Road Map for the Transition

Executive Summary

A competitive electric services industry cannot evolve without certain transitional steps. ELCON's Road Map for the Transition details the necessary structural features and steps in the transition period. The States have major responsibilities for ensuring that the inefficient regulated industry is replaced with a competitive marketplace and that the reliable operation of the grid is preserved. Existing contractual relationships between customers and their utilities, and between utilities and their suppliers, shall be honored. All parties should have a reasonable opportunity to plan for and consider new or alternative commercial relationships as a competitive marketplace evolves. Until market forces can supplant regulatory oversight, Federal, State, and local regulatory authorities should continue to exercise jurisdiction over utility transactions in order to ensure adequate consumer protection. The transition period should give new market entrants reasonable time to begin commercial operation without fear that an incumbent utility's market power would thwart those efforts.

The Transition Period

The transition period should be established as soon as possible for a period not to exceed three years. During the transition period, all currently regulated transmission and distribution facilities should continue to be subject to regulation. Generating assets that are in the rate base of regulated utilities are removed from rate base and committed back to the utility by means of transition contracts. These contracts provide important consumer protection unless and until a truly competitive market in generation services is established. Not later than 18 months after the beginning of the transition period, Day One shall be designated and scheduled. On Day One, all customers have the right to choose their providers of electric services. All customers shall be notified of their new rights at least 6 months in advance of Day One. Any customer may elect to remain served by the incumbent utility. Transition contracts with that utility's now affiliated or independent generating company shall remain in effect as long as those customers remain being served. The end of the transition period is designated Day N. At that time, all generation shall have been removed from rate base and no longer subject to rate regulation, except through extended transition contracts.

Market Power

Customer choice and free market entry are powerful checks on the abuse of market power. Therefore, no undue prohibitions should exist to entry in any market segment such as generation, grid operation, ancillary, transmission, local distribution, merchant, or customer services. There should be no legal or regulatory presumption that such entry is neither technically nor commercially viable. The market — not regulators — will be the ultimate judge of the viability of entry as long as only private capital is at risk.

Vertically integrated utilities shall be required, at a minimum, to operationally unbundle their generation, transmission, local distribution, and merchant functions into separate corporate affiliated entities. The operation of each utility's transmission system shall be assigned to one or more independent system operators (ISOs) that are unaffiliated with the utility or any of the utility's affiliates. ISOs shall be
regulated by FERC and operate under guidelines established by the North American Electric Reliability Council (NERC). ISOs shall not be involved either directly or indirectly with the actual financial transactions between buyers and sellers of electricity.

Regulation of affiliated relationships shall continue to the extent necessary to provide consumer protection against anticompetitive practices. FERC shall regulate transactions between regulated transmission companies and their affiliated generation and merchant companies. States shall regulate transactions between local distribution companies and their affiliated generation and merchant companies.

**Costs Associated with Uneconomic Assets**

The Road Map for the Transition proposes an equitable and efficient process to resolve the allocation and recovery of costs associated with uneconomic assets (a.k.a., stranded costs). This process will ensure that the investors of all utilities -- low cost and high cost -- are treated fairly. A five-step process for the recovery of the net costs associated with non-mitigable uneconomic assets is proposed for retail stranded costs subject to State jurisdiction and wholesale stranded costs subject to Federal jurisdiction.

1. The extent of a utility's uneconomic assets is made in a formal regulatory proceeding. These assets must be net of the difference between the book value of any generation-related assets below a fair market value and the fair market value and the value of any deferred accounts which constitute outstanding utility obligations owed to their ratepayers.

2. Each utility which seeks the opportunity to recover costs associated with uneconomic assets shall first commit to mitigate those costs to the maximum extent possible. Alternatively, the appropriate regulatory commission shall set a minimum mitigation threshold (MMT) designating the level of expected mitigation efforts on the part of the utility. The remaining, non-mitigable costs shall be split equitably between the utility and its customers, subject to: (a) a Responsibility Factor that accounts for the proportion of the utility's portfolio of uneconomic assets that were due to management discretion and those that were due to government mandates, and (b) the utility's performance with respect to the mitigation of the mitigable costs.

3. The appropriate regulatory commission shall allocate recoverable costs to each customer class on a pro rata basis using cost causation principles. Where feasible, the mechanism for the recovery of each customer or customer class' pro rata share shall be determined, and customized, through negotiated settlements. Otherwise, the commission shall determine such recovery mechanisms.

4. A utility's recovery period shall be predetermined for a period at least equal to the transition period but not to exceed five years.

5. The recoverable costs shall be recovered as they are stranded. Once each year during the recovery period, the level of recoverable costs shall be reevaluated and a determination shall be made to recognize more precisely the true market value of the recoverable costs.

**Universal Services**

At the commencement of the transition period, a Federal-State Joint Board that includes representatives of important consumer and supplier constituency groups shall be established for the purpose of recommending actions to State legislatures for the preservation of universal electric services. The Joint Board may consider such universal services as supplier of last resort, assistance to low income customers, and service termination moratoria. A State may consider the recommendations of the Board and adopt such recommendations, in whole or in part, and approve an adequate and sustainable support mechanism. Nothing shall preclude a State from instituting an alternative program of universal services. ###
# Blueprint for Customer Choice: EEI's Fictions versus the Blueprint's Facts

<table>
<thead>
<tr>
<th>EEI's Fictions</th>
<th>The Blueprint’s Facts</th>
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<tr>
<td>EEI asserts that the Blueprint &quot;promotes the self-interest of large industrial consumers in a manner that would result in shifting costs and raising rates to others, including small commercial and residential customers.&quot;</td>
<td>The Blueprint would give all electricity customers -- large or small -- the opportunity to share the benefits of competition. The Blueprint does not advocate cost shifting. In fact, the potential for any cost shifting is greatest the longer industry restructuring is delayed or averted. Industrials and other businesses will sell more of their products and services if all customers save money on their electric bills.</td>
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<td>EEI's claims that the Blueprint &quot;would shift value from investor-owned utility shareholders ... to the shareholders of the large industrials.&quot;</td>
<td>As EEI knows, an increasing number of low-cost utilities believe that maintaining the status quo, or worse, mandating the full recovery of certain utilities' uneconomic assets (a.k.a., stranded costs) will harm the share values of those utilities who stand to be competitive winners in a new industry. The Blueprint lets the market decide the value of any business' securities -- whether it be industrials or electricity suppliers -- based on their ability to successfully compete. In testimony presented at a House Energy &amp; Power Subcommittee hearing on FERC’s NOPR, Central Illinois Lighting Company President Bill Shay said, &quot;[u]nimites, and not regulatory commissions, make investment decisions. In the end, the utility should benefit or suffer based upon the quality of its decisions.&quot;</td>
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<td>EEI argues that &quot;efficient competition&quot; is only achieved when &quot;total system costs, including existing obligations (stranded costs), are recovered... &quot;</td>
<td>So-called stranded costs are, by definition, the costs associated with uneconomic assets. These costs are the existing premiums above true market clearing prices that are responsible for widespread rate disparities, and which are creating market pressure for deregulation. Efficient competition is wholly inconsistent with the continued employment of any uneconomic asset.</td>
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<td>EEI claims that the Blueprint 'rejects FERC's proposed policies or rules with respect to the recovery of costs associated with uneconomic assets.'</td>
<td>The Blueprint is consistent with FERC's, ongoing rulemaking process, although it argues against FERC issuing any rules that unduly impede or interfere with the promotion of wholesale competition. When Congress enacted EPAct in 1992, it directed FERC to do nothing less.</td>
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<td>EEI asserts that the Blueprint &quot;lacks an economic and regulatory framework.&quot;</td>
<td>As the French would say, &quot;Au contraire.&quot; The Blueprint predates its vision on competition where competition works, and regulation where competition can't work -- with the obvious bias in favor of greater competition. The Blueprint's first &quot;finding&quot; is, &quot;[c]ompetition, not regulation, is the best way to spur innovation and the development of new technologies and services. A competitive marketplace is the most efficient way to lower prices and increase value for consumers.&quot; EEI clearly never read the Blueprint.</td>
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<td>EEI argues that &quot;most real economic benefits that might be achieved by retail competition ... can probably be achieved at least as efficiently via other means but at significantly lower transition costs.&quot;</td>
<td>As House Commerce Committee Chairman Bliley has noted, where all customers don't have access to the marketplace, the benefits of competition are denied to them. This has been the case in natural gas where small customers are denied access, and as a result, neither efficiency improvements nor price decreases have materialized in retail service. The lesson that the Blueprint espouses is that wholesale-only competition is an oxymoron.</td>
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<td>EEI asserts that the Blueprint would interrupt state restructuring proceedings and &quot;impose a single, federally mandated, one-size-fits-all structure and regulatory regime in all states.&quot;</td>
<td>Legislation anticipated in the Blueprint would likely follow the lead of most, if not all, such state proceedings. There are real federal statutory impediments to real competition that the states cannot fix, e.g., PURPA and PUHCA repeal. These changes are necessary to ensure an efficient interstate market for electric services. That market is the &quot;one-size-fits-all&quot; model adopted in the Blueprint.</td>
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A. Introduction

Competition in electricity will benefit all consumers. ELCON’s Blueprint for Customer Choice\(^1\) outlines the economic and regulatory frameworks and necessary legislative reforms that would allow the emergence of real competition in the electric services industry. The Blueprint does not impose a specific market structure other than that the market be truly competitive. Only an irreducible minimum of physical assets and services are required to be regulated to ensure the reliable operation of the grid and service to all customers.

The Blueprint advocates the removal of Federal and State statutory and regulatory impediments to entry into the market by any entity that seeks to provide or purchase products or services presently offered as a bundled service by a vertically integrated monopolist. The Blueprint does not propose to transfer regulatory jurisdiction from States to the Federal government. The Blueprint advocates the transfer of market control from regulators to the marketplace. Thus, all market segments in the current industry structure should be unbundled and no undue prohibitions should exist to entry in any market segment, whether it be generation, grid operation, ancillary, transmission, local distribution, merchant, or customer services. The market -- not regulators -- will decide whether entry by any new competitor is commercially viable. While generation services can be provided in unregulated, competitive markets, the rates, terms, and conditions for the use of transmission and distribution facilities that continue to be provided as monopoly services should be regulated. The providers of those regulated services will retain an obligation to serve.

As a practical matter, a competitive market structure cannot evolve without certain transitional steps. This Road Map attempts to address this situation. Existing contractual relationships between native load customers and their utilities, and between utilities and their suppliers, should be honored. All parties should have a reasonable opportunity to plan for and consider new or alternative commercial relationships as a competitive marketplace evolves. Federal, State and local regulatory authorities should

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\(^1\)Electricity Consumers Resource Council (ELCON), *Blueprint for Customer Choice*, Discussion Draft, September 13, 1995.
continue to have jurisdiction over utility transactions in order to ensure adequate consumer protection until market forces can supplant regulatory oversight. The transition period should also give new market entrants reasonable time to begin commercial operation without fear that an incumbent utility’s market power would thwart those efforts. Finally, an equitable and efficient process is proposed to resolve the allocation and recovery of costs associated with the uneconomic assets (a.k.a., stranded costs) that some utilities have acquired. This process will ensure that the investors of all utilities -- low cost and high cost -- are treated fairly.

B. Objectives of the Transition Period

1. Provide, to the maximum extent practicable, an orderly, economically efficient transition. Phase out laws and regulations that continue to restrict the development of competitive electricity markets and perpetuate widespread rate inequities.

2. Ensure that all customers have an opportunity to benefit from competition.

3. Eliminate cross-class subsidies.

4. Ensure no undue cost shifting among customer classes.

5. Maintain the reliable operation of the interconnected grid.

6. Ensure that utilities have a right to establish, and the burden of proving, the existence of "stranded costs" (i.e., costs associated with uneconomic assets).

7. Ensure that incumbent utilities cannot exercise or expand market power, including the prevention of cross-subsidies and self-dealing between unregulated and regulated affiliate companies.

8. Ensure that all States expeditiously commence procedures for allowing customer choice for all consumers of electricity.

9. Remove anticompetitive Federal and State statutory and regulatory barriers to customer choice.

10. Eliminate barriers to the rapid entry of new suppliers and technologies into the marketplace.

11. Provide access to ancillary, interconnection, and backup services at nondiscriminatory rates, terms, and conditions until a competitive market for such services has emerged.

12. Provide fair compensation to incumbent utilities that continue to provide services under an obligation to serve.

13. Establish just and reasonable policies and rules for the implementation of universal services.
C. Features of the Transition Period

1. Year One -- ELCON recommends that a the transition period for the deregulation of generation and merchant services shall be established as soon as possible by each State for a period not to exceed three years. Under certain circumstances, State jurisdictional regulation shall continue for services provided to native load customers that choose to remain being served by their incumbent utility as long as the generation or merchant services market segments are deemed insufficiently competitive. During the transition period, all currently regulated transmission and distribution facilities shall continue to be subject to regulation, except as provided below, in the sections on transmission and local distribution.

2. Day One: The Beginning of the Customer Election Period -- Each State commission shall designate Day One, the beginning of the customer election period. Day One shall not be scheduled later than 18 months from the beginning of the transition period. On that date, each customer shall have the right to choose its providers of electric services. All customers shall be notified of their new rights at least 6 months in advance of Day One. All customers shall be able to reassign their customer billing, usage, and other data from their incumbent utility to a new primary service provider or other entity.

3. Day N -- The end of the transition period is designated Day N. At that time, all generation shall have been removed from rate base and no longer subject to rate regulation, except through extended "transition contracts" as specified below.

D. Market Power

1. Customer Choice and Antitrust Laws -- Customer choice is a powerful weapon against the abuse of market power. However, since customer choice alone cannot completely mitigate market power, there must also be full enforcement of laws and regulations that protect consumers against anticompetitive practices and antitrust violations.

2. Market Entry as a Check on Market Power -- Free market entry is a powerful check on the abuse of market power. Therefore, no undue prohibitions should exist to entry in any market segment such as generation, grid operation, ancillary services, transmission, local distribution, merchant, or customer services. There should be no legal or regulatory presumption that such entry is neither technically nor commercially viable. The market will be the ultimate judge of the viability of entry as long as only private capital is at risk.

3. Operational Unbundling -- Vertically integrated utilities shall be required, at a minimum, to operationally unbundle their generation, transmission, local distribution, and merchant functions into separate corporate affiliated entities. The operation of each utility's transmission system shall be assigned to one or more independent system operators (ISOs) that are unaffiliated with the utility or any of the utility's...
affiliates. This separation of the operation and dispatch of generation from the operation of the transmission system is necessary to assure that transmission market power cannot be used to distort the market for generation. As an alternative, a utility may also voluntarily divest of sufficient assets to achieve the intended mitigation of market power.

4. Interaffiliate Pricing of Regulated Services
   (a) Interaffiliate Transmission Transactions -- A regulated transmission company's affiliated generation and/or merchant companies shall be required to use the same rates, terms, and conditions for transmission services as the transmission affiliate charges to other generation or merchant companies for similar use of its system.
   (b) Interaffiliate Local Distribution Transactions -- A local distribution company's affiliated generation and/or merchant companies shall be required to use the same rates, terms, and conditions for local distribution services as the LDC charges to other generation or merchant companies for similar use of its system.

5. Regulation of Interaffiliate Transactions -- Federal and State regulation of affiliated relationships shall continue to the extent necessary to provide consumer protection against anticompetitive practices. These protections shall be as follows:
   (a) FERC shall regulate transactions between regulated transmission companies and their affiliated generation and merchant companies, and
   (b) States shall regulate transactions between local distribution companies (LDCs) and their affiliated generation and merchant companies.

6. Vertical Concentration\(^2\) -- The market power associated with vertical concentration shall be mitigated by allowing free entry into any market segment. Only the market shall judge the commercial viability of entry. Hence, if by the exercise of market power, certain products or services are offered at discriminatory prices or service is withheld, new providers of such products or services shall be allowed to enter that market segment and directly compete with the high-price supplier.

7. Horizontal Concentration\(^3\) -- The continued enforcement of antitrust laws is the main defense against the market power associated with horizontal concentration.

\(^2\)Vertical concentration is a characteristic of the electric utility industry's integrated structure, i.e., the joint ownership or control of generation, transmission, distribution, customer services, and sometimes fuel supply and the marketing of appliances and other end-use equipment. Vertical concentration becomes a market power concern when the level of concentration produces anticompetitive market outcomes.

\(^3\)Horizontal concentration often involves the acquisition by a firm of that firm's direct competitor(s). Horizontal concentration becomes a market power concern when the number of active competitors in the market has been reduced to an anticompetitive level.
8. Mitigation of Market Power by Regulation -- The Federal Energy Regulatory Commission (FERC) and the States shall make any determination of the existence or lack of market power within their respective jurisdiction, as necessary, to limit the market power of regulated entities. The FERC may make its determinations in consultation with the U.S. Department of Justice.

9. Eminent Domain and Access to Rights of Way -- To the extent that any company or affiliate of an incumbent utility retains the right of eminent domain and/or controls access to rights of ways, it shall not use this right and/or control to limit competition nor gain an unfair advantage over other entities wishing to compete. Any company wishing to use the right of eminent domain for the siting of generation or transmission and/or distribution facilities shall be subject to regulation of the facility or facilities for which the right of eminent domain was used and may be required by regulation to assume an obligation to serve for the use of the facility or facilities.

10. Public-Sector Participation -- Competition between public and private utilities has existed for over a hundred years. The options for both public and private sector service providers should continue.

E. Decontrol of Generation

1. Years One Through Three -- All generation shall be removed from rate base. During the transition period, and thereafter as necessary, the generating company shall continue to sell power (including ancillary and backup services) to the affiliated or previously affiliated distribution company or companies under transition contracts at rates based on embedded costs or other State approved rates, terms, and conditions as existed and enforced prior to the transition period. The generating companies that hold transition contracts shall be allowed an opportunity to earn a reasonable return on all prudent investments that are used and useful.

2. Transition Contracts -- The purposes of transition contracts are to allow:
   (a) Appropriate recovery of the costs associated with uneconomic assets and reasonable opportunity for the utility to mitigate all or some of those costs;
   (b) The voluntary renegotiation of purchased power and fuel supply contracts which are priced in excess of market clearing prices;
   (c) Any customer served under contract to continue being served under the contract's rates, terms, and conditions;
   (d) Native load customers who choose to remain served by their incumbent utility, or are unable of shopping because of continuing market failure, to continue such service until a functioning competitive generation market is established; and
   (e) Fair compensation to incumbent utilities that continue to provide service under an obligation to serve.

3. Ancillary and Backup Services -- Transition contracts shall also provide ancillary and backup services at nondiscriminatory rates, terms, and conditions to all producers and consumers who had or achieved PURPA-qualifying status by the beginning of
the transition period. The repeal or reform of PURPA must not commence until these contracts are in place and enforceable.

F. Costs Associated With Uneconomic Assets

1. Costs Associated with Uneconomic Assets\(^4\) -- The costs associated with a utility's uneconomic assets include:
   (a) The value in rate base of uneconomic generating assets in excess of their fair market value offset by:
      (1) The difference between the book value of any generation-related assets below a fair market value and the fair market value, and
      (2) Deferred accounts\(^5\) which constitute outstanding utility obligations to their ratepayers and are owed to their ratepayers.
   (b) The costs associated with purchased power agreements with non-affiliated companies that are in excess of market clearing prices;
   (c) The costs associated with fuel supply contracts with non-affiliated companies attributable to the proportion of unit fuel prices in excess of market clearing prices;
   (d) Properly allocated overhead expenditures associated with uneconomic assets; and
   (e) Some costs associated with the deferred recovery of certain investments or expenditures (also called "regulatory assets").

2. Non-recoverable Uneconomic Assets -- The costs associated with uneconomic assets shall not include the potential revenue stream associated with any hypothetical future use of the uneconomic assets, nor the above market costs associated with purchased power agreements and/or fuel supply contracts that the utility had with their own affiliated companies.

3. Exclusion of Post-1992 Uneconomic Acquisitions -- No utility shall be allowed to seek recovery of any costs associated with uneconomic assets that were committed to subsequent to the enactment of the Energy Policy Act of 1992 (EPAct).

4. Mitigation of Uneconomic Assets -- Utilities with uneconomic assets shall mitigate costs associated with uneconomic assets by writing off or writing down those assets against earnings, by the sale of these or other non-generation related assets, by

\(^4\)These costs are also known as stranded costs, stranded investments, stranded commitments, transition costs, excess costs over market ("ECOM"), embedded costs exceeding market prices ("ECEMP"), uneconomic sunk costs, and costs without a customer.

\(^5\)Deferred accounts may include pending rate refunds and excess deferred taxes. In addition, utilities may simultaneously accelerate the depreciation rate of uneconomic assets while decelerating the depreciation rate for assets that have a book value and embedded cost rates below marginal (market) costs.
renegotiating purchased power and/or fuel supply contracts, and/or by cost reductions. As in other private sector industries, the option to seek reorganization of a company's assets and liabilities under relevant bankruptcy laws shall not be precluded.

5. Five-Step Process for the Recovery of Net Costs Associated with Non-Mitigable Uneconomic Assets -- The net costs associated with non-mitigable uneconomic assets shall be recovered by means of a five-step recovery process pursuant to State jurisdiction for all retail stranded costs, and Federal jurisdiction for all wholesale stranded costs.

Step One: Determine Extent of Uneconomic Assets -- Establish a formal proceeding which provides an opportunity for public comment by interested parties. Determine a utility's potential uneconomic assets in advance of the recovery period. Alternatively, a utility may voluntarily divest all its generation assets to determine the costs associated with uneconomic assets as the difference between the net sales price and the book value of the sold assets (adjusted for prudence considerations). If a utility elects this alternative, the sale or spin off of multiple generating units or stations shall be staged over some finite time period to avoid or minimize any "fire sale" effect on the used generation market.

Step Two: Determine Shareholder/Customer Sharing Mechanism -- Each utility which seeks the opportunity to recover costs associated with uneconomic assets shall first commit to mitigate those costs to the maximum extent possible. Alternatively, the appropriate regulatory commission shall set a minimum mitigation threshold (MMT) designating the level of expected mitigation efforts on the part of the utility. The remaining non-mitigable costs shall be split equitably between the utility and its customers. The proportion allocated to the utility shall be subject to a Responsibility Factor as follows:

\[ \text{Utility Share} = \left[ 0.5 + (0.5 \times R) \right] \times \text{Total Non-mitigable Costs} \]

where \( R \) is the Responsibility Factor. Customers shall be allocated the difference between the utility share and total non-mitigable costs. The appropriate regulatory commission shall set \( R \) based on the following guidelines. \( R \) shall equal zero for an extremely well-managed and efficient utility whose non-mitigable costs were the result of a government mandate that the utility aggressively opposed. \( R \) shall equal one for an extremely inefficient and poorly managed utility that acquired enormous amounts of uneconomic assets due solely to management discretion. The commission may set \( R \) between zero and one taking into consideration:
(a) The proportion of the utility's portfolio of uneconomic assets that were due to management discretion and those that were due to government mandates;

(b) The utility's performance with respect to the mitigation of the mitigable costs; and

(c) The quality of the utility's management at the time the uneconomic assets were incurred.

Step Three: Negotiate Recovery Mechanisms -- The appropriate regulatory commission shall allocate recoverable costs to each customer class on a pro rata basis using cost causation principles. The mechanism for the recovery of each customer and customer class’ pro rata share shall be determined, where feasible, through negotiated settlements. Individual customers or customer groups shall not be precluded from customizing a suitable payment scheme for the recovery by the utility of that customer’s pro rata share of the recoverable amount. The appropriate regulatory commission shall determine such recovery mechanisms in the absence of a negotiated settlement. Rates during the recovery period shall not increase for utilities that are recovering any costs associated with uneconomic assets.

Step Four: Set Recovery Period -- A utility's recovery period shall be predetermined for a period at least equal to the transition period but not to exceed five years.

Step Five: True-Up Recoverable Costs -- The recoverable amount of the net costs associated with non-mitigable uneconomic assets shall be recovered as they are stranded. Once each year during the recovery period, the level of recoverable costs shall be reevaluated using the same method of determination that was used to set the recovery cap, except where assets had been sold or spun off, and a true up of recoverable costs shall be made as follows:

(a) Recoverable costs that were estimated using non-market-based, administrative procedures shall be subject to true-ups to reflect more precise determinations of the real value of the recoverable costs whenever and as such determinations are made.

(b) Recoverable costs associated with uneconomic assets that were sold or spun off by the utility shall be subject to true-ups to reflect the market valuation of the assets following their sale. In neither case shall a true up result in the utility recovering costs in excess of the recovery cap.
6. Return On Uneconomic Assets -- A utility with uneconomic assets that are subject to recovery shall be prohibited from earning a return on those assets during the recovery period.

G. Transmission and Interconnection to the Interstate Grid

1. Years One and Two -- Owners of transmission facilities currently subject to FERC regulation are required to file with the FERC within eighteen months of the commencement of the transition period, a proposal for establishing one or more RTGs, or other regional transmission organizations, for the sole purpose of planning the interstate transmission system.

2. Rates, Terms, and Conditions for Regulated Transmission Services -- The rates, terms, and conditions for the use of transmission facilities that are currently subject to FERC regulation shall continue to be regulated on a comparable and nondiscriminatory by the FERC unless evidence is provided by it owners that market power in the use of those facilities does not exist. The providers of regulated transmission services shall retain an obligation to serve.

3. Siting of Interstate Transmission Systems -- The manner in which State-Federal jurisdiction is exercised over the siting of interstate natural gas pipelines systems shall be the model for the siting of new regulated transmission facilities.

4. Self-Regulation of User-Owned Transmission Facilities (i.e., high-voltage Private Delivery Systems or PDSs) -- The owners or operators of PDSs that are for the exclusive, non-public use by the owners of such facilities, or any other user with a commercial, privately negotiated relationship with one or more owners, shall be exempt from rate regulation. The owners or operators of existing regulated transmission facilities may petition the FERC for a license to opt out from rate regulation if the owner or operator of the facility or facilities can demonstrate that the use of the facility or facilities and is not an exercise of market power and the facilities’ owner(s) did not use the power of eminent domain in the original siting process.

H. Independent System Operation and Coordination

1. ISOs and Regional Transmission Groups -- During the transition period, independent system operators (ISOs) shall be established as companies unaffiliated with the owners or users of transmission/local distribution facilities. An ISO shall be required to perform such functions necessary to coordinate reliable operation within its system. Each ISO shall be certified and regulated by the FERC. An ISO’s franchise shall be granted for a finite period of time and shall be subject to termination to allow new entities to competitively bid for the right to serve the franchise. ISOs shall
not be involved either directly or indirectly with the actual financial transactions between buyers and sellers.\(^6\)

2. Guidelines for Reliability -- ISOs shall operate the interstate grid under guidelines established by North American Electric Reliability Council (NERC) and all applicable NERC regional reliability councils (or their successor organizations). NERC membership shall be open to any party with a commercial interest in the reliable operation of the grid. These guidelines shall apply to transmission operating and reliability standards.

I. Local Distribution Functions

1. Unbundling of Traditional Distribution Services -- Traditional distribution functions shall be split between the "wires" business (i.e., local distribution companies or LDCs) and the electric services merchant business (i.e., merchants). LDCs shall be regulated by the appropriate State or local authority. Merchants shall operate on an unregulated basis with respect to price, and terms and conditions of service.

2. Electric Services Merchants -- Merchants, including marketers, aggregators, LDCs\(^7\) and brokers, are the primary service providers of all end users that do not have bilateral contracts directly with generators for all or part of their needs. There shall be no undue restrictions on any entity that wants to enter this market, nor shall there be any restrictions on what products or services shall be bundled and sold in the marketplace.

3. Customer Billing and Usage Data -- States shall promulgate rules for the transfer of customer billing and usage data to alternative service providers subject to the written consent of each customer. The transition period shall provide sufficient opportunity for new market entrants (e.g., merchants) to establish their businesses to expedite the phase out of any requirement by LDCs to continue their obligation to provide generation and customer services.

4. Private User-Ownership of Distribution Facilities (i.e., low-voltage PDSs) -- Native load customers shall be eligible to own or build their portion of the local distribution ("wires") system that physically interconnects their load(s) to the interstate grid or to other regulated distribution facilities. The owners or operators of low-voltage PDSs shall be eligible to use those facilities to serve any other users with a

\(^6\)The role of an ISO is analogous to air traffic controllers in the airline industry. Air traffic controllers are responsible for ensuring the safe and reliable operation of the air carrier business. The controllers do not and ought not be involved in the pricing of airline tickets.

\(^7\)States continue to regulate the merchant functions of LDCs and interaffiliate transactions between LDCs and their merchant affiliates. FERC would regulate transactions between transmission companies and affiliated merchant companies.
commercial relationship with one or more of the PDS' owners, and shall be exempt from rate regulation.

5. Rates, Terms, and Conditions for Regulated Local Distribution Services -- The rates, terms, and conditions for the use of local distribution facilities that are currently subject to State or local regulation shall continue to be regulated by State or local authorities unless evidence is provided by its owners that market power in the use of those local distribution facilities does not exist. The providers of regulated local distribution services shall retain an obligation to serve.

6. Responsibilities of LDCs -- LDCs shall be responsible for maintaining and operating existing local distribution facilities that are not privately owned. LDCs shall also plan and construct new facilities and offer the services of those facilities at regulated, nondiscriminatory rates. LDCs may offer to maintain and/or operate user-owned facilities (i.e., PDSs) under negotiated, market-based prices, terms, and conditions.

J. Federal-State Joint Board on Universal Services

1. Federal-State Joint Board -- At the commencement of the transition period, a Federal-State Joint Board shall be convened for the purpose of recommending actions to State legislatures for the preservation of universal electric services. In addition to the members of the FERC and State commissions, other members of the Joint Board shall be:

   (a) A representative of a national organization of State utility consumer advocates;
   (b) A representative of a national environmental advocacy group;
   (c) A representative of a national organization of industrial electricity consumers;
   (d) A representative of a national organization of commercial electricity consumers; and
   (e) One representative from each industry sector representing generating companies, transmission companies, merchant companies, and LDCs.

2. Universal Services -- The Joint Board may consider such universal services as:

   (a) Supplier of Last Resort;
   (b) Assistance to Low Income Consumers; and
   (c) Service Termination Moratoria.

3. Principles for Universal Services -- The Joint Board shall base policies for the preservation of universal services on the following principles:

   (a) Just and reasonable rates;
   (b) Comparability in urban and rural areas;
   (c) Adequate and sustainable tax mechanisms for supporting universal services; and
   (d) Equitable and nondiscriminatory contributions from all providers of services.

4. State Approval -- At least one year prior to Day N, the Joint Board shall submit its recommendations to each State legislative body. A State may consider the
recommendations of the Joint Board and adopt such recommendations, in whole or in part, and approve an adequate and sustainable support mechanism. Nothing shall preclude a State from instituting an alternative program of universal services.

5. Commencement of Universal Services -- The universal services program shall commence in each State that adopts such a program.

###
## Road Map for the Transition

**For Discussion Purposes Only**

### Transition Period

<table>
<thead>
<tr>
<th>Monopoly Era Ends</th>
<th>Year One</th>
<th>Year Two</th>
<th>Year Three</th>
<th>Competitive Era Begins</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start Transition Period: Begin Removing Federal and StateStatutory and Regulatory Barriers to Competition</td>
<td>Customers Informed of Day One</td>
<td>All Customers Can Choose Suppliers</td>
<td>Day N End of the Transition Period</td>
<td></td>
</tr>
</tbody>
</table>

### Generation
- Generation Removed from Rate Base Committed to LDCs Under Transition Contracts
- QFs Guaranteed Backup Power and Ancillary Services Under Transition Contracts
- Termination of Transition Contracts If, and Only if, Competition Exists

### Transmission
- Regulation Continues for Use of Transmission Facilities That Continue to be Provided as Monopoly Services
- User-Owned Transmission Systems Have Option of Self-Regulation
- RTGs or Other Planning Groups Established

### Grid Operation
- Independent System Operators (ISOs) Established to Maintain Grid Reliability Subject to NERC Guidelines

### Local Distribution
- "Wires" and Merchant Functions of Traditional Utilities are Unbundled -- Local Distribution Companies (LDCs) Provide "Wires" Services Under State or Local Regulation -- Merchants Are Unregulated As of Day One
- Customers Become Eligible to Own Their Portion of the Distribution System That Physically Interconnects Their Load(s) to the Interstate Grid and Contractually-related Customers
- Independent Merchants Become Eligible to Sell to Ultimate Consumers -- Customers can reassign their billing, usage, and other data from the incumbent utility to a new primary service provider

### Recovery of Uneconomic Costs
- Estimate Uneconomic Assets for Recovery Cap and Predetermine Recovery Period

### Universal Services
- Federal-State Joint Board Established for Purpose of Recommending Universal Services Programs
- Joint Board Submits Recommendations to State Legislatures
- Universal Services Programs Are Initiated Where State Approved and Funded