

A Proposal to
The New England Governors Conference, Inc.

**To Create a
Regional State Committee on Electricity Policy**

September 8, 2003

The Power Planning Committee of the New England Governors Conference, Inc. (NEGC), in cooperation with the NEGC's Committee on the Environment, recommends that the Governors authorize the creation of a new Regional State Committee (RSC) that would provide policy recommendations to the Federal Energy Regulatory Commission (FERC) for certain aspects of the region's wholesale electric power system. The Committees include representation from the public utility commissions, energy policy offices and environmental agencies of the six states. This recommendation is made after consultation with the public utility commissions in the region in recognition of their long history of interest and their continuing involvement in policy matters related to the electric power system.

The opportunity to create this committee is offered by the FERC in the context of its proposed rulemaking on a standard design for regional electric markets. The FERC has proposed to allow such a committee to recommend policy in certain instances if the states can develop a mechanism to accomplish the political coordination and executive decision-making that would be needed for such a committee to faithfully execute its responsibilities. The FERC indicates it would give great weight and deference to policy recommendations made by the RSC. In a recent White Paper, the FERC described a model in which the RSC reports its policy recommendations to the Independent System Operator of New England (ISO-NE), the organization charged by the FERC with operating New England's electric power system, which could file the RSC recommendation with the FERC for its consideration.¹

In the absence of action on our part to take up this invitation, policy decisions, as they have been previously, would continue to be made by the ISO-NE. While that organization is independent of market participants and is a highly competent operator of the system, we believe that it lacks the political representation and accountability needed to legitimately balance various public policy objectives on behalf of the states in the region.²

This memorandum provides you with the proposed rationale for creating such a Committee, the scope of its jurisdiction and the process it would use to make decisions. We present this proposal in anticipation of review and action on it by the Governors at the September meeting of the New England Governors Conference. Approval of the formation plan at that meeting would allow the NEGC to submit it to the FERC for its approval in the fall of this year. This would create the potential for the Committee to commence operation early in 2004.

¹ The specific process by which the RSC recommendations are brought to FERC for approval are outside the scope of this proposal. The RSC may have the authority to file its recommendations with FERC directly or through the ISO (or RTO).

² The RSC can also address the opportunities for further cooperation and coordination with neighboring jurisdictions.

Background

The integrated electric power system that serves New England is broadly regulated by the FERC under the Federal Power Act of 1933. Operating under authority granted by the FERC, the ISO-NE, a non-profit corporation with an independent Board of Directors, dispatches the power plants and operates the transmission lines that comprise the region's bulk power system. State public utility commissions regulate local distribution systems and retail activities within this marketplace.

In July 2002 the FERC issued a proposed rulemaking that called for regions to implement a so-called Standard Market Design (SMD) for wholesale electricity markets across the country. The rulemaking calls for major changes to the rules and technical systems used to operate and regulate wholesale power generation, power sales and electric transmission.³ In March of this year, the ISO-NE implemented many of the major market rules and technical modifications required under SMD for this region. However, the governance reforms required under SMD have not been implemented. They are now under review in the context of ISO-NE's plan to become certified by the FERC later this year as an official Regional Transmission Organization under the terms of SMD. FERC's rulemaking recognized that states have an important role to play in regional electric system planning. Included among the governance mechanisms allowed under SMD is the formation of a RSC to make policy recommendations to the FERC regarding such issues as system planning and expansion and resource adequacy within a region.⁴

Currently, issues, disputes and needs related to the electric system that transcend the boundaries and legal limits of state jurisdiction are often addressed and resolved by the ISO-NE. If conflict among market participants within the region prevents ISO-NE from obtaining support from NEPOOL and/or state utility regulators, proposed actions must be reviewed and disputes must be resolved by the FERC. State governments within the region must then acquiesce to federal intervention in matters that are fundamentally intra-regional in nature. The FERC tries to limit its involvement in these intra-regional issues by relying on ISO-NE to resolve them whenever possible. The significant technical expertise of a system operator allows it to go some distance toward successfully discharging this responsibility. However, the FERC has recognized that states within a region, acting in a coordinated way, would be better suited to address matters that, fundamentally, require the application of political judgment and the balancing of competing public policies. We agree that a committee comprised of representatives from each state would have a better understanding of the implications of key electric system policy decisions for the

³ Federal Energy Regulatory Commission, Notice of Proposed Rulemaking, Docket No. RM01-12-000, July 2002. The FERC proposed a Standard Market Design to address what it saw as persistent and costly problems in the nation's wholesale electric power markets. According to FERC, these problems include under-investment in needed transmission, generation sited far from customers, discriminatory behavior by transmission providers against independent generators and fundamental technical flaws in existing electricity markets. The overall goals of the Design are to provide clear rules governing the wholesale electric industry and to remove market impediments to competition and economic efficiency for the benefit of customers. In the proposed rulemaking, FERC outlined specific proposals to enhance workable competitive markets including requiring adequate infrastructure, balanced market rules, and customer protection through oversight and mitigation (of market power and market manipulation) when necessary. A final rule has not yet been proposed.

⁴ The FERC White Paper discusses changes it plans to make to the original rule to address various concerns that have been raised in comments it has received since issuing it. Notably for our purposes here, the White Paper retains the commitment to approve properly constituted Regional State Committees and clarifies its intent to vest such committees with significant authority. See FERC White Paper, April 28, 2003.

region's producers and consumers of electricity and would have the necessary political accountability to rightfully make policy recommendations to the FERC on these issues.

The FERC seeks to confer authoritative influence on such a committee for several key policies related to the system. These policies include the amount and type of generation a region wants to maintain in order to preserve a reliable electric system (known as resource adequacy) and the manner in which improvements to the transmission system are considered and funded (known as system planning and expansion). In addition, the Commission has suggested that such a committee might also be vested by the states with authority to resolve disputes over the siting of interstate transmission facilities. Other policy goals with which the committee might be concerned and advise the system operator could include but not be limited to security, fuel diversity, conservation and the environmental impacts of power generation.

Scope of the new Committee's Authority

The FERC has suggested a wide range of potential issues on which a Committee might recommend policy. These include but are not limited to:

- Resource adequacy standards;
- Transmission planning and expansion;
- Interstate transmission siting;
- Rate design and revenue requirements;
- Market power and market monitoring;
- Demand response and load management;
- Distributed generation and interconnection policies;
- Energy efficiency and environmental issues;
- Review of management and budget for system operator.

The Power Planning Committee believes the scope of the committee's jurisdiction, at the outset, should encompass at least two areas: regulation of resource adequacy and system planning and expansion. In addition, we propose that the Committee affirmatively investigate the issues surrounding authority for the siting of interstate transmission facilities. We recognize, however, that integrating the jurisdictional complexities associated with inter-state transmission siting with the new committee's identity would require an extensive political review and approval process, and for that reason do not propose that the RSC be given any specific authority concerning siting at this time. Further consideration by the Committee of the inter-state transmission siting issue may or may not lead to recommendations by the Committee for further action on that issue. In the Governance section below we propose that a unanimous approval by all six states would be required to expand the Committee's jurisdiction beyond these three areas. A brief discussion of the three proposed areas follows.

The Role of the RSC in Ensuring Adequate Resources

Various mechanisms are used to obtain (and pay for) a "reserve margin" of extra generating capacity, above what is expected to be the peak demand, supplemented with energy efficiency and demand reduction programs. If a region does not have adequate electric capacity

available, it is vulnerable to reliability problems, ranging from brownouts to rotating blackouts to, in the worst case, cascading or uncontrolled blackouts. The particular level of reserve margin sought should be the product of both sound technical analysis and political judgment since the margin that is achieved will impose greater or lesser costs on the region's electric ratepayers. While reducing the risk of inadequate resources may increase costs to consumers in the short term, it may also reduce costs over the longer term. In effect, this is a determination of the amount of insurance the region wants and for which it is willing to pay.

The RSC could provide a mechanism whereby the New England states can determine what degree of reliability risk they feel is appropriate and at what cost. It would recommend policies that are expected to ensure that adequate resources are available to ensure a reliable electric system at a reasonable cost.

There is considerable controversy over the impacts of current resource adequacy policies. During hours where the electric system is stretched to its limits but has not yet reached a point of physical shortage, the price of electricity may rise to extremely high levels. Currently this problem is addressed through the use of a price cap that prevents prices from reaching unacceptable levels. The RSC offers an opportunity for the states to address the competing goals of limiting volatility in wholesale electricity prices and ensuring the development of sufficient resources to produce competitive pricing at all times.

Furthermore, even if there are adequate resources overall, there may not be desired quantities of specific types of resources. At a minimum, a resource portfolio must have the ability to respond under emergency conditions and rectify supply/demand imbalances quickly. A desirable resource portfolio might also be designed to meet a broad array of other goals, such as acceptable environmental impacts, a diversity of fuel types including renewable resources and efficient electricity use by consumers. The RSC would provide a mechanism for the states to seek to reflect in the regional mix of electric resources an appropriate balance among a broad range of policy objectives.

A variety of mechanisms could be utilized to enable the RSC to accomplish its resource adequacy objectives. These mechanisms include recommendations for changes to market rules, incentive pricing mechanisms, formation of regulated buying entities and others. This proposal does not make a recommendation at this time on exactly how the RSC would accomplish its resource adequacy objectives. In performing its role with respect to resource adequacy, the RSC would need to ensure that all relevant interests are considered. Any successful resource adequacy policy would need to balance the various interests of generators, transmission owners, utilities, marketers and customers, in addition to various public policy interests.

The Role of the RSC in System Planning and Expansion

Resource adequacy policies related to generation and demand-side resources alone may not be able to ensure regional electric reliability nor can they entirely eliminate persistent and costly congestion over transmission lines. In these instances, when the need for new transmission capacity is identified, regulatory considerations that generally do not exist for generation or energy efficiency come into play (e.g. particularly determinations by regulators of the need for

the facility and approval of tariff adjustments to cover its cost). Invariably, these decisions require tradeoffs among a variety of regional policy goals: determining whether the new lines will facilitate or impede the development of competitive generation and efficiency markets, ensuring investments are cost effective for consumers, etc. The RSC can recommend policies on transmission planning and expansion that will balance these policy goals.

Currently, ISO-NE conducts transmission system reliability planning through its Regional Transmission Expansion Process (RTEP). This on-going evaluation process provides critical information to the market about emerging system needs. These needs may be met by new generation being built or by the development of new demand response programs. The RSC will seek to ensure that ISO-NE provides the market for these resources with adequate information and time to respond without relying exclusively on transmission solutions.

However, ultimately, the need to ensure reliability or reduce congestion may require expansion of transmission capacity. The RSC would review the results of the ISO-NE's RTEP analyses and use these analyses to inform its policy deliberations. The RSC would make recommendations on aspects of transmission system expansion that require more than technical analysis and judgment. For example, the RSC would be the proper forum to judge what form of cost recovery guarantees (e.g. inclusion in a regional or local transmission tariffs) should be offered to enable projects to be built. In an instance where practical considerations would prevent or delay the development of transmission, the RSC could recommend which among the alternative solutions should be undertaken and how the cost of the alternatives should be recovered.

Siting of Interstate Transmission

At this time, we do not recommend that the Governors confer on the RSC decision-making authority with reference to transmission siting. However, interstate transmission siting is a key component of the reliability of electricity in New England and deserves some careful attention. The FERC identified “under-investment in needed transmission” as one of the most persistent and costly problems in the nation’s wholesale electric power markets. In New England very little interstate transmission has been installed over the last fifteen years, while electricity demand has increased by approximately twenty-five percent.⁵ The application of individual state siting laws and processes may create a major obstacle to installing needed interstate transmission.

Most major transmission projects require the siting approval of more than one state. The state siting processes generally focus on state benefits, not regional reliability. In fact, many state siting laws require a finding that additional energy resources are needed within the state (i.e., locally) in order for a transmission facility to be approved. Multi-state transmission projects may be the optimal solution to a regional reliability deficiency, but such projects can be delayed or prevented altogether by a single state’s analysis of its own benefits and impacts, especially if the new transmission line only benefits other states. Potential developers may avoid interstate projects or be thwarted in their pursuit of permission to meet regional needs. The

⁵ ISO New England Inc., System Planning: Why is this Process so Important?

FERC suggests states consider the creation of multi-state agencies (such as the RSC) to review and approve new transmission facilities.

Most states are reluctant to cede state siting jurisdiction to a multi-state agency.⁶ However, the New England States might benefit from the regional focus that a multi-state siting agency could bring to developing and maintaining an efficient and reliable regional transmission system. An interstate siting solution could creatively incorporate the regional view without eliminating state siting authority.⁷ Therefore, we recommend that the New England Governors identify the approach to the siting of interstate transmission lines on a regional basis as an item for the RSC to study and evaluate. Any RSC decision-making authority on transmission siting would require the approval of each of the New England states.

RSC Authority/Governance

A RSC will function most effectively when it can make recommendations that are the product of a consensus of the member states. It is likely that most recommendations made by the Committee will achieve this degree of support. We expect that recommendations that have the consensus of all the states will be given most deference by FERC. When there is no consensus but there are clear majority and minority opinions both will be provided to FERC. When there is no majority opinion the RSC will not make a recommendation.

The allocation of voting rights among states for determining a majority opinion is a critical issue in the acceptability and effectiveness of a regional committee. Any political body that seeks to fairly administer regional issues in New England must take account of the unique sovereignty of each state and, at the same time, the widely differing electricity consumption characteristics of each state. Smaller, less populous states will not accept a voting mechanism that allows one or two large, populous states to impose their will. Likewise, large states will not accept a voting mechanism that allows a group of small states to impose their will on a majority of the region's electricity consumers. At the same time, all the states would want a mechanism that does not result in continuing stalemates. Thus, there is a pressing need for a voting mechanism that properly balances the principles of state sovereignty and majority rule while still enabling the committee to accomplish its task.

We recommend a model that balances these competing concerns by imitating the balanced power structure achieved in the United States Congress. Under this model a motion would have to be successful in each of two votes as is the case when both the House of Representatives and the Senate with their differing representational systems must each vote to approve a new law. Using this method of decision-making, the regional committee would take

⁶ In order to effectively give the RSC interstate siting authority, the New England Governors in cooperation with the state legislatures would need to conform the state statutes and to cede final interstate siting jurisdiction to the RSC. The RSC could not obtain such authority without being empowered by an Interstate Compact or Federal Legislation.

⁷ For example, if the RSC were given the authority, it could make a finding that an interstate transmission line is necessary from point A in one state to point B in another state. State siting authorities could consider such a finding in the context of state proceedings.

one vote on the “one state, one vote” basis with the motion successful if it received the affirmative support of at least four states out of six. The second vote would be taken on a “proportionate consumption” basis. In this case, the threshold of support which must be met for a motion to be successful through this method would be a percentage of regional demand equal to 99% less the percent of the largest state’s share of current demand. This would prevent one state from being able to prevent a motion from passing which otherwise had the support of five other states.

Like any voting mechanism, this one would be vulnerable to voting strategies that would make it difficult to obtain successful votes under both methods. For example, small states would have the potential to block action by a large state that did not address their needs while two states would have a chance to block action by the other four if they could muster a majority of the weighted votes based on their consumption. At the same time, these obstacles to success would tend to push the states to work out compromises that could obtain the necessary votes under both methods. Such actions would tend to temper the impact of a decision on a state in either minority in order to gain the necessary majority under both voting regimes. It would limit the occasions when the regional committee could impose its will over the objection of a particular state. This type of structure would strike a fair balance between the interests that would protect states with smaller loads (VT, NH, ME, and RI) from being out-voted by states with larger loads (MA and CT). Likewise, it would protect states with large loads from being out-voted by states with smaller loads.⁸

We recommend that the scope of the RSC’s jurisdiction could only be expanded (or contracted) by unanimous agreement of the member states. We further recommend that changes in the voting structure described above as well, for example to address particular types of issues (such as transmission siting) should be allowed only with the unanimous consent of the states.

Operations and Funding

ISO-NE already provides extensive technical analyses of system needs. Such analyses are a necessary pre-requisite to sound reliability planning and ISO-NE should continue to fulfill this function. A regional committee should not attempt to duplicate this function but rather should have sufficient the technical expertise to thoroughly evaluate and critique the ISO’s work. The RSC should not be entirely dependent on and unable to question the ISO’s work product. To support its policy deliberations, the regional committee should rely on the ISO’s expertise and its technical analyses.

⁸ The 2003 CELT Report indicates, based on Summer 2002 Peak MW Base Case, that the electricity demand of each state, expressed as a percentage of the total consumption, was as follows:

MA	46.2
CT	26.8
NH	8.4
ME	7.5
RI	7.0
VT	3.9

We recommend that the RSC be incorporated as a non-profit corporation with the RSC members serving as its unpaid Board of Directors. This structure will allow it the necessary permanence, independence and accountability to carry out its functions effectively. The RSC should have an executive director who will be able to hire or secure the resources needed to gather available information (from the ISO and other reputable sources), evaluate that information and prepare briefing materials for the Committee members. Technical support for the RSC members would require expertise in engineering, economics, legal and policy analysis, regional planning and public information. In instances where the RSC staff is not adequate to perform a given task or the RSC was unable to obtain sufficient analysis from the ISO, then the RSC should have the resources to retain consultants to provide the desired analysis. Ultimately, the adequacy of this staffing structure would depend on the degree to which technical analysis by ISO-NE is responsive to the Committee's need for information to support its policy-making efforts.

We recommend that the RSC be funded by revenues collected by ISO-NE in the same manner as the ISO collects its other revenues through a regional tariff. An annual amount would be requested by the RSC each year and the ISO would forward this request to the FERC as part of its annual budget submission. We would expect this amount might average between two and three million dollars per year over the first five years. This amount would be reviewed and/or modified in consultation with ISO-NE and other parties and ultimately approved by the FERC. . The FERC has already signaled a willingness to make use of such a funding procedure.

Conclusion

We recommend creation of a regional committee along the lines described above. We respectfully request that the NEGC approve this proposal for the creation of such a committee at its meeting in Groton, Connecticut on September 8, 2003.