SCOMM 109:8

REPORT AND RECOMMENDATIONS

ON

ELECTRIC UTILITY RESTRUCTURING

From

Joint Committee on Electric Utility Restructuring

19 January 1999

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Introduction

The Joint Committee on Electric Utility Restructuring was formed under House Concurrent Resolution 34. The Committee's pertinent task was to "provide to the legislature written recommendations on whether and how to implement electric utility restructuring in Alaska."

Committee members met and reviewed testimony (oral and written) from industry representatives, a consumer advocacy group, and concerned Alaskans and worked with the Alaska Public Utilities Commission to address the major issues concerning any plan for electric utility restructuring. The Joint Committee, unfortunately, did not hear from many residential consumers and is concerned about this lack of testimony from this area. Despite the best efforts of the Joint Committee Chairmen to provide public notice and encourage testimony, the residential consumer was not well represented in this process.

Contained in this Report and Recommendation are: (1) an overview of the committee's work and (2) our recommendations to the 21st Alaska Legislature concerning electric utility restructuring.

The backup documentation and files for the Joint Committee have been forwarded to the Legislative Reference Library for processing and storage. Those wishing to do further research regarding the Joint Committee's efforts may access files through that entity. The minutes from meetings held by the Joint Committee are available through the Legislature's WEB site (http://www.legis.state.ak.us).

The Co-Chairmen thank the committee members and the interested Alaskans who took the time to participate in the hearings. We also express our appreciation to APUC Chairman Commissioner Sam Cotten, Commissioner Dwight Ornquist, Commissioner Jim Posey and APUC staff members Bob Lohr and Paul Morrison who worked with the committee.

Senator Bert Sharp
Co-Chairman

Representative Norman Rokeberg
Co-Chairman

Joint Committee on Electric Utility Restructuring

JOINT COMMITTEE ON ELECTRIC UTILITY RESTRUCTURING
MEMBERS

Senator Bert Sharp Co-Chairman	Representative Norman Rokeberg Co-Chairman
Senator Loren Leman	Representative Alan Austerman
Senator Robin Taylor	Representative Fred Dyson
Senator Al Adams	Representative John Davies

Committee Staff: Janet S. Seitz
Committee Secretary: Dianna Pree

MEETINGS

August 6, 1998	Anchorage
August 18, 1998	Anchorage
September 4, 1998	Anchorage (Subcommittee Meeting)
September 16, 1998	Fairbanks*
November 18, 1998	Anchorage
January 6, 1999	Anchorage
January 18, 1999	Juneau**

*The committee hearings were all recorded with the exception of the September 16th meeting in Fairbanks. The tape recorder malfunctioned at this meeting.

Teleconference sites on line for most hearings: Fairbanks, Juneau, Kenai, Matanuska-Susitna, Kodiak, Barrow (for September 16th hearing).

**Teleconference from Juneau to Anchorage and Fairbanks

ISSUES

Should Alaska permit competition among electric utilities? If so, how should such competition be structured?

DISCUSSION

History: The electric utility industry is undergoing significant changes in many of the other 49 states. Changes have resulted in part from the Public Utility Regulatory Policy Act of 1978 ("PURPA"), the Energy Policy Act of 1992, and Order No. 888 of the Federal Energy Regulatory Commission (FERC) authorizing "wholesale wheeling". (*Note: Order No. 888* **does not** *apply to Alaska).*

Traditionally, electric industry operations are divided into three major components: generation, transmission, and distribution. "Generation" is the creation of electrical energy. "Transmission" concerns long-distance, high-voltage transport of electricity from the generation site to the local distribution system. "Distribution" refers to the physical system that connects the transmission system and the consumer (or the "end user"). It is at the distribution level that high-voltage electricity is reduced to the lower voltage used by the consumer.

The industry in the Lower 48 has begun to move away from its traditional form (vertically integrated monopoly regulated structure) to more competitive structures. Several states have adopted or are considering changes in the way consumers receive electric service. As of July 1998, 13 states have passed restructuring legislation. The electric power industry in the Lower 48 states has been undergoing changes consistent with those mandated by the Energy Policy Act of 1992 and FERC Order No. 888. There are, at the federal level, new requirements for "comparable" transmission access and non-discriminatory availability of real-time network information and these are promoting competition in generation. Approximately half of the Lower 48 states have adopted or are considering changes in the way service is delivered to the consumer. These changes include introduction or examination of retail competition and consumer choice. Hawaii is also reviewing its options in the area of electric utility restructuring. Although FERC Order No. 888 does not apply to Alaska, many

Alaskans are interested in new business structures and benefits that might arise out of restructuring.

Experience to date has not established whether such restructuring efforts can provide sustained consumer benefits. Each state's program varies and most are in the beginning stages. Some states are conducting limited trials or demonstration projects (i.e., "pilot programs").

While "wholesale wheeling" has been authorized by the federal government, retail competition has not. "Wholesale wheeling" involves a system in which a distributor of power would have the option to buy its power from a variety of producers, and the producers would be able to compete to sell their power to a variety of distribution companies.[1] "Retail competition" would involve a system where more than one electric provider can sell to retail customers. [2] The ultimate goal is to foster greater freedom in the marketplace and yield lower real cost to consumers.

Restructuring: What is "restructuring" and what does it mean as opposed to "deregulation"? "Restructuring" is a term used to describe a method of allowing electric utilities to compete within a market area but still be regulated to some degree by the appropriate utility commission, in this case, the Alaska Public Utilities Commission (APUC). The term is also used to refer to the separation of various utility functions into individually-operated and -owned utilities.[3] "Deregulation" would involve eliminating state regulation and most oversight such as has been done in other industries over the years (i.e., airline, telecommunications, etc).

A number of bills on retail wheeling have been introduced in both houses at the federal level, but have not been acted on. Alaska Senator Frank Murkowski chairs the Energy and Natural Resources Committee that will hear any proposals on this matter. Senator Murkowski has, more than once, stated that any changes in a state's regulatory structure regarding electrical utilities should be decided at the **state** level, to address that state's unique circumstances, not by federal mandate. (See Exhibit "B")

Lower 48: A full recitation of all the issues facing the Lower 48 in the area of electric restructuring is not covered by this Report and Recommendations. A summary of some of the major issues developed in each of the three operational segments is provided below:

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[1] "Glossary," National Conference on State Legislature accessed through NCSL Web Site (http://www.ncsl.org/programs/esnr/restru.html)
[2] Ibid.
[3] Ibid.

a. ***GENERATION***: Electric restructuring in the Lower 48 States arises from regulatory and technological changes. PURPA created new classes of generation sources, separate from the traditional vertically integrated regulated utility structure. Technology made smaller units more economical, reducing the cost and time to construct, further permitting power generation outside of the traditional utility structure. Moreover, it requires utilities to purchase excess power from independent generators. The existence of different generation sources, offering energy from different sources under different price schedules, forms the basis for competition in the Lower 48 states.

There are concerns that joint ownership of generation and transmission facilities presents anti-competitive opportunities which should be addressed through some form of separation. Another concern that arises is the possibility that there might be an insufficient number of competitive sources for generation now or in the future.

b. ***TRANSMISSION***: Facilities and regulatory issues are of concern in the transmission area. Electric power must be moved from the source ("generator") to a consumer/buyer located beyond traditional utility boundaries. In the Lower 48, transmission across large geographical areas is physically possible. The interstate power grid permits consumers in one state to access power produced in a different state. Transmission facilities are termed "bottleneck" facilities in that they cannot be economically replicated or effectively substituted for by competition. For example, vertically integrated utilities could arguably use control of the bottleneck transmission facilities (for which there is no competitive market) to favor sales of their own electrical generation (for which there is a competitive market). To address this potential problem, Congress encouraged FERC to open up the nationwide electric transmission system to wholesale suppliers. Order No. 888 established open access tariff requirements that provide non-utility wholesalers with access to the grid "comparable" to that afforded by the utility to itself and its affiliates. Order No. 889 provided for the establishment of real-time information systems and a code of conduct to ensure that all parties received non-discriminatory dispatch of their power. Alternatively, potential discrimination in transmission can be addressed by requiring the operation of the transmission network by an independent, non-utility entity, often called an "independent system operator" (ISO).

c. ***LOCAL DISTRIBUTION:*** Typically, a local electric utility offered electric energy as part of a "bundled" service offering which included (1) the electric energy itself, (2) delivery of energy to customers' premises, (3) meter reading, (4) billing, (5) customer services, and other matters. Under local distribution competition, electric energy is sold to end users separately from other

services or unbundled (i.e., similar to what is now being accomplished in the area of telecommunications) and this is sometimes referred to as "retail wheeling" or "direct access."

Retail wheeling raises many issues in the Lower 48 and from many utilities. Utility costs and rate processes are not geared to reflect unbundling and pricing of discreet services. From a consumer perspective, retail wheeling raises consumer information, universal service, and consumer protection issues. For the utilities, multi-party access to the local distribution system will require extensive operational, financial, and ratemaking adjustments as well as questions of ownership and operation of the local distribution system. For the consumer, rates for energy may increase instead of decreasing as unbundling occurs. High cost low volume customers may prove unattractive and therefore may be unserved or served at higher prices in a competitive market. Issues of "cherry-picking", universal service, and provider of last resort are of concern.

ALASKA: Alaska is not physically connected to the Lower 48 transmission grid; however, Alaska is not insulated from the social and political forces driving review and revision elsewhere in the country. Alaskan advocates for electrical restructuring are requesting that changes be made to the current system of exclusive certified service areas.

While the APUC has the authority under current law to issue certificates allowing competition in electric utility service[4], the Commission to some appears to be reluctant to do so without further legislative guidance or encouragement. Cited as an example is APUC's rejection of the request made by Chugach Electric Association ("CEA") to provide electrical service to customers in the area certificated to Anchorage's Municipal Light & Power ("ML&P") (DOCKET U-97-201, date of opening: October 13, 1997; date of decision May 20, 1998). CEA asserted in its pleadings that there is nothing barring competitive services under anti-trust laws. However, the APUC took exception to CEA's position that it did not need a certificate to supply customers in the ML&P service area. Currently before the APUC are some dockets involving restructuring issues:

a) Power pooling and dispatch planning among the Railbelt[5] electric utilities (DOCKET U-97-140, date of opening:

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[4] April 30, 1997 letter from Office of the Attorney General, Department of Law, to Representatives Rokeberg and Sanders, page 1. (See Exhibit "A").

[5] "Railbelt" utilities refers to the interconnected utilities of Chugach Electric Association, Inc. (CEA); Golden Valley Electric Association, Inc. (GVEA); Homer Electric Association, Inc. (HEA); Matanuska Electric Association, Inc. (MEA); the Municipality of Anchorage d/b/a Municipal Lights

September 1,1994; decisions: September 10, 1997 started investigation. DOCKET is still open.)

b) More general rulemaking inquiry into electric restructuring issues [DOCKET R-97-10, date of opening: around October 22, 1997 meeting; docket is still open (study linked.)]

c) Aurora Power Resource, Inc. application to establish a pilot program (DOCKET U-98-114, date of filing: about June 26, 1998.)

The growing consensus is that some form of electrical restructuring will come to Alaska. It is a matter of when and how. The majority of witnesses before the Joint Committee agreed with that position; however, there were a few individuals and groups who thought restructuring did not make sense in Alaska at this time. Alaska Public Interest Research Group (AKPIRG"\) was very concerned about the implementation and effect of any restructuring efforts on consumers. The International Brotherhood of Electrical Workers (IBEW) voiced strong opposition to restructuring.

As noted in the Introduction, the Joint Committee received very little testimony from individual residential consumers. It is these consumers that could experience the greatest risk if electrical utility restructuring failed to achieve its goals.

It is noteworthy that there has been a change in attitude, primarily among rural electric providers who heretofore have feared and objected to any lessening of regulatory oversight in their market areas. This change has occurred in the course of the last two years as people have become more familiar with the issues. It appears at this time that some form of retail restructuring is likely. This results from the potential for "distributive technology," e.g. on-site micro-generator and alternate power sources, and consumer demand for more efficient energy generation and usage. In addition, retail resellers (e.g. Aurora Power) have requested authorization to enter the market at the retail level. Ultimately the Legislature may be involved in deciding if limited competition or restructuring will provide sustainable consumer benefits or be merely a matter of cost shifting from larger users to individual consumers.

& Power (ML&P); City of Seward, Seward Electric Utilities Division (SES). Alaska Electric Generation & Transmission Cooperative, Inc. (AEG&T) is a wholesale supplier.

Alaska Structure of Electrical Utilities:

There are a number of features that make Alaska unique within the United States. Like Hawaii, Alaska is not a part of the national interconnected electrical grid. The special Alaskan features that need to be considered include lack of interconnection for the State, small market size, and consumer and public ownership of the infrastructure.

Interconnection and Market Size: Alaska has approximately 250,000 electrical consumers.[6] Approximately 178,000 of these consumers reside in the Railbelt area. Of those in the Railbelt area, 105,159 reside and receive service from the three utilities serving the Municipality of Anchorage (CEA 65,709, ML&P 29,450,[7] and MEA's MOA portion 10,000+/-).[8] Alaska's electric system is not interconnected with the electrical grid in the Lower 48 and, in fact, only the Railbelt area of Alaska has a large intertie system. Most rural electric utilities are not connected to one another and thus serve as stand-alone power for their particular city, town or area. The area outside the Railbelt is not generally interconnected although there are some small regional connections. Communities in many of the non-interconnected areas rely on one main power source or plant. Additionally, there are nearly 200 small communities off the grid and some form of competition may exist in some of these communities in the form of the option of self-generation by large power users.[9]

While in the Lower 48 individual utility systems are connected by transmission with the same current frequency at all points, the same is not true in Alaska. Thus power cannot move in an unrestricted fashion as fully competitive markets may require.

Another atypical characteristic concern is that there is no significant non-utility generation base in Alaska from which electricity can be obtained. Surplus power is available from co-generation, smaller PURPA, and industrial sources, as well as alternative sources, i.e., solar, wind, and geothermal generation.

Consumer and Public Ownership of Infrastructure: The structure of electric utilities in Alaska is such that consumers own more than 90% of the companies (either through cooperatives which are owned by their members or through local government-owned utilities which are owned by the citizens of that

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[6] Alaska Rural Electric Cooperative Association, "Electric Utility Industry Restructuring in Alaska," Discussion Paper #1, August 18, 1998, page 7.
[7] Telephone conversation with Bob Lohr, Executive Director, APUC, January 14, 1999.
[8] Telephone conversation with Wayne Carmony, General Manager, MEA, January 14, 1999.
[9] Alaska Rural Electric Cooperative Association, page 10.

local government).[10] This is opposite of the existing structure in the Lower 48 states where a large percentage of electric utilities are investor-owned.

[10] October 10, 1997 letter from Eric P. Yould, Executive Director, Alaska Rural Electric Cooperative Association, Inc., to Representative Rokeberg.

Issues of Concern

In the Lower 48, the electric industry has begun to move away from its traditional form – a vertically integrated, monopoly regulated structure – toward more competitive structures in some industry segments, primarily generation and wholesale wheeling. At the federal level, new requirements for new services are promoting competition in generations. At the state level, some states have adopted or are considering changes in the way local end use customers obtain electric service.[11] Where restructuring has been adopted, the ultimate goal has been to foster greater consumer freedom in the marketplace, wherever lower prices to consumers can be secured without adverse consequences in terms of the quality, availability and cost of electricity to all segments of the market.

The record developed by the Joint Committee reflects that there is no general consensus on the issues of whether and how restructuring will come to Alaska (the primary questions to be addressed by the Joint Committee). Some witnesses opposed changes in the status quo. Others favored substantial changes toward competition. Separately, disagreement existed on how policy makers should go about investigation of the need for and benefits of changes, and how to implement those changes if found appropriate. As examples, the Alaska Public Interest Research Group (AKPIRG) expressed concerns about the implementation and effects of any restructuring efforts on consumers. The International Brotherhood of Electrical Workers (IBEW) voiced strong opposition to restructuring. It should be noted, however, that the average residential customer is not aware of the issue at all.

Summarized below are some (but by no means all) of the concerns and issues brought before the Joint Committee during its hearings. The number and nature of these issues serve, at a minimum, to confirm the Legislature's view that electric restructuring is "a highly complex issue, carrying with it profound implications for all classes of electrical consumers." The order in which the issues are addressed should not be taken to imply any ranking by the Joint Committee concerning the importance of these issues – a matter better left for discussion and determination by the whole Legislature.

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[11] National Conference of State Legislatures, fax cover sheet, July 9, 1998: As of July 1998, approximately 13 states had passed some form of restructuring legislation. The majority of states have not adopted such legislation.

Customer Choice and Sustained Competition

A principal question arises concerning whether there can be enough competitors to be competitive. That is, can a sustainable competitive market for local end-user service be developed? Some testimony and evidence before the committee suggests that there is no apparent competition on the wholesale level, and thus a necessary basis for local end-user competition is absent. Other witnesses argued that a form of wholesale competition does exist.[12] Separately, the record demonstrates that all major generation is utility-owned. There is no non-utility, competitively available generation in the state. Attempts like those in the Lower 48 to force the sale of generation facilities (in order to develop competitive markets) could seriously impact the consumers who own those facilities. As an example, in Anchorage the Municipal Charter authorizes sales of utility assets only upon the prior approval of 60% of the voters. In the view of some witnesses, any attempts by the Legislature or the APUC to mandate sales of facilities will cause serious legal problems.

Moreover, in the Railbelt area the major generator of electricity for sale to other utilities (including Golden Valley Electric Association, Matanuska Electric Association, Homer Electric Association, and Seward Electric Association) is one entity: Chugach Electric Association (CEA). Such concentration of market power at the wholesale level raises questions concerning the impact at the retail level, particularly in terms of alternative electric generation to compete against such a concentration.

A related concern in the competition area is how to address the long-term power contracts which CEA currently has in place. For example, if Company A has a long-term agreement (ending in 20 years) with Company B that calls for higher payments than would be had under competition, what happens? A questions arises as to whether any changes in payments could give rise to "stranded cost" (discussed above and as an issue below). On the other hand, if the wholesale market is in fact competitive, then issues concerning stranded cost should not arise, since it is the transition to competition which gives rise to such charges.

As indicated above, the Railbelt area's major generator of electricity for sale to other utilities is CEA. ML&P does sell to GVEA in direct competition with CEA and has competed with CEA for sales to the City of Seward. GVEA has the capability of entering the competition. Alaska Electric Generation &Transmission Cooperative, Inc. does not generate much but it actually

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[12] Testimony of Eugene Bjornstad, General Manager, CEA, before the Joint Committee on August 8, 1998.

purchases and resells power to MEA and HEA which it purchases from CEA. Are there, then, enough entities to provide retail competition that would benefit the consumers?

Finally, as noted above, the absence of interconnection to the Lower 48 can cause potential problems. Consumers here cannot access competitive power from generating sources in other states, as consumers in the Lower 48 can. Nothing presented to the committee cures this limitation. Conversely, if anything happens in the course of restructuring to affect the quality, safety, or availability of Alaska's electric power, no help or remedy from the Lower 48 grid can be accessed, a matter of concern to more than one witness during our hearings.

The issues of mergers and acquisitions were also raised. Any consolidation would result in fewer potential competitors.

It is interesting to note, however, that the mere threat of competition has forced some lowering of rates in the Railbelt area. For example, MEA reduced rates for small businesses in 1998. CEA has testified that it did not pass along $3.5 million in fuel costs due to the fear of competition in 1997.[13]

"Cherry-picking" and Cost Shifting

"Cherry-picking" is the process that occurs when a new entrant into the market offers to serve only the best or largest customers. If one competing utility only offers services to the largest customers and leaves the remainder with the former utility, the former utility, which has fixed costs to pay, would have to spread those fixed costs over its remaining customers. For example, if a utility's current wholesale long-term contracts are set aside (which could violate the utility's constitutional right to due process) that would leave all those costs incurred to serve wholesale customers residing with the utility's retail customers (i.e., "cost shifting"). The impact would be higher costs, particularly to residential customers and would thus defeat one of the purposes of restructuring – lowering the cost of electricity.

[13] Ibid.

Consumer Protection

Retail competition would ideally bring about an entirely new system for the selection of service providers by consumers. Much like the old telecommunications system, where one used to go to the local telephone company and get all services (hookup, long-distance, local, etc.), an electric consumer now obtains all electric services on a combined or "bundled" basis from the local electric utility. Under competition, an electric consumer would ideally have more choices and therefore face more decisions. New, non-utility market participants would emerge, of varying capabilities and experience. The need for consumer education and protection, therefore, increases in a restructured environment. Among the matters to be considered in this area are:

a) Consumer protection/advocacy to ensure that consumers obtain the lowest cost power consistent with safety, reliability, and long-term interest.
b) Consumer education.
c) Consumer Bill of Rights.

Universal Service

The concept that electric power and electrical services sufficient for basic needs should be available to virtually all members of the population is known as "universal service."[14] A "provider of last resort" is a utility which addresses universal service by undertaking a legal obligation to provide service to customers where competitors have decided they do not want that customer's business. Questions arise concerning whether all service providers, competitors and utilities, should have the duty to serve all consumers on a non-discriminatory basis; or, if not, how will consumers at the margin receive quality service at affordable rates.

Currently there is no statutory mandate on universal service, although there is an obligation on a utility to provide service in a monopoly serving area. Cost of reaching a remote area may be borne by the residents of that remote area. For example, currently the process is to establish a cap on which services the provider will pay for and the consumer(s) will have to pay the difference between the cap and the actual cost of the service.

In the Alaska of today, electric service is just as important as any other utility service – from heating, water treatment, public safety, air traffic control, rescue operations, medical services, education, to cooking to bathing to

[14] National Conference of State Legislatures.

running electronic equipment, Alaskans depend on electrical service. Obviously, in Alaska, electric service is more important than most other utility services, in part because many other utility services depend upon electricity for operation.

Power Pooling

"Power pooling" involves an entity established to coordinate short-term operations to maintain system stability and achieve least-cost dispatch.[15]

The APUC *has received a report entitled "*Power Pooling/Central Dispatch Planning Study*"* performed by the firm of Black and Veatch (Power Pooling Study). The final report on this study was issued in October 1998 and the Joint Committee reviewed the executive summary of the study and heard testimony from Black and Veatch. The study analyzed potential benefits of a power pool with central dispatch among the Railbelt Utilities in Alaska.[16] From the results of the Power Pooling Study, it appears that some power pooling is currently in place; however, the anticipated savings from additional pooling are at a ***disappointingly low level.***

Stranded Costs

A stranded cost is an investment which is economic at the time made, in a regulated environment, but which becomes uneconomic because of the transition to competitive markets. For example, Utility Y might have built a facility that was financed over a long period of time and that becomes obsolete under a competitive environment.

In Alaska, as noted above, consumers own all of the stranded investment, because they own (directly or indirectly) all the utility generation in the state. If no one pays for these stranded costs, then the consumer as owner suffers. If someone is to pay, who should it be? How much should be recovered? What recovery mechanisms should be employed? Stranded costs are not only a utility issue, they are also a State issue because the State owns and/or finances major transmission facilities. Local governments are also affected by stranded costs.

Also of consideration in the "stranded cost" area would be the long-term contracts in place for gas supply and wholesale power.

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[15] Ibid.

[16] "Executive Summary", Power Pooling/Central Dispatch Planning Study, Docket U-97-140, page ES-1.

In the Lower 48 some stranded cost estimates run to the hundreds of millions of dollars. Alaska needs to determine what the exposure on stranded costs will be and how they will be recovered before competition can be considered for approval. Additionally, Alaska would need to develop guidelines as to what qualified as a stranded cost.

The questions for Alaska then are: Are stranded costs an issue in Alaska? If so, what are the stranded costs and what are their impacts?

Reliability/Safety

There were some concerns regarding preserving reliability and safety under competition. Like those in many other northern climates, Alaskans want to be sure that their electrical provider is reliable and has the capacity to address the needs of all its customers in a safe and timely manner. Additionally, the utility or competitive provider needs to have available increased power to meet peak load demands and/or unusual load demands caused by, for example, colder weather than normal. Spinning reserves and standby capacities are key issues. Where and how such demands would be met in a competitive market requires additional study.

Four-Dam Pool and other State-owned Facilities

The State may have some exposure on the Four-Dam Pool and other power generation and transmission lines. The State also has contractual obligations to the utilities involved and some of these are long-term. For example, the rates for power provided to communities from the State's Four-Dam Pool projects are set by long-standing contracts with the State.[17]

Statutory Guidance to the Alaska Public Utilities Commission

The record developed by the Joint Committee raises issues concerning the scope of current statutes; whether the Legislature should draft further legislation; and whether that legislation, if necessary or desirable, should be cast in terms of detail or broad guidance to the APUC. During its meetings, the Joint Committee discussed the role of the APUC in competitive market analysis and restructuring. The APUC indicated a preference for broad rather than overly detailed legislative guidance as to the State policy regarding competition for electrical utilities and providers.

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[17] Alaska Rural Electric Cooperative Association, page 10.

Some members of the Joint Committee would prefer legislation that establishes broad policy direction for the APUC. The APUC would then create the specifics of the regulatory regime. This course would avoid creating a de facto grant of legislative authority to a regulatory body. This approach recognizes that the regulatory body has the technical expertise to develop regulations but also that the Legislature should provide the broad outlines as to what the Legislature wants accomplished as to issues, such as universal service, access, reliability, cost shifting, consumer education, etc.

Other members of the Joint Committee believe that minimal statutory guidance is needed.[18]

Green Power

Several states have allowed utilities to offer electricity generated by renewable energy, such as wind, hydro and solar power at premium rates to customers. In some states, particularly California, consumers are opting for green power as a matter of choice.

[18] April 30,1997 letter from Office of the Attorney General (see Exhibit "A").

Pilot Program

A number of states have undertaken pilot programs on electric utility restructuring to see if such a restructuring would benefit their consumers. Many states have not utilized pilot programs. Others have terminated such programs relatively soon after inception. Here again, the general consensus of the testimony before the Joint Committee was that a well-designed pilot program limited in nature, geographical bounds (i.e., that is all or a portion of the Anchorage area), time, and customers could demonstrate if restructuring would benefit all or some Alaskans.

Should a pilot program be developed for the Railbelt area to see if competition would work in the largest interconnected area in Alaska? Many were concerned that competition in the rural area could involve a power seller coming in and "cherry-picking" off the largest customer in the community (i.e., the local school). This would mean that the local utility would be left with the rest of the load (probably mostly residential consumers) and prices might go up to cover the loss of a large customer. The same concerns are expressed by some of Alaska's larger electrical utility providers.

As the Railbelt is the only interconnected area, many believed that a pilot project should be limited in scope to either the Railbelt area or part of the Railbelt area. Part of the Study (see below) is development of a pilot program design.

The design of a pilot program could be based on geographic and population limits (i.e., 150,000 or more consumers), with a mandated ratio of access by large users (including industrial, public institutions, etc.) and residential consumers. In addition to the population requirement, some percentage of the overall electrical market in that area would be established as a maximum level of participation and the pilot program would have a sunset date. Participants in the pilot program would have to provide baseline and quarterly reports to the APUC.

Study of Electric Utility Restructuring in Alaska

APUC invited the Joint Committee to participate in a study on this complex and far-reaching issue – an issue that will affect every citizen in the state who pays an electricity bill. A Request For Proposal for a Study of Electric Utility Restructuring in Alaska (the Study) was issued in November 1998. Interviews were conducted on December 17 and the Selection Committee recommended contract award to CH2M Hill and its subcontractor, Econergy International Corporation. A letter of intent was issued to CH2M Hill on December 23, 1998. The protest period for that award expired on January 4,1999. The consultant is now under contract and started proceeding with the Study during the week of January 11, 1999. The Study has two deliverables:

(1) The first deliverable is due on March 1, 1999, and is to be a pilot program design recommendation.

(2) The draft report on utility restructuring is due to be delivered on March 31, 1999. It is anticipated that the Legislature will hold committee hearings on the report during April 1999. The final report is due June 30, 1999. The consultant is required to be available until December 31, 1999, for consultations.

The Joint Committee's Findings and Conclusions on Electric Utility Restructuring

1. The Joint Committee recognizes that Alaska has many unique characteristics that need to be considered. Among these are: (a) Alaska is not part of the national electric grid; (b) The intertie system is limited to the Railbelt; (c) Extreme climatic conditions have an impact on use of electricity; (d) There are numerous non-interconnected small communities; (e) There is a lack of a non-utility generation base; (f) The overwhelming majority of electric utilities are publicly owned vs. investor-owned business structures; (g) There are substantial government investments in infrastructure; and (h) There are technical problems, i.e., electric current frequency incompatibility, if interconnections are contemplated with Canada.

2. It is the general consensus of the Joint Committee that some form of electric utility restructuring should be offered in Alaska if it can be demonstrated that there will be benefit to consumers.

3. The Joint Committee is split on the major issue of whether or not the Legislature should provide additional statutory guidance to APUC.

4. The Joint Committee finds that under the current statutes there is a lack of basic principles to guide the APUC on implementation of electric utility restructuring.

5. It was the Joint Committee's decision to join with APUC in authorizing the Study of the issue rather than make specific recommendations to the 21st Legislature. This will allow the results of the Study to guide future legislation.

6. The Joint Committee finds that the APUC has the statutory authority to authorize electric utility restructuring. Members of the Joint Committee vary in their opinions about why the APUC has not proceeded with electric utility restructuring in Alaska, including: (a) No utility has properly requested authority; (b) The belief that some of the APUC Commissioners oppose electrical competition; (c) The belief that the APUC is waiting for the Study and/or Legislative guidance; and (d) It's premature; the economic structure of Alaska's electric services cannot accommodate restructuring.

7. The Joint Committee is very concerned about the lack of public awareness and participation despite the best efforts of the Joint Committee to publicize both the meetings and the subject matter. The Joint Committee is concerned that residential consumers, in particular, will face a changed service system without being educated as to the impacts.

8. The Joint Committee finds that a pilot program would be desirable in Alaska if it can be designed in a meaningful manner. The program should provide baseline information with which to verify whether the multiple goals of electrical restructuring can be achieved beyond the demonstration program. That is: Can it benefit Alaskans? The design of the pilot program should rely heavily on the recommendations of the Study.

RECOMMENDATIONS

The Joint Committee on Electric Utility Restructuring recommends to the 21st Alaska State Legislature:

1. The 21st Legislature should take up the issue of electric restructuring based upon the body of testimony submitted to the Joint Committee and the Legislature should hold informational hearings to formalize this as an issue.

2. Upon receipt of the recommendation on March 1,1999, for design of a retail access pilot program in Anchorage, the 21st Legislature should consider legislation that may be necessary to implement this program.

3. Use the Study results to decide if statutory changes are necessary for APUC to implement electric restructuring. The decision on whether or not electric restructuring should be implemented for all or part of Alaska should then be made.

APPENDIX

PERSONS TESTIFYING AT VARIOUS MEETINGS

Alaska Energy Associates: Robert Maxwell
Alaska Public Interest Research Group: Steve Conn
Alaska Public Utilities Commission: Commissioners Sam Cotten and Dwight Ornquist; Staff: Executive Director Bob Lohr, Paul Morrison.
Alaska Regional Hospital: Ernie Meier, President, Chief Executive Officer
Alaska Rural Electric Cooperative Association: Eric Yould, Executive Director
Dr. Peter Fox-Penner of The Brattle Group
Alaska Sales and Service: Ann Robinson
Anchorage Baptist Temple: Glenn Clary, Assistant Pastor
Aurora Power: Mary Ann Pease, Vice President; Robin Brena of Brena, Bell & Clarkson
Ausman, Earl
Barry, Mike
Beltrami, Vince
Black & Veatch: Myron Rollins
Copper Valley Electric Association: Robert A. Wilkinson, General Manager
Chugach Electric Association: Eugene Bjornstad, General Manager; Don Edwards, Counsel;
Enstar Natural Gas: Dick Barnes, President
Four-Dam Pool Purchasing Utilities: Robert A. Wilkinson
Giuchici, John
Golden Valley Electric Association (Fairbanks): Mike Kelly, President and Chief Executive Officer; Robert Hanson, Chief Operating Officer
Growth Resources: Dave Lappi, Chairman
Homer Electric Association: Norman Story, General Manager; Jim Patras
International Brotherhood of Electrical Workers: Gary Brooks, Business Manager
Jewel, Barbara
Kodiak Electric Association: Ed Kozak
Matanuska Electric Association: Bruce Scott, Consumer Relations
McKee, Charles
Municipal Light & Power (Anchorage): Meera Kohler, General Manager; Donn Wonnell, Attorney.
Signature Flight: Bruce Vergason, Plant Manager
Southeast Service Corporation: Ken Langsford, Facility Manager
Staudenmaier's Electric Merger Committee: Tom Staudenmaier

PERSONS SUBMITTING WRITTEN TESTIMONY (in addition to many previously listed)

Anchorage Sand and Gravel Co., Inc.: Steven M. Lovs, Vice President/General Manager
Best Western Barratt Inn: John J. Payne, General Manager
Bogan, Mary
Bonner, Laura
Cartwright, Pierce Co., Inc.: Pierce Cartwright, Chairman
Coppock, Stefanie
Davis, Paul
Doyle, Robert
Fancher, Will L.
Hallum, J. M.
Henke, Jerry
Henningsen, Richard S.
Hodge, Joseph
Ibele, Lyndon C.
Indelible Ink: Stu Kingsley
International Brotherhood of Electrical Workers, Local 1547: Mike Notar, Assistant Business Manager
Johnson, Alethea
Lang Consulting: Henry P. Lang, Electric Utility Engineer
Long, Richard
Mann, Nina M.
Marathon Oil Company: John A. Barnes, P.E., Alaska Region Manager
Miller, S. L.
O'Brien, Chris
Plumb, Gary and Vera
Regal Alaskan Hotel: Max F. Lowe, General Manager
Seitz, Bill
Smith, Darrell F.
Squiers, Richard
Utilities Consulting Services: Robert L. Hufman
Visual Information System: Donald B. Cassas
Webb's Business Consulting Services: William F. Webb

Weidner Investment Services: Gail Chamber, Regional Property Director
Weeks, Nadine
Westbrook Associates: William J. Westbrook, P.E.
Whitesides, Byron

MEMBER COMMENTS

Comments of Co-Chairman, Senator Bert Sharp:

The proposed Chugach Electric pilot program, in my opinion, would only jeopardize the basic utility rate making fundamental of cost causer – cost payer philosophy

The Committee should not recommend any legislative action on mandating competition of electrical rates between electric utilities. I think it would result in prejudicial rates not only within classes, but would result in extreme cost shifting to the residential customers.

****

Comments of Co-Chairman, Representative Norman Rokeberg:

As a capitalist and believer in the crucible of the market place, I have a bias in favor of competition and deregulation.

It is clear from the testimony before the joint committee that electric utility restructuring at the retail level ("EUR") can contribute to the commerce and prosperity of the United States. But, only if the elements and implementation fit the circumstances and conditions of a particular state or region.

Alaska is unique in many instances making rapid and broad implementation of EUR unworkable and risky to residential consumers, particularly in rural areas.

Therefore, I would caution patience, study and informed decision making by the policy makers of Alaska when considering this issue.

However, I would take exception to those that would block or impede the efforts of future Legislature's from bringing the potential benefits of EUR to Alaskan consumers, specifically more efficient and lower cost delivery of electrical energy.

A number of witnesses have advised or requested the committee recommend a wait and see attitude. While review of the success or failures of EUR in the lower 48 has merit, delay for the purpose of maintaining the status quo does not. The unique characteristics of Alaskan electrical services are not replicated elsewhere. The only way to derive the benefits

of EUR is to design a statutory and regulatory framework that will satisfy the needs of all Alaskans.

Therefore, establishment of a pilot program of limited scope designed to yield empirically verifiable evidence of efficacy of EUR appears to a reasonable method in developing an Alaskan approach.

The design of any pilot program should consider the recommendations of the joint committee/APUC study.

If Alaska cannot do EUR right - then it should not do it.

****

Comments of Senator Loren Leman:

I believe that free market competition is the best protection for consumers because it generally maximizes value to the consumer. Retail competition should be allowed and promoted consistent with standards of safety, economy, reliability, universal availability and recovery of stranded costs due to competition.

I encourage implementation of a well-designed pilot study in Anchorage to produce meaningful data to be used to implement fair competition in Alaska. I look forward to reviewing the consultants' comments on March 1.

****

Comments of Representative John Davies:

After listening to much testimony, attending a number of conferences and information meetings and reading a great deal on this issue, I believe that any recommendation to move ahead with restructuring in Alaska at this time is very premature. There are a few places in the lower 48 that are in various stages of restructuring efforts, none of these claim to be successful yet. It appears that there are a variety of thorny issues including stranded investments, universal service, cherry picking, access to and control of the electric power grid, and consumer protection that have not been solved. The lower 48 is mostly interconnected to a very large grid so that, at least in theory, there are enough providers to foster true, market-based competition. It is not clear that Alaska even approximates the conditions required to foster this kind of competition. We have only about 400,00 customers (rough number) connected to one power line (not a grid) and only a handful of providers. Most of the

providers are co-ops or municipal utilities, groups that are not generally involved in the restructuring efforts in the lower 48, so we have little example to draw from. Since there is no clamor from customers in Alaska for this kind of major change to our power deliver system and since its benefits are yet to be proven any where in the lower 48, I believe that we should take a very cautious posture with respect to restructuring in Alaska.

I agree that the pilot in Anchorage should be allowed to go forward after we get some expert guidance on how to set it up so we can get the best information possible out of it. It should have automatic sunset provisions so it ends unless the APUC approves its continuation or expansion. I also support the RFP for a more in-depth analysis of the benefits and pitfalls for Alaska. The special committee should be explicitly charged with carrying forward the work of this committee.

EXHIBITS

TONY KNOWLES, GOVERNOR

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DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

April 30, 1997

4:05pm
MAY 01 1997

The Honorable Norman Rokeberg
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

The Honorable Jerry Sanders
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Re: APUC Authority

Dear Representatives Rokeberg and Sanders:

At the House Labor and Commerce Committee hearing on HB 235 on April 16, 1997, you asked Robert A. Lohr, Executive Director of the APUC for a report on the Commission's authority to issue an electric utility a certificate to compete with an existing utility, and to impose conditions that protect the public from "cream-skimming." Because these questions involve a review of legal authorities, the Attorney General's Office, as legal counsel for the Commission, was asked to prepare this response.

The APUC Has Authority Under Current Law to Issue Certificates Allowing Competition in Electric Utility Service.

A. Statutory Certification Authority

The Alaska legislature has required a public utility to obtain a certificate of public convenience and necessity from the Alaska Public Utilities Commission before operating or receiving compensation for providing the utility commodity or service. AS 42.05.221(a).[1] Through this statute, the

[1] SECTION 42.05.221. CERTIFICATES REQUIRED. (a) A public utility may not operate and receive compensation for providing a commodity or service without first having obtained from the commission under this chapter a certificate declaring that public convenience and necessity require or will

EXHIBIT A

legislature placed control over entry into the utility business in the Commission's hands. Nothing in this statute suggests that the certificates granted by the Commission are exclusive, or that the Commission's authority to grant a certificate is restricted or limited if the applicant would compete with an existing utility.

AS 42.05.241 establishes procedural and substantive guidelines for the Commission in exercising its authority to grant certificates. This statute provides:

> A certificate may not be issued unless the commission finds that the applicant is fit, willing and able to provide the utility services applied for and that the services are required for the convenience and necessity of the public .... (emphasis added)

In compliance with this statute, the Commission must examine the question of whether the public needs the additional service when it considers granting a competing certificate. The Commission cannot grant the competing certificate unless, after examining the question, it finds that the public convenience and necessity do require the competing service.

The term "public convenience and necessity" cannot support an argument that competing certificates are prohibited. Interpreting this term, one court looked back to previous decisions and said:

> The court has stated that the "public convenience and necessity" standard allows the department to exercise wide discretion to take into account a broad range of factors in making the determination whether it has been met. Almeida Bus Lines, Inc. v. Department of Pub. Utils., 203 N.E. 2d 556 (1965). Holyoke St. Ry. v. Department of Pub. Utils., 198 N.E. 2d 413 (1964). Newton v. Department of Pub. Utils., 160 N.E.2d 108 (1959) (all of which discussed the propriety of using the value of competition as a basis for making a "public convenience and necessity" finding).

Zachs v. Department of Public Utilities, 547 N. E. 2d 28 at 32 (Mass. 1989). (State reporter citations omitted).

Therefore, although it requires the question to be addressed and a finding made, AS 42.05.241 gives the Commission the policy-making authority to grant a competing certificate, including

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require the service. Where a public utility provides more than one type of utility service, a separate certificate of convenience and necessity is required for each type. A certificate must describe the nature and extent of the authority granted in it, including, as appropriate for the services involved, a description of the authorized area and scope of operations of the public utility. . . . (emphasis added)

a competing electric utility certificate, if the Commission decides that the public will benefit from competing utility service.

B. Natural Monopoly Theory

It is true that in the past the Commission has not issued certificates authorizing competitive provision of electrical service. This long-standing policy is not based on lack of authority or on any legal restriction prohibiting the Commission from issuing a competive utility certificate. The non-competitive policy is based on an economic theory widely accepted in the past, but now subject to question (or already rejected) in policy debates all over the United States and in some foreign countries as well. The economic theory was that utilities, including electric utilities, are natural monopolies and should have exclusive service territories because competition would mean wasteful duplication of the capital investment in facilities required to provide the service.

As discussed above, the natural monopoly theory is not formalized in Alaska's statutory scheme, and therefore no statutory change is required before the Commission can consider whether the public convenience and necessity require any competing certificate to be issued. The Commission has authority to change its monopoly policy in granting certificates.

The natural monopoly theory is also not formalized in the legal concept of a certificate. In Alaska, a series of court decisions resulted from competition between electrical utilities in the 1960's and 1970's. These cases involved competition between REA cooperative electric utilities certificated by the Commission, and municipally owned utilities operating under statutory authority. Before 1970, the municipal utilities were not required to obtain certificates from the Commission.

In the first of these cases, the Alaska Supreme Court rejected the argument that a certificate granted by the Commission was an exclusive right to provide service in the specified service area. It is arguable that this ruling only addressed the situation of competition from an uncertificated utility operating under a municipality's statutory authority. Nevertheless, it is clear that the court rejected the argument that the natural monopoly theory must lead to the conclusion that a certificate is an exclusive right to serve a particular area. Homer Electric Association v. City of Kenai, 423 P.2d 285 at 288-289, n. 16. (1967). See also, Chugach Electric Association v. City of Anchorage, 426 P. 2d 1001, 1003 (1967).

In these decisions, the court recognized that the effect of holding that a utility certificate was not exclusive could be uneconomic duplication of facilities. The court urged the legislature to fix this problem. See Homer, 423 P. 2d at 290; Chugach, 426 P.2d at 1004-05. In response the legislature adopted

AS 42.05.221(d).[2] This provision, while making explicit the Commission's authority to eliminate undesirable duplication of facilities, is carefully drafted not to require the Commission to eliminate all competition. This statute directs the Commission to eliminate the competition only if the Commission finds 1) that there is competition, and 2) that the competition is not good for the public. Like AS 42.05.241, AS 42.05.221(d) clearly leaves the door open for a policy-making determination that competition between electrical utilities may be good for the public.

C. *Longstanding Interpretations*

Finally, the Commission has in the past interpreted its statutes to give it authority to issue competing certificates when it concluded that competition was in the public interest, and the legislature has apparently agreed. In interpreting a statute, the court will give some weight to a long-standing agency interpretation. Nat. Bank of Alaska v. State, Dept of Rev., 642 P.2d 811 at 815 (Alaska 1982). The APUC has granted competing certificates for refuse collection utilities: (Re Claude Bailey d/b/a Valley Refuse, et al, 7 APUC 97 (1985); Re Wasilla Refuse, Inc., 8 APUC 106 (1987); for radio common carriers, (RE Competition and Deregulation of Radio Common Carriers as Public Utilities, 5 APUC 86 (1982)); and for water utilities (Re Eagle Utilities, Inc., 7 APUC 548 (1986). For telecommunications utilities, statutory directives (state and federal) now require the Commission to grant competing certificates. In adopting a mandate for competition in long distance telephone service (AS 42.05.800-AS 42.05.890 , § 2 ch 93 SLA 1990), the Alaska legislature did not think that the underlying statutory scheme for certification needed amendment before the Commission had authority to grant competing certificates.

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[2] SECTION 42.05.221. CERTIFICATES REQUIRED. ...

(d) In an area where the commission determines that two or more public utilities are competing to furnish identical utility service and that this competition is not in the public interest, the commission shall take appropriate action to eliminate the competition and any undesirable duplication of facilities. This appropriate action may include, but is not limited to, ordering the competing utilities to enter into a contract that, among other things, would:

(1) delineate the service area boundaries of each in those areas of competition;

(2) eliminate existing duplication and paralleling to the fullest reasonable extent;

(3) preclude future duplication and paralleling;

(4) provide for the exchange of customers and facilities for the purposes of providing better public service and of eliminating duplication and paralleling; and

(5) provide such other mutually equitable arrangements as would be in the public interest.

(emphasis added)

II. The Commission Has Some Authority to Prevent Cream-skimming.

When competition in utility service is permitted, it is predictable that competitors will seek to serve the most profitable customers. The competing utilities may be less willing to serve smaller users, typically residential and small commercial customers. The result may be that service deteriorates while costs rise for those customers. The practice of targeting service only to the most profitable customers is called "cream-skimming." Existing statutes, including AS 42.05.221(d),[3] AS 42.05.241[4], AS 42.05.271,[5] and the Commission's general powers, AS 42.05.141[6], give the Commission some authority to deal with

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[3] See page 4.

[4] SECTION 42.05.241. CONDITIONS OF ISSUANCE. A certificate may not be issued unless the commission finds that the applicant is fit, willing and able to provide the utility services applied for and that the services are required for the convenience and necessity of the public. The commission may issue a certificate granting an application in whole or in part and attach to the grant of it the terms and conditions it considers necessary to protect and promote the public interest including the condition that the applicant may or shall serve an area or provide a necessary service not contemplated by the applicant. The commission may, for good cause, deny an application with or without prejudice. (emphasis added)

[5] SECTION 42.05.271. MODIFICATION, SUSPENSION OR REVOCATION OF CERTIFICATES. Upon complaint or upon its own motion the commission, after notice and opportunity for hearing and for good cause shown, may amend, modify, suspend, or revoke a certificate, in whole or in part. Good cause for amendment, modification, suspension or revocation of a certificate includes

(1) the requirements of public convenience and necessity;

(2) misrepresentation of a material fact in obtaining the certificate;

(3) unauthorized discontinuance or abandonment of all or part of a public utility's service;

(4) wilful failure to comply with the provisions of this chapter or the regulations or orders of the commission; or

(5) wilful failure to comply with a term, condition, or limitation of the certificate. (emphasis added)

[6] SECTION 42.05.141. GENERAL POWERS AND DUTIES OF THE COMMISSION. (a) The Alaska Public Utilities Commission may do all things necessary or proper to carry out the purposes and exercise the powers expressly granted or reasonably implied in this chapter, including

(1) regulate every public utility engaged or proposing to engage in such a business inside the state, except to the extent exempted by AS 42.05.711;

(2) investigate, upon complaint or upon its own motion, the rates, classifications, rules, regulations, practices, services and facilities of a public utility and hold hearings on them;

(3) make or require just, fair and reasonable rates, classifications, regulations, practices, services and facilities for a public utility; . . . .

cream-skimming problems. However, because of limitations within these statutes or their general nature, the Commission's authority may not reach all variations of cream-skimming problems that may arise.

The discussion below shows how these statutes provide Commission authority to protect the public against cream-skimming, and discusses the limitations.

AS 42.05.221(d). Where the Commission finds competition exists and is not in the public interest, this statute authorizes the Commission to take action to "eliminate the competition and any undesirable duplication of facilities." This statute seems to contemplate a remedy that would eliminate the competition, not a remedy that would seek to make competition serve the public interest. For example, if an appropriate cream-skimming remedy may be to order a competitor in a concentrated market to also serve a remote community, this statute does not seem to provide that authority.

AS 42.05.241. This statute gives the Commission broad authority to impose conditions needed to protect the public when it grants a certificate. The Commission can attach to the grant of a certificate the terms and conditions it considers necessary to protect the public interest. One common remedy against cream-skimming is specifically authorized in this statute—the Commission can require a certificate applicant to provide a service that the applicant does not seek to provide. The language also clearly authorizes other remedies the Commission may devise at the time a certificate is granted. However, if the need for a condition to prevent cream-skimming does not become apparent until after the certificate is granted, this statute may not help.

AS 42.05.271. This statute is quite broad, and, along with the Commission's general powers, AS 42.05.141, arguably provides authority to address cream-skimming by requiring a utility to provide service to neglected customers. However, in the past, Commission orders have been challenged on the basis that the Commission's statutory authority is not "explicit," resulting in costly litigation over the extent of the Commission's "implied" authority.

Very truly yours,

BRUCE M. BOTELHO
ATTORNEY GENERAL

By: Virginia A. Rusch
Virginia A. Rusch
Assistant Attorney General

VAR:jem

United States Senate

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510-6150

October
~~September~~ 9, 1997

MEMORANDUM

TO: Members, Committee on Energy and Natural Resources
FM: Frank Murkowski, Chairman
RE: Electric power industry competition legislation

The Energy Policy Act of 1992 (EPAct) was the first major action taken by Congress to promote competition in the electric power industry. Since the enactment of EPAct, the industry has undergone dramatic change. While this is partially due to regulatory changes made by States, FERC and EPAct, it is largely attributable to the unleashing of market forces. The question facing the Committee is: What more can we do to promote market-based competition?

Over the past two Congresses, the Committee has held numerous hearings and workshops to review the state of competition in the electric power industry, and to identify what changes in Federal law should be made. During the 104th Congress, the Committee held six hearings. During the first session of the 105th Congress, the Committee held eight hearings and workshops.

These hearings and workshops have been wide-ranging and intensive. The topics covered include: FERC's open access wholesale transmission rule (Order No. 888); the issues involved in competition; the role of public power in a competitive environment; the effects of competition on fuel use and types of generation; PURPA and PUHCA repeal; the financial implications of restructuring; the benefits and risks of restructuring to consumers and communities; the regional effects of restructuring; and the overall need for Federal legislation.

This review was undertaken with eleven guiding principles in mind -- namely, that any Federal legislation should: 1) reduce electricity prices for residential consumers; 2) ensure continued system reliability; 3) provide more choices to all consumers; 4) create fair competition; 5) protect individual and pension fund investments; 6) lead to fair stranded cost recovery; 7) protect the environment; 8) assure that no person is left without electricity; 9) empower the States to promote competition; 10) protect the States from overzealous Federal mandates; and 11) deregulate, not create different regulation.

More than 130 witnesses appeared at the Committee's 14 hearings and workshops. These included representatives of residential consumers, commercial consumers, industrial consumers, small business, big business, independent power producers, investor-owned utilities, municipally-

EXHIBIT B

owned utilities, cooperatively-owned utilities, consumer advocates, public interest advocates, the financial community, utility stockholders, farmers, retirees, gas producers, coal producers, nuclear power producers, renewable energy producers, the environmental community, State public utility commissions, cities, the Tennessee Valley Authority, the Federal Energy Regulatory Commission, the Securities and Exchange Commission, and the Department of Energy.

Based on the Committee's extensive review of the issues, I have reached the following conclusions.

- o First and foremost, competition is in the public interest. Competition will assure consumers an adequate supply of reasonably priced power.

- o Second, if consumers are to benefit from competition it must be market-based, not government-run. Government management of the market -- command-and-control -- cannot substitute for the discipline of the free market.

- o Third, we must encourage and empower the States to promote retail competition. The States are not only keenly interested in promoting retail competition, they have aggressively taken the lead. Thirteen States have already adopted some type of retail competition, either by law or through public utility commission regulation. These States encompass roughly one-third of the U.S. population. Of the remaining States, virtually every one is now actively considering what it should do to promote retail competition.

- o Fourth, States are best able to determine how to promote retail competition that is in the overall public interest. States are in the best position to take into account local needs, circumstances and interests when fashioning a retail competition program.

- o Fifth, the Federal government has an important role in promoting competition, but it should be limited to that which is truly interstate in nature and cannot otherwise be done by the States or by a combination of States. For example, the FERC has aggressively promoted wholesale competition through its nondiscriminatory wholesale open access transmission rule, Order No. 888, and that seems to be working well.

- o Sixth, there are a number of provisions of Federal law that impair competition, either by impeding State action, or by preventing competitors from competing, or by creating unfair competitive situations. These should be eliminated.

This leads me to the fundamental conclusion that if there is going to be Federal legislation, it should consist of provisions that deregulate, streamline and empower the States to promote competition -- not provisions that enhance government command-and-control of the market, or preempt or place a Federal mandate on the States. In summary, I believe that the public interest is best served through market-based competition, not government-managed competition.

In light of this, the following are the principle matters that I believe need to be considered as part of Federal legislation.

ISSUE: ***Should Congress give States exclusive authority to order retail wheeling?***

Existing law is ambiguous as to State authority over retail wheeling. States assert that they have jurisdiction over retail transmission. FERC asserts that it, not the States, has exclusive jurisdiction over all transmission, including retail transmission. Absent Congressional action, this is an issue that will only be resolved by the courts.

> Note: In the Energy Policy Act of 1992, Congress specifically prohibited FERC from ordering retail wheeling. Thus, if FERC is right that it has exclusive jurisdiction over transmission, that raises the question of who can order retail wheeling.

Proposed Resolution:

Make clear that States have the exclusive authority to order retail wheeling. States are closest to the economic impact of retail wheeling (including retail stranded costs), and they are best able to determine when and how it should occur.

ISSUE: ***Should Congress confirm that States will continue to have the authority under State law to address retail distribution issues?***

States, through their public utility commissions, have traditionally had exclusive responsibility for the local distribution and sale of electricity to consumers. Local distribution issues include: obligation to serve; assured service to low-income and rural consumers; safety; universal service; renewable energy; energy conservation; and recovery of transition costs.

Proposed Resolution:

Confirm that States will continue to have the exclusive authority to address local retail distribution issues under State law.

ISSUE: ***Should States be authorized to voluntarily establish Interstate Compacts under the Constitution to jointly regulate regional electric markets?***

States cannot regulate matters that are in or affecting interstate commerce without the consent of Congress through a Compact. Aspects of interstate commerce that a multi-State compact could regulate include: regional reliability; reciprocity of competition between States; regional transmission pricing; and recovery of wholesale competition transition costs.

Proposed Resolution:

Authorize States to form regional regulatory compacts that would govern reciprocity and reliability issues, among other things. (This could be similar to that which is in the low-level nuclear waste bill.)

ISSUE: ***Should all transmission owners be required to comply with FERC's nondiscriminatory wholesale open access transmission program (FERC Order No. 888), not just investor-owned utilities as under current law?***

Under the Federal Power Act, FERC has authority to impose nondiscriminatory wholesale open access transmission only on investor-owned utilities. Municipally-owned utilities, most cooperatively-owned utilities, the Federal PMAs and TVA – all of whom own substantial transmission lines – do not have to comply with FERC's open access rule.

Proposed Resolution:

Require all transmission owners to comply with FERC's nondiscriminatory wholesale open access transmission program.

ISSUE: ***Should PURPA's mandatory purchase requirement be terminated prospectively?***

At the Committee's hearings and workshops clear and convincing evidence was presented that PURPA, although well intended, harms consumers and utilities. PURPA requires utilities to purchase power whether or not they need it, and to pay "avoided cost" whether or not that bears any relationship to market price.

PURPA's avoided cost rate was supposed to result in electricity prices no higher than they would have otherwise been – but it did not work out that way. As a result, utilities will pass on to consumers hundreds of millions of dollars extra in above-market PURPA electric rates. These are costs that consumers will continue to pay into the future because most PURPA contracts were for a long period of time and few have market-based price clauses. Moreover, some electric utilities now find themselves in serious financial straits, as they are unable to pass on above-market PURPA costs in increasingly competitive markets.

Proposed Resolution:

Repeal PURPA prospectively, with protection for existing contracts.

> One option is to repeal PURPA only where a State has adopted retail competition.

ISSUE: ***Should wholesale sales of electricity be deregulated?***

FERC has jurisdiction over wholesale electric rates. FERC has created a competitive wholesale market for electricity through Order No. 888, which provides nondiscriminatory transmission access to all sellers of wholesale power.

FERC is already heading in the direction of deregulation of wholesale sales by granting "market-based-rates" for wholesale power on a case-by-case basis. Unfortunately, even these FERC-granted "market-based-rates" remain subject to FERC jurisdiction; they are

not truly deregulated. Without legislation, wholesale sales of electricity will not be subjected to the full discipline of market forces.

There is a strong parallel with natural gas deregulation. Congress deregulated natural gas at the wellhead, but left regulated the interstate transmission of gas. There is universal agreement that wellhead gas deregulation benefitted consumers by lowering prices and increasing supply.

In this regard, it is important to note that the deregulation of wholesale sales does not deregulate retail sales of electricity to consumers. Retail sales would remain regulated by State public utility commissions in accordance with State law.

Proposed Resolution:

Deregulate wholesale sales of electricity.

ISSUE: ***Should utility merger approval authority be moved from the FERC to the Department of Justice?***

Even the FERC admits that its merger review process is not working well. In some cases, it has taken the FERC years to review and act on a proposed merger, and in the meantime the merging utilities and their customers are in limbo waiting for a decision. Notwithstanding FERC's review of proposed mergers, the Department of Justice still has jurisdiction over utility mergers under the antitrust laws. Furthermore, State public utility commissions also must review and approve utility mergers, in addition to FERC and the DOJ.

Proposed Resolution:

Move FERC's authority to review and approve utility mergers to the Department of Justice.

ISSUE: ***Should the construction of wholesale electric transmission lines be expedited through the use of Federal eminent domain, as is now the case with interstate gas pipelines.***

As the electric power industry becomes more competitive, constraints on high-voltage wholesale transmission will become increasingly significant. The issue is whether the right of Federal eminent domain should be provided for the construction of new wholesale transmission lines. That authority would help address the market power issue where there is a transmission bottleneck, and it will help assure that new supplies of wholesale power will be able to move to where it is needed. There is similar eminent domain authority in the Natural Gas Act for interstate natural gas pipelines.

Proposed Resolution:

Allow the use of Federal eminent domain to facilitate the construction of new

transmission lines for the purpose of addressing market power and where it will help assure that new supplies of wholesale power can access the market. Such authority should not be available to Federally-owned utilities, or to those who will use it to competitively market power produced by generation financed with tax-exempt bonds.

ISSUE: ***Should Federal PMA wholesale power be required to be sold competitively?***

Federal power marketed by the PMA's is sold at cost. In many instances that price is far below the market value. It is offered first to public "preference" customers, primarily municipally-owned and cooperatively-owned utilities. There is a wide range in those who receive preference power, from large urban cities such as Las Vegas to small cities, rural communities, water projects and Indian tribes. Federal power was originally conceived in the 1930's as a way to electrify regions that did not have power, and to help promote economic development.

As we move to an increasingly competitive marketplace where publicly-owned utilities will compete directly with privately-owned utilities, Federally subsidized power confers a substantial competitive advantage to those who receive it. Moreover, many of the original purposes of Federal power have long been satisfied.

Requiring Federal PMA power to be sold competitively on the open market as existing contracts expire would eliminate this problem without imposing undue hardship to customers of public power utilities. In the alternative, Federally-subsidized power could be made available only for purposes worthy of the subsidy.

Proposed Resolution:

Upon the expiration of a PMA wholesale power contract, require that the power be sold on an open, competitive basis. Existing power contracts would not be affected.

> As an alternative, amend the preference laws to redirect lost-cost Federal preference power to those who most need it.

ISSUE: ***Should those who have generation facilities financed through Federal tax-exempt bonds be prevented from selling power outside of their existing service areas?***

Under the Federal tax code, publicly-owned utilities (and certain investor-owned utilities) are able to construct powerplants using tax-exempt debt. If those facilities are used only to supply consumers in their service territory, the impact on competition is minimal. However, because tax-exempt financing substantially lowers the cost of construction, it would be competitively unfair to allow those who have built facilities with tax-exempt financing to use those facilities to compete against others who do not have access to this special tax exemption.

Proposed Resolution:

Prevent those who have generation facilities built using Federal tax-exempt financing from selling power from those facilities outside of their existing service areas.

ISSUE: ***Should provisions be included to address the various issues relating to the Bonneville Power Administration?***

The Bonneville Power Administration is a unique Federal agency. It is more than just a power marketing administration. The Northwest Power Planning Act imposes a host of special requirements on BPA. In addition, BPA has a number of other unique requirements created to help restore the fisheries. This is a very complex matter, and the Members of the Northwest delegation have been working with the Governors of the Northwest States to find an acceptable solution.

Proposed Resolution:

The Members from the Northwest should craft a resolution of the issue.

ISSUE: ***Should Congress establish an "emission-free portfolio standard" for electrical generation?***

There are concerns that competition will adversely affect the environment by increasing emissions from fossil-fuel powerplants. There is also a concern that emission-free generation sources such as nuclear, solar, geothermal, hydro and wind will suffer in a competitive, deregulated marketplace.

An "emission-free portfolio standard" would retain the existing percentage of U.S. electricity supply that comes from emission-free sources of electricity, including nuclear energy, hydro and renewables, as a baseline. Each power producer must provide credits in the amount of the existing national percentage of emission-free sources. Credits for emission-free sources would be tradable. The required percentage of emission-free sources could be adjusted to meet any emission reduction goals set in the future.

It would provide an incentive to keep existing emission-free sources operating and replace them with emission-free sources when they reach the end of their operating lives. This would be an economically efficient method of ensuring that air quality is not degraded by competition.

Proposed Resolution:

Create an emission-free portfolio standard that would be enforced through a trading program.

ISSUE: ***Should the Federal Trade Commission be required to create an "electricity labeling" program whereby consumers will know the type generators that produced the electricity they are purchasing?***

In competitive electricity markets, absent further information, consumers will choose their electricity supplier solely on the basis of price. There is a concern that this will

result in an increase of generation and emissions from old coal-fired power plants that are exempted from many of the provisions of the Clean Air Act.

Proposed Resolution:

Require the Federal Trade Commission to create an "electricity labeling" program whereby consumers will know the type of generators that produced the electricity they are purchasing. This would allow consumers to base their purchasing decisions on factors other than price, if they so choose.

ISSUE: ***How can Congress act to retain the nuclear power option?***

Some analysts have predicted that as many as 39 nuclear power plants will shut down as a result of the move to competitive electricity markets. Nuclear energy accounts for 89% of all the CO_2 emissions avoided by U.S. electric utilities between 1973 and 1995. In total, more than 1.9 billion metric tons of carbon emissions have been avoided in the U.S. alone through the use of nuclear energy. In the face of growing concern over the potential effects of emissions on the global climate, it would be prudent to ensure that, at a minimum, our existing emission-free generation sources have a fair chance to compete, and that competition does not degrade our nation's air quality.

Proposed Resolution:

Ensure that nuclear energy has a reasonable opportunity to compete with other forms of generation, and remove existing impediments that inhibit nuclear power plants' ability to compete. This would be done by--

> Establishing a workable, integrated solution for unfunded decommissioning obligations. These changes would ensure that, despite competitive pressures on pricing and corporate restructuring, the funds will be available for the decontamination and decommissioning of nuclear plants as they reach the end of their operating licenses.

- Unfunded nuclear power plant decommissioning costs could be recovered through a non-bypassable "wires" charge mandated by the federal government.

- Monies collected for the purpose of decommissioning nuclear power plants should continue to be deductible for federal income tax purposes as allowed under current law.

- In the event of bankruptcy, trust funds established for the purpose of decommissioning nuclear power plants should not be considered the property of the bankrupt entity.

> Correct unfair statutory requirements that will put nuclear power plants at a competitive disadvantage. The statutory restriction on foreign ownership may have

made sense 40 years ago in the early days of nuclear power. Given the global political and economic changes that have occurred since then, this blanket prohibition no longer makes sense. Major overseas corporations – *i.e.*, British Energy – have expressed an interest in investing in U.S. commercial nuclear power plants. Such investments by U.S. allies should not be foreclosed arbitrarily. Specifically:

- Repeal the requirement that the Nuclear Regulatory Commission conduct antitrust reviews of all licensing actions. The requirement that NRC conduct antitrust reviews is duplicative. State regulatory agencies, the U.S. Department of Justice, the Federal Trade Commission, the Federal Energy Regulatory Commission and the Securities and Exchange Commission are already conducting antitrust reviews in every case involving mergers, transmission tariffs or other industry restructuring initiatives. Potential competitors will be able to use the hearing process to delay license transfers or restructuring, thereby potentially placing the nuclear plant in question at a competitive disadvantage.

- Repeal the prohibition on foreign ownership of U.S. commercial nuclear power facilities.

> Ensure that the Nuclear Regulatory Commission's license transfer process and licensing board proceedings are disciplined and accountable. The transition to greater competition in electricity generation will likely result in the formation of new corporate entities such as joint nuclear operating companies. By focusing resources solely on nuclear power operations, such restructuring will further enhance nuclear power plant reliability, safety performance and, in parallel, economic performance. The public interest is best-served if such restructuring—which will improve operational reliability and efficiency—are managed with dispatch and not delayed unnecessarily by a lengthy, undisciplined hearing process. Past experience suggests that these proceedings likely will be very lengthy. In a competitive market, success will be determined by the speed with which companies can implement business decisions. The nuclear licensing process should be as efficient as possible to allow nuclear operating companies to make timely business decisions.

- Limit NRC review to issues that arise because of the license transfer or amendment being sought.

- Provide that there must be a safety basis for issues raised by intervenors in NRC proceedings.

> Require a comprehensive assessment of innovative financing techniques to ensure construction of new, advanced-design nuclear power plants in the U.S. when they are needed. The 1992 Energy Policy Act reaffirmed the strategic importance of nuclear energy in U.S. electricity supply. The legislation included a number of provisions—including a new licensing process for new nuclear power plants—to ensure a continuing role for nuclear energy. The new licensing process resolves all

design-related and safety issues before plant construction begins. Several advanced-design nuclear power plants are in the process of obtaining certification and pre-approval from the Nuclear Regulatory Commission. These advanced-design plants are being sold and built overseas, but construction of new, advanced-design nuclear power plants in the United States is subject to unique conditions and risks because of extensive and intrusive federal government involvement in the nuclear power business.

The regulatory risks associated with unpredictable and changing Nuclear Regulatory Commission requirements may be sufficiently large to deter construction of any new nuclear power plants in the United States by private industry. Private industry should, and will, accept the normal market risks associated with building new nuclear generating facilities in a competitive market. Private industry cannot, however, be expected to shoulder the risks that result from federal government intervention in the timely construction and licensing of new nuclear power plants.

This provision would require a comprehensive assessment of innovative financing techniques that might be employed to ensure construction of new, advanced-design nuclear power plants in the U.S. when they are needed to meet growing demand for electricity. This assessment would best be conducted by an independent firm with specialized expertise reporting directly to the President and the U.S. Congress (similar to the Smith Barney assessment that established the terms and conditions for privatization of the Department of Energy's uranium enrichment enterprise and led to the formation of the U.S. Enrichment Corp.).

CBO Publication

S U M M A R Y

November 1997

SHOULD THE FEDERAL GOVERNMENT SELL ELECTRICITY?

The Tennessee Valley Authority and the power marketing administrations of the Department of Energy supply about 8 percent of the nation's electricity. Municipal and cooperative utilities in the West and the Southeast are the main customers for that power, and two-thirds of it goes to just four states. The federal presence in what is primarily a private and local function is in many ways an anomaly, little changed since the New Deal era. Today, many policymakers question whether the government should continue to produce and sell electricity. The Congressional Budget Office's (CBO's) study *Should the Federal Government Sell Electricity?* reviews the operations of federal power agencies, examines the ways in which the benefits and costs of the federal presence in power supply have changed over time, and describes options for altering or ending that presence.

Many of the original concerns that gave rise to the current federal role have greatly diminished. The stimulation of rural communities by the construction of dams and electric grids was realized long ago. The market power of private utilities is now limited by federal and local regulation and, increasingly, by competition. And the old conservation philosophy of not letting water flow by unused has given way to environmental concerns about saving waterways. A growing recognition of the full costs of government solutions has emerged as well. Evidence of those costs comes from the inadequate maintenance of power assets and low utilization rates of hydropower plants. New competition in power markets may add to the problems of federal agencies in the future.

CBO's study considers three options for change. The Congress may legislate reforms such as market-based pricing to make federal programs operate more efficiently; it may transfer, or devolve, responsibility for federal facilities to local governments; or it may privatize those facilities. Legislating reforms to address all the management failures inherent in federal ownership may not be possible, and local governments may fall prey to the same problems that now hamper federal management. Privatization may offer the best opportunity for enhancing the efficiency of power markets and producing budgetary savings. In the study, CBO estimates the market value of federal power assets and the long-term budgetary savings from their sale, but the analysis does not represent an official CBO cost estimate of any legislation.

CBO estimates that businesses might pay from $45 billion to $62 billion for federal power assets, depending on assumptions about future power rates. Those assets include all facilities that directly support power production and transmission. But such a sale would yield long-term budgetary savings only if the proceeds were greater than the income that the government would forgo. That income includes the revenues that the power agencies collect to pay for past construction. Those revenues, which are net income to the Treasury, would be lost after a sale.

On net, a sale of all power assets could yield budgetary savings totaling as much as $16 billion (for a sale at a high market value) or a loss of $0.2 billion (for a sale at a low market value). The actual budgetary savings could be greater if there were new subsidies for federal power in the future or if the Congress decided to include some nonpower assets in the sale. Congressional action may not depend solely on budgetary considerations, however, because budgetary savings are not a measure of the gains in efficiency from privatization.

Questions about this study should be directed to Richard D. Farmer of CBO's Natural Resources and Commerce Division at (202) 226-2940. For additional copies of the report, please call CBO's Publications Office at 226-2809. The study is also available at CBO's World Wide Web site: http://www.cbo.gov/

CONGRESSIONAL BUDGET OFFICE
Second and D Streets, S.W.
Washington, D.C. 20515

CS FOR HOUSE CONCURRENT RESOLUTION NO. 34(L&C) am

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - SECOND SESSION

BY THE HOUSE LABOR AND COMMERCE COMMITTEE

Amended: 4/27/98
Offered: 4/9/98

Sponsor(s): HOUSE LABOR AND COMMERCE COMMITTEE

A RESOLUTION

Establishing a Joint Committee on Electric Utility Restructuring.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

WHEREAS electricity is among modern society's most basic requirements and commodities; and

WHEREAS even other forms of infrastructure, such as water and waste water systems, are largely dependent on electricity; and

WHEREAS the provision of adequate, reliable, and reasonably priced electrical energy is essential to the daily functions, safety, and economic well-being of Alaskans, their local communities, and the state; and

WHEREAS fundamental restructuring of the electric utility industry is now under deliberation by the Congress and other states; and

WHEREAS electric utility restructuring is a highly complex issue, carrying with it profound implications for all classes of electrical consumers; and

WHEREAS the implications and ramifications of such restructuring deserve detailed, careful, and informed decision making by the Alaska State Legislature;

BE IT RESOLVED by the Alaska State Legislature that a Joint Committee on Electric Utility Restructuring is established; and be it

EXHIBIT C

FURTHER RESOLVED that the Speaker of the House of Representatives and the President of the Senate shall determine an equal number of members of the House of Representatives and of the Senate to serve on the joint committee, and that the Speaker of the House of Representatives shall appoint the representatives to the committee and that the President of the Senate shall appoint the senators to the committee; and be it

FURTHER RESOLVED that the presiding officer of each body shall apportion minority members to the joint committee as provided in Rule 1(e), Uniform Rules of the Alaska State Legislature, for standing committees; and be it

FURTHER RESOLVED that the joint committee may meet during and after the Second Session of the Twentieth Alaska State Legislature and is terminated on the convening of the First Session of the Twenty-First Alaska State Legislature; and be it

FURTHER RESOLVED that the joint committee shall provide to the legislature written recommendations on whether and how to implement electric utility restructuring in Alaska.