INDEPENDENT SYSTEM OPERATORS AND POWER EXCHANGES: THE ROLES OF THE STATES AND FERC

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I. The States' and FERC's Responsibilities Intersect

A. States' Responsibilities

1. In general: Approve the transfer or acquisition of operational responsibility (or ownership) of transmission or generation.

2. When generation is transferred: verify that the state's customers receive an appropriate share of the gain from the sale of generating capacity for which they have paid historically.

3. When transmission is transferred: verify that the state's customers will receive access rights at a price commensurate with the costs they have borne historically.

4. New construction: Approve construction of generation and transmission facilities in the state, whether proposed by a utility, a new seller or an ISO or power exchange.

5. License new sellers of retail power and operators of major facilities:

    a. Physical reliability issues

    b. Financial reliability issues

    c. Other

B. FERC's Responsibilities

1. Traditional Responsibilities Under the Federal Power Act

    a. Review of Transactions

(1) Transmission service (of wholesale and retail power) in interstate commerce

(2) Wholesale transactions in interstate commerce

(3) Mergers (FERC's role depends on corporate structure)

b. Principles

(1) Reasonable rates

(2) Nondiscrimination

(3) Avoidance of increases in market power in wholesale generation

2. FERC's Recent Actions on ISOs and Power Exchanges

a. FERC has not mandated ISOs or power exchanges; instead FERC accepts, rejects or conditions proposals filed by transmission owners

b. Controversial Matters

(1) <u>Governance</u>: Who controls the ISO's policies?

(2) <u>Pricing</u>: Who pays what?

(3) <u>Cost Recovery</u>: Who decides the compensation for the ISO and the transmission owners?

(4) <u>Operations</u>: Who makes the daily and hourly decisions?

(5) <u>New Facilities</u>: Who decides what gets constructed when?

(6) <u>Market power over wholesale generation</u>: Who detects it and who eliminates it?

C. Areas Where Coordination Will be Important

1. Reliability and safety

2. New construction: generation and transmission

3. Market power

    a. "Wholesale" vs. "retail" market power

    b. "New" market power vs. "existing" market power

    c. Remedies to protect consumers

II. The Techniques for Measuring Market Power Remain Unsettled

A. The role of concentration analysis

B. The role of strategic bidding

C. The role of capacity withholding

D. Data questions

E. Other uncertainties

III. If FERC Chooses to Defer to the ISOs on Market Power, Important Questions Remain

A. Transmission owners continue to have influence over important decisions

B. ISO decisionmaking may be slowed by internal committees, reviews and appeals to arbitrators and to FERC

C. ISO's authority to penalize misbehavior is legally uncertain

D. ISO expertise will take time to build

E. ISO existence still dependent on the parties' agreement, including the agreement of the transmission owners

IV. There is Legal Uncertainty Over FERC's Authority to Implement Complete Remedies for Market Power

A. Mandating ISOs

B. Mandating power exchanges

C. Mandating changes in asset ownership

D. Mandating construction of transmission

E. Price-capping retail sales

F. Elimination of "existing" market power vs. "new" market power

V. FERC's ISO Regulation Addresses Only Some Market Power Issues

A. FERC's emphases: generation and transmission

B. States will need to address --

1. Market power associated with the joint ownership of both generation and distribution

2. Product diversity (as opposed to price regulation-

3. Retail generation sales

4. Retail marketing sales

5. Metering, billing, customer service

6. Interactions between distribution and generation