

CORPORATION COMMISSION OF OKLAHOMA



CODY L. GRAVES
CHAIRMAN

Jim Thorpe Building
P.O. Box 52000-2000
Oklahoma City, Oklahoma 73152-2000
405-521-2267

June 23, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

RE: Federal Electric Utility Industry Legislation -- Survey Responses

Dear Representative Dingell:

Below are the responses to your survey of April 10, 1997. We appreciate the opportunity to provide this input.

- 1. *Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?***

The Electric Restructuring Act of 1997 was signed into law by Governor Keating on April 25, 1997. The Act requires full retail access to competitive services for all consumers by July 1, 2002. Among several other studies the Commission is to complete prior to this date one is an assessment of potential consumer impacts of retail direct access. This study must be completed and provided to the legislature's Joint Electric Utility Task Force by August 31, 2000, along with any recommendations about the issue the Commission wishes to make.

- 2. *Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?***

The answer to all three questions is no.

3. ***Does your Commission currently have sufficient authority to resolve stranded cost issued in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?***

The Commission will be able to address the stranded costs issues arising from “competition” as a result of the Commission’s overall jurisdiction arising from Article 9 Section 34 of the Oklahoma Constitution and Title 17 O.S. 151 et seq.

4. ***Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?***

As to the first question in No. 4 concerning “competition”, the Commission’s overall jurisdiction arising from Article 9 Section 34 of the Oklahoma Constitution and Title 17 O.S. 151 et seq., Oklahoma would provide the necessary authority to address issues arising from federal legislation mandating competition. The second question in No. 4 concerning whether the authority regarding PURPA would exist on the state level if Congress repealed the act, should be answered no. If PURPA was repealed our state would be preempted by the Supremacy Clause to exercise authority over PURPA-type agreements, at least as to future PURPA-type cases. Our state/Commission would be required to make a policy decision concerning existing PURPA agreements; although, a recent decision from the Oklahoma Supreme Courts concerning PURPA, in Smith Cogeneration Management, Inc. v. The Corporation Commission and Public Service Company of Oklahoma, 863 P.2d 1227 (Okla.1993) may have already dictated that decision. The Court held that the Commission has no authority to intervene or reconsider agreements made pursuant to PURPA after they were entered into by the parties. One action that would be necessary by the Commission would be amend or revoke Commission rule OAC 165:35-29-1. As to the issue of the repeal of PUHCA, it will be addressed in Question No. 15.

5. ***Would any constitutional issues be raised by federal legislation:***
- a. ***mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?***

- b. requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?**

Yes. Federal Preemption and the Tenth Amendment are constitutional issues which are raised by (a) and (b). Pursuant to the Tenth Amendment, "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." The United States Supreme Court has often held that there are limits upon the power of Congress to override state sovereignty, even when exercising its otherwise plenary powers to tax or to regulate commerce. In *Fry v. United States*, 421 U.S. 542 (1975), the Court held that the power of Congress is limited by the Tenth Amendment. The court held:

While the Tenth Amendment has been characterized as a truism stating merely that all is retained which has not been surrendered, it is not without significance. The Tenth Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system.

The Preemption doctrine typically arises when federal legislation restricts state regulatory power. When Congress expressly preempts state regulatory power, the supremacy clause controls. *Pacific Gas & Electric Co. v. State Energy Commission*, 461 U.S. (1983), holding, the federal Atomic Energy Act did not preempt California Pub.Res.Code Section 25524.2. *In Jones v. Rath*, 430 U.S. 519, (1977), the Court held:

[I]t is well-established that within Constitutional limits, Congress may preempt state authority by so stating in express terms. However, absent explicit preemptive language Congress' intent to super-cede state law altogether may be found from a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room to supplement it, because the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject or because the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose. *Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982).

- 6. From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not**

grandfather prior state action?

If the time line and overall mandates of the Congressional legislation did not preempt Oklahoma's Electric Restructuring Act of 1997, then no significant problems are created. If the Congressional legislation preempts the time line by mandating retail direct access prior to July 1, 2002, the following are some possible problems:

- (1) time may not be sufficient to complete research and planning necessary for proper implementation of direct retail access in Oklahoma;
- (2) with a compressed time schedule, design of an efficient and consumer oriented market may not be completed prior to the opening of direct retail access;
- (3) the chances are increased that reliability of services to consumers may be compromised; and
- (4) a compressed time schedule may impede or even prevent the full development and proper operation of a regional independent system operator, an element absolutely essential for successful direct retail access.

If the Congressional legislation preempts one or more of the primary mandates of Oklahoma's Electric Restructuring Act of 1997, the following are some possible problems:

- (1) the Commission's jurisdiction to ensure fair and reasonable opportunities for consumers to switch service providers may be threatened;
- (2) the actions in the competitive market of municipal electric systems and perhaps the Grand River Dam Authority (a state power authority) may not be properly guided;
- (3) research and planning necessary for proper implementation of direct retail access in Oklahoma may not be completed or may be unable to provide sufficient information for crucial decisions; and
- (4) identification, quantification, and recovery of stranded costs may be jeopardized.

7. In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional

legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.

- a. Are you aware of any study or analysis relevant to your State that supports this conclusion?**
- b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.**

a. Analysis relating to this very subject is on-going at the Commission. Oklahoma State Statues allow competition for facilities that have a connected load of 1,000 kW or greater. Negotiation of rates between large-volume customers and the utility are driven by competition. Recruitment of businesses into and retention of business in Oklahoma has been, and remains, a driving force of negotiated "special contract" rates. The OCC has approved negotiated rates between large-volume customers and utilities partially to increase economic development efforts and to stimulate the state economy. Historical related information regarding the average cost of electric power in the state was previously supplied to the Energy and Power Subcommittee in the OCC/PUD survey responses dated February 27, 1997. Below is a brief view of information that was submitted listing historical average cost per kWh's.

	<u>Residential</u>	<u>Industrial</u>
1996	\$0.0700	\$0.0450
1995	\$0.0710	\$0.0470
1994	\$0.0720	\$0.0510
1993	\$0.0740	\$0.0450
1992	\$0.0750	\$0.0440
1991	\$0.0720	\$0.0440
1990	\$0.0725	\$0.0440
1989	\$0.0710	\$0.0583
1988	\$0.0720	\$0.0576
1987	\$0.0720	\$0.0600
1986	\$0.0778	\$0.0656

b. The OCC has not allowed a certain class of consumers to bear the burden of subsidization of other consumers. By performing cost-of-service and financial studies on the filing utilities the OCC has been able to reduce the impact of (if any) subsidization, by reducing the financial returns received by the utility (stockholders).

8. *Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.*

See response to Question #7.

9. *Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers. What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility ratepayers, utility shareholders or the highest bidder?*

Such a policy is likely to have a detrimental impact on ratepayers, for several reasons. First, centralization of markets and regulation leads to homogenization in which local needs, concerns, and perspectives are frequently not addressed. Since Oklahoma is not a major force in national politics, such a policy is likely to leave many of its local concerns and needs unheard and unresolved. Second, such a policy is likely to lead to rate increases in Oklahoma, without any accompanying improvements or expansions of service. As both a small state and a state with electric rates well below the national average, Oklahoma, under such a policy may quite possibly become merely a site for generation stations selling power into other parts of the country. Finally, the overall quality of life in Oklahoma could be negatively impacted by such a policy, as more and more large electricity producers use the state for production and/or transmission, with little or no commitment to the general welfare of the state itself.

Potential impacts of such a policy on shareholders are more difficult to identify with specificity. However, at least the following seems clear. First, it is likely that the percentage of stock in electric service providers operating in Oklahoma owned by state residents will decline. Second, the pressure to produce returns which are larger and more immediate will increase, thus placing greater pressures on company management to refocus a larger and larger portion of their attention on returns and away

from the provision of services to customers.

How Congress and states seek to manage these issues really depends on how far Federal legislation goes in removing states' authority to regulate the provision of local electric services. If Congress removes all such authority, including the authority to oversee local competitive markets, then there doesn't appear to be much that states could do to deal effectively with the problems this policy is likely to create for states. If Congress narrows the focus of the restrictions on states, to say, for example, developing and mandating a common definition of workably competitive electric markets, then states would still have extensive latitude to develop and implement oversight, review, and shaping of local markets to better meet local needs.

Assuming these resources are sold at market prices, and stranded cost recovery is not allowed, then, as a floor, the benefits should be shared equally between utility ratepayers, on the one hand, and utility shareholders and the highest bidder, on the other hand. The division of the share of the benefits going to utility shareholders and the highest bidder could be allowed to fluctuate, based on prevailing market conditions. However, ratepayers should be assured at least a 50% share of any such savings.

- 10. *Of those states which have adopted retail competition, how many have addressed the issued of "reciprocity," (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?***

Oklahoma has not yet addressed the issue of "reciprocity." Reciprocity is intended to protect the interests of local utilities and other local electricity providers, along with the interests of ratepayers. It protects the interests of local electricity providers by ensuring that the financial condition of their companies cannot be impacted by providers from outside the state taking customers without giving the local providers the opportunity to seek to gain customers in the territories of the out of state providers. Reciprocity protects ratepayers, as well, by ensuring that local rates do not increase due to out of state providers either taking local customers, and thus increasing the burden on the remaining in-state customers, or reducing rates to their local customers by selling at rates which average the lower rates in Oklahoma with the higher rates in the out of state provider's local territory. At this point in time, reciprocity appears to be the only means available to protect these interests.

- 11. *If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?***

This could create a wide array of problems, ranging from operational problems to rate design and planning problems. For example, if local distribution services are unbundled, will the distribution capacity be available for purchase and perhaps even resell? Such a "market" in distribution capacity could have serious negative impacts on service reliability, particularly for residential and other small volume customers. In addition, unbundling distribution capacity and allowing the sale of such capacity within some type of capacity reservation arrangement could have very substantial negative impacts on the physical operation of the distribution system, including dispatch, load balancing and following, and system access, as well as on long-range planning for the construction and maintenance of distribution facilities to meet future load requirements. Also, it seems highly unlikely that residential and other small volume customers would accept or benefit significantly from the establishment of a competitive market for distribution services. Some aspects of distribution service seem to be less of a problem if unbundled. For example, it seems highly probable that such aspects of distribution service, such as meter reading and customer billing, could be unbundled with few negative impacts on either service pricing or reliability.

- 12. *Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?***

At this time Oklahoma is not experiencing any significant problems related to federal power or federal public power authorities. The Grand River Dam Authority (GRDA), a state power authority, operates within Oklahoma. One question related to the operation of this state authority may become a problem for Oklahoma in the future. This question relates to the possibility that the GRDA may use state tax revenues to "participate" in a future competitive generation market in Oklahoma. Specifically, would such a situation give the GRDA an unfair advantage in such a competitive generation market, and if the answer to this question is yes, what action(s) should be taken to resolve this problem.

- 13. *How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?***

Federal legislation mandating competition by a date significantly earlier than July 1, 2002, clearly has the potential to greatly increase the level and complexity of the Commission's workload. Without an increase in the Commission's Staff, equipment (primarily computers), and software commensurate with this change in workload, the likelihood that the Commission would be able to successfully deal with this expanded and more complex workload seems small. It is impossible to say with any certainty, at this time, whether additional funding would be made available to the Commission in such a circumstance.

14. *Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?*

Securitization as a means of providing for recovery of utility stranded assets has not been considered in Oklahoma, by either the legislature or the Commission. At this point in time, the Commission has not conducted any research concerning this question, although such research may take place during the next three years.

15. *There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.*

a. *Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?*

b. *Do you believe Congress should modify or repeal PUHCA? If so, why, and under what if any conditions?*

c. *Should Congress enact legislation to modify the holding in Ohio Power Co. v. FERC, 954 F.2d 779 (D.C. Cir. 1992)?*

a. Pursuant to Section 11(a) of PUHCA, registered holding companies should be regulated as integrated public utility systems. It is this integration requirement present in PUHCA that may be inconsistent with certain forms of restructuring, such as unbundling.

The PUHCA was originally intended to protect consumers from the burden of utility holding company investments in nonutility enterprises. The consumer burden which may result from these investments manifests in various forms, for instance, ratepayers could be asked to shoulder the

financial risk of facilities or services not necessary to the provision of utility service or in the alternative, ratepayers could be asked to shoulder the burden of failed nonutility investments which adversely impact the capital structure of the utility holding company. In an effort to minimize consumer risk, PUHCA restricts registered holding companies from participation in enterprises which are not "reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system." [*Public Utility Holding Company Act*, 11 (b)(1)] This functional diversification requirement of PUHCA could be viewed as an impediment to certain forms of competition. However, over time, the SEC has lessened the impact of its restrictions on non-affiliate enterprises companies by allowing at least 50% of goods and services of a holding company to be provided to non-affiliates.

Any amendment to PUHCA which increases a utility holding company's potential for market power could impede competition. This market power concern is especially prevalent in the wake of utility mergers and registered holding company expansions.

b. If PUHCA repeal is truly an unavoidable reality, then PUHCA should be conditioned upon certain safeguards afforded to the states and the FERC. Such safeguards should include, but not be limited to the following for states who do not have certain statutory protections:

1. Affirmative review of books and records of holding companies and all affiliates (both utility and nonutility) regardless of geographical location.
2. Regulatory review of inter-affiliate transactions.
3. Review of affiliate charges.
4. Review of capital structures not related to utility service.
5. Review of indirect costs not related to utility service.
6. Review and pre-approval of resource acquisition plans.

Certainly, conditional repeal of PUHCA should in no way impede or preempt state jurisdictional authority.

c. Yes, Congress should enact legislation to modify the holding in *Ohio Power*. The inter-affiliate transaction determination in *Ohio Power* results in a considerable impediment to effective regulation and review of affiliate charges for services and products for states as well as the FERC. It can be inferred from the federal court's decision in *Ohio Power* that just

as the FERC's review of affiliate charges in a wholesale rate increase application proceeding was determined to lie within the jurisdiction of the SEC, a state's review of affiliate charges could also be forbidden by virtue of the *Ohio Power* court interpretation of SEC jurisdiction.

Sincerely yours,

A handwritten signature in black ink that reads "Cody Graves". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Cody L. Graves
Chairman

cc: Bob Anthony, Commissioner
Ed Apple, Commissioner
Jay Edwards, General Administrator
Ernest G. Johnson, Director, Public Utility Division