

Federalism, Regionalism and Energy Policy

The Relationship Between Wholesale and Retail Markets;
National and State Policy and Regional Strategies

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*"I have yet to see any problem,
however complicated, which,
when looked at in the right way,
did not become still more complicated."*

- Poul Anderson
Author of Hokas Pokas,
and other works of science fiction

Overview

- Introduction
- RTOs and SMD – precursor or vehicle?
- FERC Standard Market Design
 - Policy
 - Practical concerns
 - Implications for federalism
- Approaches to Federalism
 - Is a cooperative federalist approach possible to interstate energy issues? “Western Market Design?”

Federal issues

- Implementation of Regional Transmission Organizations (RTOs), required by Federal Energy Regulatory Commission
- FERC's proposed rules for Standard Market Design.
 - Competition in wholesale power markets
 - Non discriminatory access to transmission grids
 - Transmission congestion management/pricing
 - Resource adequacy
 - Market monitoring and market power mitigation

Regional issues

- Encourage FERC to defer to a Western-driven wholesale market design process
- Continue to develop and evaluate RTO-West
- Coordinate RTO-West with CA Independent System Operator and West Connect

Electric restructuring in theory

- Generation component of electricity service becomes competitive.
- Many suppliers offer supply services to consumers and deliver the services over the transmission and distribution systems of public utilities.
- Development risk stays with developers
- But: High externalities, capital access, coordination, information, asymmetries, etc., make for a very long critical path from lip to cup.

Regional Transmission Organizations

- FERC Order 200, December, 1999
 - “Voluntary mandate” to form regional transmission organizations (RTOs)
 - Defined the characteristics and functions of RTOs
 - Independent operation of critical transmission facilities
 - Reliable system operations
 - Initiated regional processes to develop RTO plans for approval by FERC.

FERC

Market Oversight and Investigation

- **Two tiered system**
 - Market monitoring units (MMUs) for each SMD market
 - FERC office of market oversight and investigation (OMOI)
- **What are MMUs?**
 - Independent market experts at market level
 - Independent of all market participants
 - Independent of Independent Transmission Provider (ITP) managers
 - Report to ITP board and FERC
 - Report on market performance, problems as they arise, and perform investigations within the market
- **What is OMOI?**
 - New office within FERC
 - Staff of 110 by FY '04
 - Wide range of expertise to understand markets and remedy problems
 - Understand markets, analyze problems and recommend fixes, and remedy individual behavior problems

How Do SMD and RTO West Tie Together?

- **RTOs are now the path to SMD**
- **RTO West filing**
 - Very close to SMD in most ways
 - Cooperation in Northwest is impressive
 - Later orders: FERC will not revisit issues it doesn't flag in RTO order

How Will Western Seams Issues be Solved?

- **Seams Steering Group – Western Interconnection (SSG-WI)**
- **Immediate job**
 - Lay out market design elements in western RTOs
 - Decide which need to be standardized and how much
 - Report to FERC
- **Longer term**
 - Propose the solutions
 - Oversee the overall western market
- **Tension**
 - Want answers fast
 - Want answers that work for the west

Questions Posed in NOPR

- Over 120 requests in SMD NOPR for specific comment on requirements.
- Reciprocity provisions, prescriptive governance requirements, reliability impacts, transmission planning protocols and inter-ITP transmission pricing (with cost shifts) are areas of great interest.
- April White Paper will respond to state and other criticisms, suggestions.

What are some concerns
with the NOPR?



Concerns with SMD NOPR

- Asserts FERC jurisdiction over transmission element of bundled retail service
 - Affects states that have not restructured at retail.
 - Affects default supply in restructured states (MT)
- Prohibits favoring transmission for native load customers (“undue discrimination”)
- Uncertain whether LMP is best approach for complex Northwest hydro system
 - Unified operation of hydro system
 - Non-power obligations
 - LMP hydro examples not as complex as NW
 - Modifications required (zonal v. nodal)
 - Note modified LMP in RTOWest.
- Generally prohibits “through and out” transmission pricing.
 - Possibly 25% revenue impact for NorthWestern, and therefore its customers.
 - Could disrupt RTO West arrangement. Adequately addressed in RTO West order?

Concerns with SMD NOPR

- Role of Power Marketing Authorities/BPA
- Effect on non-jurisdictional entities, cooperatives, municipals, Generation & Transmission (G&T) cooperatives
- State role in planning and resource adequacy
- Effect on existing transmission rights
- Possible cost shift to Load Serving Entities?
- Many additional specific concerns
- Bottom line: Is the paradigm right?

Questions in SMD

- What problems does SMD attempt to resolve?
- Is the problem statement correct?
 - Are the problems the same in all regions?
- Are the strategies identified to address the problems the best set?
 - Will the solutions work in all regions?
- What legal issues does SMD raise?
 - Conflicting readings of NY PSC v. FERC.
 - Conflicting views of EPACT wheeling amendments.
 - Is it better to have “bright lines” or can some uncertainty facilitate cooperation?
- What is behind the political positions on both sides?
 - Uniquely strong and sustained Congressional/State opposition.
 - Can FERC “get the message” and respond constructively?
 - Can opponents accept that FERC “gets it”?
- *Are we heading toward a lose-lose?*

Western “Must haves”

These are the agreed upon principles contained in a letter sent on April 16, 2003 to FERC Chairman Pat Wood. The letter was signed by:

- Commissioners from California, Colorado, Idaho, Montana, Nevada, Oregon, Utah, and Washington,
- the Consumer Counsel of Montana and the Director of the Utah Committee of Consumer Services,
- the Chairs of the California Energy Commission and California Power Authority.

Western “Must haves”

States with “bundled” retail utility service must retain jurisdiction over the retail transmission service. FERC must not assert jurisdiction over the transmission component of bundled retail service or default supply service.

Market design for the western interconnection must be developed specifically for the region through cooperation efforts with the states and provinces.

RTO formation must be voluntary & supported by evidence costs are reasonable compared to benefits.

Western “Must haves”

Must have efficient, open access grid management that recognizes existing rights.

FERC must not apply inflexible rules that discourage states moving forward.

Essential that wholesale markets be free of market abuse. FERC should pursue timely, effective market monitoring and mitigation of market power abuses.

Additional comment in April 14th letter by Rowe to FERC Chairman Wood concerning Western interconnection “must haves” in SMD rule

Letter Urges:

- improved management of grid that still retains benefits of Bonneville power system for region
- transparency and public accountability
- avoidance of preemptive federalism
- fundamental revision of SMD to allow for a cooperative process.

FERC April 28 White Paper: What FERC will have in its final rule on Standard Market Design.

- FERC will focus on **RTO formation** & allow flexible implementation schedules depending on local/regional needs. Implementation of some features can be phased in.
- The RTO or ISO, **not FERC**, will develop the detailed market rules by which the wholesale market will operate in its region.
- Will **require** public utilities who have not joined an RTO to join.
- Will assert jurisdiction over terms and conditions of transmission, but not over rates.
- Will not require auctioning of firm transmission rights of existing customers.
- Will rely heavily on **regional state committees** for resource adequacy review, resolution of seams issues, allocation of firm transmission rights for current customers, and allocation of new facility costs.
- Will consider compatibility of mitigation proposals by RTOs in the same interconnection.

FERC Western Market Manipulation Report

- “Cop on the Beat”
- Investigation commenced 2-13-02, order available 3-27-03.
- Natural Gas
 - Gas transaction misreporting and wash trading.
 - Gas prices in Cal Refund Proceeding to be substantially reduced over 9 month refund period.
 - Generic proceeding concerning reporting and monitoring.
- Electric
 - Despite Cal ISO and PX anti-gaming rules, economic withholding, trading strategies, inflate bidding occurred.
 - OTSC to be issued against over 30 possible offenders (including BPA, PacifiCorp, Idaho Power).
 - OTSO to revoked certain market-based rate authorities.
 - Short-term markets affected LT contracts. Analysis should inform L-T contract proceedings and complaints.
 - Condition all market-based rate authorities on “complete, accurate and honest information” to price indices publishers.
 - Require actual trade data for price indices.
- Order, material available at www.ferc.gov

Is a Cooperative Federalist approach to regional energy issues possible?

A discussion in progress



*“Now what we have here
is a failure to
communicate,”
Cool Hand Luke (1967),
just before the gunfire
started.*

Let's avoid that mistake!

Old world: “One big company,”
two regulators, and a
“horse high fence.”
Dual federalism.

New world: Broken fences,
lots of “borders” – technology, layers,
jurisdictions, etc., but nobody can find
the property lines.
Many issues happen on the borders.

Alternative 1: *Preemptive federalism.* Efficiency,
consistency, scope of markets require national action.
 (“Withering away of the states.”) Strongly top down.

Alternative 2: *Subsidiarity.* “Bottoms up.” Articles of confederation.

Alternative 3: *Cooperative federalism.* Both federal
and state authorities charged with implementing
federal within a federalist structure. Less top down. More shared authority

Dual federalism

- Most common form pre-New Deal.
- States generally focused on infrastructure, education.
- Feds generally focused on defense, foreign affairs, monetary policy.
- States originated many policies later adopted nationally – child labor, minimum wage, unemployment, income taxes, etc.
- Telecoms – Inter/Intra state. '34 Telecom Act.
 - Smith v. Illinois – Jurisdictional separations.
 - Modified by '96 Telecom Act.

Dual federalism

- Electricity – '35 Federal Power Act.
 - Vertically integrated industry.
 - State – retail.
 - Federal - wholesale.
 - States concerned with infrastructure at all levels.
 - Feds concerned with interstate commerce, coordination between vertically integrated companies, sales to all-requirements customers.
- Energy – strong state experimentation, leadership on retail and market issues.
- Strengths – simple, clear authority, consistent with states as sovereigns.
- Limits – Brittle, arbitrary, tough to deal with complexities.

Preemptive federalism

- National government makes policy.
- State role limited to implementation.
- May be tied to receipt of funds.
- Broad federal authority under Commerce Clause.
- Strengths – consistency, clear authority, easy to understand, appears efficient, may help overcome local “democratic failure” (e.g. denial of civil rights).
- Weaknesses – Brittle, inflexible, limited public participation, may be perceived at local level as illegitimate.

Compare European subsidiarity

- Bottoms up.
- Generally, decisions made as close to the citizen as possible.
- Maastricht Treaty - in areas not within the EU's exclusive competence, will act only if objectives cannot be achieved by Member States, and due to scale or effect of the proposed action, can better be achieved by the Community
- Amsterdam Treaty - Community action should not exceed what is necessary to achieve the objectives ("proportionality principle")
- Strengths – Recognizes origins of EU in individual nations. Consistent with democratic governance.
- Weaknesses – difficult to implement, hard to determine lowest possible level of decision-making.
- Similar to Articles of Confederation.

Cooperative federalism

- “All involved governments are regarded as mutually complimentary parts of a single governmental mechanism all of whose powers are intended to realize the current purposes of government according to their applicability to the problem at hand.” E.S. Corwin (1950)
- No level seeks an advantage over the other, both are united by a common purpose.
- Sharing of power, policy development and implementation between levels of government.
- Characterized by shared costs, federal guidelines, shared administration. (Robert Lineberry, 1989)
- Strengths – flexibility, civic participation, diversity.
- Weaknesses – perceived delay, complexity, inconsistent results, gaps in authority. *It's messy!*

Jurisdiction - New York v. FERC

- 122 S. Ct. 1012 (March 4, 2002), Stevens
- Affirms FERC Order 888.
 - FPA Section 205 prohibits unreasonable rates/undue discrimination in interstate transmission.
 - Section 206 gives FERC power to correct abuses.
 - Order 888 ordered functional unbundling of wholesale G&T; required open access for unbundled interstate retail transmission; and declined to exercise jurisdiction over transmission in bundled retail sales.
- Rejects NY argument that statute draws bright line between wholesale and retail. Affirms FERC authority over unbundled retail transmission.
 - Preemption analysis based on unambiguous grant of authority in FPA.
 - Policy arguments should be addressed to FERC and Congress.
- Rejects Enron argument that FERC must regulate bundled retail transmission.
 - Statutorily permissible policy choice.
-

Reasons for cooperative federalism

- Sharing resources.
- Taking advantage of particular competencies in each partner.
- Tailoring policy to specific circumstances.
- Diversity benefit of experimentation (“States as laboratories”).
- Competition among states - promote economic development by creating certain policy mixes. (At least one CLEC has said in deciding whether to enter a state it considers whether that state’s commission is “fully empowered” to enforce wholesale-level terms and conditions.)
- Reducing risk of error, especially in the early stages of policy implementation.
- Civic participation, with decision making as close to citizens (and customers) as possible.

Cooperative federalism – a (mixed) telecoms example

- 1996 Federal Telecommunications Act mentions state PUCs over 100 times, places key burdens on states.
- Interconnection
 - Prices
 - Terms
 - Facilities
 - Enforcement
- Advanced services
- Promoting competition
- Maintaining and advancing universal service
 - Antithesis of competition, or basis for some competition?
 - ED/CD opportunities and approaches?
- Protecting customers of monopoly and competitive services

Cooperative federalism – a telecoms example

(From 1999 NARUC resolution)

- Both FCC and state proceedings are **fact-based** and both are able to analyze and act on **complex records**.
- Federal agencies possess both **national and global perspectives**.
- **States are:**
 - **Close to local markets** and have developed methods for evaluating them.
 - **Close to customers**.
 - Have experience with **multiple industry restructurings** - including natural gas , telecommunications and electricity.
- FCC actions affecting states undertaken **mindful of states' unique knowledge** of local conditions and experience in regulating the local market.
- Where national standards are appropriate, the FCC will strive to implement them in a way that encourages state input to the fullest extent possible.
- Note **value of experimentation** and diversity (Brandeis)
- Practices – active consultation, use of guidelines and best practices, models to be considered by states, floors and ceilings.

NARUC Resolution, cont.

- Recognize the value of diversity and of experimentation in many circumstances.
- States will support the FCC in its efforts to meet challenges presented by implementation to the fullest extent possible.

Compare FCC State and Local Advisory Committee "Statement on Telecomm Competition," 1977.

Cooperative federalism – precedent

- Public Utility Regulatory Policy Act, amended by '92 Energy Policy Act.
 - Congress sets standards that state PUCs must consider in a hearing-type format within a certain time.
 - PUC may reject, modify, or accept, as long as they consider.
- *“The states did the work and the federal government received the benefits of a relatively seamless set of coherent and consistent energy policies covering all states.”*

- Dr. Ray Lawton (NRRI)

Cooperative federalism – an energy example

- Reasons for success (Lawton)
 - Standards – no need to “reinvent the wheel.”
 - Process – parties’ confidence in data and fair consideration.
 - State flexibility – Feds may participate in state proceedings, but may not preempt or review.
 - Participation – public participation widely encouraged.
 - Produced a coherent set of state energy policies.
 - Little enduring federal-state disagreement.
- Can we achieve these in current environment?

PHASES OF INTERGOVERNMENTAL RELATIONS

Phase Descriptor	Main Problems	Participants' Perceptions	IGR Mechanisms	Federalism Metaphor	Approximate Climax Period
Conflict	Defining boundaries Proper spheres	Antagonistic Adversary Controversy Exclusivity	Statutes Courts Regulation	Layer cake Federalism	Pre-1937
Cooperative	Economic stress International threat	Collaboration Complementary Mutuality Supportive	Policy planning Broad formula grants Open-ended grants Tax credit	Marble cake Federalism	1933-1953
Concentrated	Program needs Capitol works	Professionalism Objectivity Neutrality Functionalism	Categorical grants Service standards	Focused or channeled federalism (water taps)	1945-1960
Creative	Urban-metropolitan Disadvantages clients	National goals Great society Grantsmanship	Program Planning Project grants Participation	Fused-foliated Federalism (proliferated)	1958-1968
Competitive	Coordination Program effectiveness Delivery systems Citizen access	Disagreement Tension Rivalry	Revenue sharing Reorganization Regionalization Grant consolidation	Picket fence Federalism (fragmented)	1955-?

Cooperative federalist approach to SMD/wholesale markets



FERC believes NOPR is cooperative federalist proposal

- Coordination with states
- Regional State Advisory Committees for policy issues, RTO management and budget review
- Multi-State Entities for planning, certification, and siting at a regional level (National Governors Association concept)
- One western PUC commissioner responded, *“states cooperate and FERC federalizes.”*

Why it's worth trying

- Potential for lose-lose
 - FERC faces sustained political opposition from many quarters
 - Legal questions of jurisdiction complex
 - Midwest and Northeast believe NORP addresses real issues in their region and is generally a good platform for action
 - Strong opposition in Southeast and West raises legitimacy question.
- FERC-state and region-region disputes could weaken all
- And ensure that *real problems* are not addressed.

Is there another way?

- Consider bottoms-up approaches, driven from within the region.
 - Possible basis in RTO work (FERC approved RTO West)?
 - Regional reliability councils, CREPC.
 - *Wholesale* market focus.
- Start with regional structure.
- Identify regional issues.
- Identify regional strategies.
- Identify where states have sufficient authority, and where FERC action is required.
 - State authority to approve utility actions?
 - State authority to participate in regional bodies, express or implied?
- FERC pushes, convenes, supports, and approves outcomes.

RTO West order, par. 273

*“Several intervenors comment that attention must be given to how RTO West’s proposal fits [within SMD] . . . We look to the RTO West filing as **both informing and being informed by** the proposed [SMD] rule. To this end, we order further technical conferences on certain aspects of the filing in order to fully explore a regional approach”*

FERC RTO West order

- Indicates move away from strict East/West model, toward RTO-specific approaches?
- Commits to follow up through workshops.
- Defers to RTO proposal on many issues.
 - Supports existing transmission rights.
 - 8 yr. company rates and license plate approach.
 - Cost recovery compromise.
- Possible remaining issues:
 - Positive benefit/cost
 - Rate pancaking based on voltage level.
 - One-way jurisdictional ratchet.
 - Others?

Basic steps

- Regional structure –
 - FERC works with region (Governors, PUCs, Committee on Regional Electric Power Cooperation, non-jurisdictional entities, stakeholders) to convene process.
 - Develop ground rules/decision rules, responsibility.
 - Basis and examples in other regional efforts.
- Issue identification.
 - Focused work to identify issues of near-term, long-term concern to West, or to sub-regions.
 - FERC NOPR necessarily general, factual can't be well-developed in national NOPR.

(“Assume away the FERC”)

Are these Western issues?

(Which ones, how critical?)

- Efficient use and expansion of (investment in) transmission system?
- Price signals for new generation (investment)?
- Reasonable market certainty?
- Transparency?
- Price signals for new large load?
- Transformation from mainly cooperating vertically-integrated utilities (opportunity transactions) to larger role for wholesale market?
 - Will this transformation occur in the same way in the West as in other regions?
- Role of BPA transmission?
- Role of hydro?
- Role of non-jurisdictional entities?
- Preservation of cost-based BPA power?

Regional/cooperative approach to Standard Market Design

- Consider bottoms-up approaches, driven from within the region.
 - Possible basis in RTO work (FERC approved RTO West)?
 - Regional reliability councils, CREPC.
 - *Wholesale* market focus.
- Start with regional structure.
- Identify regional issues.
- Identify regional strategies.
- Identify where states have sufficient authority, and where FERC action is required.
 - State authority to approve utility actions?
 - State authority to participate in regional bodies, express or implied?
 - Ways to incorporate non-jurisdictional entities?
- FERC pushes, convenes, supports, and approves outcomes.

Stalemate, preemption, or federalism?

Options for Cooperative decision-making?

- States implement Federal standards; PURPA model; possible for interconnection policy.
- States supplement “baseline” Federal standards; possible for consumer protection policy.
- States authorized to form regional institutions to implement collective oversight; possible for transmission related issues.

• Strategy for recognizing non-jurisdictional entities?

“I got my mind right boss”

Cool Hand Luke (1967), just before Luke drove off in dump truck on his third escape attempt.

