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Electricity Restructuring: Comparison of S. 1401, H.R. 655, H.R. 1230, S. 722, and H.R. 1960

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Electricity Restructuring: Comparison of S. 1401, H.R. 655, H.R. 1230, S. 722, and H.R. 1960

Summary

Once considered the nation's most regulated industry, the electric utility industry is evolving into a more competitive environment. At the current time, the focus of this development is the generating sector, where the advent of new generating technologies, such as gas-fired combined cycle, has lowered both entry barriers to competitors of traditional utilities and the marginal costs of those competitors below those of some traditional utilities. This technological advance has combined with legislative initiatives, such as the Energy Policy Act (EPACT) to encourage the introduction of competitive forces into the electric generating sector.

The questions now are whether further legislative action is desirable to encourage competition in the electric utility sector and how the transition between a comprehensive regulatory regime to a more competitive electric utility sector can be made with the least amount of economic and service disruption.

Five comprehensive restructuring bills have been introduced in the 105th Congress to expand on the initiatives contained in EPACT and to build on the Federal Energy Regulatory Commission's (FERC) actions to encourage wholesale competition. A "comprehensive approach" to utility restructuring involves three components: (1) provisions for retail competition (called "retail wheeling"), which permit retail consumers to choose from whom they obtain their electricity supplies; (2) provisions reforming section 210 of the Public Utility Regulatory Policies Act (PURPA), which provides cogenerators and small power producers a guaranteed market for their power; and (3) provisions reforming the Public Utility Holding Company Act (PUHCA), which regulates various financial transactions of holding companies that have interests in public utility companies. S. 1401 (a refinement of S. 237), introduced by Senators Bumpers and Gordon, H.R. 655, introduced by Representative Schaefer, H.R. 1230, introduced by Representative DeLay, S.722, introduced by Senator Thomas, and H.R. 1960, introduced by Representative Markey, contain all three components.

The five bills differ significantly in various aspects of restructuring the electric utility industry. With respect to retail competition, H.R. 1230 mandates its implementation the soonest — January 1, 1999. S. 1401 provides the most time to achieve retail competition — January 1, 2002. H.R. 655's implementation date is December 15, 2000. In contrast, S. 722, and H.R. 1960 contain no federal mandate for retail competition; rather, they encourage the states to develop retail competition programs. Likewise, each bill takes a different approach to "stranded" costs, that is, investments made by a utility under the regulatory scheme that may not be recoverable under competition. S. 1401 has detailed procedures to ensure stranded cost recovery by affected utilities, including having the FERC exercise the authority if states fail to provide for it. In contrast, H.R. 655, S. 722, and H.R. 1960 contain no federal mandates with respect to stranded cost recovery, leaving that decision to the states. Finally, H.R. 1230 not only contains no federal mandates with respect to stranded cost recovery, but also prohibits states from imposing exit fees on departing customers to provide for such a recovery.

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Overview

Once considered the nation's most regulated industry, the electric utility industry is evolving into a more competitive environment. At the current time, the focus of this development is the generating sector, where the advent of new generating technologies, such as gas-fired combined cycle, has lowered both entry barriers to competitors of traditional utilities and lowered the marginal costs of those competitors below those of some traditional utilities. This technological advance has been combined with legislative initiatives, such as the Energy Policy Act of 1992 (EPACT), to encourage the introduction of competitive forces into the electric generating sector. The questions now are whether further legislative action is desirable to encourage competition in the electric utility sector and how the transition between a comprehensive regulatory regime to a more competitive electric utility sector can be made with the least amount of economic and service disruption.

The Federal Power Act (FPA) and the Public Utility Holding Company Act (PUHCA) of 1935 established a regime of regulating electric utilities that gives specific and separate powers to the states and the federal government. State regulatory commissions address intrastate utility activities, including wholesale and retail rate-making. State authority currently tends to be as broad and as varied as the states are diverse. At the least, a state public utility commission will have authority over retail rates, and often over investment and debt. At the other end of the spectrum, the state regulatory body will oversee many facets of utility operation. Despite this diversity, the essential mission of the state regulator is the establishment of retail electric prices. This is accomplished through an adversarial hearing process. The central issues in such cases are the total amount of money the utility will be permitted to collect and how the burden of the revenue requirement will be distributed among the various customer classes (residential, commercial, and industrial).

Under the Federal Power Act, federal economic regulation addresses wholesale transactions and rates for electric power flowing in interstate commerce. Federal regulation followed state regulation and is premised on the need to fill the regulatory vacuum resulting from the constitutional inability of states to regulate interstate commerce. In this bifurcation of regulatory jurisdiction, federal regulation is limited and conceived to supplement state regulation. The Federal Energy Regulatory Commission (FERC) has the principal functions at the federal level for the economic regulation of the electric utility industry, including financial transactions, wholesale

rate regulation, interconnection and wheeling[1] of wholesale electricity, and ensuring adequate and reliable service. In addition, to prevent a recurrence of the abusive practices of the 1920s (e.g., cross-subsidization, self-dealing, pyramiding, etc.), the Securities and Exchange Commission (SEC) regulates utilities' corporate structure and business ventures under the Public Utility Holding Company Act (PUHCA, Title 1 of the Federal Power Act).

This regulatory regime changed little between 1935 and 1978. Beginning in 1978, primarily in response to the "oil crisis," laws were passed to encourage the development of alternative sources of power. The Public Utility Regulatory Policies Act of 1978 (PURPA) was established in part to augment electric utility generation with more efficiently produced electricity and to provide equitable rates to electric consumers. Section 210 of PURPA requires that a public utility purchase the power produced by qualifying facilities (QFs, generally small producers and cogenerators[2]). In addition to PURPA, the Fuel Use Act of 1978 (FUA) helped QFs become established. Under FUA, utilities were not permitted to use natural gas to fuel new generating technology. QFs, which are by definition not utilities, were able to combine the availability of natural gas and new, more efficient generating technology, such as combined-cycle, with a regulatory system that provided them with a captive market that priced their product at their local utility's "avoided cost." The introduction of new generating technologies lowered the financial threshold for entrance into the electricity generation business and shortened the lead time for constructing new plants. FUA was repealed in 1987, but by this time QFs and small power producers had already gained a portion of the total market for electricity supply.

This influx of QF power challenged the cost-based rates that previously guided wholesale transactions. Before implementation of PURPA, FERC approved wholesale interstate electricity transactions based on the seller's costs to generate and transmit the power. As more nonutility generators entered the market in the 1980s, these cost-based rates were challenged. Since nonutility generators typically do not have enough market power to influence the rates they charge, FERC began approving certain wholesale transactions whose rates were a result of a competitive bidding process. These rates are called market-based rates.

Most recently, the Energy Policy Act of 1992 (EPACT) furthered competition in electricity supply by removing several regulatory barriers to entry into electricity generation. Specifically, EPACT provides for the creation of new entities, called "exempt wholesale generators" (EWGs), that can generate and sell electricity at wholesale without being regulated as utilities under PUHCA. Under EPACT, these EWGs are also provided with a way to assure transmission of their wholesale power to a wholesale purchaser. However, EPACT does not permit the FERC to mandate that utilities transmit EWG power to retail consumers (commonly called "retail

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[1] Wheeling is the transmission of electric power from one party to another party via a third party that does not own or directly use the power being transmitted.

[2] Cogeneration is the simultaneous production of electric power and thermal energy (i.e., steam). Cogeneration plants are considered qualifying facilities under PURPA.

wheeling"), an activity that remains under the jurisdiction of state public utility commissions.

In line with EPACT, FERC issued a Notice of Proposed Rulemaking, since called the Mega-NOPR, to allow more competition in the generation sector by ending the utilities' transmission dominance. On April 24, 1996, FERC issued two final rules on transmission access. In issuing its final rule, FERC concluded that these Orders will "remedy undue discrimination in transmission services in interstate commerce and provide an orderly and fair transition to competitive bulk power markets." Under Order 888, the Open Access Rule, transmission owners are required to offer both point-to-point and network transmission services under comparable terms and conditions that they provide for themselves. The rule provides a single tariff providing minimum conditions for both network and point-to-point services and the non-price terms and conditions for providing these services and ancillary services.

FERC Order 888 also allows for full recovery of so-called stranded costs from wholesale customers wishing to leave their current supply arrangements. With the introduction of competition, utilities have been concerned that construction costs that they incurred under their monopoly service territory agreements may not be recovered. These costs, called stranded costs, can be viewed as a transition problem resulting from the movement from a comprehensive regulatory regime to a more competitively based electric generating sector. The utilities' current investments in electric generating facilities are based on a "regulatory bargain" where utilities are obligated to serve wholesale customers through contractual arrangements and obligated to serve retail customers through their monopoly franchise rights. In return for providing service on demand, the regulatory authorities ensured financial integrity by permitting the utilities to recover, over a multi-year period, prudently incurred costs plus a reasonable rate of return. This system has been upset by the emergence of competitive forces in the electric generating system driving outside parties to build facilities that can generate electricity at lower cost than many utilities' embedded generating costs, competitive forces that national policy is nurturing and encouraging. For some utilities, this shift in policy results in some of their investments, although prudently incurred under the regulatory system, potentially becoming uneconomic or "stranded" by the new market pricing mechanism. For example, utilities built nuclear capacity, some of which turned out not to be needed, which cost much more than comparable gas-fired capacity. In a competitive market, the cost of this capacity may be "stranded" by the availability of the lower cost gas-fired capacity. As a result, those utilities would have a difficult time recovering their capital investment in the higher cost nuclear facility.

Order 889, the Open Access Same-time Information System (OASIS) rule, establishes standards of conduct to ensure a level playing field. It requires utilities to separate their wholesale power marketing and transmission operation functions, but does not require corporate divestiture of assets. FERC also issued a new Notice of Proposed Rulemaking that requests comments on whether the single tariff contained in the final open access rule should be replaced with a capacity reservation tariff that would indicate how much transmission is available at any given time.

Legislative Proposals

Five comprehensive utility restructuring bills have been introduced in the 105th Congress to expand on the initiatives contained in EPACT, and to build on FERC's actions. In general, these "comprehensive" approaches to utility restructuring have three components: (1) provisions for retail competition (commonly called "retail wheeling"), which would permit retail consumers to choose from whom they obtain their electricity supplies; (2) provisions reforming section 210 of PURPA, which provides cogenerators and small power producers a guaranteed market for their power; and (3) provisions reforming PUHCA, which regulates various financial transactions of large holding companies having interests in public utility companies. S. 1401, introduced by Senators Bumpers and Gordon, H.R. 655, introduced by Representative Schaefer, H.R. 1230, introduced by Representative DeLay, S. 722, introduced by Senator Thomas, and H.R. 1960, introduced by Representative Markey, contain all three components.

The criteria used in this report to compared these bills were derived from a CRS analysis of the basic issues surrounding electricity restructuring.[3] The five initiatives summarized here — S. 1401,[4] H.R. 655, H.R. 1230, S. 722 and H.R. 1960 — significantly differ in the emphasis each takes in restructuring the electric utility industry. The issues and differing approaches are briefly summarized below.

Retail Competition

Retail competition refers to the ability of retail consumers to obtain their electric services from anyone they choose. Currently, such a scheme would entail a competitive generation market combined with a regulated transmission and distribution system. The transmission and distribution system currently are not considered amenable to competition, so that part of the electricity supply system would be regulated to provide customers access to the competitively based generation on a reasonable and nondiscriminatory basis. FERC Orders 888 and 889 represent FERC's attempt to achieve this competition on a wholesale level. However, FERC does not have jurisdiction over retail competition, as explicitly stated in EPACT. Currently, that is under the jurisdiction of the states.

The bills summarized here address the retail competition issue differently. S. 1401 has a federal mandate requiring retail competition by January 1, 2002, with enforcement provided through the federal courts, not by any assumption of authority by FERC. However, the bill has detailed procedures to ensure stranded cost recovery by affected utilities, including having the FERC exercise the authority if states fail to

[3] Parker, Larry B. *Electric Utility Restructuring: Overview of Basic Policy Questions*. CRS Report 97-154 ENR. January 28, 1997.

[4] Introduced in November 1997, S. 1401 is a refined and enlarged version of S. 237, introduced by Senator Bumpers in January 1997. Besides moving up the date for retail competition from December 15, 2003 to January 1, 2002, S. 1401 has substantial provisions on the Bonneville Power Administration (BPA) and the Tennessee Valley Authority (TVA) not included in S. 237.

provide for it. S. 1401 also has detailed provisions establishing Independent System Operators (ISOs) and to ensure reliability, and enhance efficiency and competition.

H.R. 655 mandates retail competition by December 15, 2000. The bill provides for states and nonregulated utilities to choose to implement this requirement themselves or have the FERC exercise that authority. But the bill contains no federal mandates with respect to stranded cost recovery or establishment of ISOs. Decisions with respect to stranded cost recovery and reliability are left to the states.

H.R. 1230 mandates retail competition by January 1, 1999, with FERC given general authority to implement the provisions of the bill. The bill contains no federal mandates with respect to stranded cost recovery, and prohibits states from imposing exit charges for such a recovery on customers deciding to leave a utility system. FERC has authority to ensure transmission reliability under H.R. 1230; states have authority to ensure local distribution reliability.

In contrast to the above proposals, S. 722 and H.R. 1960 contain no federal mandate or deadline for implementing a retail competition program. S. 722 clarifies that the state have jurisdiction over retail electric supply, excluding interstate transmission, and includes reciprocity requirements to ensure that utilities in states without a retail competition program may not take retail customers away from utilities in states that do have a retail competition program. The bill contains no federal mandates with respect to stranded cost recovery or establishment of ISOs. Decisions with respect to stranded cost recovery and reliability are left to the states.

H.R. 1960 encourages states to initiate retail competition by making certain federal actions contingent on state action. Specifically, H.R. 1960 makes the suspension of both PUHCA and PURPA contingent on state certification that a utility is complying with competitive requirements in the bill. The bill contains no federal mandates with respect to stranded cost recovery, leaving that decision to the states. H.R. 1960 does provide for FERC to oversee a self-regulating national Electric Reliability Council designed to protect system reliability.

PURPA

Section 210 of PURPA is commonly called the mandatory purchase requirement. With a comprehensive approach to competitive electric markets embedded in these bills, the mandatory purchase requirement of section 210 of PURPA is considered by many to be outdated. Under S. 1401, section 210 would cease to apply to new generating facilities or new contracts as of January 1, 2002. Under H.R. 655 and H.R. 1960, section 210 would not apply to new contracts for utilities that have been deemed by their state regulatory commissions as providing for retail competition on a competitive and nondiscriminatory basis. H.R. 1960 contains detailed provisions for states to follow in making this certification. Under H.R. 1230, section 210 would not apply to a utility the state determines provides retail competition on an open and nondiscriminatory basis. Finally, S. 722 provides that section 210 of PURPA would not apply to new facilities that begin commercial operation after the date of enactment, unless a power purchases contract had been entered into before enactment. All five bills contain language that grandfather or protect existing contracts under PURPA, although they differ in detail. Also, S. 1401, H.R. 655, and

H.R. 1960 contain a renewable energy set-aside program, although they differ in details. H.R. 1230 and S. 722 contain no such provision.

PUHCA

PUHCA was enacted to prevent the abuses of the 1920s. However, with a comprehensive approach to competitive electric markets, PUHCA is viewed by many as an unnecessary impediment to competition. Concern about recurrence of the earlier abuses is generally addressed through provisions providing for improved access to company records by state commissions and FERC. S. 1401 would repeal and replace PUHCA one year after enactment, while S. 722 would do so 18 months after enactment. H.R. 655 would suspend PUHCA for utilities deemed by their state regulatory commissions as providing for retail competition on a competitive and nondiscriminatory basis. S. 1401, H.R. 655, and S. 722 would replace PUHCA's strictures with provisions enhancing federal and state commission access to company records; however, only H.R. 655 and S. 722 make requests by state commissions enforceable in federal courts. H.R. 1230, like H.R. 655, would suspend PUHCA when the affected states determine that the company offers retail competition on an open and nondiscriminatory basis. However, H.R. 1230 does not replace PUHCA with any provisions enhancing federal or state access to company records. Finally, H.R. 1960 would make suspension of PUHCA dependent upon state certification of a utility's compliance with various competitiveness criteria. But, in contrast to the other bills, H.R. 1960 would include substantially enhanced state and FERC authority to oversee utility mergers, acquisitions, diversification efforts, and market power.

The reader should note that this is a brief summary of major provisions, not a complete, comprehensive, word-for-word comparison of bills. Readers interested in the precise language of a given provision should refer to the bill in question.[5]

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[5] For a more detailed (although not word-for-word) comparison of S. 237 (the previous version of S. 1401) and H.R. 655, see Parker, Larry. *Electric Restructuring: Comparison of Major Provisions of S. 237 and H.R. 655.* CRS Report 97-314 ENR. February 28, 1997.

Table 1: Summary of Major Provisions of S. 1401, H.R. 655, H.R. 1230, S. 722 and H.R. 1960

Provision	S. 1401	H.R. 655	H.R. 1230	S. 722	H.R. 1960
Deadline for Retail Competition	January 1, 2002	December 15, 2000	January 1, 1999	No federally imposed deadline	No federally imposed deadline
Federal Role in Implementing Retail Competition	Federal mandate enforceable in federal courts	Federal mandate enforceable by FERC	Federal mandate enforceable by FERC	No federal mandate. Retains role in interstate transmission	No federal mandate. Enhanced utility oversight, environmental and consumer protection role
State Role in Implementing Retail Competition	Retains role in protecting the public interest, and regulating distribution and retail transmission service	Detailed state implementation requirements for retail competition along with retaining role in local distribution and consumer protection	Retains role in protecting the public interest, and regulating local distribution service	Lead role in deciding on retail competition reforms. Retains role in protecting public health and safety	Lead role in deciding on retail competition reforms based on detailed federal provisions. Enhanced role in utility oversight
Transitional Concerns — Stranded Costs	Detailed requirements for stranded cost recovery with FERC serving as a backstop	No requirement. States may choose to impose a charge to provide for such recovery	No requirement. States may not impose an exit charge to provide for such a recovery	No requirement. States may choose to impose a charge to provide for such recovery	No requirements. Any stranded cost recovery must be allocated in an equitable manner to all customer classes

Provision	S. 1401	H.R. 655	H.R. 1230	S. 722	H.R. 1960
Structuring the Market — Reliability	Detailed provisions for ISOs, along with state authority to ensure reliability	State authority to ensure reliability	FERC to ensure transmission reliability; states to ensure local distribution reliability	State authority to ensure reliability	Creates self-regulating utility councils under FERC oversight to protect reliability
Structuring the Industry — Corporate Structure (including PUHCA)	ISOs must be independent PUHCA repealed 1 year after enactment, replaced by enhanced federal and state access to company records "Ohio Power" provision to permit state review of affiliate transactions	PUHCA ceases to apply to a company when the affected states determine the company offers effective retail competition. Replaced by enhanced federal and state access to company records	Functional divestiture of transmission/ distribution and generation components PUHCA ceases to apply to a company when the affected states determine the company offers effective retail competition	PUHCA repealed 18 months after enactment and replaced by enhanced federal and state access to company records	PUHCA ceases to apply to a company when the affected states certify the company's compliance with federal retail competition and public benefit standards. Replaced by enhanced federal and state authority to oversee utility mergers, acquisitions, affiliate relationships, and diversification efforts

Provision	S. 1401	H.R. 655	H.R. 1230	S. 722	H.R. 1960
Structuring the Industry — Corporate Transactions (including PURPA)	Sec. 210 of PURPA does not apply to new facilities after January 1, 2002 Existing contracts are unaffected	Sec. 210 of PURPA does not apply to a utility the state determines provides effective retail competition Existing contracts are unaffected	Sec. 210 of PURPA does not apply to a utility the state determines provides effective retail competition Contracts as of the date of enactment are unaffected	Sec. 210 of PURPA does not apply to new facilities after the date of enactment unless a power purchase contract had been entered into beforehand Existing contracts are unaffected	Sec. 210 of PURPA ceases to apply to a utility when the affected state certifies the utility's compli-ance with federal retail competition and public benefit standards Existing contracts are unaffected

Provision	**S. 1401**	**H.R. 655**	**H.R. 1230**	**S. 722**	**H.R. 1960**
Structuring the Industry — Public Power	TVA fence is removed if in U.S. interests; purchase contracts with TVA may be terminated on 1-year notice after January 1, 2001; privatization study required. BPA regional governing body authorized. Authorized BPA compliance with FERC open access rules and participation in a ISO shall not threaten U.S. Treasury receipts.	Purchasers of Power Marketing Administration (PMA) power may not resell that power outside their distribution area	No specific provisions	All transmitting utilities are subject to FERC with respect to any wholesale transmission service Study of tax benefits of public and investor-owned power	Except for existing arrangements, TVA and PMAs may not provide retail service to customers outside their areas unless retail competition is available to all customers within such area
Non-economic Issues — Environment	EPA study of air pollution standards and electricity restructuring by January 1, 2000	States may assess charges to fund environmental programs	No specific provisions	States may assess charges to fund environmental programs	President to prevent advantage to utilities whose plants emit excessive amount of sulfur dioxide, nitrogen oxides, and carbon dioxide

Provision	**S. 1401**	**H.R. 655**	**H.R. 1230**	**S. 722**	**H.R. 1960**
Non-economic Issues — Renewable Energy	Renewable set-aside requirement and trading program	Renewable set-aside requirement and trading program	States may permit consumer choice with regard to renewable energy	States may assess charges to fund renewable energy programs	Renewable set-aside requirement and trading program
Non-economic Issues — Other	States may assess charges to fund public benefit programs, such as universal service protection for customers, low-income energy assistance, R&D programs, and energy efficiency and conservation	States may assess charges to fund public benefit programs, such as universal service protection for customers, low-income energy assistance, and/or environmental, renewable, efficiency, conservation, or other such programs	States may assess charges to continue universal service protection for customers States retain authority over conservation, R&D, and other programs deemed appropriate by the state	States may assess charges to fund public benefit programs, such as universal service protection for customers, low-income energy assistance, R&D efforts, and environmental, renewable energy, energy efficiency or conservation programs	As part of the certification process, states must generally assess charges to fund public bene-fit programs, such as low-income services, renew-able energy and energy efficiency