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Executive Summary

Public Citizen believes that electricity is a vital necessity to a healthy standard of living and to a strong economy. Our belief is based on fundamental principles that have guided the electric power industry for 130 years:

- The provision of electricity is essential for maintaining and improving public health and welfare;
- Because electricity is so important, then government must make electricity available to all who need it;
- Government has two choices in providing electricity. Either government provides the electricity itself, or it allows private companies to provide electricity on government's behalf;
- Regardless of whether government or private companies provide electricity, consumers and society want the appropriate amount of electricity at the lowest possible prices.

Given that the Eastern, Western, and Texas Interconnections are natural monopolies, Public Citizen recommends that all of the transmission facilities of each Interconnection should be owned and operated by three non-profit public transmission companies (one for each Interconnection). Having non-profit public transcos own and operate the nation's three transmission systems will provide consumers with the most efficient, lowest cost transmission service, eliminating the conflicting incentives created when for-profit companies own transmission facilities.

There is a strict conflict between electricity consumers who want to minimize their use of the transmission system and to pay as little as possible for transmission services, and for-profit transmission owners who want consumers to use the transmission system as much as possible and to pay the highest possible prices for transmission service. A for-profit transmission system

would be the consumers' worst nightmare.

For all of its pitfalls for residential and small business consumers, deregulation is opening the door for each Interconnection to be owned and operated by a single owner. The physical and economic laws that define the transmission systems as natural monopolies can no longer tolerate having multiple owners of the three Interconnections. Creating a single owner/operator for each Interconnection would eliminate all the bizarre rules and practices that have been caused by having many transmission owners within each Interconnection, and that have been created in preparation for deregulation.

Since investor-owned holding companies own most of the nation's transmission system, and since they also own most of the power plants, distribution systems, and power marketing firms that sell electricity in wholesale and retail markets, holding companies will use their ownership and control of the transmission system to favor their affiliates that supply and sell electricity at the expense of their competitors and customers.

Utility holding companies provide a mixture of services, some that need to be regulated, such as transmission and distribution services, and some that do not, such as the production and sale of electricity. Any time regulated and non-regulated services are provided by the same company, or by affiliates in the same holding company system, regulators must police affiliate transactions to prohibit self-dealing and cross-subsidies between the regulated and non-regulated services. However, regulation of affiliate transactions has always been expensive, obtrusive, and ultimately ineffective.

As long as holding companies are allowed to own transmission systems along with power plants and electricity marketing firms, there can never be reasonably priced, open-access to the

transmission system, there will never be a reduction of ineffective regulation, and there will never be true competition in wholesale or retail electricity markets.

The Transmission Solution: Non-profit Public Transmission Companies

Instead of leaving most of the transmission system (and the workers that operate it) in the hands of holding companies, it is finally time to embrace a solution that has its roots in the early part of this century, namely a publicly-owned transmission company, or a “public transco.”

Three publicly-owned non-profit transmission companies (public transcos) should own and operate the transmission systems of the Eastern Interconnection, the Western Interconnection, and the Texas Interconnection. Each public transco should be responsible for providing non-discriminatory open access to each transmission system at affordable rates approved by the Federal Energy Regulatory Commission.

Duties and responsibilities of each public transco should include scheduling and dispatching power plants; maintaining the transmission system; planning, building, and owning transmission system improvements; developing and implementing standards for system reliability; and arranging for the provision of ancillary services.

For the first time in the history of the electric power industry, all of the transmission workers, facilities, and responsibilities (including reliability) of each Interconnection would be under one non-profit roof. Under the full embrace of a public transco, each Interconnection could be planned, operated, and priced as an interconnected and coordinated system. For the first time, the ownership and operation of each Interconnection would finally match its physical reality of a networked system of power plants, power lines, and power consumers.

Ideally, the board of directors for each public transco should be comprised of consumers

with no financial interest in any power supplier or marketer. By having a publicly-accountable board of directors, the “government” of the transmission system would be of consumers, by consumers, for consumers. Power suppliers and marketers can participate through advisory committees.

After nearly 100 years of ineffective policing of affiliate transactions between regulated and non-regulated affiliates within the same holding company system, the public transco would remove the regulated assets, services, and staff into a separate, stand-alone, non-profit company that would have no affiliates and no subsidiaries.

Self-dealing and cross-subsidies between regulated and non-regulated subsidiaries would disappear, along with the need for expensive, intrusive, and ineffective regulation of affiliate transactions. A structural remedy to holding company abuses would finally be in place decades after it was formally proposed by President Franklin D. Roosevelt in March 1935.

A public transco will have plenty of incentive to maximize the efficiency of the transmission system. Consumers want access to the least expensive power available, yet they also want to minimize transmission system investments because they are costly, damaging to the environment, damaging to property values, and potentially dangerous.

This tension between access to low cost power and resistance to new transmission facilities will ensure that a public transco will build only those facilities that serve the public interest, provided that the governance of the public transco truly represents the interests of consumers.

With these principles in mind, and given the sharp conflict-of-interest between consumers and for-profit transmission owners, Public Citizen recommends that the Commission order the

creation of three non-profit public transmission companies (public transcos), and that it orders each public transco to purchase all of the transmission facilities needed to provide consumers with transmission service.

If the Commission believes it lacks clear authority to create three public transcos, or to allow the public transcos to purchase all transmission facilities, then it should petition Congress for the needed authority.

I. Introduction

Public Citizen recommends that the Federal Energy Regulatory Commission create three publicly-owned non-profit transmission companies (public transcos), which should own and operate the transmission systems of the Eastern Interconnection, the Western Interconnection, and the Texas Interconnection. Each public transco should be responsible for providing non-discriminatory open access to each transmission system at affordable rates approved by the Federal Energy Regulatory Commission.

Duties and responsibilities of each public transco should include scheduling and dispatching power plants; maintaining the transmission system; planning, building, and owning transmission system improvements; developing and implementing standards for system reliability; and arranging for the provision of ancillary services.

The creation of three non-profit public transcos would put all of the transmission facilities and responsibilities (including reliability) of each Interconnection under one non-profit roof. Under the full embrace of a public transco, each Interconnection could be planned and operated as an interconnected system. For the first time, the ownership and operation of each Interconnection would finally match its physical reality of a networked system of power plants, power lines, and power consumers.

These comments explain how three non-profit public transmission companies can meet the characteristics and functions proposed by the Commission in its notice of proposed rulemaking.

II. The NOPR's Missing Characteristic: Non-profit Ownership of the Transmission System

In Section III.A. of the NOPR, the Commission correctly identifies how transmission engineering and economics can create barriers for efficient transmission service. The Commission also correctly describes how transmission owners can favor their own (or their affiliates) ability to generate, trade, and sell electricity at the expense of their competitors, and ultimately consumers.

However, completely absent from the Commission's proposal is any discussion of how the ownership of the transmission system by for-profit companies harms consumers. With regards to transmission service, the interests of electricity consumers are in direct conflict with the interests of for-profit transmission owners.²

The conflict is very straightforward and simple: consumers want to minimize their use of the transmission system and to pay as little as possible for transmission services, whereas for-profit transmission owners want consumers to use the transmission system as much as possible and to pay the highest possible prices for transmission service.

Given this inherent conflict between consumers and for-profit transmission owners, Public Citizen believes all of the transmission facilities of each Interconnection should be owned and operated by three non-profit public transmission companies (one for each Interconnection). Having non-profit public transcos own and operate the nation's three transmission systems will

² See, for example, *Remarks of Alan Richardson on behalf of the American Public Power Association*, FERC Technical Conference Concerning Independent System Operators, Washington, DC, January 24, 1996; The Large Public Power Council, *Uncrossing the Wires*, December 1998; *Statement of Roy Thilly on behalf of the American Public Power Association*, before the U.S. House of Representatives Committee on the Judiciary, June 4, 1997; *Statement of Roy Thilly*, FERC Independent System Operator Conference, April 15, 1998.

provide consumers with the most efficient, lowest-cost transmission service, eliminating the conflicting incentives created when for-profit companies own transmission facilities.

Consumers Are Harmed by For-Profit Transmission Owners

Since consumers have to pay for electricity, they only want to use as much electricity as they need. Similarly, consumers want to pay the lowest price possible for the electricity they use. Using only the electricity they need, and paying the lowest possible price for that electricity allows consumers to purchase other needed goods and services, or to save or invest their money in other places. Optimal consumption also sends signals to electricity suppliers about the type and amount of power plants needed to provide the appropriate amount of electricity. No more than the appropriate number of power plants (and transmission lines) will be built, and damage to the environment (excess pollution, unneeded corridors for transmission lines) and to the economy (misdirected investment) will be minimized.

Because transmission service is a cost of using electricity, consumers want to minimize their use of the transmission system, and they want to pay as little as possible for any transmission service purchased. Ideally, an electricity consumer would prefer not to pay for *any* transmission service. However, since most consumers will be served by central-station power plants and their inseparable transmission lines for at least the next decade, at this time the goals of most consumers are to use as little transmission service as possible, and to pay the lowest possible price for transmission service.

In contrast, a for-profit transmission owner wants electricity consumers to use the transmission system as much as possible, and to pay the highest possible prices for transmission service. The motivation for a for-profit transmission owner is simple and straightforward:

Higher usage and higher rates lead to larger profits. Indeed, for-profit transmission owners have a legal obligation to maximize profits for shareholders.

The for-profit transmission owner will also encourage electricity consumers to use as much electricity as possible, especially if the for-profit transmission owner is part of a utility holding company that produces or sells electricity. Encouraging consumers to use as much electricity as possible leads to overconsumption, which diverts consumer dollars away from purchasing other goods, or away from personal investment or savings. Overconsumption creates more pollution. Overconsumption leads to unneeded investments in power plants and transmission lines, and it takes away electricity from those who need it. Overconsumption is not in the interest of neither the consumer nor the public interest, yet overconsumption clearly benefits companies that profit from electricity use, including for-profit transmission companies.

As long as for-profit transmission owners are allowed to exist, they will try to manipulate the operation of their systems to maximize profits, especially if they (or their affiliates) own power plants or provide marketing services.

To reduce competition and maximize profits, the for-profit transmission owner will try to withhold or distort information concerning the operation, maintenance, or planning of their systems.

To increase profits, the for-profit transmission owner will try to cut costs wherever it can, potentially threatening the reliability of competing power suppliers, and perhaps the reliability of the grid itself.

For-profit transmission owners will try to serve only profitable customers and will ignore everyone else. The lines serving profitable customers or regions will receive more maintenance

and upgrades compared to lines serving less profitable customers.

For-profit owners will make transmission improvements that generate more profits, fighting against any solution that threatens transmission revenue, such as distributed generation or energy efficiency, even though costs could be reduced for consumers.

For-profit transmission owners will try to favor themselves or their affiliates, requiring expensive and ultimately ineffective regulation of cross-subsidies and self-dealing.

All of the tendencies by for-profit transmission owners toward profit maximization conflict with the interests of electricity consumers and society at large. Consumers want to minimize their use of the transmission system, and they want to pay the lowest possible price for whatever transmission service they use. For-profit transmission owners want consumers to use the transmission system as much as possible, as well as pay the highest possible price for transmission service. They will also try to manipulate their systems in ways that maximize profits at the expense of competitors, consumers, and the public interest.

III. Only Public Transcos Can Provide Efficient, Low-Cost Transmission Service

In Section III.A. of the NOPR, the Commission correctly identifies how transmission engineering and economics can create barriers for efficient transmission service. We believe that creating three non-profit public transmission companies, each owning and operating all of the transmission facilities of each Interconnection, can eliminate the many engineering and economic barriers that make transmission service more expensive and less reliable than it should be.

Physics Demands a Single Non-profit Owner/Operator

Due to economies of scale and scope, the Eastern, Western, and Texas Interconnections are natural monopolies. Someday, distributed generation may make central station power plants and transmission lines obsolete, but as long as there are central plants networked together by transmission lines, the three Interconnections will be natural monopolies.

Given the fact that each Interconnection is a natural monopoly, then by definition one owner of each system can provide transmission services less expensively than many owners.

Because all aspects of generating, transmitting, distributing, and selling electricity were regulated, it was possible for many transmission owners to own pieces of the three “single machines” that are the three Interconnections. As the NOPR correctly points out, the many transmission owners were able to voluntarily coordinate the operation of the Interconnections because, as regulated companies, they were not in competition with each other.

With deregulation replacing cooperation with competition, the physical and economic laws that define the transmission systems as natural monopolies can no longer tolerate having multiple owners of the three Interconnections. For all of its pitfalls for residential and small business consumers, deregulation is opening the door for each Interconnection to be owned and operated by a single owner.

Creating a single owner/operator for each Interconnection will eliminate the needless Balkanization of the transmission system. Creating a single owner will also eliminate all the bizarre rules and practices that have been caused by Balkanization, and that have been created in preparation for deregulation.

For example, with one owner/operator, loop flow problems will disappear. Pancaked

rates will disappear. Most of the bizarre and unfair penalties exacted for scheduling imbalances should disappear. Inconsistent and inaccurate calculations for total transmission capability and available transmission capability will be replaced by *real* values available to all suppliers and consumers at the same time. Discriminatory operation, maintenance, and improvement of parts of each Interconnection should cease. Each Interconnection will have a system-wide pricing structure that can mimic the physics of the system, instead of the contract-path pricing scheme that has no basis in physical reality.

Only RTOs that completely encompass each Interconnection will be able to develop engineering and pricing models that reflect the physics of the system. The only way to get the price right for transmission service is to use engineering and pricing models that reflect the physics of the system. The Commission should not approve any RTO that is smaller than an Interconnection, because such an RTO will have to deal with all the engineering and economic inefficiencies mentioned above and in the NOPR, ultimately leading to higher cost transmission service for consumers.

President Roosevelt's Concerns and PUHCA's Logic Are Still Valid

Creating a single owner/operator for each Interconnection will build upon the engineering principles that built the nation's three single-machine Interconnections. Back in the early part of this century, utility engineers and economists realized that by connecting power plants together with transmission lines, utilities could share power plants, thus reducing the cost of producing power and increasing system reliability.

The Public Utility Holding Company Act of 1935 was signed into law in response to the

wave of mergers and consolidations that gripped the industry during the Roaring Twenties. One of the goals of PUHCA was to reorganize the ownership of utilities into systems that “are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system...”³

The utility mergers that occurred during the Roaring Twenties did not result in “interconnected and coordinated” systems. The large holding companies of the day owned utilities scattered throughout the U.S. and the world, making it mostly impossible for the economic interconnection of systems. Since the holding companies owned systems that did not result in an “interconnected and coordinated system,” holding companies could not deliver to consumers the promise of lower electricity rates.

President Franklin D. Roosevelt’s administration was very concerned about the inefficiencies that dominated the industry prior to the enactment of PUHCA:

The growth of the holding-company systems has frequently been primarily directed by promoters’ dreams of far-flung power and bankers’ schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth has been actuated primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operations and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever increasing complexity and steadily diminishing coordination and efficiency.⁴

³ 15 U.S.C. §79b(a)(29).

⁴ *Report of the National Power Policy Committee, 74th Congress, 1st Session, House Doc. No. 137, March 12, 1935, at 5 (hereinafter cited as NPPC).*

The enforcement of PUHCA reorganized the industry into utility systems that were able to provide benefits to consumers that can only be achieved by “interconnected and coordinated” operation of the utility system. Between 1938 and 1951, average monthly bills for ratepayers dropped 10 to 14 percent, mostly due to the benefits of “interconnected and coordinated” operation.⁵

The logic of PUHCA and the words of the Roosevelt administration are still relevant today, especially given the wave of dubious mergers sweeping the industry. If utilities cannot be connected to each other into a single “integrated and coordinated system,” few savings will result to the consumer. Or conversely, having many owners of a transmission system that is a single machine will also frustrate economies that can only be achieved by “interconnected and coordinated” operation.

For example, the proposed merger between American Electric Power Company and Central and South West Corporation will not be able to provide savings to consumers because their two systems cannot be operated as an “interconnected and coordinated system,” especially since the proposed merger is between a utility in the Eastern Interconnection (AEP) and a utility that is partly in the Texas Interconnection (CSW). Similarly, the proposed merger between New Century Energies and Northern States Power Company involves utilities in the Western Interconnection (NCE) and the Eastern Interconnection (NSP). Since these two systems cannot be operated as an “interconnected and coordinated system,” consumers are not likely to see lower electricity prices. These proposed mergers violate the physical laws that define the single machines of the Eastern, Western, and Texas Interconnections.

⁵ Joel Seligman, *The Transformation of Wall Street*, Boston: Northeastern University Press, 1995, at 263.

It is time to look at the integration and coordination requirements of PUHCA in a new way. Conceding the point that electricity generation and marketing are best provided by many competitors, it is time to create single non-profit owner/operators for that part of the industry that would benefit the most from “interconnected and coordinated” operation: the Eastern, Western, and Texas Interconnections.

IV. Public Transcos Can Eliminate Holding Company Abuses

In Section III.A. of the NOPR, the Commission correctly identifies how “utilities that control monopoly transmission facilities and also have power marketing interests have poor incentives to provide equal quality transmission service to their power marketing competitors” (at 59). The Commission also notes that “functional unbundling,” the solution relied on by the Commission in Orders 888 and 889 to reduce cross-subsidies and self-dealing, “did not change the incentives of vertically-integrated utilities to use their transmission assets to favor their own generation, but instead attempted to reduce the ability of utilities to act on those incentives” (at 60).

The NOPR then goes on to describe many instances of alleged or actual abuse against competitors (and ultimately consumers) at the hands of transmission owners that are also involved in (or affiliate with) power marketing. In particular, the Commission notes that the problems of self-dealing are due to the inequitable sharing of critical transmission information. We agree with the Commission that self-dealing problems “could be greatly reduced through more distinct organizational separation” (at 80).

Public Citizen believes that the best solution to self-dealing problems is to require utilities to divest their regulated transmission services and facilities into three non-profit public

transcos that have no affiliates or subsidiaries (that is, non-profit transcos should own and operate the transmission facilities of each Interconnection). This solution would focus regulation only on regulated services. No longer would there be the need to police affiliate transactions for self-dealing between regulated and non-regulated affiliates. It would eliminate “fishing expeditions” by regulators into the activities of non-regulated companies. It would reduce significantly the cost and intrusiveness of regulation.

Self-Dealing, Cross-Subsidies, and Other Holding Company Abuses

President Franklin D. Roosevelt proposed a similar solution to self-dealing problems almost 65 five years ago. In the debate preceding the enactment of the Public Utility Holding Company Act of 1935, the Roosevelt administration recommended that utility holding companies should be prohibited from owning regulated and non-regulated subsidiaries:

Holding companies should be restricted as soon as practicable to the business of operating and owning the securities of public utility properties; they should not be permitted to engage in non-utility or speculative ventures.⁶

At the time, all aspects of the electric utility, which produced, transmitted, distributed, and sold electricity at retail, were considered regulated services. Thus, Roosevelt’s recommendation would have prohibited ownership by utility holding companies of any business that did not produce, transmit, distribute, or sell electricity. The holding company lobby was able to defeat Roosevelt’s approach, and instead PUHCA was weakened to allow holding companies to own both regulated and non-regulated businesses.⁷ Utility holding companies have

⁶ NPPC, note 4, at 10.

⁷ Seligman, note 5, at 248; Douglas Hawes, *Utility Holding Companies*, New York: Clark Boardman Company, 1987, at 2-15 (hereinafter cited as Hawes); Philip Funigiello, *Toward a National Power Policy: The New Deal and the Electric Utility Industry, 1933-1941*, Pittsburgh: University of Pittsburgh Press, 1973, at 96; Michael Parrish, *Securities Regulation and the New Deal*, New Haven, CT: Yale University Press, 1970, at 175.

taken advantage of this weakening, thus today there are 150 utility holding companies with over 4,200 non-utility subsidiaries.⁸

Even though weakened, PUHCA still contains the following warning: “The national public interest ... may be adversely affected...when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm’s length bargaining or from restraint of free and independent competition; ...”⁹

It is time to heed PUHCA’s warning, and to finally implement the solution to holding company abuses recommended by President Roosevelt almost 65 years ago--a solution that will also create the most efficient and low-cost transmission system. The solution is to create three non-profit public transcos that will purchase and operate all of the transmission facilities of each Interconnection. Prohibited from having subsidiaries or affiliates, each public transco will provide transmission service and nothing else, eliminating self-dealing problems that have haunted the industry for most of this century.

The separation of regulated companies from non-regulated companies would also eliminate cross-subsidies. Any time regulated and non-regulated companies are brought together in a holding company system, there is the potential for cross-subsidies to flow from the regulated subsidiary to the non-regulated subsidiary, to the detriment of consumers, competitors, and shareholders.

⁸ U.S. Securities and Exchange Commission, *Financial and Corporate Report, Holding Companies Registered Under the Public Utility Holding Company Act of 1935 as of June 1, 1998*, and *Financial and Corporate Report, Holding Companies Exempt from the Public Utility Holding Company Act of 1935 Under Section 3(a)(1) and 3(a)(2) Pursuant to Rule 2 Filings or by Order as of November 1, 1997*, Washington, DC.

⁹ 15 U.S.C. §79a(b)(2).

Cross-subsidies harm ratepayers because they end up paying higher rates for purchasing regulated services, with some of their rates being used to subsidize other services provided by non-regulated affiliates that the ratepayer may not even use. Since ratepayers have to buy the regulated product, ratepayers are often forced to pay higher rates to cover these subsidies.

Competitors suffer because the non-regulated affiliates are receiving subsidies from ratepayers, allowing the affiliates to unfairly reduce prices to either take customers away from their competitors or to drive them out of business. For example, many small business contractors that provide air conditioning, heating, electrical, plumbing, appliance sales, and appliance repair services are facing unfair competition from utility affiliates propped up with cross-subsidies that ultimately come from the ratepayer. When a small business owner pays his or her monthly power bill, they are likely providing subsidies to holding company affiliates that are trying to put them out of business.¹⁰

Shareholders and bondholders of the utility holding company are potentially harmed because cross-subsidies impose burdens on various parts of the holding company system, making securities more risky and less valuable. Shareholders and bondholders of firms that compete with utility affiliates suffer because their securities are made less valuable through unfair competition by subsidized affiliates of utility holding companies. President Roosevelt was critical of utility holding companies and their cross-subsidies:

In its destruction of local control and its substitution of absentee management, [the utility holding company] has built up in the public-utility field what has justly been called a system of private socialism which is inimical to the welfare of a free people.¹¹

¹⁰ See, for example, *Testimony of Anthony Ponticelli for the National Alliance for Fair Competition*, before the U.S. House of Representatives Committee on the Judiciary, June 4, 1997 (hereinafter cited as Ponticelli).

¹¹ NPPC, note 4, at 3.

President Roosevelt equated private socialism with cross-subsidies because ratepayers end up paying for cross-subsidies through higher rates. The higher rates are a similar to a tax that is collected by a private, investor-owned corporation, hence the term “private socialism.” Mr. Roosevelt’s criticisms are still valid today, especially since many utility holding companies are engaged in a frenzy of mergers and acquisitions involving regulated and non-regulated companies. Cross-subsidies, self-dealing and other forms of holding company abuse will likely get worse as deregulation progresses.

Regulation of Holding Companies is Expensive, Obtrusive, and Ineffective

Because utility holding companies have always played a dominate role in the electric power industry, the attempt to eliminate self-dealing and cross-subsidies by regulating affiliate transactions has been one of the regulators’ principle jobs.¹² The policing of affiliate transactions requires that regulators have access to the books and records of all the companies in a holding company system, so that regulators can inspect or audit the transactions between regulated and non-regulated subsidiaries.

However, regulation of affiliate transactions has always been expensive, obtrusive, and ultimately ineffective.

There are three approaches in regulating affiliate transactions to reduce cross-subsidies. The first approach is to prohibit the mixing of regulated and non-regulated businesses in the same holding company system, thus *eliminating* transactions between regulated and non-regulated affiliates. This approach is known as a structural remedy to the problem of affiliate

¹² Phillip Blumberg, *Procedural Problems in the Law of Parent and Subsidiary Corporations*, Boston, MA: Little, Brown and Company, 1983, at 86.

transactions because it prohibits the use of a corporate structure, namely the holding company, which allows the ownership of regulated and non-regulated companies, the very root of cross-subsidies. Structural remedies are favored by the Federal Trade Commission, the Department of Justice, and others (including Public Citizen).¹³

The second and third approaches are known as behavioral remedies, which means that regulators try to control the behavior of utility holding companies to reduce cross-subsidies. One approach is to require that the holding company notifies the regulator in advance, or even seeks regulatory approval, before it engages in certain affiliate transactions or acquisitions. The other approach has a regulator deciding whether the transaction was appropriate after the transaction took place.

For both approaches, “the key to effective regulatory control [of affiliate transactions] is the same: access to detailed information about both the specific transaction in question and the general business, operations, costs, and profitability of the affiliate.”¹⁴

For either behavioral approach, regulators need to determine whether the affiliate transaction was priced appropriately.¹⁵ Or, regulators need to determine whether the rate of return enjoyed by the affiliate is reasonable when compared to the returns enjoyed by the utility

¹³ *Comment of the Staff of the Bureau of Economics of the Federal Trade Commission*, before the Public Utilities Commission of Texas, Project Number 17549, June 19, 1998, (hereinafter cited as FTC) at 2; *Comments of the U.S. Department of Justice*, in the matter of Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Dockets RM 95-8-000 and RM 94-7-001, Washington, DC, August 7, 1995, (hereinafter cited as DOJ) at 4; Ronald Binz and Mark Frankena, *Addressing Market Power*, Washington, DC: Competition Policy Institute, June 1998, at 52-56 (hereinafter cited as Binz and Frankena).

¹⁴ Phillip Blumberg and Kurt Strasser, *Problems of Parent and Subsidiary Corporations under State Statutory Law*, Boston: Little, Brown and Company, 1995, at 91-92 (hereinafter cited as Blumberg and Strasser 1995).

¹⁵ Hawes, note 7, at 10-1.

and to non-affiliated competitors.¹⁶ Both determinations require that regulators make extensive reviews of the costs of providing the service in question, what the service would have cost if provided by a non-affiliate, or a thorough examination of the return enjoyed by other non-affiliated suppliers of the service.

All of this data gathering and examination concerning the appropriateness of affiliate transactions is way beyond the capability of state and federal regulatory commissions, since most have far fewer staff and resources than needed to police thousands of affiliate transactions.¹⁷

Further, holding companies often dispute the findings of a regulator concerning the appropriateness of the affiliate transaction, often taking the matter to court, where the lawyers of the holding company almost always make their case with more legal resources (paid for by the ratepayer) and more information than the regulators.¹⁸

Competitors harmed by self-dealing or cross-subsidies have a similar uphill battle in stopping abusive affiliate transactions.¹⁹ Competitors, usually much smaller than utility holding companies, have far fewer resources with which to pursue justice. Competitors have restricted access to information about the affiliate transactions in question. Even if competitors had perfect access to information, holding companies often appeal any ruling made against them, delaying any compensation or remedy to the aggrieved small business. Finally, the competitor may have

¹⁶ Hawes, note 7, at 10-4 to 10-6.2

¹⁷ FTC, note 13, at 2; DOJ, note 13, at 3.

¹⁸ Richard Hellman, *Government Competition in the Electric Utility Industry*, New York: Praeger Publishers, 1972, at 43. Also see Blumberg and Strasser 1995, note 14, at 98-99 for citations of cases involving disputes over affiliate transactions.

¹⁹ See, for example, Ponticelli, note 10; *Testimony of Michael Travieso on behalf of the National Association of State Utility Consumer Advocates and the State of Maryland Office of People's Counsel*, and *Testimony of John O'Brien for the Wheeled Electric Power Company*, all before the United States House of Representatives Committee on the Judiciary, June 4, 1997.

gone out of business long before any court or regulatory agency could come to the rescue.

In short, given that there are thousands of affiliate transactions within any given holding company system, regulators can do little more than scan the books of the affiliates of the holding company to determine if abuses are occurring, a situation far from adequate.²⁰

All of this regulatory scrutiny, including an intrusive requirement to inspect the books and records of non-regulated affiliates, plus all of the costs associated with enforcing transaction rules, represents a huge cost that ratepayers and private businesses have to pay just to allow holding companies to own both regulated and non-regulated businesses. Indeed, even the non-regulated affiliates suffer by having regulators probe their books and records, in what the companies like to call “fishing expeditions.”²¹

Another cost to both society and to private capital is the number of companies that have been put out of business when trying to compete against holding company affiliates receiving cross-subsidies from regulated affiliates.²²

The solution to cross-subsidies and self-dealing is the same: require utilities to divest regulated services and facilities into stand-alone companies that have no affiliates or subsidiaries.

²⁰ Binz and Frankena, note 13, at 33.

²¹ Ibid, at 53-4.

²² Ibid, at 32.

V. The Transmission Solution: Non-Profit Public Transmission Companies

Three publicly-owned non-profit transmission companies (public transcos) should own and operate the transmission systems of the Eastern Interconnection, the Western Interconnection, and the Texas Interconnection. Each public transco should be responsible for providing non-discriminatory open access to each transmission system at affordable rates approved by the Federal Energy Regulatory Commission.

Duties and responsibilities of each public transco should include scheduling and dispatching power plants; maintaining the transmission system; planning, building, and owning transmission system improvements; developing and implementing standards for system reliability; and arranging for the provision of ancillary services.

For the first time in the history of the electric power industry, all of the transmission workers, facilities, and responsibilities (including reliability) of each Interconnection would be under one non-profit roof. Under the full embrace of a public transco, each Interconnection could be planned, operated, and priced as an integrated system. For the first time, the ownership and operation of each Interconnection would finally match its physical reality of a networked system of power plants, power lines, and power consumers.

Public Transcos Would Handle Reliability, Planning, and Pricing

The three public transcos would assume the duties and the staff of the North American Electric Reliability Council and its regional reliability councils. Public transcos would eliminate the needless, duplicative bureaucracies such as ISOs, for-profit transcos, regional transmission groups, regional regulatory authorities, and all the other half-steps suggested by holding

companies and their supporters. These half-steps needlessly divide responsibilities for operation, reliability, and planning into separate organizations, even though operation, reliability, and planning are truly inseparable functions of an efficient, reliable, and low-cost transmission system.

Each public transco should be responsible for planning and building transmission improvements using the principles of integrated-resource planning. Since each public transco will correspond to one of the three Interconnections, planning decisions can be based on looking at the whole network, not at balkanized pieces arbitrarily created by the whims of holding companies or other entities. (Siting authority and the power of eminent domain should remain in the hands of local or state government, because consumers are too easily abused when siting authority is centralized.)

The only way to get the price right for transmission service is to use engineering and pricing models that reflect the physics of the system. Thus, each public transco will develop and administer a system-wide transmission tariff that can mimic the physics of the system, instead of the contract-path pricing scheme that has no basis in physical reality.

Public Transcos Should Purchase Transmission Assets with Long-Term Debt

All transmission assets (regardless of whether the owners are private, municipal, cooperative, or federal) should be purchased by the public transcos at depreciated original cost (book value) using tax-free debt. Transmission assets to be purchased include the transmission wires, transmission substations, and all control area facilities.

Although distributed generation will hopefully eliminate many transmission lines, we will continue to be served by large power plants and large transmission lines for many years if

not decades. Transmission assets are very long-lived, meaning they can be purchased with debt that can be paid back over many decades, thus taking advantage of lower interest rates. Further, many existing transmission facilities have been paid for, making a purchase of the entire transmission system a bargain at twice the estimated cost of \$52 billion.²³

Instead of Profits, Public Transcos Will Provide Consumer Benefits

A public transco will have plenty of incentive to maximize the efficiency of the transmission system. Consumers want access to the least expensive power available, yet they also want to minimize transmission system investments, because they are costly, damaging to the environment, damaging to property values, and potentially dangerous.

This tension between access to low cost power and resistance to new transmission facilities (especially when distributed generation could replace the need for new transmission facilities) will ensure that a public transco will build only those facilities that serve the public interest, provided that the governance of the public transco truly represents the interests of consumers.

Public Transcos Would Eliminate Abuses of Vertical Integration

All of the employees involved in operating and controlling the transmission system should become employees of the appropriate public transco. As mentioned, this should include all the staff of the North American Electric Reliability Council and its member councils, since

²³ Total Transmission Plant (without allowance for depreciation and amortization) for investor-owned utilities, \$66 billion; Public Generators, \$11 billion; Public Non-Generators, \$1 billion; Co-ops, \$7 billion; for a total of \$85 billion. For IOUs, accumulated provisions for depreciation and amortization equal 38 percent of total utility plant, 35 percent for public, and 30 percent for co-ops, thus the transmission system's estimated depreciated value is \$52 billion. All figures from Energy Information Administration, *Financial Statistics of Major U.S. Investor-Owned Electric Utilities 1996* (unfortunately, the last one to be published), and *Financial Statistics of Major U.S. Publicly Owned Electric Utilities 1997*, Washington, DC.

each public transco will be responsible for developing and implementing standards for maintaining system reliability.

Having all of the transmission and reliability employees under one non-profit roof will ensure that employees are making decisions for the good of the system, instead of the good of the for-profit holding companies, who continue to employ most of the transmission system personnel, even under approved ISOs. No longer would there be paper walls created by “functional unbundling,” “standards of conduct,” and other behavioral remedies that attempt to separate transmission, generation, and power marketing employees of the same holding company.

Public Transcos Would Eliminate Abusive Affiliate Transactions

Each public transco must have no subsidiaries and no affiliations with anyone, and they cannot diversify into any other business. Public transcos must provide transmission service and nothing else.

After nearly 100 years of ineffective policing of affiliate transactions between regulated and non-regulated affiliates within the same holding company system, the public transco would remove the regulated assets, services, and staff into a separate, stand-alone, non-profit company that would have no affiliates and no subsidiaries.

Cross-subsidies between regulated and non-regulated subsidiaries would disappear, along with the need for expensive, intrusive, and ineffective regulation of affiliate transactions. A structural remedy to holding company abuses would finally be in place decades after it was formally proposed by President Franklin D. Roosevelt’s administration in March 1935.

Regulators could focus on making sure the regulated transmission system was providing

the best possible service for the lowest possible price. They would be free from the political pressure to favor for-profit suppliers at the expense of consumers.

Holding companies would no longer have the books of their non-regulated subsidiaries opened for “fishing expeditions” by regulators. If they also divest their distribution systems to consumers, the holding companies would no longer own any regulated assets at all. Holding companies (no longer “utility” holding companies) would be free of most rate regulation for the first time since 1882.

Public Transcos Would Be Accountable to the Public

By having a publicly-accountable board of directors, the “government” of the transmission system would be of consumers, by consumers, for consumers. The actual corporate structure of the public transco could take several forms. It could be a subdivision of federal government, patterned after the federal power marketing administrations, such as the Western Area Power Administration. Or, it could be organized as a private non-profit corporation, or as a non-profit consumer-owned cooperative. The important thing is that the governance of the public transco be directly accountable to the consumers using the transmission system, and that the governance (and employees) be completely free of affiliation with any power supplier or marketer.

Nevertheless, the public transco has room for everyone. Power plant owners, power marketers, and other suppliers can all participate through advisory committees, provided all the important decisions are made by a board of directors directly accountable to consumers.

VI. Recommendations

Public Citizen recommends that the Commission order the creation of three non-profit public transmission companies (public transcos), which should own and operate the transmission systems of the Eastern Interconnection, the Western Interconnection, and the Texas Interconnection. Each public transco should be responsible for providing non-discriminatory open access to each transmission system at affordable rates approved by the Federal Energy Regulatory Commission.

Duties and responsibilities of each public transco should include scheduling and dispatching power plants; maintaining the transmission system; planning, building, and owning transmission system improvements; developing and implementing standards for system reliability; and arranging for the provision of ancillary services.

We also recommend that the Commission orders each public transco to purchase all of the transmission facilities needed to provide consumers with transmission service.

If the Commission believes it lacks clear authority to create three public transcos, or to allow the public transcos to purchase all transmission facilities, then it should petition Congress for the needed authority.

The creation of three non-profit public transcos would put all of the transmission facilities and responsibilities (including reliability) of each Interconnection under one non-profit roof. Under the full embrace of a public transco, each Interconnection could be planned and operated as an interconnected system. For the first time, the ownership and operation of each Interconnection would finally match its physical reality of a networked system of power plants, power lines, and power consumers.

Respectfully submitted August 16, 1999

by _____

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