?

- 930 Consumer-owned, Consumer-governed utilities
- Over 37 million consumers in 47 states
 - 12% of the population, 75% of nation's area
- Own approx. 47% of nation's distribution, approx. 7% of nation's transmission
- Generate approximately half of the generation they need for their consumers.
- Formed because of market failures



Thesis

There is no consensus on the Commission's market vision of the industry.





Thesis cont'd

The industry cannot develop a consistent transmission policy until it reaches some consensus on a common goal

A return to the EPAct/888 open access vision of the industry has the best chance of achieving consensus



Three Visions

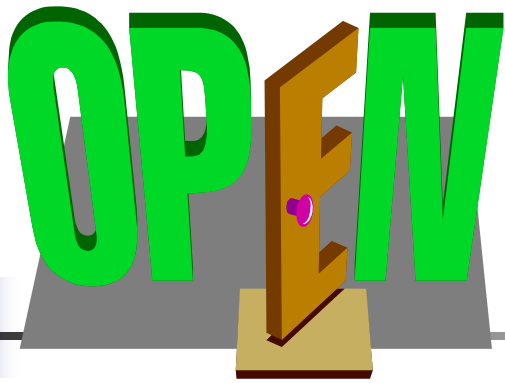
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- Traditional
 - Open-Access
 - Markets



Traditional Vision

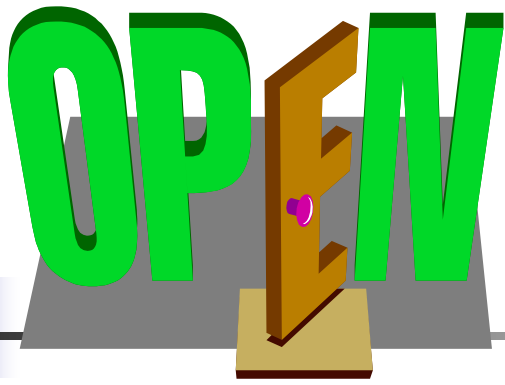


- Vertically integrated utilities with the obligation to serve and to conduct long-term least-cost planning for their consumers
- State regulation of virtually all utility functions
- Limited wholesale exchanges
- Worked pretty well, but subject to regulatory inefficiencies and market-power abuses
- Traditionalists oppose nearly all FERC efforts to open the grid or encourage wholesale competition – not always openly



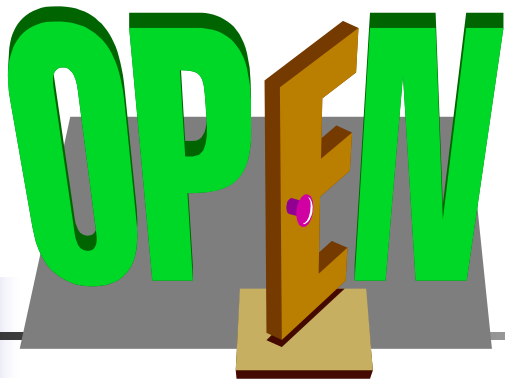
Access Vision

- Intended to address key shortcomings of traditional system
 - Inability of TDUs to acquire lower-cost competitive energy supplies
 - Lack of competitive pressures on wholesale power prices
- Support EPCRA '92, Order Nos. 888 & 889, FERC efforts to prevent and remedy market power



Access Vision cont'd

- Incremental change to traditional vision
- EAct '92 did not:
 - Alter FERC obligation to ensure just and reasonable rates, terms & conditions
 - Mandate market-based rates
 - Alter jurisdictional lines
- LSEs still have obligation to serve and to conduct long-term least cost planning



Access Vision cont'd

- State/federal conflict limited
 - FERC/States must share jurisdiction over transmission used to serve native load and wholesale market
 - 888 still gives priority rights to native load, network, long-term customers
- Goal: to permit LSEs to better meet their traditional obligation to serve by permitting them to acquire lower cost energy resources



Market Vision



- Characterized by SMD
- Centralized bid-based security constrained wholesale spot markets and locational marginal pricing (“centralized markets”)
- Dramatic change from traditional and open-access visions of the industry

Market Vision cont'd



- Goal: to ensure efficient allocation of resources as determined by willingness to pay
- Focus changed from LSEs and their consumers to power marketers and IPPs:
 - Gives PMs and IPPs ability to increase transactions
 - Native load, network customers, and long term customers no longer have priority
 - LSE's ability to obtain price certainty reduced
 - LSE's ability to make long-term resource decisions reduced



Market Vision Cont'd



- State role significantly reduced:
 - No jurisdiction over transmission
 - Less ability to regulate resource planning and acquisition
- FERC role altered:
 - Market designer and monitor
 - Markets, not FERC, responsible for ensuring just and reasonable rates



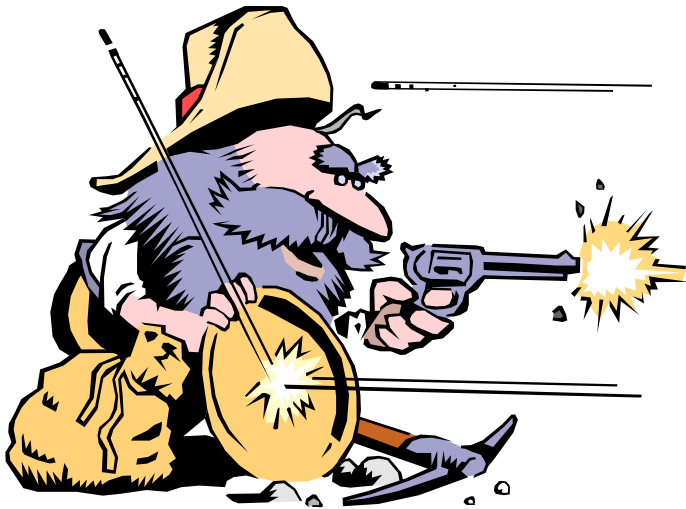
The Problem: Political Heat

“No final rule mandating a standard electricity market design pursuant to [the SMD NOPR], including any rule or order of general applicability within the scope of the proposed rulemaking, may be issued before October 31, 2006, or take effect before December 31, 2006.”

-- Energy Policy Act of 2003, H.R. 6

The Problem: Stalemate

- Proliferation of rulemakings and proceedings required to implement markets
- Few conclusions





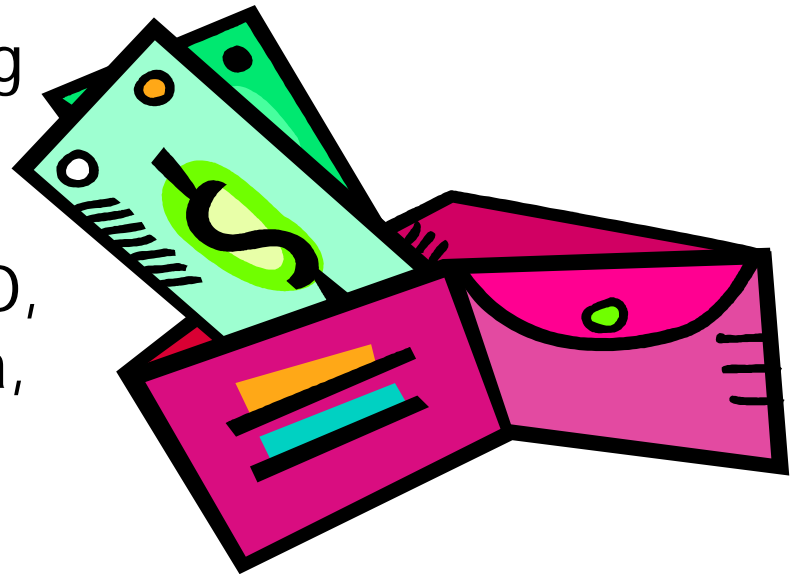
Stalemate cont'd

- Standards of Conduct (RM01-10)
- Electricity Market Design and Structure (RM01-12)
- Standardization of Generation Interconnection Agreements and Procedures (RM02-1)
- Standard of Review for Proposed Changes to Market-Based Rates (PL02-7)
- Standardization of Small Generator Interconnection Agreements and Procedures (RM02-12)
- Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid (PL03-1)
- Market-Based Rates for Public Utilities (RM04-7)

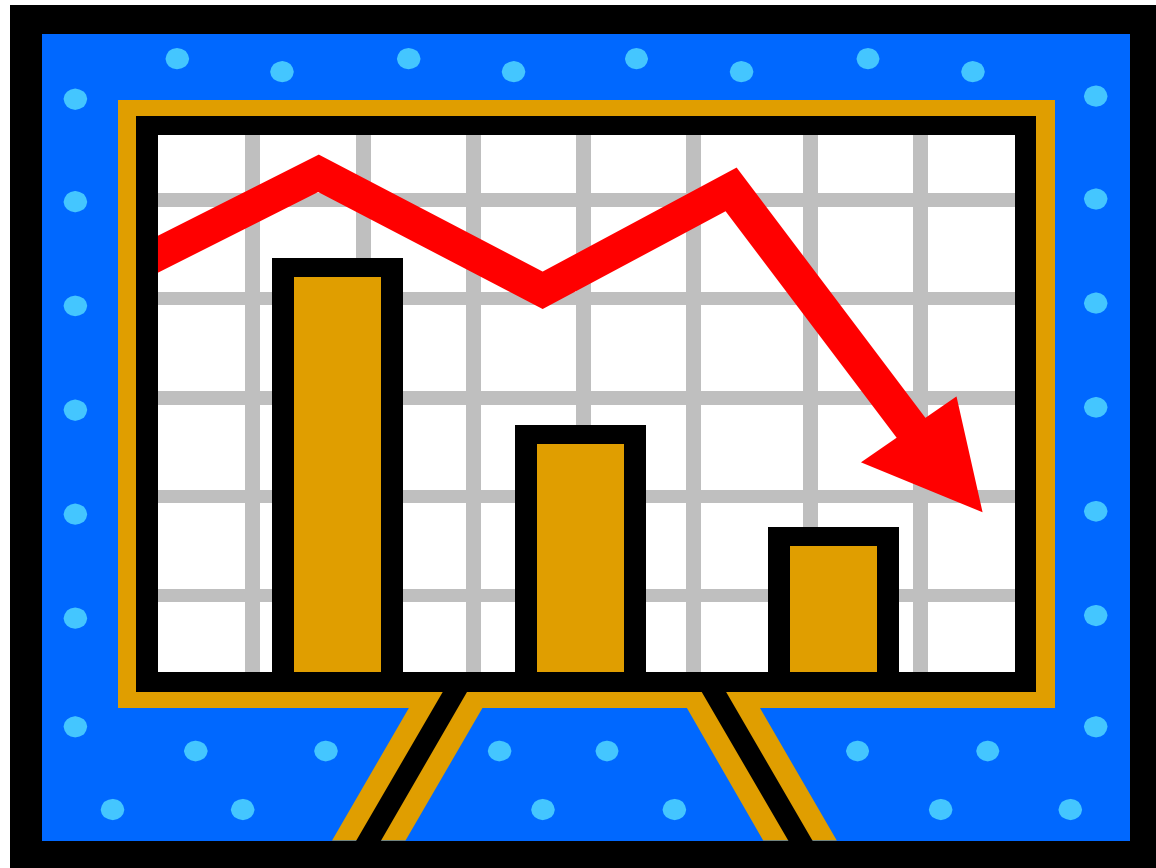


The Problem: Consumer Cost

- Continuing costs of market power and market abuses
- Extensive costs for negotiating and litigating incomplete rulemakings and industry initiatives, e.g., Single NE RTO, Alliance, SETrans, Grid Florida, Grid South, Grid West, West Connect, Crescent Moon RTE, Desert Star ISO, RTO West



The Problem: Insufficient Investment





Reasons for Opposition

- Consumer-focus



- Concern for Grandma Millie – risks of abuse, volatility, higher prices
- Willingness to trade-off some inefficiency for greater long-term price-certainty
- Belief that consumers who paid for transmission system should have priority access



More Reasons for Opposition

- 80-20 Rule
 - 80% of benefit available for 20% of the cost
 - Last 20% of benefit takes 80% of the cost and may not be worth while
 - Moving from open-access with ISOs to Day-2 RTOs with centralized markets and LMP is enormously expensive and complicated.
 - **Incremental** value may not exceed **incremental** cost.

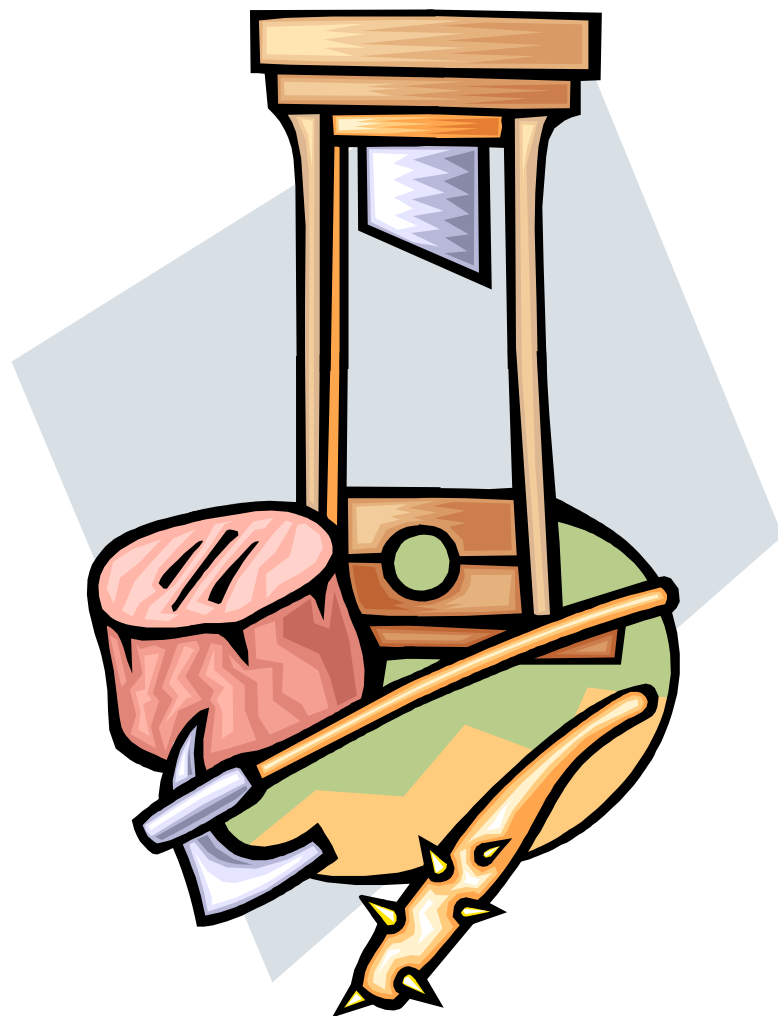


Even More Reasons

- Skepticism about Centralized Electricity Markets
 - Concern electric industry inherently subject to serious market failures
 - Belief long-range least-cost planning and obligation to serve more effective in meeting consumer needs than invisible hand – esp. given political realities re. real-time pricing, market mitigation, “political” market power
 - Difference between competition in peaking and intermediate energy markets and competition in provision of electric service
 - Belief centralized markets more subject to regulatory error

Economics Is All About The Assumptions

- FERC and industry cannot successfully assume away either the physics or the **politics**
- In economic terms, value can be shown through political process instead of through willingness to pay
- What is politically feasible without losing your head?





Solution

- Pursue Open-Access Vision of Industry
- Make “noisy withdrawal” from Market Vision (outside NE, NY, MidAtlantic)
- Give industry participants, politicians assurance that ISOs will not lead inevitably to centralized markets



What does that mean?

- Pursue benefits of competition to degree possible with open-access and without centralized markets or LMP
- Pursue ISOs
 - Independent regional system operation, redispatch, market monitoring
 - Independent calculation of ATC, TTC
 - Regional transmission planning
- Get Transmission Built
 - Provide certainty of cost recovery: NOT participant funding
 - Permit third-party transmission construction and ownership
- Renew efforts to promote effective redispatch options
- Address market power
- ?



It's Not Either-Or

There is a compromise position between
Markets and Full Regulation





What Consumers Value as Demonstrated by Willingness to Vote

“While competition in the wholesale power market might also benefit retail electric consumers, it must be allowed to develop and operate compatibly with the existing vertically integrated structure.”

-- Oct. 1 Letter to Chairman Wood
from 70 members of Congress



Challenge

Rather than chastising regulators and politicians for interfering with “ideal markets,” use economic tools to determine the best approaches to maximize **consumer** benefits within political as well as physical realities.

