

Crossed Wires

*Electric Power Deregulation Leaves Holes in the Nation's
High-Voltage Transmission System*

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The survey

Between January 20 and March 8, 1999, the Terra Group and Neil Palmer and Associates interviewed senior regulatory commission staff members in 15 states about *the impact of electricity deregulation on the country's high-voltage transmission systems*. In several key states, environmental leaders were also interviewed. This report summarizes our findings.

Three years ago, we first examined the potential impacts of deregulation on transmission capacity and on the role of municipal utilities.¹ Among other conclusions, we suggested that senior state regulatory staff members “believe complete deregulation will be a gradual process, perhaps taking as long as 20 years.”² Despite widespread conviction at the time that restructuring would move forward quickly, our most recent survey again confirms that many states are still “not in a big hurry to deregulate.”³

But other significant changes have occurred since FERC issued its Order 888 in April, 1996. Environmental and consumer groups – virtually absent from the deregulation debate three years ago – have now become active participants in many states. Currently, many more (and different) players are involved in this debate than in past years, broadening it from a technical discussion among regulatory and industry insiders into a truly public conversation.

Quite often, these new players are sophisticated, knowledgeable and very successful in mobilizing support from community members and elected officials. **Understanding their agendas and perspectives has become an important part of the electric power business.**

In general, environmental activists are uneasy about deregulation because they fear that energy efficiency, conservation and renewables will fare badly in the open market. In the upper Midwest, they also argue that further restructuring will lead to increased air emissions as low-cost coal plants are cranked up to sell more power outside the region. Finally, they favor vigilant regulatory oversight that emphasizes demand-side management, distributed generation, wind and solar power, and other low-impact technologies over new transmission lines.⁴ **The result: even in areas where new transmission capacity may be needed, “construction of any high-voltage transmission line will be controversial.”⁵**

¹ See The Terra Group and Neil Palmer and Associates, “Trouble on the Line: Deregulation Fuels Public Opposition to Transmission Lines,” October, 1995; reprinted as a special supplement to *PUR Utility Quarterly*, Fourth Quarter, 1995. The second report was titled “State Regulators See New Role for Munis in Deregulated Electric Markets,” June, 1996.

² This summary is quoted from *The Energy Daily*, June 14, 1996, p. 4.

³ Interviews were conducted with regulators in California, Colorado, Connecticut, Florida, Illinois, Massachusetts, Minnesota, Michigan, New Jersey, New York, Ohio, Pennsylvania, Texas, Virginia and Wisconsin.

⁴ For example, the Environmental Law and Policy Center in Chicago intervened against a proposed merger of Northern States Power in Minnesota and Wisconsin Electric Power Company because the arrangement “would have federalized many regulatory functions in ways that could potentially preempt important environmental safeguards under existing Minnesota and Wisconsin laws. Minnesota has enacted statutory mandates requiring Northern States Power to acquire clean resources (windpower, biomass and efficiency) on a specified timetable.”

⁵ Public Service Commission of Wisconsin, *Report to the Wisconsin Legislature on the Regional Electric Transmission System*, September, 1998, p. viii.

To address these challenges, we recommend three steps for companies that decide to build new transmission or generation capacity:

- ⚡ Identify all potential stakeholders, including landowners, nearby residents, environmental and community groups, local governments and others.
- ⚡ Develop a strategic communication plan that provides meaningful involvement for stakeholders in a constructive, orderly process.
- ⚡ *Anticipate* potential objections and *be first* to provide clear, concise information about the project.

A national patchwork

“FERC has left everybody out on a limb.” That is how one regulatory official in the Northeast described the impact of deregulation on the country’s high-voltage transmission systems. In one form or another, this view was echoed by other regulatory staff members in the Midwest, the Northeast, California and other regions. Instead of moving toward an integrated national wholesale market for electric power, these officials contend, what exists now is an emerging patchwork of regional grids that often operate at cross purposes to each other. “The system was simply not designed to do what FERC wants it to do,” one of them explained – in almost exactly the same words that were used three years ago.

Here are the survey’s other key findings:

- ⚡ **Community opposition to transmission projects, fueled in part by local reaction against electricity deregulation, has grown significantly over the past three years.** In about 20 percent of our interviews, regulators described increased pressure to allow greater local veto power over proposed transmission projects. This pressure takes several (apparently

contradictory) forms: raising the voltage threshold for issuing a Certificate of Need or Public Convenience and Necessity (which in many states leaves eminent domain authority for lower voltage lines in the hands of local judges); or alternatively, lowering the standard for state review as far as 34.5 kV, which encourages greater public involvement in the review process. Meanwhile, as one official put it, community opposition “has shown much greater legal, technical and political sophistication” in recent years. One example: because power lines are no longer linked directly to local service, grassroots groups have been very successful in mobilizing opposition from town councils and city governments along proposed transmission routes.

- ⚡ **Many investor-owned utilities (IOUs) apparently lack incentives to build additional transmission facilities, even in highly constrained areas.** In most cases, these utilities have limited their investments to modest upgrades and other short-term measures that allow them to continue serving their existing retail customers. In contrast, major outlays for new transmission capacity – which would be used primarily for wholesale transactions – are virtually unknown. This reluctance even extends to improving interconnections with neighboring utilities, which may soon become competitors.⁶ “Why build for someone else?” one official asked. The upshot: in the upper Midwest and elsewhere, regulators fear that bottlenecks are getting worse with no relief in sight. “It’ll all come out in the wash,” one of them said, “but maybe not until we’ve had a blackout.”

- ⚡ **State officials agree almost unanimously that traditional IOUs will retain exclusive rights to invoke the power of eminent domain or “condemnation,”**

2 ⁶ One former utility executive pointed out that making such investments might also increase an IOU’s overall cost structure – a potentially fatal move on the eve of further deregulation.

which often is needed to build new transmission lines. With one possible exception, few state legislatures are inclined to extend these rights to non-utility generators of electricity or private transmission companies. In effect, this trend forces independent power producers to build their facilities “right up against the fence line” of existing substations and tends to make them a “captive generator” for local IOUs – even though, as one official said, “the obligation to serve includes hooking up IPPs.” In theory, such problems will be solved when transmission systems are fully managed by independent systems operators or by arms-length transmission companies. For example, the ERCOT ISO in Texas now identifies market-based gaps in the regional grid and directs its IOU members to fill them. Still, non-IOU members of ERCOT complain that utilities meet their own needs first, and put NUG requests “at the bottom of the pile.”

✦ **Many commissions are broadening their view of “public convenience and necessity” in issuing certificates for new power projects.** Even though most states retain CPCN requirements for new generating plants, regulators argue that existing legislation already gives them the authority to approve a NUG’s application based on its overall benefit to the public – not just traditional criteria like enhancing reliability or meeting local demand. Where state laws specifically direct these regulators to balance economic advantages against environmental impacts or alternative sources of supply, for example, they suggest that they might weigh non-traditional factors such as a new plant’s increased contribution to the regional tax base or its role in making wholesale power markets more competitive. One senior official even said that his commission might take into account the potential benefit of proposed facilities to *other* states in his region. Many staff members say that a

similar logic should apply to high-voltage transmission lines. Underlying this shift is a sea change in regulatory responsibility: as one staff member put it, “if the ratepayer isn’t harmed, the commission shouldn’t get in the way.”

✦ **In general, enthusiasm for deregulation has increased slightly among state regulators over the past three years.** This is particularly true where NUGs have emerged to provide lower-cost power in areas of high demand. As a result, many commissions now encourage utilities to meet their need for new electricity supplies by buying from non-utility producers, not by building new generating units. Yet skepticism remains. “I don’t care if you can sell cheap power to the East Coast; we want a reliable market right here,” one Midwestern official said, emphasizing why state legislators have balked at deregulation. And a colleague in California points out that FERC has left the states to administer a system of “half-regulation,” where ratepayers must, in effect, pay for transmission lines that merchant operators should probably build for themselves. But without eminent domain or similar authority, these operators will remain dependent on IOUs for transmission service.



In summary, commission staff members are more or less equally divided between two different views of today’s status quo: either we are feeling the natural

(albeit potentially severe) growing pains of a truly national market for electric power, or we have embarked upon a risky experiment that must be carefully monitored lest it spiral out of control.

“A hole in the regulatory system”

How will the country’s transmission problems be resolved? And who bears primary responsibility for forging a national bulk power grid out of the essentially unrelated regional systems that grew up to serve local customers?

On this score, at least, federal and state regulators agree on the outlines of a solution: the future lies in creating ISOs or other entities – variously called independent transmission operators (ITOs), regional transmission operators (RTOs) or transcos – to operate the system. (Several officials also want to require power exchanges operated by third parties to insure fair and equitable bidding for electric supplies.) Similarly, there is general agreement on where the major transmission gaps occur: for example, between western and eastern Wisconsin; through Michigan into Canada; across Pennsylvania and Virginia to the East Coast; and from northeastern New England into southwest New England. Once ISOs mature, many officials argue, they will find a way to close these gaps.

But the devil, of course, is in the details.

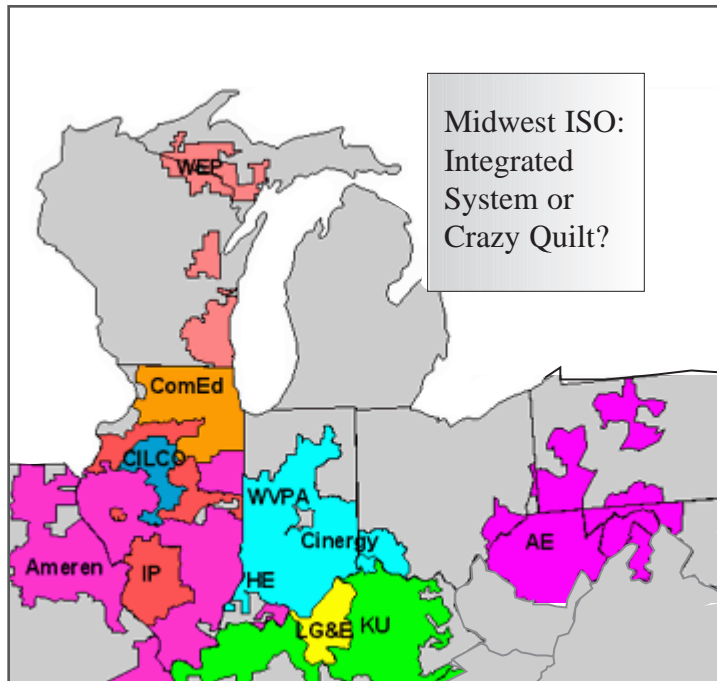
Most regulators accept the view that the flow of bulk power across the interstate transmission system caused severe dislocation and near collapse in several regions last summer. In a report prepared recently for the Ohio legislature, state officials observed that

“transmission system performance is less predictable than in past years, in view of burgeoning wholesale power transactions and the prospect of retail wheeling. In fact, the balance of generation supply and

customer demand may become even more precarious as a result of federal environmental rules limiting electric utilities’ release of nitrogen oxide emissions.”⁷ But it also pointed out that the “price spike” of June, 1998, was due in part to power marketers who defaulted on their supply contracts, allowing generators to fill the gap at record prices.

Such problems might be largely solved by turning over system management to ISOs. But several officials expressed reservations about ISO performance, at least over the next few years. For example, one staff member in California observed that the ISO there “is starting to look like a utility rather than an independent operator” and suggested the need for ongoing regulatory supervision. This view was echoed in other states, where regulators also questioned whether ISOs could maintain acceptable operating standards. “We’re very concerned about reliability and load forecasting,” one of them said. “We need to make sure that the obligation to serve is met.” Added another: “The ISO may just have too many masters...”

Meeting this obligation poses a difficult challenge in several regions. Many commission staff members believe that normal load growth has outpaced construction and now places added stress on systems that are nearly overwhelmed by wholesale transactions. Several officials also suggested that the high cost of transmission was limiting competition and forcing NUGs into very narrow niches close to existing loads. One obvious solution: where shortages occur, why not allow competitive bidding to meet the need? Yet



transmission systems remain under utility control, beyond the reach of other players. “The problem,” one strategic planner noted, “is that we have a hole in the regulatory system.”

Finally, most regulators acknowledged that they are awaiting more initiatives from the federal government – on transmission tariffs, on ISO operations and a host of other issues. More than one official mentioned that state legislatures had moved into a “reactive mode” – deferring deregulation until federal policies become clearer. Others described the current system as a “half-baked cake” that should be put back in the oven. Many of them emphasized the need for greater coordination with state agencies to minimize future surprises. As one senior official put, “Everybody’s worried about those four letters that strike fear in us all: FERC.”

The environmental agenda

Three years ago, only a handful of public-interest groups – chiefly national consumers organizations – took an interest in electricity deregulation. Today, in the upper Midwest alone, several dozen groups have formed state-wide coalitions that monitor legislation, attend public hearings, file legal documents and intervene in pending cases.

In general, environmental organizations remain suspicious of deregulation, which they believe would primarily benefit “industrial customers, typically pursuing a larger national or even international agenda,” as one group recently warned its members.⁸ They are particularly uneasy about retail competition, which “would increase pollution, reduce reliability, shift costs to small consumers, and eliminate energy efficiency and renewable energy progress.”⁹

In contrast, many groups are more optimistic about *wholesale* competition – as long as sufficient safeguards are put in place. For example, the Environmental Law and Policy Center in Chicago has developed a set of “Public Interest ISO Principles” that include “broad representation of stakeholder interests (including environmental advocates) on the

Board of Directors” and a prohibition against new transmission capacity “where re-dispatch, demand-side management or distributed power options are available.” These principles would ensure that the transmission system becomes “more efficient, more effective, more equitable and less environmentally damaging.”¹⁰

Still, one token seat on an ISO board does not replace public intervention in the traditional regulatory process. Where state legislatures have loosened requirements for integrated resource planning, public-interest groups feel that they no longer have meaningful involvement in deciding what gets built and where. A case in point involves Wisconsin, where environmental leaders argue that energy efficiency spending has dropped 58 percent since deregulation began. Before they are willing to support new generation or transmission facilities there, they want to see significant emphasis on improved efficiency and environmental research.

At the same time, moderate environmental leaders recognize that new transmission capacity may indeed play an important role in solving the country’s energy problems. “Our position,” one of them explained, “isn’t ‘Just say no!’ We may very well find that we need more capacity,” especially to transmit power eastward from renewable sources in Minnesota and the Dakotas. The real test, he added, lies in whether the new transmission planning process – whatever shape it takes – will allow for effective public participation and comment.

Building stakeholder confidence

As generation and transmission companies around the country move to address emerging capacity shortages, they must remember that community acceptance of new facilities will depend largely on *creating an effective and orderly process of public involvement*. Here are three steps that should be kept in mind:



Understand your stakeholders.

Power companies must clearly identify *who* will be interested in proposed electric

⁸ “SEED Restructuring Campaign,” on the Minnesotans for an Energy-Efficient Economy web site, www.me3.org/.

⁹ Environmental Law and Policy Center web site, <http://www.elpc.org/energy/index.htm/>.

¹⁰ Environmental Law and Policy Center web site, <http://www.elpc.org/energy/index.htm/>, under “Midwest Independent System Operator (MISO).”

facilities and *what* their concerns might be. Once a stakeholder analysis has been completed, companies must develop a detailed *public participation and information program* ensuring that these concerns will be heard and addressed.

Please note: This program is not a public relations campaign. It demands real commitment to public involvement and flexibility in project execution, and should be separate from any regulatory requirements for public hearings or other meetings. In our experience, such hearings may meet legal standards, but they do not provide an appropriate forum to air opposing views and resolve differences. A far more detailed and timely process is required for successful project completion.

✎ ***Create your own public participation plan.*** Within broad economic limits, power lines can follow many potential routes and use several designs. The main challenge in avoiding needless controversy lies in understanding how to organize an effective outreach effort and in involving public affairs specialists who have managed successful programs. Remember: the challenge is not to build the cheapest or straightest line: it's to win community support.

✎ ***Be open and transparent at all times.*** The key to working with communities and other stakeholders involves establishing a relationship of *trust and credibility* with them from the outset. If people don't trust you, they will probably not listen to lengthy explanations of community benefits or environmental safeguards, much less the details of load flow analysis and transmission planning. Company representatives must *take the initiative* to create an open and honest dialogue with a broad range of stakeholders and ensure that this dialogue is maintained.

Building transmission and generation facilities poses far greater challenges than in the past. New actors have entered the public debate over electricity restructuring and bring with them a set of issues and concerns that NUGs, IOUs and regulators must now address outside the old "compact" of government-supervised monopolies. In so doing, they have raised the standard for communication between companies and their stakeholders: environmental groups, consumers organizations, communities and local officials. Mastering this challenge will play an important role in determining who succeeds and who fails in the emerging electricity marketplace.

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