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# New Directions for T&D Policy

Since the early 1970s, there has been an intensive move across the U.S. economy to deregulate businesses that once were considered incompatible with competition.

This trend toward a competitive market outcome also has taken root in the electric power industry. The market for electric generation was opened to competition during the 1970s. Since that time, the vast majority of new generation has been constructed by companies other than traditional utilities. Unfortunately, many do not feel these new entrants have delivered on the promised benefits of competition.

In retrospect, deregulating the electric generation sector by itself could have never achieved the promised results. Without a corresponding effort by owners of transmission systems to upgrade and expand the grid to accommodate this new generation, the move toward competition in generation was set up to fail. That's because customers in this environment were still faced with the choice of purchasing generation from their incumbent suppliers or paying above-market prices in order to transport generation from remote sources, due to the lack of economically accessible transmission. Customers continued to face these limited choices so long as transmission ownership continued to reside with the entities that own generation. The need to maintain the artificial comparative advantage of existing uneconomic generation discouraged owners of generation from investing in expanding their transmission systems. Thus, transmission infrastructure investment was treated as an inferior investment.

Starting in the late 1990s, however, the Federal Energy Regulatory Commission (FERC) recognized the need to change the incentive structure associated with the ownership, operation, and expansion of the U.S. electric infrastructure. By encouraging the formation of both regional transmission organizations (RTO) and independent transmission companies, the FERC hoped to accomplish two public policy objectives: (1) weaken the incentives faced by the owners of both generation and transmission to use their control over the transmission system as a way to force customers to purchase uneconomic generation, and (2) promote regional planning and cost recovery mechanisms for those transmission projects designed to have broader regional and market benefits.

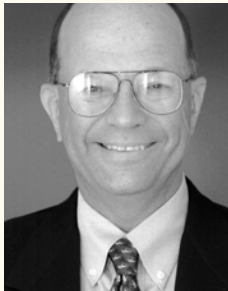
To a large extent, these efforts have already begun to pay off. For example, greater economic

benefits have been provided to entities that have been willing to participate in the RTO process. Others that have divested their transmission systems to independent transmission companies have enjoyed the advantages of RTO participation by the new owners, along with benefits associated with the infusion of capital into their organizations arising from sales prices that reflected a portion of the value of the future independence of the transmission assets.

The expansion of the RTO model, along with the limited amount of system divestitures to date, cannot solely overcome the countervailing pressure by utilities to continue to own both the generation and related transmission in their service territories. As a result, the FERC recently expanded the opportunities to sellers of transmission systems. Sellers can now retain up to a 49 percent passive ownership share in the new ITC established by the purchaser. This means the seller now has the ability to retain a sizeable portion of the future economic value of the system through the passive ownership route.

FERC's recognition of the benefits of allowing passive ownership of transmission is appropriately conditioned on making sure that a market participant cannot effectively control the operation of a transmission-only entity through direct or indirect influence. In addition to the 49 percent limit on individual passive ownership interest, FERC specified six other factors it would use as "tests" to determine whether or not control of the operating utility existed. In its comments to the commission in Docket No. PL05-11, Trans-Elect specifically suggested that it should review other elements regarding corporate governance besides simply the percentage of passive ownership beyond such obvious items as the make-up of the transmission company's board of directors. The commission accepted these comments, and incorporated them into its order.

At present, the financial community and the current owners of transmission assets are exploring ways to realize the value from this change in FERC policy. Unlike other policy orders issued by the FERC, transactions entered into under current regulation will lead to substantial review and scrutiny by the commission. We believe that transactions under this policy undertaken in concert with the incumbent independent transmission companies will minimize the amount of mitigation necessary to achieve approval.



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