ELECTRIC GENERATION ASSOCIATION’S

VISION

of a

FULLY COMPETITIVE

ELECTRIC INDUSTRY
PREFACE

Since Congress, the states, and some utilities are considering restructuring the electric industry in fundamental ways, EGA presents its vision of how such restructuring should occur for the consideration of federal and state policy makers.

ELEMENTS OF THE ELECTRIC GENERATION ASSOCIATION’S VISION

A RESTRUCTURED INDUSTRY

➢ Generation: Creating a Fully Competitive Market
➢ Transmission: Guaranteeing Non-Discriminatory Access
➢ Distribution: Connecting Customers and Suppliers
➢ Providing Transparency in Customer Supply Services
➢ Establishing a Clear Role for States
➢ Assuring Competitive Markets
    ➢ Providing adequate safeguards against abuse of market power
    ➢ Ensuring comparable treatment

TRANSITION ISSUES

➢ Honoring Regulatory Commitments and Contractual Obligations
➢ Defining and Limiting the Transition Period
➢ Enacting Comprehensive Federal Legislation
➢ Establishing Minimum Standards of a Competitive Market

March, 1996
The Components of a Restructured Industry

Electric Generation Association's Vision

Executive Summary

SERVICES

Customer Supply

DISTRIBUTION

Transmission

GENERATION

Support a Fully Competitive Generation Market

To Support a Fully Competitive Generation Market, participants in a non-discriminatory manner must be applied in a non-discriminatory manner to
- Business process, terms, and conditions.
- Open access to transmission facilities, including a non-discriminatory open access service at fair and equitable rates.
- Non-discriminatory open access.
- Reregulated companies (TCGs) will remain a single regulated company.

In a regulated industry:

- Customers, suppliers, and competitors will be free to choose suppliers, including a variety of service providers.
- Short-term spot market includes both long-term and bilateral contracts.
- Generation will be priced, and the choice of suppliers is available to purchase from generation markets.

In a fully competitive industry:

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**Transition Issues**

**Electric Generation Association's Vision**

**Executive Summary**
THE ELECTRIC GENERATION ASSOCIATION’S VISION OF A FULLY COMPETITIVE ELECTRIC INDUSTRY

A RESTRUCTURED INDUSTRY

To accomplish the goal of a fully competitive power market, the Electric Generation Association (EGA) believes the industry must be restructured as follows.

**Generation**

EGA supports the development of a fully competitive generation market, (including generation-related ancillary services), characterized by the ability of customers to purchase power from their choice of competitive suppliers, including generators, marketers and brokers. In a fully competitive generation market, all power suppliers should be treated equally and should have equal access to the market. To ensure fairness and to guard against self-dealing, EGA urges that existing vertically-integrated utilities be required, at a minimum, to functionally unbundle their generation resources from their transmission and distribution activities. With appropriate safeguards to ensure against market abuses, the generation marketplace can include affiliate transactions.

**A fully competitive generation market would include the following characteristics:**

- All generation will be priced by the market. State and federal cost-of-service rates will be eliminated for all generation resources.
- The generation market will include both long-term bilateral contracts and short-term spot market transactions.
- For short-term markets, power exchanges could establish market prices for generation supplies and must be completely separated from transmission system operations.
- Safeguards against abuse of market power should exist for all industry participants.
- Environmental and siting laws and regulations should be applied in a consistent and non-discriminatory manner to all industry participants.
- Capacity and energy owned or controlled by federal and state governments should be privatized.
- There should be no federal or state ownership or integration restrictions, such as the Public Utilities Holding Company Act (PUHCA), or other legal or regulatory barriers to entry into the generation market.
- The mandatory purchase requirements of the Public Utility Regulatory Policy Act of 1978 (PURPA) and other restrictions will be eliminated.

March, 1996
**Transmission**

Non-discriminatory open access to the transmission system and transmission-related ancillary services at fair, efficient and comparable prices, terms, and conditions is critical to the development of a fully competitive electric power industry.

**A fully competitive market requires:**

- The development of regional transmission grids with common access and pricing rules. All transmission facilities, including those owned by cooperatives, municipal utilities, and federal power marketing administrations, but not private use facilities, should be subject to the jurisdiction of the Federal Energy Regulatory Commission.

- The development of independent system/grid operators (ISOs). To ensure independence, the ISO (1) should have no financial interest in the outcome of transactions under the ISO’s control and (2) should completely separate its management and control of the transmission system from the management and control of transmission system owners. Without requiring changes to the current ownership of the transmission system, ISOs could be created as independent operating companies responsible for managing the operation and ensuring the reliability of the transmission system. ISOs (if they are open to participation by all market entities) or Regional Transmission Groups (RTGs) could be responsible for system planning.

**Distribution**

The local distribution company (LDC) should remain a state-regulated entity. LDCs should, at a minimum, provide a wires-only service to connect customers with suppliers and must offer open-access distribution service at fair, efficient and comparable prices, terms and conditions. EGA believes that if and when an LDC is acting as a supplier of last resort, it must purchase power supplies from the spot market or through competitive procurement. The LDC can help accomplish a state’s social goals in regard to electricity production and service.

**Customer Supply Services**

Customers must be able to choose among a variety of suppliers, including generators, marketers, brokers, energy service companies, and, where permitted by state law and regulation, local distribution companies. If a customer selects an LDC as its supplier, for purposes of price transparency and to eliminate any potential for abuse of continued monopoly power, the LDC must adopt billing procedures that provide customers with separately stated line items for distribution, transmission/generation, social costs and taxes on their bills.
Role of the States

State legislatures and state public utility and regulatory commissions will continue to play a key role in setting utility policy in their jurisdictions. Universal basic service, demand side management, lifeline rates, low-income assistance and other social programs can be established and maintained by state regulatory commissions using non-bypassable distribution charges. State legislatures and regulatory commissions can set minimum entry, financial integrity, reliability and technical standards for LDCs and can determine whether LDC service is a monopoly service in certain or all jurisdictions.

In addition, states will continue to use their traditional authority to ensure resource and fuel diversity, using mechanisms such as tax incentives and siting authority that do not unfairly skew power costs. States should retain the authority to site generation and transmission facilities. All qualified market participants should have the same access to the rights to site and build facilities.

States will no longer be responsible for setting cost-of-service rates for generation supplies or intrastate transmission services, but will play a key role in the transition process.

Assurance of Competitive Markets

Safeguards Against Abuse of Market Power

EGA urges the development and application of safeguards that address the issues of horizontal and vertical market power in the restructured electricity industry. In a competitive marketplace, many of the regulatory safeguards against utility abuse of market power are no longer appropriate or adequate. In a restructured competitive industry, it is important that any assessment of market power properly recognize the regional and, increasingly, national scope of electricity markets. It is also important in a restructured industry that both safeguards and remedies be imposed on and available to all industry participants on a non-discriminatory basis.

Comparable Treatment

In a fully competitive world, similarly situated entities must be treated comparably and without regard to ownership structure. Historically, competitive power suppliers and utilities have not been treated comparably in several areas, including the application of environmental laws, siting restrictions, financing, and tax laws. All electric suppliers in a restructured, fully competitive industry, including federal power marketing administrations, investor-owned utilities, municipalities, cooperatives and competitive power suppliers, must be subject to the same policies, laws, and regulations.
TRANSPORTATION ISSUES

Recognition of Existing Utility Investments, Regulatory Commitments and Contractual Obligations

EGA believes that any successful transition to a fully competitive market must address and fairly resolve stranded cost issues. EGA members and their utility and industrial customers have invested billions of dollars in power facilities that have met the demands of the regulated market and that will operate efficiently in a competitive market. In the transition to full competition, it is critical that the power purchase agreements and prior regulatory approvals supporting the financing and development of those facilities be protected, and that those contracts and regulatory commitments be honored.

Honoring these agreements and commitments is central to the future success of the restructured electricity market. The competitive benefits that PURPA fostered are grounded in the principle of contract sanctity. The acknowledged strength of power purchase, fuel supply, construction, energy service and financing contracts has been critical to the development of competition in the generation industry. As industry restructuring continues, there is no question that the contract regime will be even more important in an emerging competitive market. A market consisting of multiple transactions between numerous buyers and sellers will require contracts and agreements in which all parties must have total confidence. Clearly, yesterday’s contractual obligations must be honored if tomorrow’s contracts are to have the necessary credence to allow the competitive market to mature.

It is important to remember that stranded cost recovery is essentially a transition issue. The key to a successful transition is to achieve certainty on stranded cost issues. However, because of the potential impact of stranded costs on the development of a competitive industry, there may be instances where spreading stranded cost recovery over a longer period of time will smooth the transition to a competitive marketplace.

Resolution of stranded cost issues involves three key steps:

1. Identifying the scope of stranded costs by using market-based valuation mechanisms.

State and federal regulators must identify the appropriate scope of stranded costs and the appropriate mechanisms for stranded cost recovery as quickly as possible. Determining appropriate stranded cost recovery for each utility has the potential to be a contentious and time-consuming task. Therefore, EGA supports the use of market mechanisms, such as auctions, bidding, or bilateral contract arrangements to determine both the costs and the benefits to each utility from the new competitive environment. At the outset, the sources and amounts of wholesale and retail stranded costs, and the offsetting benefits and mitigation measures, from transmission access and customer choice must be identified.
2. Designing the appropriate mechanisms for stranded cost recovery at both the wholesale and retail levels.

Once the appropriate level of stranded cost is identified, stranded cost recovery mechanisms must be designed and implemented. To the extent that wholesale stranded costs are contract-based, EGA supports FERC's proposal to directly assign such stranded costs to departing customers in the form of exit fees. With respect to retail stranded costs, however, EGA supports transitioning to the use of broad-based access fees, since all retail customers will eventually benefit from increased competition. EGA urges federal and state policy makers to address and resolve the stranded cost recovery issue quickly and to determine a definite time frame in which stranded costs are identified for recovery.

3. Ensuring 100 percent recovery of the eligible stranded costs of utility assets and power purchase contracts.

Even though stranded cost recovery will prevent customers from seeing market-based prices immediately, EGA supports the full recovery of all net legitimate, verifiable, prudently incurred, non-mitigatable and public utility commission (PUC) approved stranded costs. Such recovery includes both existing utility assets and power purchase contracts. Only costs incurred prior to the enactment of the Energy Policy Act of 1992 (EPAct) would be eligible for recovery.

The Need for a Definitive Transition Period

Energy consumers in a fully competitive electricity market will be the beneficiaries of lower prices, increased technological and environmental innovation, a wider range of choices, and a continued high level of customer service and reliability. Because any industry restructuring of this magnitude results in uncertainty and confusion, the transition period should be a reasonable length of time, but completed by a date certain. The date should be set in federal law and the transition to fully competitive markets should be completed no later than January 1, 2003.

A definitive time frame for the transition provides several benefits. First, a date certain will minimize structural upheavals, yet allow a new competitive market to emerge by enabling all parties to participate in the development and understanding of the new rules. Second, it will eliminate the uncertainty caused by the current confusion over state and federal jurisdictional roles. By clearly defining the state role and making it distinct from the federal oversight role, both states and federal regulators can focus on the tasks that must be accomplished by the date certain. Third, it will also enable all industry participants, including customers, suppliers, and utilities, to prepare for the restructured markets in an orderly fashion and to make rational business decisions about the future.
The Need For Comprehensive Federal Legislation

The electricity industry is evolving into a system of fully competitive power markets, based on a legal and regulatory framework that will allow the market to establish the price of electric power for consumers. The changes already taking place in the electricity industry are far-reaching, complex, and extremely significant for the strength and competitiveness of the U.S. economy. Electricity is a vital component of everyday lives and a critical factor in American businesses. Because an efficient and competitive electricity industry is in the nation’s interest and because the electricity market is now characterized by numerous regional and interstate transactions, federal legislation is necessary to ensure nationwide standards that will help maintain a robust competitive market.

As it has in so many other industries, increased competition in the electric generation sector has brought lower prices, technological efficiency, environmental improvements, and increased innovation. However, to go forward requires that the national scope of the electric industry be recognized and that comprehensive federal legislation establish minimum national standards for a consistent and uniform competitive electric industry. The reforms and restructuring identified by EGA as the hallmarks of a new competitive industry are closely interrelated and should occur in a cohesive, coordinated fashion.

Thus, EGA supports the adoption of comprehensive federal legislation creating a mandatory framework for the adoption and implementation of regulations and policies that establish fully competitive electricity markets by a date no later than January 1, 2003.

Minimum Standards of a Competitive Market

Where states choose to encourage competitive electric markets in advance of January 1, 2003, certain standards must be established to ensure that those competitive programs are fair to all market participants. For example, the transition to market-based generation prices for all generation before a fully competitive market exists could lead to abuses of market power. While there may be many different mechanisms to achieve a competitive market, the success and the viability of that market must be established under a common national standard.

As part of comprehensive federal legislation, FERC should be directed to undertake a notice-and-comment rulemaking to establish appropriate standards for its appellate review of policies adopted by states that choose to develop competitive electricity markets in advance of the date required by federal law. FERC should be authorized to certify the existence of a competitive market, in which a utility must show that its market power has been mitigated through unbundling, sale or divestiture of generation resources or by other means. Such steps would be a prerequisite, for example, for acceptance of market-based rates or elimination of PURPA’s mandatory purchase requirements.
The existence of this appellate process would allow all industry participants a mechanism to ensure that competitive markets in a particular state meet certain national standards of fairness.

➢ A Call to Action ➢

Industry participants must be active players in the public policy debate over restructuring the electricity industry. To that end, we look forward to receiving your feedback on our Vision. EGA believes our Vision offers all parties an equal opportunity to compete for the privilege of serving electricity consumers. We invite you to join us in working toward the development of a fully competitive electricity industry.
ELECTRIC GENERATION ASSOCIATION
OVERVIEW

The Electric Generation Association (EGA) is a national trade association representing competitive power suppliers and those involved in supplying goods and services to the competitive electric power industry. The Association's name reflects its vision of a competitive generation industry where all power generators compete on an equal footing for the privilege of serving their customers. EGA's members provide their customers with safe, reliable, low-cost, and clean electricity. Collectively EGA members employ more than 7,000 people and operate more than 200 plants generating over 17,000 megawatts.

EGA represents competitive power companies at the forefront of technology in the electric power industry. EGA member companies are leaders in the use of modern, state-of-the-art technologies to build clean, new, environmentally sound power plants. Fuel sources include natural gas, "clean coal," and renewable energy resources such as wind, wood, water, or solar energy. By using cogeneration -- a generation process which uses the same fuel twice -- many projects operate more efficiently, saving money and natural resources.

EGA, which is funded through member dues, devotes the majority of its resources to shaping public policy on significant industry issues. Current priorities include participating in the Congressional discussion and consideration of electric industry restructuring, working with the Federal Energy Regulatory Commission on its electricity agenda, monitoring state regulatory commission proceedings on industry restructuring, and participating in the Environmental Protection Agency's regulatory proceedings. In addition, EGA has established an International Issues Committee to respond to our members' needs in this critical area. EGA also provides a broad range of member benefits including active programs in public affairs, insurance, and industry data. EGA's insurance program underscores the organization's commitment to providing programs which respond to the unique needs of EGA members and the independent power industry.

Since 1990, competitive power producers have accounted for over 50% of all new electric generation capacity brought on line in the U.S. Current estimates predict that competitive power suppliers will continue to supply 50% or more of the nation's new electric generation capacity. The members and staff of the Electric Generation Association are proud to be at the forefront of change at this time of dramatic change within the electricity industry.

March 1996
MEMBER COMPANIES

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