Proposed New Energy Legislation: How Will It Impact Power Marketing Transactions?

Roger D. Feldman
Partner and Co-Chairman
Project/Structured Finance Group
Bingham, Dana & Gould
Washington, DC

As a transactional attorney poised to follow the new power markets and assist in their financing, I follow the legislative debate not from the perspective of the absolute public policy merit of positions (which generally are rhetorical anyway), but from what they will mean for entrepreneurs seeking to exploit the potential of open access via sales or via aggregation.

While that means, of course, that I (like most of you) am fundamentally in favor of open access, it also means that I keep my eye cocked on the implication of certain key questions. What I would like to do with you is consider:

(1) What the overall approach of the three archetypal bills before Congress are to the generic questions of interest to those involved in power marketing;

(2) How interested parties might meld their self interest with respect to these questions with the titanic struggle of other interests reflected in the legislative fray; and

(3) Identify what special key questions are presented by these bills and what additional statutory guidance they might seek in this regard.

As a baseline, let's begin by defining the power marketer's legislative self interest. Recognizing that power marketers are not a uniform bunch there are a few keys to their success.

- First obviously, market homogeneity making feasible the treatment of power as a commodity freely transportable and tradeable without necessary barriers in interstate commerce. Read, in legislative terms: State versus Federal jurisdiction and treatment of stranded costs;

- Second, protection from de facto inability to reach markets because of practical economic or operational constraints on doing so, or newly imposed regulatory requirements. Read, in legislative terms: market dominance through anti-competitive actions or through affiliate ownership arrangements;

- Third, protection of the feasibility of those activities which enhance the long-term competitive position of those in the power marketing business. Read: focus on key business trends which power marketers are now recognizing as the competitive parameters of the market become clearer. These include:
  - — convergence of gas and electricity sales
  - — combination or competition with energy management service provision
  - — Flexibility in aggregation arrangements
  - — Niche emphasis on utilization or aggregation of renewables

In considering the ramifications of the bills against this baseline, it is useful to keep in mind their origins and different focuses. The **Schaefer Bill**, introduced last year, represented a bold thrust toward deregulation, but one designed to offer placatory incentives to electric utilities and to holding companies. The just introduced **DeLay Bill** is consistent in spirit with Schaefer, but also is designed as a warning shot across the bow of the recalcitrant utilities. The **Bumpers Bill**, from the other side of the aisle, supports deregulation, but reflects additional environmental and populist concerns. Some synthesis of the three bills would be ideal, with a few additional twists.

Now, let's look at the key generic policy denominators of these bills which affect power marketing.

(1) First, the extent of substitution of federal directives for state action. The underlying conflict here is between open access proponents, anxious both to press their case and avoid the need to deal with a crazy quilt of jurisdictional responses to open access and a variety of supporters of the contrary position, which include not only higher cost "just go slower" utilities; but also legislators from lower cost power states; certain consumer groups; public power systems; and, of course, state regulators.

The Schaefer Bill seeks to straddle this issue, by providing the states with an opportunity to conduct proceedings to establish nondiscriminatory retail access by a date certain, as reflected in proceedings which include mandatory consideration of specified principles. Nonregulated utilities are afforded this opportunity as well. In the event of state failure to implement retail access in accordance with these principles, FERC is directed to step in and by December 15, 2000 to effectuate customer choice.

The proceedings designed to provide the state portals to full deregulation and the cessation of state price regulation are required to insure universal power availability, reliability, energy efficiency, conservation and environmental programs—*and* cost recovery of stranded investment and PURPA contract costs. The potential complexity could exceed the old PURPA proceedings.

There is also a contemplation of a FERC findings separating its jurisdiction over unbundled interstate retail transmission and continuing state jurisdiction over local distribution.

DeLay's proposed legislation would delete the craftsmanship of the Schaefer Bill—leaving regulatory authorities only with deference in certain decisions relating to electric service, and obliterating any distinction between regulated and non-regulated utilities.

It also articulates final "consumer choice" conclusions which otherwise might be more finely tuned in state proceedings: a ban on exit fees, subsidies or other penalties on exercising right of choice; a ban on restriction of alternate choices.

State authority is left over distribution systems; protection of safety and reliability; and of consumer rights. States are also left with a variety of responsibilities of interest to power marketing specialty

firms: interim rates; continuation of universal service; conservation programs and initiatives; consumer choice with regard to renewable energy; research and development. In other respects, FERC is directed to provide for nondiscriminatory prices with respect to distribution (as well as transmission).

The Bumpers Bill would mandate retail access in 2003, unless earlier instituted by state governments. More expansively than the other alternatives, it continues consistent state local distribution and retail transmission regulation. Bumpers would permit stranded cost recovery where retail energy regulation requirements are met, subject to broad general guidelines and specific multistate utility company stranded cost rules, but insulated from retroactive prudence review. It also would specifically permit nuclear decommissioning cost recovery.

More than its Republican counterparts—which focus almost exclusively on market deregulation—(except in the area of Renewable Energy Credits), Bumpers also makes specific provisions for "reregulation" of the deregulated transmission sector. It makes recommendations, for example, for transmission regions; standards for and regulation of Independent System Operators through Regional Transmission Oversight Boards. We may hear more about these requirements.

From the power marketing standpoint, specifically, the resolution of the state authority issue ought to be to make retail access the law of the land, right away. But the straightest available line to this point politically may well be: (1) specific federal acknowledgment of state authority to implement retail wheeling; (2) Emphasis on the development of state consistency, through establishment of more detailed Federal standards than currently are under state consideration. The possibilities of acceptance are enhanced.

With respect to the treatment of the stranded cost issue, many power marketers may applaud the DeLay approach: if implemented, it certainly would take down several of their competitors; permit greater differentials in competitive rates offered by power marketers; and create resultant incentives for major power flow transactions.

While all of this may be true, it seems very unlikely to happen, given the institutional strength of the utilities; utility willingness to accede to restructuring, at least superficially; and the welcoming of open access. On the other hand, right to stranded cost

securitization—a matter of great interest to utilities—might more productively be made an issue of permitted degree; a function of timing in moving to open access; and subject to conditions of transmission system management raised by Bumpers.

(2) A second generic basis for distinguishing among current legislative proposals is their treatment related to assurance of removal of market imperfections. Principally, this will relate to two issues: treatment of market power, and the form and scope of dismantling of the Public Utility Holding Company Act (and PURPA).

The Schaefer Bill, whether from naive or disingenuous faith in how private firms actually behave in free markets, or fundamental aversion to the recrudescence of intrusive regulation, basically does not focus squarely on the market power issue. It does make clear that the antitrust laws are not superseded, but for the most part its focus is on assurance of the removal of governmental barriers to competitive market entry.

Perhaps because of its intention to pressure utilities to reach closure on open access, or perhaps because the full ramifications of the utility merger trend were coming to light by the time it was developed, DeLay would direct FERC specifically to ensure that present and future utility exercises of market power do not impair the objectives of open access. The proposed authority is very broad, extending to restrictions, under certain circumstances, on sales at market prices and divestiture orders. Bumpers would go even further, focusing an entire statutory Title on "Competitive Generation Markets," providing FERC with authority to deal with situations "inconsistent with effective competition among retail and wholesale electrical providers."

It is likely that efforts to, in effect, make FERC a free market policeman will encounter serious political resistance. The issues already faced in the merger context would pale by comparison in number and scope. On the other hand, market strength abuse ought to be an area of considerable concern to power marketers, given the rapid transformation of the form of the market to one in which large utilities will be servicing and seeking to retain large numbers of customers.

It is somewhat ironic that at the same time as markets are slated to be made more competitive, there is a perceived need by some

to give FERC the general type of oversight powers which the SEC has exercised with respect to holding companies under PUHCA—which all of the proposed bills contemplate repealing. The logic in the latter case, is that the need for PUHCA is obviated if the competitive circumstances necessitating its imposition are removed. The politics are that the same utilities which are being asked to cede open access—and basically are opposed to it—are also, however, anxious to see Holding Company Act repeal.

Schaefer devotes a separate Title to PUHCA repeal, picking up many of the provisions found in the special purpose legislation which was introduced last year. Basically, it contemplates that the PUHCA shackles will be removed when retail access is established in all states in which the holding company operates. Authority is provided for federal access to books and records, and for state access as well. Continued federal and state jurisdiction is provided over affiliate transactions. The DeLay Bill continues parallel deregulation provisions, but without the very important books and records provisions. As might be expected, Bumpers not only contains analogues to the Schaefer Bill provisions, but also would extensively empower FERC to police interaffiliate transactions.

PURPA repeal is an element of all three bills, to be triggered upon full realization of open access. The proposals are focused on preservation of old contracts. Only Bumpers explicitly purports to protect against mandatory downward negotiation of existing rates.

A possible additional condition to these PURPA repeal provisions, which many power marketers would favor, would be the preclusion of utility participation in distant territories which have been deregulated, unless their own territory has been deregulated at the retail level as well. This would seem particularly relevant given the linkage of some power marketing efforts to projects still enjoying or in need of PURPA-type benefits.

TRANSACTIONAL NICHES

(3) While the battle swirls around the larger generic legal issues just discussed, power marketers would do well to assure that the new legislation also serves the purposes of enabling them to continue to develop and expand their own transactional niches: convergent en-

ergy supply services; interface of energy management/service and power marketing.

(a) First, power marketing and natural gas marketing (not to mention the marketing of additional fuels) are becoming a single (sometimes national, sometimes regional) enterprise.

Schaefer recognizes this in its PUHCA authorization—which requires as a condition of the lapse of PUHCA jurisdiction over a holding company, that its gas utility customers also have the benefit of retail open access in the gas field as well. In all other respects, its focus is on electric retail access. DeLay does not deal with the issue. Bumpers' more extensive concern with the potential unfair impact of market competition extends to "natural gas utility company" acquisition, to which it would apply a broad "public interest" standard to permitted acquisition. It also has an explicit anti-cross subsidization provision.

A key strategic issue for many involved in energy marketing is whether it will be sufficient for them to continue their reliance on applicable gas and electric deregulation provisions fitting together, or whether the interface of convergence and deregulation should be acknowledged specifically, so that they can compete effectively in offering energy services.It could be the predicate of a proactive or a defensive strategy, depending on the power marketer.

(b) The issue of interface of power marketing with energy management service activities presents a similar type of two edged sword. Some power marketers have offered ESCO services and vice versa. Some of each have emphasized the superiority of their respective approaches.

The Schaefer Bill captures in its definition of "retail electric energy service" the full panoply of activities which may occur as a result of retail access. It includes billing and metering, "electric management services" for ultimate consumers and other electric service alternatives to those offered by applicable utilities. State open access implementation proceedings are required to address energy efficiency. The DeLay Bill is as expansive in its definition, including virtually all services other than transmission and distribution. Bumpers would seem to be more narrow in the markets it opens: it applies to "ancillary services sold for ultimate consumption." Remem-

ber, the narrower the definition the smaller the explicit window for deregulated utilities.

Markets for power marketing are created through, or in conjunction with, effective energy efficiency activities. The issue of whether E.M.S. services are properly treated as an unbundled component of supply or merely an ancillary activity would benefit from closer delineation. For example, it impacts the issue of the extent to which utilities can use energy management service provision as a basis for protecting their market share. It could also impact the issue of a potential split between state regulation of ESCOs and federal regulation of power marketing.

The issue is indirectly, of course, related as well to the interface between power markets and customer groups—the type of "aggregation" which has begun to emerge nationwide. Aggregators may facilitate their operations by engaging in energy management as well. Interestingly, while the Schaefer Bill is a consumer driven statute, focused on removing barriers to consumer sales, it does not specifically make provision for the rights to consumers to form cooperative purchasing arrangements.

Bumpers, by contrast, specifically acknowledges the existence and permissibility of aggregation, but only if the members are in a state "where there is retail electric competition." While presumably this was not meant to be limiting language, it could have that limiting effect if—for unrelated reasons—other disputes are proceeding as to whether there is retail electric competition in the jurisdiction.

The treatment of renewables as a specially favored source of electric energy could have a positive benefit to the limited population of power marketers/aggregators who wish to focus on renewable energy supply. It could, however, result in an additional burden for those marketers also directly or indirectly in effect are compelled to traffic in renewable energy.

Under the Schaefer Bill, each "electric generator" must meet a quota for renewable energy—not including hydro. The applicable percentage would progress by increments from 2% in 2001-2004 to 4% after 2010. Renewable energy credits will, however, be tradeable, and therefore available to be purchased to meet these requirements. Renewable PURPA contracts will be available to be credited to purchasing utilities. The DeLay Bill is silent on the use of renewables—probably reflecting its aversion to the imposition of new regulatory

disciplines. Bumpers proposes a comparable but more elaborate renewable energy credit package. It also provides for the accommodation of additional requirements of state renewable energy programs as well.

CONCLUSIONS

What, then, are the prospects for power marketing under the new legislation? Until the full outlines of the legislative compromises are visible, it will not be entirely clear how rapidly retail access and the opportunity for power marketers will emerge. As with wholesale wheeling, it may be that actual market transactions serve to define the considerable fuzziness which characterizes the standards. It would be a mistake, however, to assume that this will automatically be the case. Special provisions affecting the energy power marketing business have not been crafted carefully. They deserve focus by industry players.

Power marketing based transactions, and transactions launched to take advantage of power marketing, need to be planned now with the possibility of the legislative scenarios in mind. Open access is a foundation of market opportunities, but not, by itself, for product differentiation.

ABOUT THE AUTHOR

Roger D. Feldman is co-chairman of the 40-person Project/Structured Finance Group of the 250+ attorney firm of Bingham, Dana & Gould, based in Washington, DC. He has represented the Power Marketers Association and individual power marketers, and also has represented power purchasing trade associations and aggregators. He is Washington editor of *The Cogeneration and Power Marketing Letter* and of *The Construction Business Review*. In his more than 25 years of practice, he has participated in the closing of over $8 billion in transactions.
