

Commonwealth of Kentucky  
Before the Public Service Commission

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PUBLIC SERVICE  
COMMISSION

In the Matter of:

AN ASSESSMENT OF )  
KENTUCKY'S ELECTRIC )  
GENERATION, TRANSMISSION) )  
AND DISTRIBUTION NEEDS )

Administrative Case No. 2005-00090

**COMMENTS BY THE ATTORNEY GENERAL'S OFFICE**

Comes now the Attorney General's Office, by and through his Office of Rate Intervention, and provides these written comments in response to the Public Service Commission's ( hereinafter the "Commission") letter of invitation to provide same dated 11 May 2005.<sup>1</sup>

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<sup>1</sup> See attachment 1.

## COMMENTS BY THE ATTORNEY GENERAL'S OFFICE

In the Commission's letter of 11 May 2005, witnesses have been directed to address three questions. Specifically, the noted areas are: what additional information or data, if any, should the Commission consider in developing the Strategic Blueprint;<sup>2</sup> what are the top issues facing the electric power industry over the next 20 years; and what barriers, if any, exist to meeting future investment needs in electric power infrastructure in Kentucky? These inquiries as well as any tangential concerns will be considered in their respective order.

### **What additional information or data, if any, should the Commission consider in developing the Strategic Blueprint?**

The Commission has asked two sets of data requests of the energy providers. While these questions explore at some length the various aspects of the planning and implementation process for future energy needs and the effects thereon to each company, its ratepayers, and the Commonwealth as a whole, direct inquiries are not made as to any *regulatory* barriers to investment in generation, transmission, and distribution infrastructure in Kentucky. The Executive Order mandates the Strategic Blueprint to analyze the existence of barriers to investment in generation, transmission, and distribution infrastructure in Kentucky. As a state in which the provision of energy

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<sup>2</sup> The phrase "Strategic Blueprint" refers to a concept articulated in the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy – Opportunities for our Future*. The task force was assembled by the Governor to finalize a comprehensive energy policy for Kentucky. See attachment 2. Subsequent to the release of the report, the Governor issued an Executive Order which ultimately led to the instant case. See the Commission's letter of 11 May 2005 and Executive Order 2005-121.

is fully regulated, the central question continues to be whether the regulatory scheme presents barriers to investment in Kentucky. To date, Kentucky's regulatory framework has proven to be quite effective in securing low cost rates for the ratepayers while simultaneously affording the suppliers with a reasonable return on their investment. Uncontroverted evidence to this fact is evinced by simply looking at the recent history of acquisitions and mergers within the Commonwealth. One can hardly argue that a Kentucky utility would be purchased unless a profit was expected. Accordingly, any suggestion that the regulatory scheme should be altered or otherwise modified to promote investment should be dismissed. However, since the underlying cause for this case is the quest to improve infrastructure investment, direct questions should be asked of the utilities in order to ascertain their position on the issue.

**What are the top issues facing the electric power industry over the next 20 years?**

Admittedly, the national regulatory framework holds uncertainty. This uncertainty creates an undesired dynamic environment at the national level which affects Kentucky. This issue alone should be considered as a main priority to address, whether it be related to environmental compliance, control of transmission, or otherwise.

Just as important as the elimination of the regulatory dilemma is the need to stabilize the cost of electricity. As the Commonwealth's chief consumer advocate, every

effort must be observed to accomplish this goal while maintaining a healthy electric industry.

In addition to those issues which are readily identifiable but remain “moving targets,” a matter which has not received much recognition is the General Agreement on Trade in Services currently being negotiated by the United States Trade Representative (USTR) with the World Trade Organization. At this point in time the Attorney General’s Office has more questions than answers, but it appears as though the USTR<sup>3</sup> has committed to offering “services incidental to the distribution of electricity” as service which, under GATS, must not have any unduly burdensome barriers to competition placed upon it. As best as can be surmised on documents now made public, regulation as we know it will change. Attached to these comments as attachment 3 is an Interim Report on GATS and Electricity prepared by the Working Group on Energy & Trade Policy of the National Conference of State Legislatures. As more information becomes available, this office will disseminate it to the public.

**What barriers, if any, exist to meeting future investment needs in electric power infrastructure in Kentucky?**

The answer to this question was addressed in response to the first inquiry. However, in order to emphasize the point, to date, Kentucky’s regulatory framework has proven to be quite effective in securing low cost rates for the ratepayers while simultaneously affording the suppliers with a reasonable return on their investment.

Uncontroverted evidence to this fact is evinced by simply looking at the recent history of acquisitions and mergers within the Commonwealth. One can hardly argue that a Kentucky utility would be purchased unless a profit was expected. Accordingly, any suggestion that the regulatory scheme should be altered or otherwise modified to promote investment should be dismissed. Unless the Executive Order should be interpreted to ask the Commission to engage in reviewing barriers outside of its regulatory jurisdiction, and the Commission could somehow do so, the issue is moot.

### **Additional Remarks and Conclusion**

The effort to promote economic development and lower barriers to investment should not be accomplished at the expense of the ratepayers in one of the poorest states in the nation. Already the statutory scheme of cost recovery, including profit, for environmental costs puts the burden of sustaining the Kentucky coal industry on the shoulders of the ratepayers. This differs from the opportunity afforded the utility to earn a reasonable profit on investment necessary to serve Kentucky consumers set out in the regulatory scheme. As the cost of environmental compliance to allow continued use of Kentucky coal dramatically increases, this burden on the ratepayer becomes ever greater. By way of comparison, in the natural gas industry recent legislation also saddles ratepayers with the costs, rather than the opportunity to earn a reasonable return on investment to serve Kentucky consumers, of pipeline replacement programs

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<sup>3</sup> By letter dated 13 April 2005 the USTR appears to disavow that electricity is a service being negotiated under GATS. However, the USTR's own press releases indicate otherwise.

commenced in the name of safety. Safety is a valid concern, but it is the obligation of the utility, to make a timely replacement of its pipes. Extraordinarily expensive programs implemented following on the long-term failure to make timely investments in replacement of pipes should not be rewarded by moving the investment from the regulatory framework of an opportunity to earn a return on that investment to a guaranteed cost recovery for that investment.

The current statutory safeguards against unnecessary investment should be maintained and strengthened to safeguard against unnecessary investment for which the Kentucky consumer must pay in the name of economic development or infrastructure development if the Kentucky ratepayer is not the ultimate recipient of the benefit of that investment. Upgrades of the transmission systems to aid consumers in other states and adding generation utilities that are not necessary to serve the Kentucky consumer should be avoided.

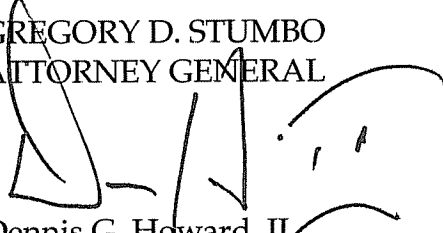
To conclude, the Attorney General's Office participated in the public remarks process that purportedly factored into the contents of the Commonwealth Energy Task Force's Report. However, the report does not appear to contain any significant cautions proposed by this office. As a result, the written comments as well as the speech presented to the Task Force are attached as item 4 and are incorporated herein. In sum, while the Commonwealth should explore a strategic blueprint for its electric industry, any investment in the infrastructure to maintain reliability must *only* be done with a clear understanding of the costs to be borne by the ratepayers. Unnecessary or unduly costly investment will arbitrarily inflate rates. This result translates into additional

financial burdens on part of Kentucky's population already at the precipice of bankruptcy in addition to a disincentive if not impediment to economic growth.

The Commission and the Commonwealth of Kentucky should proceed cautiously and without haste in implementing any changes to its current regulatory scheme. Notwithstanding the Governor's Executive Order, to do otherwise could lead to a result akin to that of the previous Governor of California, Gray Davis, who chose to hastily rework that state's electric utility industry. That catastrophe speaks for itself and must not be repeated.

Respectfully submitted,

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*Certificate of Service and Filing*

Counsel certifies that an original and ten photocopies of these Comments of the Attorney General's Office were served and filed by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct of the same, first class postage prepaid, to

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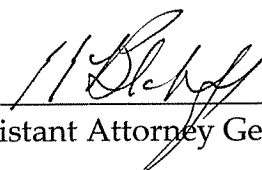
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all on this 6<sup>th</sup> day of June, 2005.

  
Assistant Attorney General



# **ATTACHMENT 1**

Ernie Fletcher  
Governor

LaJuana S. Wilcher, Secretary  
Environmental and Public  
Protection Cabinet

Christopher L. Lilly  
Commissioner  
Department of Public Protection

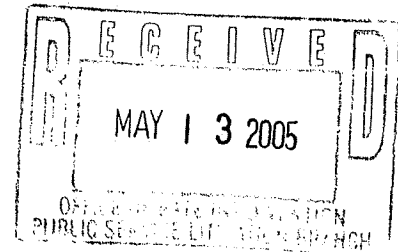


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Mark David Goss  
Chairman

Gregory Coker  
Commissioner

May 11, 2005



Attorney General Greg Stumbo  
Office of the Attorney General  
The Capitol, Suite 118  
700 Capitol Avenue  
Frankfort, KY 40601

Dear Mr. Stumbo:

I am writing to invite you or your designee to participate in a Technical Conference to be held at the Kentucky Public Service Commission on Tuesday, June 14, 2005 beginning at 8:30 a.m. The purpose of the conference is to obtain additional comment in PSC Case No. 2005-00090, An Assessment of Kentucky's Electric Generation, Transmission, and Distribution Needs.

The Commission established Case No. 2005-00090 in response to Executive Order No. 2005-121, issued by Governor Fletcher on February 7, 2005. The Executive Order directs the Public Service Commission, in conjunction with the Commerce Cabinet and Environmental and Public Protection Cabinet, to develop a Strategic Blueprint to guide policy makers to ensure the continued use and development of reliable electric energy in Kentucky and to ensure Kentucky's competitive, low-cost electric advantage while protecting the environment. For your convenience, I have attached hereto a copy of the Executive Order No. 2005-121.

The Technical Conference on June 14<sup>th</sup> is an opportunity for interested parties and members of the public to present additional information to the Commission for consideration in developing the Strategic Blueprint. The format will consist of three panels of witnesses in the morning, with an open comment period for the public in the afternoon. The first panel will consist of electric utilities that are jurisdictional to the PSC. The second panel will consist of electric industry representatives that are not jurisdictional to the PSC. The third panel will represent consumer, academic and environmental concerns. Invited witnesses for the morning session are asked to submit written comments of a reasonable length to the Commission no later than Wednesday, June 8<sup>th</sup>. Those comments will be posted on the Commissions Web Page,

<http://www.psc.state.ky.us>. At the Technical Conference, the witnesses will have five minutes to summarize their written comments, to be followed by questions from the Commission and staff.

Witnesses are asked to focus their comments in response to the following questions:

- 1) What additional information or data if any, should the Commission consider in developing the Strategic Blueprint?
- 2) What are the top issues facing the electric power industry in Kentucky over the next 20 years?
- 3) What barriers, if any, exist to meeting future investment needs in electric power infrastructure in Kentucky?

Please confirm your willingness to participate in the technical conference by contacting Karen Easterling with the Commission staff at (502) 564-3940. If you have any questions regarding the conference or the format for providing comments, please contact Bob Amato, Deputy Executive Director for the Commission at the number listed above. Thank you in advance for your cooperation.

Sincerely,



Mark David Goss  
Chairman

MDG/kle  
Attachment  
C: Main Case File  
✓ Dennis Howard



ERNIE FLETCHER  
GOVERNOR

EXECUTIVE ORDER

2005 - 121

Secretary of State  
Frankfort  
Kentucky

February 7, 2005

WHEREAS, the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy - Opportunities for our Future*, recommended, "The Commonwealth of Kentucky should utilize the 'strategic blueprint' to develop policies to ensure sufficient investment in electricity infrastructure—generation, transmission and distribution—to sustain Kentucky's low cost electricity into the future."; and

WHEREAS, the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy - Opportunities for our Future*, recommended, "The Commonwealth of Kentucky should identify impediments to investment in electricity generation, transmission and distribution and develop policies to promote investment while ensuring that appropriate environmental protections are maintained and local voices are heard."; and

WHEREAS, the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy - Opportunities for our Future*, recommended, "The Commonwealth of Kentucky should design and implement policies that promote, but do not mandate, the use of renewable energy resources in Kentucky's electricity generation portfolio.";

NOW, THEREFORE, I, Ernie Fletcher, Governor of the Commonwealth of Kentucky, by virtue of the authority vested in me by the Kentucky Constitution and in particular Sections 69 and 81, and Chapter 278 of the Kentucky Revised Statutes, and as further invested in me by the laws of the Commonwealth, do hereby FIND, DECLARE, ORDER and DIRECT the following:

1. The Kentucky Public Service Commission shall develop, in conjunction with the Commerce Cabinet and the Environmental and Public Protection Cabinet, a Strategic Blueprint to promote future investment in electric infrastructure for the Commonwealth of Kentucky, to protect Kentucky's low-cost electric advantage, to maintain affordable electricity rates for all Kentuckians and to preserve Kentucky's commitment to environmental protection.
2. The Strategic Blueprint referenced herein shall analyze the projected needs for new electricity generation, transmission, and distribution in Kentucky going forward and include the following information: the status of electricity generation, transmission, and distribution in Kentucky; available sources of electricity supply for Kentucky ratepayers; projected demands for electricity in Kentucky through 2025; the existence of any barriers to investment in generation, transmission, and distribution infrastructure in Kentucky; the existence of any barriers to the utilization of technologies in generation, transmission and distribution of electricity that will minimize impacts to the environment; strategies directed at the utilization of technologies to improve the efficiency of electricity service in Kentucky; opportunities to promote the utilization of renewable energy resources in Kentucky's electricity portfolio; and such other information as the Public Service Commission determines may help to ensure future investment in electricity infrastructure to meet Kentucky's needs.





ERNIE FLETCHER  
GOVERNOR

EXECUTIVE ORDER

Secretary of State  
Frankfort  
Kentucky

2005 - 121

February 7, 2005

RELATING TO THE PUBLIC SERVICE COMMISSION  
TO REPORT ON THE FUTURE NEEDS FOR ELECTRICITY  
IN THE COMMONWEALTH

WHEREAS, the Commonwealth Energy Policy Task Force issued a comprehensive energy strategy to guide energy policy decisions for the Commonwealth of Kentucky; and

WHEREAS, protection of Kentucky's air, land, and water resources is necessary to achieve environmental, economic development, and human health goals; and

WHEREAS, the Commonwealth of Kentucky enjoys some of the lowest electricity rates in the nation; and

WHEREAS, Kentucky's low-cost advantage in electricity is an important catalyst for economic growth and business development in Kentucky; and

WHEREAS, maintaining low electricity rates is critical to improving the lives of Kentucky's low-income families and protecting those with fixed incomes; and

WHEREAS, the laws and regulations governing the electric power industry have undergone significant changes at the state and federal levels over the past decade with implications for Kentucky; and

WHEREAS, the blackout of August 14, 2003, demonstrated vulnerabilities in regional electric power grids, which can affect the lives and livelihoods of all Kentuckians; and

WHEREAS, future investment in Kentucky's electricity infrastructure will be needed to ensure abundant and affordable supplies of electricity for all Kentuckians and to maintain Kentucky's low-cost advantage in electricity; and

WHEREAS, the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy - Opportunities for our Future*, recommended, "The Commonwealth of Kentucky should develop a comprehensive statewide assessment of Kentucky's electricity infrastructure—generation, transmission and distribution—which includes reasonable projections of future electricity requirements."; and

WHEREAS, the Commonwealth Energy Policy Task Force's report, *Kentucky's Energy - Opportunities for our Future*, recommended, "The Commonwealth of Kentucky assessment should serve as a 'strategic blueprint' for policy-makers to determine future investment requirements in Kentucky's electricity generation, transmission, and distribution infrastructure."; and



ERNIE FLETCHER  
GOVERNOR

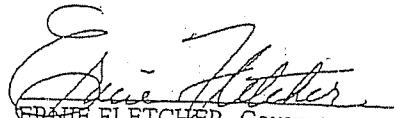
EXECUTIVE ORDER

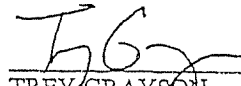
2005 - 121

February 7, 2005

Secretary of State  
Frankfort  
Kentucky

3. The Public Service Commission shall issue a report to the Governor containing the Strategic Blueprint no later than six (6) months from the effective date of this Order and shall periodically update the report to reflect changes in infrastructure and future electricity requirements.

  
ERNIE FLETCHER, Governor  
Commonwealth of Kentucky

  
TREY GRAYSON  
Secretary of State



## **ATTACHMENT 2**

2004-02386



ERNE FLETCHER  
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November 4, 2004

Honorable Greg Stumbo  
Attorney General's Office  
700 Capital Ave.  
Frankfort KY 40601

Dear Mr. Attorney General,

Governor Fletcher has announced the formation of the Commonwealth Energy Policy Task Force to finalize a comprehensive energy policy for Kentucky.

The final part of this effort will be a series of public meetings conducted over the next few weeks to garner public input into the plan.

As co-chairman of the Energy Policy Task Force, I want to invite you (or a designee from your organization) to provide testimony to the task force on November 12<sup>th</sup> at the Central Kentucky Technical College campus located in Lexington. (See [www.kctes.edu](http://www.kctes.edu) for the address and directions).

The meeting will begin at 8 am. We have targeted your testimony to begin at approximately 10:45 am. Please RSVP to Sarah McCann at the Commerce Cabinet (502-564-4270).

The meetings are structured so the task force can cover a wide range of issues related to energy and the environment. Therefore, each organization will be limited to fifteen minutes for testimony and Q&A. I'd advise that testimony should be no longer than 5-7 minutes so sufficient time remains for questions.

To further focus our efforts, we also ask that you be prepared to specifically speak to the role of the Attorney General's Office in energy issues facing Kentucky's consumers in your testimony.

Since time is limited, the task force welcomes the submission of longer written testimony and any policy papers that your organization feels will contribute to the formulation of a comprehensive energy policy for the Commonwealth.

I look forward to your participation and working with you on the vital energy issues facing Kentucky.

*Look forward to your  
appearance if you  
can do it.*

Sincerely,

*W. James Hoet*  
W. James Hoet



# **ATTACHMENT 3**

Interim Report *GATS*  
and **Electricity**

**Working Group on Energy & Trade Policy**  
**Representative George Eskridge (Idaho), Chair**  
Completed March 25, 2005  
Released April 15, 2005



**Interim Report – GATS & Electricity**  
Working Group on Energy & Trade Policy  
Representative George Eskridge (Idaho), Chair

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**Working Group on Energy & Trade Policy**

This is an interim report of the Working Group on Energy & Trade Policy. Working group participants are public officials and staff from state legislatures, public utility commissions, attorneys general, city and county attorneys, municipal utilities, and several national associations. Participants contribute as individuals; their organizations may not have taken a position on the issues raised by this report.

The chair of the working group is Representative George Eskridge of the Idaho House of Representatives, and the convening organization is the National Conference of State Legislatures. Jeremy Meadows is NCSL’s staff director for trade issues. Counsel to the working group is the Harrison Institute for Public Law, Georgetown University Law Center. See page 28 for working group participants.

The working group invites comments on this report. If you have comments, please contact Jeremy Meadows at 202-624-8664, <Jeremy.Meadows@NCSL.org>.

## Executive Summary

This is an interim report of the state and local Working Group on Energy & Trade Policy. The mission of the working group is to investigate the potential impact of trade rules on domestic energy policy, raise questions of potential interest to U.S. trade negotiators and report back to state and local governments and associations.

1. **Why regulation of electricity is a trade issue.** The European Union, the United States and other countries have published proposals that would apply trade rules under GATS, the General Agreement on Trade in Services, to regulation of electricity by federal, state and local governments. If implemented, these international proposals might conflict with state electricity policy and alter the balance of domestic regulatory authority between states and the Federal Energy Regulatory Commission (FERC). Trade rules of GATS apply to more than cross-border trade; they also cover state or federal regulation of utilities or domestic electricity markets where multinational companies have a commercial presence.
2. **Meetings with U.S. trade negotiators.** In 2004, the Working Group on Energy & Trade Policy consulted three times with U.S. trade negotiators, who described the meetings as timely, productive and unprecedented.
3. **GATS commitments and negotiations.** In subsectors where countries make a “specific” commitment, GATS trade rules prohibit quantitative limits on service suppliers and policies that place foreign firms at a competitive disadvantage. The current U.S. commitment applies to “services incidental to distribution of electricity.” Proposed commitments would extend to services incidental to transmission, wholesale trade and access to transmission facilities. In addition, WTO members are negotiating GATS rules that would apply to domestic regulation generally, not just to specific commitments.
4. **Selected domestic measures and risk of trade conflict.** The working group has identified questions about the potential impact of current or proposed GATS commitments regarding:
  - **State and local monopolies for distribution** – States regulate investor-owned utilities, publicly owned utilities and rural coops, many of which are monopolies for distribution of electricity. The United States has committed to follow a GATS rule that prohibits monopolies for services incidental to distribution.
  - **Ancillary services for transmission** – Scheduling and system control is an “ancillary” service that is necessary for transmission of electricity. The service is provided by exclusive service suppliers such as regional transmission organizations (RTOs), among others. A proposed GATS commitment would prohibit authorizing exclusive suppliers of services “incidental” to transmission of electricity.
  - **Native load preferences** – Many states require the utilities they regulate to serve local customers at regulated rates (“native load”) and to reserve their transmission capacity to serve this native load. A proposed GATS commitment would obligate the United States to “ensure” that third-parties (*e.g.*, independent wholesalers or generators) would have access to the same transmission facilities.
  - **Rates of federal power marketing authorities (PMAs)** – The Bonneville Power Administration is the largest of four federal PMAs that supply wholesale electricity to preferred customers (mostly publicly owned utilities) at the cost of production, which is usually well below wholesale market prices. A proposed GATS commitment would prohibit policies that create an advantage for domestic suppliers of wholesale services.
  - **Renewable portfolio standards (RPS)** – A growing number of states require the utilities they regulate to obtain a minimum quota of electricity from “renewable” sources that do not include the large-scale hydroelectricity that Canadian suppliers sell into the U.S. wholesale market. A proposed GATS commitment would prohibit policies that disadvantage foreign suppliers of wholesale services.
  - **Regulation “in the public interest”** – State Public Utility Commissions (PUCs) regulate rates and corporate acquisitions under a broad “public interest” standard that considers cost to consumers, environmental protection and financial stability of a utility. A proposed GATS rule would limit domestic regulation to measures that are no more burdensome than necessary to ensure the quality of a service.
5. **Next steps.** The working group will continue its analysis and will explore potential safeguards for state and local authority such as excluding selected topics from GATS commitments (*e.g.*, renewable energy) or limiting the coverage of trade rules on domestic regulation of services.

## Interim Report – GATS & Electricity

*Working Group on Energy & Trade Policy*

### I. Introduction – why regulation of electricity is a trade issue

#### A. Trade negotiations cover domestic policy

Energy services are regulated by state and federal governments in a balance of power that is controversial and in a state of flux. In the midst of a national energy debate, state and local officials were surprised to learn that international negotiations on electricity may cover many of the same policy decisions being debated in Congress and state capitols.

These negotiations are part of the “successive rounds of negotiations” under the General Agreement on Trade in Services (GATS), which is one of the trade agreements administered by the World Trade Organization (WTO).<sup>1</sup>

Recent developments in the GATS negotiations include a January 2005 communication in which the European Union requests a commitment from the United States (a commitment to follow trade rules) on “services related to energy networks, services for the supply of energy (wholesale, trading and brokering of energy products), services for the final use (energy auditing and energy saving) and decommissioning.”<sup>2</sup> The next deadline for the United States to respond to the EU request is May 1, 2005.<sup>3</sup>

The United States has not disclosed its request in the GATS negotiations. However, since 1994, the United States has committed itself to follow trade rules regarding “services incidental to energy distribution”<sup>4</sup> and has more recently published proposals that cover services incidental to transmission, wholesale trade, and third-party access to transmission facilities. The similarity of U.S. and EU proposals suggests that a trade deal on electricity is nearing completion.

The U.S. trade negotiators first published their proposals on electricity trade in 2000 in response to the WTO Energy Services Coalition, which was co-chaired by executives of Enron and Halliburton.<sup>5</sup> Since that time, the nation has witnessed the California energy crisis, the fall of Enron, and a heightened sense of caution on the part of state and local policy makers.

While some states have decided to restructure their electric utilities, every state is considering some type of reform in the electric industry. Considering the value of such experimentation, there remains a consensus among states that they should retain jurisdiction to decide whether, how and when to reform.<sup>6</sup>

For example, approximately 17 states now require their utilities to unbundle their retail sales. Approximately 28 states have chosen not to unbundle retail sales, at least not yet. They believe that preserving state regulation of vertically integrated utilities will provide a more stable and efficient energy

*The European Union  
requests a commitment from  
the United States on ...*

**“services related to  
energy networks,  
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services for the final use  
(energy auditing and  
energy saving) and  
decommissioning.”**

*European Commission*

future. A third group of approximately six states has delayed, suspended or changed a decision to restructure retail electricity trade.<sup>7</sup>

Another debate surrounds the efforts of FERC, the Federal Energy Regulatory Commission, to push for a competitive national market for wholesale electricity. Some states have embraced the FERC model for restructuring, and some states have resisted. After years of contentious debate, there are signs of mutual accommodation between FERC and the states. In Congress, the energy debate remains quite fluid, but there is strong bipartisan support for preserving state regulatory authority, while still moving toward a more reliable and efficient system for transmission of electricity.<sup>8</sup>

The question on the mind of state and local officials is this: *Will international negotiations lock the country into trade commitments on electricity at a time when domestic policy on electricity is still in a state of flux? More specifically, would proposed trade commitments expand the legal basis for federal preemption of state regulatory authority*, whether under the trade rules directly, under rules of the federal energy regulators, or some combination of federal rules and international commitments?

Before analyzing this question, it helps to consider why electricity is a trade issue in the first place.

## **B. Foreign subsidiaries are major players**

Most Americans think of international trade as just goods and services crossing the border. There is, in fact, a growing cross-border trade in electricity between Canada, the United States and Mexico— with the United States becoming an importer of more and more electricity. Trade rules might enable Canada to challenge state or federal policies that constrain the ability of Canadian utilities to sell electricity into the U.S. market. For example, Canadian officials have complained that renewable energy policy discriminates against Canadian exports of electricity.

An even larger dimension of international trade is called “commercial presence” in GATS, which includes foreign ownership of domestic utilities. Commercial presence entails not only established subsidiaries, but also “establishment,” the ability of a foreign firm that is not in the U.S. market to establish its presence in the U.S. market.

Companies based in the United States are also major players abroad. Between 1993 and 1998, energy investments and sales through foreign subsidiaries of U.S. companies increased by well over 100 percent. This expansion was a direct response to domestic restructuring in the UK, Australia and Latin America, and it prompted Enron to lead the advisory committee that guided USTR’s proposals for GATS negotiations.<sup>9</sup> The U.S. trade negotiators seek to expand access to foreign markets for U.S. firms and their subsidiaries.

At the same time, European holding companies are acquiring American subsidiaries. As a consequence, state regulation of electricity is an issue under GATS because service providers in the United States are owned by foreign firms, whose home country is a member of the WTO.

**Selected Subsidiaries of Foreign Companies  
in the U.S. Electricity Market**

<b>Electricity Subsector</b>	<b>Subsidiary &amp; Foreign Owner</b>	<b>Geographic Market</b>
<b>Vertically integrated utilities</b>	PacifiCorp (US) – owned by Scottish Power (UK) <sup>10</sup>	California, Oregon, Washington, Utah, Idaho and Wyoming
<b>Unbundled distribution utilities</b>	National Grid U.S. – owned by National Grid Transco (UK) <sup>11</sup>	New Hampshire, New York, Massachusetts, and Rhode Island
<b>Unbundled generation utilities</b>	Brascan New York, Maine Power, New Hampshire Power, Louisiana Power (US) – owned by Brascan Power (CAN) <sup>12</sup>	Hydro generation in New York, Maine, New Hampshire and Louisiana
<b>Transmission companies</b>	GridAmerica (US), managing partner is National Grid (US) – owned by National Grid Transco (UK) <sup>13</sup>	Transmission and related services in Illinois, Indiana, Missouri, Ohio and Pennsylvania

**C. GATS commitments could affect state and federal policy**

The office of the United States Trade Representative (USTR) leads trade negotiations for the United States. In a recent article, the USTR’s electricity market analyst explained the relationship between the GATS negotiations and domestic regulatory reform (or “deregulation”) of electricity markets:

Should trade negotiations, which endeavor to expand trade, seek to bring about regulatory reform? Some feel this would be taking the mandate for trade policy too far. \* \* \* While trade negotiations do not appear to be an appropriate means for bringing about regulatory reform, they nevertheless may offer an instrument for supporting reform programs.<sup>14</sup>

This statement raises questions. Would trade negotiations offer an instrument that FERC can use to restructure electricity markets and state-level regulation? Once trade commitments are in place, would they tie the hands of FERC, eliminating FERC’s ability to develop flexible regional solutions? In the future, trade commitments could be used to persuade states to deregulate, but also to pressure or force states to deregulate. Once made, trade commitments have teeth; they can be enforced through both international and domestic means.

- *International enforcement.* Foreign governments can enforce trade commitments through trade sanctions (punitive tariffs) against U.S. goods and services in any sector. For example, a trade conflict on electricity could lead to trade sanctions on financial services, telecommunications or agriculture.
- *Domestic enforcement.* The U.S. government has an obligation to “take such reasonable measures as may be available to it to ensure their observance [of trade commitments] by regional and local

governments and authorities and non-governmental bodies within its territory.”<sup>15</sup> Those measures include:

- o withholding of federal funds, permits or other kinds of discretion; and / or
- o federal preemption of state or local law that conflicts with trade rules.<sup>16</sup>

The threat of preemption is not new in the electricity sector, but FERC may only preempt where it is authorized to do so by federal statutes. Trade agreements can create a broader scope of federal power to preempt than FERC has asserted in the past.<sup>17</sup> As outlined below, various GATS proposals appear to cover state regulation of:

- State and local monopolies for distribution
- Native load preferences
- Renewable portfolio standards
- General utility regulation in the “public interest”

The GATS proposals also appear to cover federal policies in which most states have a very strong interest. These include FERC regulation of:

- Ancillary services for transmission
- Rates of federal power marketing authorities (PMAs)

#### **D. Response by state and local officials**

There is substantial overlap of the EU GATS request, the U.S. GATS proposals, and FERC’s domestic policy agenda. Considering the potential impact on state regulatory authority, state and local officials recognized the need to monitor the trade negotiations, much as they would any other federal initiative that affects state sovereignty. In 2003, the chair of Idaho’s joint Committee on Energy, Rep. George Eskridge, expressed his general concerns in a letter to USTR. When there was no response, the NCSL committees on energy and trade invited USTR to attend their December 2003 meeting to discuss the Idaho questions. USTR’s senior energy negotiator did attend and agreed that the questions merited further consultations between USTR and state and local officials.

**“NCSL considers federal preemption of state regulation of the electric industry to be wholly inappropriate and unacceptable and opposes federal standards to govern state electric utility regulation or retail ratemaking by state commissions. State jurisdiction should not be eroded.”**

To prepare for consultations with USTR staff, NCSL took the lead and created the state and local Working Group on Energy and Trade Policy in early 2004.

*NCSL 2004-2005 Policies,  
Electric Industry Restructuring*

Participants in the working group include public officials and staff of state legislatures, utility regulators, attorneys general, city and county attorneys, local governments, municipal utilities and several national associations that represent state and local public officials in Washington, DC.

Before meeting with U.S. trade negotiators, the working group identified questions about potential conflict between trade rules and domestic energy policy. Given the current language of GATS trade rules and proposed commitments, many of these questions are unanswerable because the trade rules are open-ended or ambiguous and will remain so until a WTO dispute panel interprets them.

Following these meetings, the working group prepared this interim report to assess the potential impact of trade negotiations on domestic electricity policy and to raise questions of potential interest to U.S. trade negotiators. It does not take positions or make recommendations. The working group compiled the report based on contributions from participants (as individuals) with diverse expertise and professional experience. Thus, the report is not designed to reflect the views of any individual or organization. No individual or organization has "endorsed" the report as a policy statement; nor is it binding on any individual or organization.

## **II. Meetings with U.S. trade negotiators**

The working group consulted three times with U.S. trade negotiators, including the staff of USTR and other federal agencies, in early 2004: (1) an introduction to state and local concerns (February 20<sup>th</sup>), (2) a discussion of procurement questions (April 16<sup>th</sup>), and (3) a workshop on the scope of services provided by state-regulated monopolies, federal power authorities and independent transmission companies (April 30<sup>th</sup>).

Much of the meeting time with U.S. trade negotiators was devoted to explaining how states regulate electricity services and how the utilities that states regulate compete in national markets, even though they may be perceived as monopolies in their local markets.

The trade negotiators described these meetings as timely, productive and unprecedented. However, their condition for meeting was that all conversations were off the record. In this report, the working group honors that commitment by not using any information, opinions or interpretations provided by U.S. government staff at those meetings.

Fortunately, there are numerous other sources for this report including public documents filed with the WTO by the United States and other countries engaged in electricity negotiations. In addition, the WTO Secretariat, the Organization for Economic Cooperation and Development (OECD), United Nations agencies, and other organizations have published reports on the status of negotiations on trade in services, including electricity.

### III. GATS commitments, negotiations and trade rules

If GATS trade rules apply to domestic electricity policy, will GATS tip the balance of power between states and the federal government (or between states and foreign governments)? This part of the report explains the legal context for answering that question. It summarizes GATS coverage and trade rules, including some of the commitments that have been proposed in the current round of GATS negotiations.

Given the open-ended language of GATS rules and current wording of proposed commitments, it is difficult to interpret the actual risk of conflict until it is too late – when there is an actual dispute and a WTO panel decides what the language should mean. As demonstrated in the recent WTO dispute on Internet gambling, the *intent* of U.S. negotiators as to the meaning of a GATS commitment is irrelevant. What matters is whether the language of commitments is sufficiently precise to avoid a trade dispute. If it is not, then the burden is on the United States to limit its commitment by listing the categories of law-making that a commitment does *not* cover.<sup>18</sup>

#### A. General Scope of GATS

There are several international agreements that cover U.S. domestic policy on electricity, including agreements on trade in goods, trade in services and investment. The following chart summarizes this legal context.

**International Agreements that Cover Electricity**

Electricity as . . .	Applicable International Agreements
Trade in goods	WTO - GATT, General Agreement on Tariffs & Trade NAFTA, North American Free Trade Agreement, chapters 3 (goods) and 6 (energy)
Trade in services	WTO - GATS, General Agreement on Trade in Services NAFTA chapter 6 (energy)
Foreign investment	NAFTA, chapter 11 (investment) FTAs, chapter 10 (investment) WTO – TRIMs, Trade Related Investment Measures

This report focuses only on how GATS covers electricity. However, before we summarize GATS, it is worth noting that more likely scenarios for international trade conflict involve other agreements such as NAFTA’s chapter 11 (foreign investor protection) or the General Agreement on Tariffs and Trade (trade in electricity as a good). For example, a Canadian investor may be more likely to challenge domestic U.S. policies that promote renewable energy than is the Canadian federal government.<sup>19</sup> Recent WTO decisions have made clear that trade agreements are likely to overlap, with multiple agreements covering a single government policy measure.<sup>20</sup>

There are three questions for determining whether a trade agreement, in this case GATS, conflicts with domestic electricity policy. The questions involve coverage, conflict with trade rules, and exceptions that excuse conflicts.

- **Coverage.** The first step of analysis is, does GATS cover the electricity measure in question? GATS applies to any government “measure” at any level of government “affecting trade in services.”<sup>21</sup>



GATS defines trade in services in terms of four modes of delivery, two of which are relevant to this report, as highlighted below: <sup>22</sup>

- (1) *delivery across the border, such as transmission of electricity from Canada to the United States,*
- (2) delivery to a visiting consumer from another country, such as when a Canadian tourist visits New York,
- (3) *delivery through “commercial presence,” such as when a UK corporation acquires a subsidiary in Oregon,* and
- (4) delivery by a visiting supplier from another country (a “natural person”), such as when an engineer from India comes to the United States to practice engineering.

When a nation commits to follow GATS trade rules, it does so with specific reference to each of these modes of service delivery. With electricity, the important modes are (1) cross-border trade and (3) commercial presence.

GATS is complex because it applies two levels of various trade rules to government policy measures. The first level includes general obligations (sometimes called “top down” obligations) that apply to all nations in the WTO unless GATS excludes a government measure from the agreement. These general obligations include Most-Favored-Nation Treatment (no favoring service providers from one country over those of another country),<sup>23</sup> transparency, domestic regulation rules, and monopoly rules. GATS also calls for negotiations on procurement and subsidies of trade in services.<sup>24</sup> The general rules and the general exclusions are explained below.

The second level includes “specific commitments” (sometimes called “bottom up” commitments) within over 120 service sectors and subsectors to follow additional trade rules. The rules include National Treatment (no discrimination), Market Access (*e.g.*, no quantitative limits on the number of service suppliers), and additional commitments (such as third-party access to transmission facilities). National governments make these specific commitments in a process of ongoing rounds of “request-offer” negotiations. To a great extent, this report is concerned with how the United States proposes to define subsectors of electricity trade for purposes of specific commitments that are now being negotiated.

- **Rule conflict.** The second step of analysis is, if GATS covers an electricity measure, does it conflict with a particular trade rule? The GATS rules that are most likely to apply to electricity include “general” rules on domestic regulation and monopolies and “specific commitment” rules including, National Treatment, Market Access and third-party access to transmission facilities. These are all discussed below.
- **Exceptions.** The third step of analysis is, if GATS covers an electricity measure and there is a conflict, does GATS provide an exception that would excuse the conflict? Unlike the GATT, GATS

**“The scope of the GATS encompasses any measure ... to the extent that it affects the supply of a service regardless of whether such measure directly governs the supply of a service ...”**

*WTO Panel, EC – Bananas*

provides no exception for environmental resource conservation.<sup>25</sup> GATS might excuse a trade conflict if a specific electricity measure falls within the range of policies that are designed to protect “public morals” or “human, animal or plant life or health.”<sup>26</sup> Of the various electricity measures covered in this report, the renewable energy measures discussed in part IV.D arguably serve a health objective. However, the health exception has been interpreted narrowly so as to cover only measures that are “necessary,” meaning that the exception is only available when there are no reasonably available alternatives.<sup>27</sup> The GATS health exception is not likely to apply in the electricity context, so further discussion of the exception exceeds the scope of this report.

In the following summary of GATS, we alter the analytic sequence (coverage, conflict with trade rules, exceptions) by presenting the relevant trade rules first. Explaining the trade rules first provides a context for understanding the importance of GATS coverage. For example, if you know that a state law on licensing monopolies violates a trade rule that prohibits monopolies, you can better appreciate why it is important to limit the commitments that would apply GATS coverage to the state law in the first place.

## B. GATS trade rules

1. **General rules.** The trade rules under Part II of GATS, General Obligations and Disciplines, apply to any measure that affects trade in services, so long as the law is not excluded by the “government authority” test, which described in the following section.

- a) **Domestic regulation.** Negotiations are now underway (and behind schedule) at the WTO’s Council on Trade in Services to “develop any necessary disciplines” for rules that would apply generally to domestic regulation.<sup>28</sup> Two of these rules would obligate the United States to ensure that electricity measures relating to qualification requirements and procedures, technical standards and licensing requirements are:

- (1) “based on objective and transparent criteria,” and
- (2) “not more burdensome than necessary to ensure the quality of the service.”

As part of the current negotiations, WTO member-nations presented examples of measures that they believe violate these rules. Among the examples are sub-federal measures that are different from one state to the next or measures that differ from federal standards,<sup>29</sup> a description that fairly applies to federal and state electricity policy in the United States.

The WTO negotiations on domestic regulation are at a substantive stage. Proposals or analysis have been submitted on topics of central concern to state and local utility regulators, for example, the

*Examples of measures that might violate GATS trade rules on domestic regulation include ...*

**“Federal and subfederal licensing requirements are different, making a license ... obtained in one state not valid in other states.”**

**Different sub-federal regulations for recognition of qualifications.”**

*WTO Secretariat,  
Note on members’ examples*

burden/necessity test (WTO Secretariat), transparency disciplines (United States), and disciplines on licensing procedures (European Union), including licensing at the sub-federal level.<sup>30</sup>

- b) **Monopoly disciplines.** GATS provides that the United States “shall ensure” that a monopoly in its territory (even if regulated by a state) complies with U.S. specific commitments and:
- (1) “shall ensure that such a supplier does not abuse its monopoly position” when it provides services covered by a specific commitment outside of its monopoly service area;<sup>31</sup> and
  - (2) if a state grants monopoly rights for services covered by a specific U.S. commitment, the United States must negotiate compensatory adjustments in its schedule of GATS commitments.<sup>32</sup>

2. **Sector-specific rules.** The following rules apply to measures that regulate those sectors in which the United States makes a specific commitment *unless* the United States limits its commitment. There are currently no limits on the current U.S. commitment for “services incidental to distribution of electricity.”

- a) **Domestic regulation.** Pending implementation of the general rules on domestic regulation (noted above), the transparency and least-burdensome rules also apply to new measures (post-1994) in subsectors in which the United States made a specific commitment (e.g., services incidental to distribution of electricity).<sup>33</sup> While intended as an interim means of protecting the value of commitments, this provision may gain in importance as the WTO continues to negotiate (and not implement) the rules on domestic regulation as a general obligation.

**“The main difficulty with these [schedules of GATS commitments] is the difficulty of reading them, much less interpreting them. ... the service schedules make this skill less art than fetish.”**

Jeffrey Lang,  
Former Deputy USTR  
January 21, 2000

- b) **National Treatment.** GATS prohibits discrimination against foreign service providers, including treatment that “modifies the conditions of competition in favor of services or service suppliers” of domestic firms compared to foreign firms. Various WTO and GATT panels have interpreted National Treatment to require “effective equality of opportunities.”<sup>34</sup>
- c) **Market Access.** GATS prohibits several kinds of quantitative limits on service suppliers, including government measures that limit their number “in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test,” limits on the number of service operations, or measures that restrict or require specific types of legal entity or joint venture.<sup>35</sup>
- d) **Third party access to transmission and distribution networks.** GATS allows countries to negotiate commitments in addition to National Treatment and Market Access. U.S. trade negotiators have proposed an additional commitment to third-party access to transmission and distribution networks. This proposal is modeled on

the existing additional commitments for telecommunications.<sup>36</sup> Under the telecom model, these commitments would obligate the United States to:

- ensure that major suppliers provide access to, interconnection to, and use of “public ... transport networks and services” and other “essential facilities” on terms, conditions and cost-oriented rates that are reasonable,<sup>37</sup> and
- maintain appropriate measures to prevent major suppliers from “engaging in or continuing anti-competitive practices.”<sup>38</sup>

According to the WTO, this language requires WTO Members to ensure access “whether or not they have liberalized” the service.<sup>39</sup> Unlike the other GATS rules, which merely prohibit certain measures, the third-party-access rules appear to require a government to act, or as some call it, to make a pro-competitive commitment.<sup>40</sup>

## C. GATS coverage of domestic measures

### 1. General exclusions from GATS coverage

- a) **Government authority exclusion.** GATS does not cover a service if it is provided under “government authority,” which means that the service “is supplied neither on a commercial basis nor in competition with one or more service suppliers.”<sup>41</sup> This provision is sometimes referred to as the government authority exclusion. The way this works is that GATS *does* cover a service if it is *either* supplied “on a commercial basis,” *or* if it is supplied “in competition with one or more service suppliers.”<sup>42</sup> This test does not exclude a supplier of electricity service simply because the supplier is a monopoly (no competition). That is only one prong of the “neither/nor” test.

The government authority test would exclude electricity services if a monopoly produces electricity and then provides it free to consumers. Such services would be neither commercial nor in competition. However, even non-profit, publicly-owned utilities and cooperatives usually charge for their services at cost.

The WTO Secretariat has opined that any kind of charge or user fee renders a service “commercial” in nature.<sup>43</sup> That would mean that even nonprofit providers (providers-at-cost) are covered by the general provisions of GATS. Most regulated utilities in the United States are for-profit, investor-owned corporations. Some of the utilities are monopolies, but they all provide “commercial” services in the sense that they charge for their services. In short, the “government authority” exclusion of GATS is likely to exclude monopoly providers of free electricity.

- b) **Government procurement exclusion.** GATS does not apply certain trade rules (Most-Favored-Nation Treatment, National Treatment and Market Access) to procurement *unless* the government agency purchases the electricity or service “with a view to commercial resale or with a view to use in the supply of services for commercial sale.”<sup>44</sup> In other words, if a government agency purchases electricity or related services and resells to local consumers, then the procurement

exclusion does not apply, and those services are covered by GATS rules on MFN Treatment, National Treatment and Market Access.

## 2. Specific commitments under GATS

### a) *Existing U.S. commitment*

In 1994, the United States made a specific GATS commitment on “services incidental to energy distribution.” The WTO Secretariat and the United States seem to agree that the U.S. commitment on services incidental to distribution includes regulation of “transmission and distribution services on a fee or contract basis of electricity.”<sup>45</sup> The WTO further explains that this commitment “seems to include transport and distribution of electricity ... when these services are operated by an independent services supplier and not by a vertically integrated manufacturer.”<sup>46</sup>

The WTO’s conflation of distribution with transmission, as well as “incidental” services with “actual” distribution and transmission, continues in the current GATS negotiations. Recent WTO minutes report that “the Indonesian paper [which responds to earlier proposals by the United States] stated that transmission and distribution of electricity was included in services incidental to energy distribution.”<sup>47</sup>

In short, the scope of the current U.S. commitment on “services incidental to distribution” is open to retroactive interpretation as recently happened in a WTO decision against the United States on Internet gambling.<sup>48</sup> According to both U.S. and WTO sources, it may apply to services incidental to transmission as well as distribution. In addition (as noted below), it may be difficult to separate the services that are necessary for transmission and distribution from the actual transmission and distribution of electricity.

*A proposal by Indonesia in the current GATS negotiations reports that ...*

**“... transmission and distribution of electricity was included in services incidental to energy distribution.”**

*WTO Secretariat*

Since existing U.S. commitments may cover state regulation of distribution and federal regulation of transmission to some degree, the question becomes whether the proposed commitments now being negotiated offer more clarity or limits on the existing commitments.

### b) *Proposed commitments*

The working group does not have access to the negotiating proposals that the United States is currently presenting to other countries. However, the European Union has recently released its GATS request, and U.S. negotiators have circulated informal proposals to the WTO in public documents over the past several years. Based on this record, the leading GATS negotiators appear to be advancing several proposals that could affect state and local policy, as well as federal policies that have a direct impact on state and local government.

Recent WTO minutes indicate that the United States, Japan and Chile

have proposed a “Guide for Scheduling Commitments on Energy Services in the WTO.”<sup>49</sup> This guide is part of WTO negotiations on how to index the energy sector into a set of common sub-sectors with standard terms for use in negotiating GATS commitments. The working group has not seen this index.

Based on previously published recommendations (not official U.S. requests or offers), there appear to be several proposed commitments that would affect state and local interests. These include:

- (1) services incidental to transmission or distribution;
- (2) wholesale, trading and brokering services, and
- (3) access to transmission facilities.<sup>50</sup>

#### **IV. Selected domestic measures and the risk of trade conflict**

In the electricity sector, Congress has chosen to maintain a system of dual sovereignty – a sharing of regulatory power between the states and the federal government. Generally, the federal government regulates transmission and wholesale electricity trade, while states regulate generation and retail distribution of electricity.

As noted above, states differ in their approach to restructuring (or “unbundling”) traditional electric utilities. While not all states have decided to restructure their electric utilities, every state is considering some type of reform to its electric industry, including both de-regulation and re-regulation. There is a consensus among states that they should retain their current regulatory authority to decide whether, how and when to reform.<sup>51</sup>

The general concern of state and local officials is that if GATS trade rules apply to domestic energy policy, GATS will influence the balance of power between states and the federal government (or between states and foreign governments) in a way that is not desirable. This part of the report identifies potential trade conflicts regarding a number of selected domestic measures, some state and some federal. The sections below follow the same methodology for assessing the potential for conflict between GATS rules and a state or federal energy policy:

- **Domestic measure** – First, which domestic “measure” is at risk of a potential trade conflict under GATS?
- **Coverage** – Second, is that measure covered by GATS? GATS coverage involves two steps of analysis.
  - The first step is whether a measure is covered by the general provisions of GATS. Does the measure affect a service that is either commercial or supplied in a competitive market? If not, then the measure is excluded from GATS and the specific commitments do not apply to the measure.
  - If the measure is covered by GATS generally, the second step is whether a specific commitment applies to the measure. Potential specific commitments on electricity include the following services: (1) services incidental to transmission and distribution, (2) wholesale trade, and (3) operation of transmission facilities.
- **Potential for conflict** – Third, which trade rule is most likely to create a potential conflict? The trade rules that apply when there is a specific

commitment include National Treatment, Market Access and third party access.

In the sections that follow, this report identifies “GATS questions” where there is an issue of GATS coverage of state or federal policy or where there is a potential risk of conflict between a trade commitment and domestic policy. The questions are denoted in the text with a “?” in the following format:

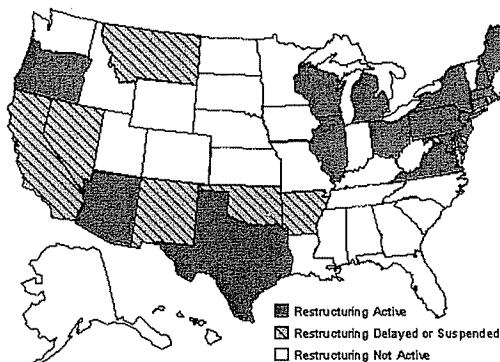
? **GATS question – scope of services incidental to distribution.** What is the scope of “services incidental to distribution of electricity”? Is it possible to cover the incidental services that are necessary for distribution and not effectively cover the distribution itself?

## A. State and local monopolies for distribution

1. **Domestic measure.** As noted above, approximately 28 states continue to regulate vertically integrated utilities. Generally, vertically integrated utilities operate within monopoly service areas and provide services at all three stages of electricity supply: generation, wholesale transmission and retail distribution. For example, within its service area, Idaho Power provides transmission and services incidental to transmission, and it has a monopoly for distribution and services incidental to distribution. Idaho Power also buys and sells electricity in the national wholesale market.

Approximately 17 states have required their vertically integrated utilities to separate transmission from distribution functions.<sup>52</sup> However, in the wake of problems with deregulation in states like California and Montana, approximately six states have delayed or suspended their process of restructuring vertically integrated utilities. For example, to stabilize rising electricity prices, California re-established certain monopoly functions and entered the wholesale market as a purchaser of electricity through long-term wholesale contracts.

**Restructuring Retail Access to Electricity**  
State Activity as of February 2003



In addition to licensing vertically integrated utilities, many states license municipal utilities and consumer-owned cooperatives, which are monopoly providers of distribution and services incidental to distribution. They purchase some or all of their electricity on the wholesale market for resale to local consumers.

2. **Coverage.** GATS covers state regulation of distribution monopolies generally if those utilities operate either commercially or in a competitive market.<sup>53</sup> Idaho Power is an investor-owned utility that provides electricity services for a profit, so its services are commercial in that sense. There is no language in GATS to support the position that electricity services are not “commercial” just because they are provided

by a regulated monopoly. Coops and municipal monopolies may not operate for a profit, but they do charge to recover the cost of their services, so their services are “commercial” in that sense.

- ? *GATS questions – commercial suppliers.*** The plain language of GATS appears to generally cover distribution monopolies because they are commercial in the sense that they charge for their services.
- o Are there any grounds for saying that charging for electricity at cost is not “commercial”?
  - o Are there any grounds for saying that for-profit distribution monopolies are not commercial?

Assuming that GATS applies generally to distribution monopolies, the question of GATS coverage shifts to whether distribution monopolies are covered by a GATS specific commitment.

In 1994, the United States made a specific GATS commitment to “services incidental to energy distribution,”<sup>54</sup> which is retained in the current U.S. offer in the GATS negotiations.<sup>55</sup> The scope of this commitment is unclear in terms of the makeup of “services incidental.” The GATS negotiations to adopt an energy index could clarify the commitment, but publicly available documents do not add clarity.<sup>56</sup>

- ? *GATS questions – scope of services incidental to distribution.***
- o What is the scope of “services incidental to distribution of electricity”?
  - o Is it possible to cover the incidental services that are necessary for distribution and not effectively cover the distribution itself?

The WTO has indicated that governments are free to maintain a monopoly, so long as the country does not make a specific commitment in that service sector, or if it does, so long as the country limits its commitment with respect to that monopoly.<sup>57</sup> The United States has no such limits on its commitment regarding services incidental to distribution.

As noted above, the WTO Secretariat and the United States seem to agree that the U.S. commitment on services incidental to distribution includes regulation of “distribution services on a fee or contract basis of electricity.”<sup>58</sup> The WTO says that this commitment “seems to include ... distribution of electricity ... when these services are operated by an independent services supplier and not by a vertically integrated manufacturer.”<sup>59</sup> The implication is that when a vertically integrated manufacturer provides services to itself, it is not engaging in trade. However, as noted above, vertically integrated utilities charge their ultimate consumers for integrated services, and many vertically integrated utilities contract out for services incidental to distribution (*e.g.*, meter reading or billing services).

- ? *GATS questions – fee or contract services.***
- o Is a monopoly covered by a GATS commitment on services incidental to distribution only when the monopoly contracts out for that service?
  - o If so, what is the basis in GATS for covering monopolies that contract out a service, but not nearby monopolies that provide the



same service for themselves?

? **GATS question – scope of U.S. market.** In a broader sense, some states have retained their traditional monopolies, while other states have unbundled their monopolies.

- o In this regard, is the United States a single market to which GATS applies, or is it 50 state markets?
- o If the United States is a single market from the view of GATS, then why would a GATS commitment *not* apply to those states with monopolies?

3. **Potential for conflict.** Assuming that distribution monopolies are covered by GATS generally and also by a commitment to services incidental to distribution, as noted above, the GATS rule on Market Access might conflict with state measures that authorize distribution monopolies. This rule prohibits limits on the number of service providers in the form of monopolies or exclusive service suppliers.<sup>60</sup> However, many states do not require their monopolies to contract out incidental services.

? **GATS question – unbundling of services incidental to distribution.** If state and local monopolies are covered by a commitment on services incidental to distribution, then does the Market Access rule require that states unbundle those incidental services?

? **GATS question – preemption.** Would a conflict between state-regulated distribution monopolies and the GATS Market Access rule authorize the federal government to preempt state law without a specific act of Congress?

Another GATS rule is the general requirement that if the United States grants monopoly powers, then it has to renegotiate its GATS commitments by providing compensatory access to other markets.<sup>61</sup> This appears to apply to situations where a state deregulates a utility and later decides to provide those services as a single state supplier (as California has done) or through a regulated monopoly.

? **GATS question – renegotiation of GATS commitments.** If a state decides to re-regulate a service in a monopoly setting after a failed experiment in deregulation, then would the United States have to renegotiate its GATS commitments?

Multi-national energy service companies, both at home and abroad, have an interest in expanding GATS coverage to distribution of electricity in the United States. This is because GATS rules such as Market Access function to open markets and limit government measures that create barriers to entry or growth of the company. With regard to services incidental to distribution of electricity, foreign subsidiaries of U.K. companies, such as National Grid U.S. and PacifiCorp, own and operate distribution utilities in the United States. For example, Massachusetts Electric is a National Grid U.S. subsidiary that provides distribution services to 1.2 million customers.<sup>62</sup>

## B. Ancillary services for transmission

1. **Domestic measures.** Generally, FERC regulates interstate transmission and wholesale trade of electricity. Transmission involves more than the physical movement of electric power over transmission lines. In addition, transmission requires a set of “ancillary services” that are necessary to ensure that transmission occurs when and where the electricity is needed and that the transmission does not overload or destabilize the grid. Industry actors use the phrase “ancillary services” in different ways, and there appears to be no standard definition or index listing a common set of “ancillary services.”<sup>63</sup> Any effort to define and classify these services is further complicated by the fact that some regulators use the phrase “interconnected operations service,” which appears to be a broader category that includes certain types of “ancillary services.”<sup>64</sup> These variations in language create room for expansive interpretations if a WTO panel decides a challenge to domestic electricity measures.

This being said, FERC Order 888 does single-out and define six specific “ancillary services” and requires that they be provided with actual transmission because they are “necessary for providing basic transmission service to a customer.”<sup>65</sup> The first ancillary service listed in Order 888 is “scheduling, system control, and dispatch service” (hereafter, scheduling and system control). This is the service to “schedule the movement of power through, out of, within or into [a transmission provider’s] control area.”<sup>66</sup> The service also “requires action by both the customer who provides information about a transaction and the control area that evaluates and accepts (schedules) the transaction,” as well as “dispatch [of] generating resources to maintain generation/load balance and maintain security during the transaction.”<sup>67</sup>

By necessity, scheduling and system control is provided within a service territory. This service plays an important role in FERC’s policy to promote regional transmission service. In late 1999, FERC issued Order 2000, which promoted the voluntary formation of Regional Transmission Organizations (RTOs).<sup>68</sup> RTOs operate transmission facilities on a regional basis, scheduling the movement of power across the transmission grid. In other words, one of the core functions of an RTO is to provide scheduling and system control. This service is not unique to RTOs; all transmission providers, including the traditional vertically integrated utilities, must use the same service as well.

2. **Coverage.** GATS covers FERC regulation of scheduling and system control generally if that service is provided either commercially or in a competitive market.<sup>69</sup> All transmission providers, including RTOs, charge for scheduling and system control as provided in their open-access transmission tariffs, which are approved and regulated by FERC,<sup>70</sup> so the service is commercial in that sense. Moreover, it should be noted that scheduling and system control is only one of six defined “ancillary services” in FERC Order 888, so GATS may cover the other services as well.

Assuming that GATS applies generally to scheduling and system control, the question of GATS coverage shifts to whether the service is covered by a GATS specific commitment. As noted above, the current U.S. GATS commitment appears to cover services incidental to transmission as well

as distribution.<sup>71</sup> U.S. trade negotiators have recommended a GATS commitment for “services ancillary to transmission and distribution of electricity,” which arguably includes scheduling and system control, as well as other ancillary services.<sup>72</sup> The intent of the proposal is not, however, to cover the actual transmission of electricity.<sup>73</sup>

The scope of this commitment is unclear in terms of the makeup of “services incidental.” The GATS negotiations to adopt an energy index could clarify the commitment, but publicly available documents do not add clarity.<sup>74</sup>

**? GATS questions – scope of services incidental to transmission.** The term “incidental” differs from the term “ancillary” that regulators use in the United States.

- o What is the scope of “services incidental to transmission”?
- o Are “incidental” services synonymous with “ancillary” services, including the services that are necessary for transmission of electricity?
- o Are any “interconnected operations services” included within the scope of “incidental” services?
- o Is it possible to cover the services that are necessary for transmission and not effectively cover the transmission itself?

3. **Potential for conflict.** Assuming that the service of scheduling and system control is covered by GATS generally and also by a commitment on services incidental to transmission, as noted above, the GATS rule on Market Access might conflict with FERC regulation of this service. The Market access rule prohibits government appointment of “exclusive service suppliers.”<sup>75</sup>

FERC Order No. 888 requires that transmission providers “must provide” and transmission customers “must purchase” scheduling and system control, as well as another service called “reactive supply and voltage control from generation sources.”<sup>76</sup> All FERC-regulated transmission providers operate on a regional or control-area basis, which means that they are the sole service providers of these two required ancillary services within their service areas.

A GATS commitment to refrain from using exclusive suppliers for scheduling and system control may seem implausible. Yet the comparison of three transmission providers – CAISO (California), MISO (Midwest) and PJM (Mid-Atlantic)– shows that there are choices of degree, even when a monopoly service is involved. Both the MISO and PJM tariffs appear to allow for the contracting out of scheduling and system control to companies that operate at the sub-regional level of a control area.<sup>77</sup> For example, GridAmerica, an independent transmission company that serves five states within MISO, provides scheduling and system control within its service area. GridAmerica is managed by a subsidiary of National Grid Transco, a U.K. corporation.<sup>78</sup> In contrast, CAISO does not contract out scheduling and system control.<sup>79</sup> In other words, RTOs and other transmission providers (including vertically integrated utilities) have choices: Contract out the service or provide it in-house? One regional control area or sub-regional control areas? Three year contracts or 10-year contracts?

**? GATS questions – Market Access and ancillary services.**

- Does a GATS commitment on services incidental to transmission conflict with FERC rules that require transmission providers (including RTOs) to be the exclusive suppliers of scheduling and system control service?
- Could a GATS commitment on services incidental to transmission obligate FERC to change the way it regulates the sole providers (including RTOs) of scheduling and system control or other ancillary services?

**? GATS question – preemption.** Does a GATS commitment authorize FERC to preempt states that do not restructure monopoly provision of services incidental to transmission?

A GATS commitment on ancillary services is consistent with the GATS purpose of opening domestic markets. However, such a GATS commitment may be inconsistent with FERC rules that establish scheduling and system control as a monopoly function of RTOs and other transmission providers. Application of Market Access rules to ancillary services makes it possible for multinational companies (such as GridAmerica) to cite GATS commitments as a reason they should be able to compete for ancillary services (including scheduling and system control) with other sub-regional suppliers or perhaps even the RTO itself.

## C. Native load preferences

1. **Domestic policy.** In most states, the state public utility commission (PUC) licenses electric utilities to operate under a “service obligation.” This obligation is to serve any retail user that requests electricity service within the utility’s service territory.<sup>80</sup> The industry term for serving this in-state demand is “native load.” Federal law also requires the federal power marketing administrations (PMAs, e.g., the Bonneville Power Administration) to serve native load, which includes cooperatives and municipally owned utilities.<sup>81</sup> Under this service obligation, utilities reserve a portion of their transmission capacity to serve their native load, and they manage congestion in transmission through “curtailment,” meaning they suspend access to transmission to external customers if there is a conflict with serving native load.<sup>82</sup>

The Energy Policy Act of 1992 provides for *nondiscriminatory* open access to the transmission grid to support development of wholesale electricity markets. In Order 888, FERC ordered investor-owned utilities that own transmission lines to make any unused portion of their capacity available to third parties for transmission of wholesale electricity through the utility’s service area (known as “wheeling” electricity).

Wholesale marketers have complained to FERC that native load preferences are discriminatory, and one filed a lawsuit, claiming that the preferences violate Order 888.<sup>83</sup> FERC rejected that complaint,<sup>84</sup> but it has described native load preferences as “problematic” in more recent cases.<sup>85</sup>

2. **Coverage.** GATS covers regulation of native load preferences (by states or by FERC) generally if the transmission is provided either commercially or in a competitive market.<sup>86</sup> Native load preferences are part of

transmission services provided by for-profit, investor-owned utilities. However, the preferences cover transmission capacity that a utility reserves for itself. Yet even then, utilities charge their customers for the transmission facilities and service, so it is commercial in that sense. For this reason alone, transmission capacity appears to be covered generally by GATS.

It could be argued that a utility's internal transmission capacity is not provided in competition with another supplier. Yet even the transmission capacity that is not reserved is sold by the utility to external wholesale suppliers who usually have multiple routes to wheel their electricity to a given destination. Moreover, some parts of the U.S. market have unbundled all transmission services, so those parts of the market are competitive. Thus, the presence of competition depends on timing and availability of local transmission alternatives.

**? GATS question – general coverage of transmission capacity.**

- Does the “competition” test of the government authority exclusion apply to the United States as a national market?
- Or does it apply to specific states or regions in a way that transmission capacity might be in competition in one state, but not in competition in a neighboring state?
- Would GATS apply if a utility's transmission capacity is only sometimes supplied in competition?
- Does GATS apply to a utility when it is serving itself, but still charging its consumers for the service?

If GATS applies to the U.S. electricity transmission market like Swiss cheese, depending on changing local conditions of competition, then there might be circumstances in which native load preferences are not generally covered by GATS. But there is nothing in the plain language of GATS to suggest that is the case.

Assuming that GATS applies generally to native load preferences, the question of GATS coverage shifts to whether the preferences are covered by a GATS specific commitment.

The proposed GATS additional commitment on third party access would apply to “major suppliers” of “essential facilities” for transmission networks and services.<sup>87</sup> In the first GATS case to interpret third party access to telecommunications facilities, the WTO defined “major supplier” in keeping with domestic competition authorities.<sup>88</sup> In the electricity sector, FERC regulates competition using a “market power” test, which looks to whether a company is a pivotal supplier in a state or region with the ability to materially affect participation in that market.<sup>89</sup> In some states, investor-owned utilities and PMAs are the predominant transmission suppliers, and in other states, there are alternatives such as independent transmission companies or RTOs. In other words, coverage of the GATS commitment on third party access may depend on market conditions that vary from one state to another.

**? GATS question – major suppliers.**

- Would a GATS commitment that applies to “major suppliers” of “essential facilities” for transmission apply to investor-owned

utilities and PMAs in states where they are still the predominant supplier of transmission services?

- If so, would the commitment apply to such a utility when it operates outside of the area in which it is a major supplier?

3. **Potential for conflict.** Assuming that native load preferences are covered by GATS generally and also by a commitment to third party access, as noted above, the GATS rules on third party access might conflict with state laws. The related GATS rule would require ensuring third party access on terms, conditions, and cost-oriented rates that are “reasonable.”<sup>90</sup> The first GATS case to interpret the rule on third party access found that Mexico’s interconnection rates for telecommunications were unreasonable because the rates excluded price competition for access to telecom facilities.<sup>91</sup>

**“[R]ates ... whose uniform nature excludes price competition ... do not provide [reasonable] access to ... transport networks ...”**

These rules may conflict with native load preferences. The very purpose of the preferences is to limit third-party access and to avoid price competition by reserving transmission capacity for native load.

*WTO Panel,  
Mexico - Telecom*

- ? **GATS question – native load.** Would a GATS commitment to third party access conflict with transmission practices that are designed to avoid price competition for third-party access by reserving transmission capacity for native load?

- ? **GATS question – anti-competitive practices.**

- Has FERC or another federal agency described as “anti-competitive” the practices of state-regulated utilities or PMAs?
- If so, could such statements be grounds for challenging state or PMA native load preferences under this trade rule?

- ? **GATS question – preemption.**

- Would a GATS commitment to third party access obligate the United States to take affirmative action to implement the commitment?
- If so, would this commitment obligate the federal government to preempt state policies (that do not ensure third-party access) without a specific act of Congress?

## D. Renewable portfolio standards

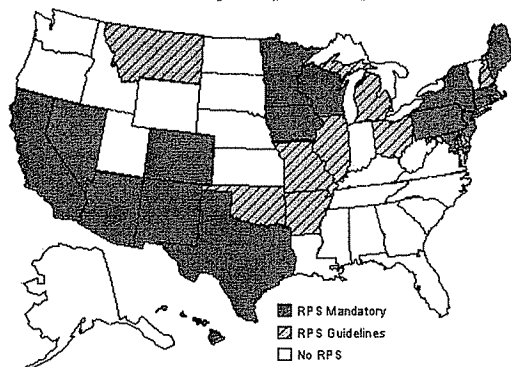
1. **Background.** A growing number of states are adopting policies to promote use of renewable energy sources as a result of growing environmental concerns. Recently, the Western Governors Association adopted a resolution in support of renewable energy as part of a “clean and diversified” energy strategy for Western states.<sup>92</sup>

The “renewable” sources usually include wind, solar, small-scale hydro, geothermal and biomass, among other sources.<sup>93</sup> These sources are based on being more environmentally friendly than conventional electric power generation methods. Thus far, none of the sources include large-scale hydropower stations generating greater than 100 megawatts.<sup>94</sup>

As of January 2005, 18 states and the District of Columbia have adopted mandatory Renewable Portfolio Standards (RPS), which require certain percentages of energy sold or consumed in a state to come from renewable resources – either presently or in the future. The states include Arizona, California, Colorado, Connecticut, Hawaii, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico, New York, Pennsylvania, Rhode Island, Texas and Wisconsin.<sup>95</sup>

A second group of nine states encourage but do not require use of renewable sources. These states include Arkansas, Delaware, Illinois, Michigan, Missouri, Montana, New Hampshire, Ohio, and Oklahoma.<sup>96</sup>

**Renewable Portfolio Standards**  
State Activity as of January 2005



2. **Coverage.** GATS covers RPS measures generally if renewable energy suppliers operate either commercially or in a competitive market.<sup>97</sup> Renewable energy is supplied in a competitive market in most states, including states with monopolies for distribution. Some monopolies meet their RPS obligations by purchasing electricity from renewable sources from competitive markets, and all utilities charge their customers for the renewable energy.

? **GATS question – commercial or competitive suppliers.** The plain language of GATS appears to generally cover RPS because renewable energy is commercial in the sense that some utilities purchase it in the competitive market and utilities charge their customers for electricity from renewable sources. Are there any grounds for saying that renewable electricity is not purchased “in competition” or that it is not sold on a “commercial basis”?

Assuming that GATS applies generally to RPS measures, the question of GATS coverage shifts to whether the purchase of electricity from renewable sources is covered by a GATS specific commitment.

The EU recently requested a U.S. commitment to wholesale energy services.<sup>98</sup> U.S. trade negotiators have proposed making commitments based on an index that includes wholesale markets, trading and brokering (including sales) and retail supply (including sales).<sup>99</sup> Based on the plain language of “wholesale” trade, these proposed commitments appear to apply to RPS measures that require utilities to purchase a certain percentage of their electricity from renewable energy sources. A question could be raised as to whether the term “wholesale” services might be interpreted more narrowly than the plain language connotation of “sales” so as to cover only transaction services and not the electricity being purchased.

? **GATS question – scope of wholesale commitment.** Would a GATS commitment to “wholesale trade” somehow not include the actual

electricity that utilities purchase? For example, might the commitment apply only to transaction services?

3. **Potential for conflict.** Assuming that RPS measures are covered by GATS generally and also by a commitment to wholesale trade, as noted above, existing or proposed GATS rules might conflict with the state laws. First, the National Treatment rule prohibits *de facto* discrimination when a measure works to the disadvantage of foreign suppliers.<sup>100</sup> In addition, U.S. negotiators have recommended a “variety of principles aimed at ensuring the greatest possible market opening.” One of the principles is “technological neutrality,” meaning that “Market Access commitments should be made without regard for the technology used to provide energy services ...”<sup>101</sup>

Canadian officials and policy analysts have already argued that mandatory portfolio standards place Canadian utilities at a competitive disadvantage.<sup>102</sup> Canadian utilities aim to sell their surplus generation capacity from large-scale hydro stations into the U.S. wholesale market.

To date, RPS measures exclude large-scale hydro. For example, the New Jersey RPS excludes electricity generated by large-scale hydropower stations that produce more than 30 megawatts.<sup>103</sup> Approximately 96 percent of Canadian hydro capacity is produced by hydro generating stations of greater than 30 megawatts, and roughly 60-65 percent of total Canadian exports of electricity to the US are produced from hydropower.<sup>104</sup>

Whether this amounts to a violation of National Treatment depends on whether an RPS measure “modifies the conditions of competition in favour of services or service suppliers” of the United States compared to suppliers from Canada.<sup>105</sup> Defenders of RPS measures assert that a differential impact on large-scale hydro “does not translate into *de facto* discrimination against Canada” because RPS sources do not discriminate against imports any more than they discriminate against U.S. producers of hydroelectricity.<sup>106</sup>

**? GATS question – National Treatment and burden of proof**

- What is the market (or “like product”) for considering National Treatment of Canadian utilities under RPS measures? Is it the U.S. electricity market as a whole (including non-renewable sources), or is the market limited to renewable sources of electricity? If the latter, is large-scale hydro “like” the RPS sources of renewable energy (including small-scale hydro)?
- What is the burden of proof to support a claim that RPS measures, which are facially neutral, change the conditions of competition so as to violate National Treatment? It is enough that the RPS measures exclude large-scale hydro, or would Canada have to prove a certain effect on the ability of Canadian utilities to compete?

In addition to National Treatment, the U.S. proposal on “technological neutrality” for Market Access commitments appears to be at odds with RPS measures, which by nature are technology preferences. They are not neutral. The Market Access provisions of GATS do not prohibit quotas on “inputs” of electricity supply,<sup>107</sup> so the issue is whether a neutrality principle would cover electricity inputs.



? **GATS question – technological neutrality.** Would a GATS principle of technological neutrality prohibit quotas regarding inputs to electricity supply based on renewable energy technology?

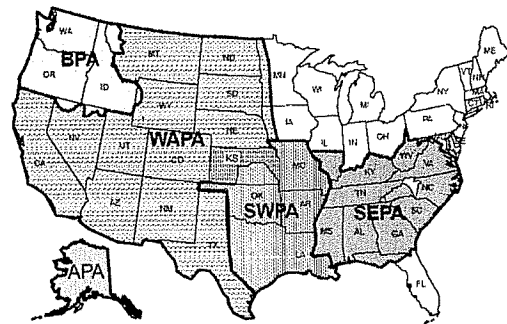
? **GATS question – international preemption.** Would a conflict between state RPS measures and National Treatment or technological neutrality authorize the federal government to preempt state law without a specific act of Congress?

## E. Rates of federal power marketing administrations

1. **Background.** Congress established five Power Marketing Administrations (PMAs) as federal agencies (now under the Department of Energy) to sell low-cost hydroelectric power from federal dams to largely rural areas that needed electricity in order to develop economically. Of the four PMAs that still exist, the oldest and largest is the Bonneville Power Administration (BPA). The others include the Western, Southwestern and Southeastern Power Administrations (see map).<sup>108</sup>

While the federal government produces about 10<sup>109</sup> percent of electricity sold in the United States, BPA provides about half the electricity used by Northwestern states (Oregon, Washington, Idaho and Western Montana) and operates over 75 percent of the region's high-voltage transmission assets.<sup>110</sup> BPA constructs, operates, and maintains the nation's largest high-voltage transmission system. The measure in question is the method by which BPA sets its rates for wholesale electricity.

**Power Marketing Administrations**



BPA – Bonneville Power Admin.  
WAPA – Western Power Admin.  
SEPA – Southeastern Power Admin.  
SWPA – Southwestern Power Admin.  
APA – Alaska Power Admin. (privatized)

2. **Coverage.** GATS covers BPA rate setting generally if BPA sells wholesale power either commercially or in a competitive market.<sup>111</sup> BPA's wholesale services are like any commercial operation, except for its mandate to sell to public utilities (co-ops and municipal utilities) at cost.<sup>112</sup> Even if selling at cost is not commercial, BPA competes with other service providers. For example, BPA customers are free to purchase from Avista and BC Hydro.

? **GATS question – commercial or competitive suppliers.** GATS appears to generally cover BPA rates based on the plain language of GATS and the fact that BPA customers are free to buy electricity from other suppliers. Are there any grounds for saying that BPA rates for electricity at cost are not supplied “in competition”?

Assuming that GATS applies generally BPA rates, the question of GATS coverage shifts to whether BPA marketing is covered by a GATS specific commitment.

As noted above, both the EU and the United States have proposed a GATS commitment on wholesale markets, trading and brokering services. Wholesale power marketing is BPA's primary function. Yet as noted above, there remains a question about the scope "wholesale" trade.

**? GATS questions – scope of wholesale commitment.**

Would a GATS commitment on wholesale services somehow not include the actual electricity that BPA sells to its wholesale customers? For example, might the commitment apply only to transaction services?

- 3. Potential for conflict.** Assuming that BPA rates are covered by GATS generally and also by a commitment to wholesale trade, as noted above, the GATS National Treatment rule might conflict with BPA rates. National Treatment provides that government measures must not change the conditions of competition in favor of domestic compared to foreign service providers.<sup>113</sup>

BPA rates for wholesale electricity are based on the cost of producing electricity by federal dams plus BPA operating expenses.<sup>114</sup> A recent report indicates that BPA's wholesale rate is \$31 per megawatt hour compared to \$40 to \$50 per megawatt hour on the open market.<sup>115</sup>

Critics of the BPA maintain that its rates reflect advantages such as the ability to self-finance and borrow from the U.S. Treasury.<sup>116</sup> Defenders of BPA argue that BPA actually pays above-market interest to the Treasury and that the cost differential comes not from any federal subsidy, but from the lower cost of hydro resources in the Pacific Northwest.<sup>117</sup>

- ? GATS question – National Treatment and BPA rates.** Does BPA's statutory mandate to sell electricity at cost change the conditions of competition so as to disfavor foreign wholesale suppliers in violation of National Treatment under GATS?

The prospect of a GATS commitment that could apply the National Treatment rule to wholesale electricity sales by PMAs comes at a time when there is a domestic policy debate about BPA rates. The federal budget proposed on February 7, 2005 includes legislation to require BPA and the other PMAs to charge market rates.<sup>118</sup> Members of Congress from states that depend on PMA sales of electricity announced their opposition to changing BPA's wholesale rates.<sup>119</sup>

- ? GATS question – National Treatment and wholesale rates.** Would an international trade commitment under GATS authorize or even obligate the federal government to change the rates charged by BPA and other PMAs, even without congressional legislation to do so?

## **F. Regulation of electricity "in the public interest"**

- 1. Background.** State public utility commissions (PUCs) make many regulatory decisions (*e.g.*, licensing, rates and approval of a merger or acquisition) based on whether the request is "in the public interest." Usually, state law provides multiple factors that a PUC may consider in defining the public interest on a case-by-case basis.<sup>120</sup> The reason that the

PUC exists is to exercise discretion in weighing these multiple factors – in other words, to make subjective decisions that balance competing public and private interests.<sup>121</sup>

2. **Coverage.** GATS covers state regulation generally if the regulated services are provided either commercially or in a competitive market.<sup>122</sup> In some jurisdictions, the utilities that PUCs regulate are monopolies within their service areas. Some monopolies that PUCs regulate are private, investor-owned utilities that charge for their services, make a profit and pay dividends to shareholders. The services they offer are commercial in those ways. In addition, the state-regulated monopolies buy, sell and provide electricity services on a competitive basis outside of their monopoly service areas.

Some PUCs regulate municipal utilities and cooperatives, which usually operate as nonprofit distribution monopolies.<sup>123</sup> They often purchase their electricity in the competitive wholesale market, and they charge for the electricity they sell to their customers.

Finally, some state-regulated utilities are no longer monopolies. They now must compete in the market under state regulation.<sup>124</sup>

The plain language of GATS suggests that state-regulated utilities are both commercial and competitive, which means that GATS generally applies to state regulation “in the public interest.” To the extent that there are questions about the scope of GATS general coverage, these have been raised above under part IV.A on state-regulated monopolies.

Assuming that GATS applies generally to state regulation, the question of GATS coverage shifts to whether regulation “in the public interest” is covered by a GATS specific commitment.

In 1994, the United States made a specific GATS commitment to “services incidental to energy distribution,”<sup>125</sup> which is retained in the current U.S. offer in the GATS negotiations.<sup>126</sup> As noted above in part IV.A, states regulate distribution and services incidental to distribution.

3. **Potential for conflict.** Assuming that state regulation “in the public interest” is covered by GATS generally and also by a commitment on services incidental to distribution, as noted above, the GATS rules on domestic regulation might conflict with the “public interest” standard. As explained in part III.B, negotiations are underway to implement these rules across the board to all state measures that set qualification requirements, technical standards and licensing requirements.

The GATS rules on domestic regulation require that governments make decisions based on objective and transparent criteria, and that the decisions must not be more burdensome than necessary to ensure the quality of a service.<sup>127</sup> In general, PUC criteria are transparent, but they call for balancing and subjective judgment rather than “objective” outcomes.

? **GATS question – objective criteria and the public interest.** The GATS rule requires “objective” standards, whereas the “public interest” standard requires a PUC to balance competing public

interests. What is the nature of objectivity, and does it permit balancing of competing interests?

The nature of balancing competing interests is that a regulatory decision will be neither the most burdensome nor the least burdensome, but something in between. Sometimes the competing interests involve quality of service (e.g., reliability), but sometimes they involve environmental protection, financial stability of the utility, affordability of rates for most consumers, or economic development of the community at large.

**? GATS questions – least-burdensome test and the public interest.**

The GATS rule requires measures to be no more burdensome than necessary to ensure the quality of a service, whereas the “public interest” usually produces a compromise or middle-ground policy.

- o Does GATS define “burden” only from the perspective of foreign-owned firms seeking to compete in a market?
- o Or does it consider the burden of externalized costs on consumers, communities, the environment or other actors?

**? GATS questions – quality of service test and the public interest.**

The GATS rule limits the objective of domestic regulation to ensuring the quality of a service, whereas the “public interest” takes into account other factors such as environmental protection.

- o Does GATS exclude consideration of public interests beyond the scope of the quality of a service?
- o Does GATS exclude cost to consumers as a dimension of “quality of service”?

## V. Next steps

May 1<sup>st</sup> of 2005 is the next date by which WTO nations must post their “offers,” which are publicly announced commitments in specific subsectors. Since 1994, the United States has committed itself to give National Treatment and Market Access to “services incidental to distribution of electricity.” The most recent U.S. offer (March 2003) states that the United States may expand the offer “to include additional services. The specific content of commitments for services ... will be developed pending the results of discussions concerning a proposed guide for scheduling commitments on energy services.”<sup>128</sup>

The Working Group on Energy & Trade Policy convened with a concern that the United States may be finalizing a guide for energy commitments, as well as negotiating commitments on electricity in particular, without first understanding the potential impact on domestic policy or state authority to regulate electricity. The working group successfully initiated an unprecedented yet fruitful exchange and has studied the relevant issues. This report seeks to inform the negotiating process and create a framework for continued dialogue between trade negotiators and state and local officials. Specifically, this report identifies over 50 questions on the potential impact of GATS negotiations, with each question in a specific context of federal, state or local policy on electricity. The working group

**“The ... issue is the need to address the overwhelming uncertainty about the meaning of the provisions of the GATS. \*\*\* Some of these provisions are so obviously problematic that they cry out for substantive re-negotiation.”**

*Jeffrey Lang,  
Former Deputy USTR  
January 21, 2000*

hopes that U.S. trade negotiators and other interested parties will find this report to be a useful resource.

The working group styled this report as “interim” for several reasons. First, it was not possible to do a thorough analysis of the issues given the time constraints and limited information on GATS negotiations. There are several next steps that the working group may take to further investigate the potential impact of GATS negotiations on domestic regulation of electricity.

1. **Coverage of proposed commitments.** Time did not permit study of several measures of interest to participants in the working group. The working group may extend its analysis of specific measures, including questions that may be of interest to U.S. trade negotiators.
2. **Trade rules on domestic regulation.** Negotiations continue at the WTO on trade rules that might cover domestic regulation across the board, not just within specific sector commitments. The United States is likely to be a pivotal player on such topics as how “licensing” is defined, when a measure becomes more burdensome than “necessary,” and whether the WTO should limit the scope of legitimate regulatory objectives. The working group may look more closely at these proposals, which go to the core of state regulatory authority.
3. **Potential safeguards.** The working group may also identify potential safeguards to avoid conflicts between trade rules and governing authority. For example, the range of potential safeguards may include these options:
  - a. **Clarify the text of GATS**, particularly the provisions on domestic regulation that are currently being negotiated at the WTO.
  - b. **Clarify and limit the existing U.S. commitment** to “services incidental to distribution of energy” so as to carve out state regulatory authority over distribution monopolies and other state or federal policies that may be covered by an expansive interpretation of this commitment by the WTO.
  - c. **Clarify and limit any new commitments** that would adversely affect state regulatory authority or federal regulation of a rapidly changing system of wholesale trade and transmission.

This report is also “interim” in the sense that GATS is only one aspect of trade negotiations that could affect electricity, and electricity is only one of several energy concerns of state and local governments, which include natural gas and oil, among others. For example, the GATS negotiations include a potential U.S. offer that appears to cover siting of new natural gas pipelines and storage facilities.<sup>129</sup> Proposed FTA chapters on investment and cross-border trade in services may affect electricity and other energy concerns. The working group expects to study these agreements and issues as well.

The working group thanks participating contributors and U.S. federal officials and invites comments on this report and potential next steps. If you have comments or questions, please contact Jeremy Meadows at 202-624-8664, <Jeremy.Meadows@NCSL.org>.

## **Working Group Participants**

Working group participants are public officials and staff from state legislatures, public utility commissions, attorneys general, city and county attorneys, municipal utilities, and several national associations.

**Chair of the working group** – Representative George Eskridge, Idaho House of Representatives, Co-chair of the Idaho Committee on Energy, member of the NCSL Energy Committee.

**Convening organization** – National Conference of State Legislatures (NCSL). Jeremy Meadows is the staff director for the NCSL Committee on Economic Development, Trade and Cultural Affairs.

**Working group mission and participants** – The mission of the working group is to investigate the potential impact of trade negotiations on domestic electricity policy, raise questions of potential interest to U.S. trade negotiators, and report back to state and local governments and their associations. It does not take positions or make recommendations. The working group compiled this Interim Report based on contributions from participants (as individuals) with diverse expertise and professional experience. Thus, the report is not designed to reflect the views of any individual or organization. No individual or organization has "endorsed" the report as a policy statement; nor is it binding on any individual or organization. Working group participants include –

- Representative Sheryl Allen, Utah House of Representatives, Co-chair of the Utah Energy Policy Task Force, Chair of the NCSL Committee on Economic Development, Trade and Cultural Affairs
- Matthew Brown, Director of the Energy Program, NCSL
- Karen Cordry, Bankruptcy Counsel, National Association of Attorneys General
- Dick Byers, Policy Analyst, Washington Utilities and Transportation Commission
- Jeffrey Conopask, Ph.D., Staff Subcommittees on Electricity and Gas, National Association of Regulatory Utility Commissioners (NARUC)
- James Harding, Senior Policy Analyst, Seattle City Light
- Donald Howell II, Deputy Attorney General, Idaho Office of Attorney General, and Lead Attorney, Idaho Public Utilities Commission
- Kevin McCarthy, Principal Analyst, Connecticut General Assembly
- Sona Pancholy, Associate Counsel International Municipal Lawyers' Association (IMLA)
- Nancy Skancke, member of IMLA and partner, Law Offices of GKRSE
- Grace Soderberg, Assistant General Counsel, NARUC
- Henry W. Underhill, Jr., General Counsel and Executive Director, IMLA
- Carl Wood, former Commissioner, California Public Utility Commission

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## Endnotes

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- <sup>2</sup> European Commission, Summary of the EC's Revised Requests to Third Countries in the Services Negotiations under the DDA (Brussels, Jan. 24, 2005) 8, available at [http://trade-info.cec.eu.int/doclib/cfm/doclib\\_type.cfm?type=10](http://trade-info.cec.eu.int/doclib/cfm/doclib_type.cfm?type=10), viewed March 2, 2005.
- <sup>3</sup> WTO, Decision Adopted by the General Council on 1 August 2004, para. (e) Services, WT/L/579, 2 August 2004, available at [http://www.wto.org/english/tratop\\_e/dda\\_e/draft\\_text\\_gc\\_dg\\_31july04\\_e.htm](http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm) viewed Feb. 20, 2005.
- <sup>4</sup> United States of America, Schedule of Specific Commitments, GATS/SC/90 (April 1994) 40.
- <sup>5</sup> Ellen Gould, *TACD Background Paper on Trade in Services*, Trans-Atlantic Consumer Dialogue (October 2002) 24-25, available at <http://www.servicesforall.org/html/GATS/Gould-TACD%20trade%20in%20services.pdf>, viewed Mar. 1, 2005 (hereafter, TACD Background paper)
- <sup>6</sup> See, e.g., NCSL, Policy on Electric Industry Restructuring, in 2004-2005 Policies for the Jurisdiction of the Energy and Electric Utilities Committee, available at <http://www.ncsl.org/statefed/energy.htm#electricrestructuring>, viewed Feb. 20, 2005; American Public Power Association (APPA), *Restructuring at the Crossroads: FERC Electricity Policy Reconsidered* (December 2004); APPA, "Restructuring Reconsidered," (Apr. 4, 2004), available at <http://www.appanet.org/aboutpublic/index.cfm?ItemNumber=9559&sn.ItemNumber=2102>, viewed Mar. 4, 2005.
- <sup>7</sup> For an overview of state-level restructuring of electricity markets, see Energy Information Administration, Status of State Electric Industry Activity – as of February 2003 (February 2003 was the last update. No further updates are planned.), available at [http://www.eia.doe.gov/cneaf/electricity/chg\\_str/restructure.pdf](http://www.eia.doe.gov/cneaf/electricity/chg_str/restructure.pdf), viewed Feb. 20, 2005. See also Electric Power Supply Association, "EPSA State Proceedings / Legislation Matrix on Electric Industry Restructuring (Aug. 30, 2004), available at <http://www.espa.org/Competition/3.PDF>, viewed Feb. 20, 2005.
- <sup>8</sup> See, e.g., Mary Driscoll, Lawmakers staking out electricity, MTBE positions (Environment & Energy Daily, February 18, 2005). E&E Daily is available to subscribers at <http://www.eenews.net/EEDaily.php>, viewed on February 20, 2005.
- <sup>9</sup> Christopher Melly, Electric Power and Gas Market Reform and International Trade in Services, in *Energy and Environmental Services: Negotiating Objectives and Development Priorities* (UNCTAD 2003, UNCTAD/DITC/TNCD/2003/3) 164, 172. See U.S. Direct Investment Abroad: Financial and Operating Data for U.S. Multinational Companies, 1999 (the most recent data) at <http://www.bea.doc.gov/bea/di/di1usdop.htm>, viewed Feb. 20, 2005; Ellen Gould, *TACD Background Paper*, at 24-25.
- <sup>10</sup> PacifiCorp, "About US, PacifiCorp Facts," <http://www.pacificorp.com/Navigation/Navigation3877.html>, viewed Feb. 20, 2005.
- <sup>11</sup> National Grid, "About US, Our Business," [http://www.nationalgridus.com/aboutus/a2-1\\_business.asp](http://www.nationalgridus.com/aboutus/a2-1_business.asp), viewed Feb. 20, 2005.
- <sup>12</sup> Brascan, Our Operations, Power Generation, available at <http://www.brascan.com/OurOperations/OurOperations.html>, viewed Feb. 20, 2005. Brascan, About Brascan, Corporate Governance, Statement of Corporate Governance, available at <http://www.brascan.com/AboutBrascan/StmtGovern.html>, viewed Feb. 20, 2005.
- <sup>13</sup> GridAmerica news release of June 21, 2002, [http://www.gridamericallc.com/newsroom\\_1.html](http://www.gridamericallc.com/newsroom_1.html), viewed Feb. 20, 2005.

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<sup>14</sup> Christopher Melly, *Electric Power and Gas Market Reform and International Trade in Services, in Energy and Environmental Services: Negotiating Objectives and Development Priorities* (UNCTAD 2003, UNCTAD/DITC/TNCD/2003/3) 164, 173-174 (hereafter, *Electric Power and Gas Market Reform*). Mr. Melly published this paper prior to serving on the staff of USTR; at the time, he was a Program Manager at the Services and Investment Division of the U.S International Trade Commission. *Id.* See *CHEA Update*, Number 4, December 23, 2003 (“On December 10, 2003, Judith Eaton and David Ward, president of ACE, met with the newly appointed officials at USTR who have direct responsibility for negotiations on services and investments: James Mendenhall and Christopher Melly.”), available at [http://www.chea.org/Government/HEAupdate/CHEA\\_HEA122303.htm](http://www.chea.org/Government/HEAupdate/CHEA_HEA122303.htm) viewed March 2, 2005.

<sup>15</sup> GATS art. 1.3(a).

<sup>16</sup> Uruguay Round Agreements Act, 19 U.S.C. § 3512(b)(2)(A).

<sup>17</sup> FERC has recently sought to preempt state law, but based on FERC’s own authorizing legislation, not on federal authority to preempt state law under trade agreements. See Jim Chen *THE NATURE OF THE PUBLIC UTILITY: INFRASTRUCTURE, THE MARKET, AND THE LAW*, 98 Nw. U. L. Rev. 1617 (Summer 2004) 1661-1665; “Grid battle is joined: FERC’s AEP ruling begs the question: can the feds bypass states that block transmission reform?”, 142 Pub. Utilities Fort. 20 (January 2004).

<sup>18</sup> See WTO, Report of the Panel, *United States – Measures Affecting the Supply of Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, 10 November 2004.

<sup>19</sup> For a broader review of how trade agreements could affect electricity policy, see Barry Appleton, Opinion letter on the impact of Ontario’s proposed Electricity Restructuring Act, 2004 (“Bill 100) on Canada’s international law commitments under the NAFTA, the GATT and the GATS (December 21, 2004), released on February 14, 2005 by the Society of Energy Professionals. A summary of the opinion letter is available at <http://www.thesociety.ca/pages/news.html>, viewed Feb. 20, 2005.

<sup>20</sup> WTO, Report of the Appellate Body, *EC – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, September 9, 1997, 97.

<sup>21</sup> GATS art. 1.1.

<sup>22</sup> GATS art. 1.2.

<sup>23</sup> GATS art. II.

<sup>24</sup> GATS arts. XIII.2 (procurement) and XV.1 (subsidies).

<sup>25</sup> Compare GATS art. XIV (no conservation exception) with GATT art. XX(g) (conservation exception).

<sup>26</sup> GATS art. XIV (b). See WTO, Report of the Panel, *United States – Standards for Reformulated and Conventional Gasoline*, 96-0326, WT/DS2/R, 29 January 1996, ¶¶ 6.21. There are other more technical general exceptions that also are not relevant to this report including measures that are: necessary to secure compliance with laws that prevent deceptive practices or protect privacy; aimed at ensuring imposition or collection of direct taxes; or the result of an agreement on avoidance of double taxation. GATS art. XIV (c), (d) and (e).

<sup>27</sup> See WTO, Report of the Appellate Body, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, AB-2000-11 WT/DS135/AB/R, 12 March 2001, ¶¶ 164-175; see generally, WTO Analytic Index, GATT 1994, GATT art. XX (b), ¶¶ 505-513, available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gatt1994\\_07\\_e.htm#articleXX](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#articleXX), viewed Mar. 21, 2005.

<sup>28</sup> GATS art. VI.4.

<sup>29</sup> WTO, Working Party on Domestic Regulation, Informal Note by the Secretariat, Examples of Measures to Be Addressed by Disciplines Under GATS Article VI.4, Annex I – Examples Contributed by Members, Job (01)/62/Rev.2 (July 12, 2002), part A, Licensing requirements and Qualification requirements; Informal Note by the Secretariat, *Examples of Measures to be Addressed by Disciplines under GATS Article VI:4*, JOB(02)/20/Rev.8, 16 September 2004.



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- <sup>30</sup> WTO, Working Party on Domestic Regulation, *Annual Report of the Working Party on Domestic Regulation to the Council for Trade in Services (2004)*, 04-5148, S/WPDR/7, 26 November 2004, ¶¶ 6-9; WTO, Working Party on Domestic Regulation, Note by the Secretariat, “*Necessity Tests*” in the WTO, 03-6404, S/WPDR/W/27, 2 December 2003; WTO, Working Party on Domestic Regulation, Communication from the European Communities, *Proposal for Disciplines on Licensing Procedures*, S/WPDR/W/25, 10 July 2003; WTO, Working Party on Domestic Regulation, Communication from the United States, *Proposal for Transparency Disciplines in Domestic Regulation*, JOB(04)/128, 15 September 2004.
- <sup>31</sup> GATS art. VIII.2.
- <sup>32</sup> GATS art. VIII.4.
- <sup>33</sup> GATS art. VI.5. See WTO, Working Party on Domestic Regulation, Report on the Meeting Held on 15 May 2003, S/WPDR/M/21/Rev.1 (25 June 2003) ¶ 13 and ¶ 19; WTO, Working Party on Domestic Regulation, Report on the Meeting Held on 30 September 2003, S/WPDR/M/23 (27 November 2003) ¶¶ 5-7; WTO, Working Party on Domestic Regulation, Report on the Meeting Held on 3 December 2003), S/WPDR/M/24 (22 January 2004), Agenda Item: Singapore’s Paper on GATS Article VI:5.
- <sup>34</sup> See *Canada – Certain Measures Affecting the Automotive Industry*, WT/D5139/R, WTD5142/R, February 11, 2000, ¶ 10.78; GATT L/6439, ¶ 5.11-5.13, *United States – Measures Affecting Alcoholic and Malt Beverages*, Report by the Panel adopted on June 19, 1992 (DS23/R) ¶ 5.31; *United States – Section 337 of the Tariff Act of 1930*, Report by the panel adopted on November 7, 1989.
- <sup>35</sup> GATS art. XVI.2(a), (c) and (e).
- <sup>36</sup> OECD, *Managing Request-Offer Negotiations Under the GATS: The Case of Energy Services*, OECD, TD/TC/WP(@003)24/FINAL (Nov. 5, 2003) 12; WTO, Communication from the United States:, Energy Services, S/CSS/W/24 (Dec. 18, 2000). See Christopher Melly, *Electric Power and Gas Market Reform*, at 174-176.
- <sup>37</sup> WTO, U.S. Schedule of Specific Commitments, Supplement 2 (Telecommunications), Attachment – Reference Paper, GATS/SC/90/Suppl.2 (Apr. 11, 1997) ¶2.2.
- <sup>38</sup> WTO, U.S. Schedule of Specific Commitments, Supplement 2 (Telecommunications), Attachment – Reference Paper, GATS/SC/90/Suppl.2 (Apr. 11, 1997) ¶1.1.
- <sup>39</sup> WTO, *Explanation of the Annex on Telecommunications*, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/telecom\\_e/telecom\\_annex\\_expl\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_annex_expl_e.htm)
- <sup>40</sup> See, e.g., Ellen Gould, *TACD Background Paper on Trade in Services*, Trans-Atlantic Consumer Dialogue (October 2002) 20-26, available at <http://www.servicesforall.org/html/GATS/Gould-TACD%20trade%20in%20services.pdf>, viewed Feb. 26, 2005 (hereafter, TACD Background paper); Hong Kong Coalition of Service Industries, “Preparing for Services 2000,” *The Bulletin (June 1998)*; Pierre Sauve, “Open Services Markets Matter,” Working Party of the Trade Committee, OECD (Dec. 11, 2001) ¶ 46.
- <sup>41</sup> GATS art. 1.3(b) and (c).
- <sup>42</sup> *Id.*
- <sup>43</sup> WTO Secretariat, Energy Services: Background Note by the Secretariat, 3, September 9, 1998 (S/C/W/52) 3; Communication from the United States, Classification of Energy Services, 7, May 18, 2000 (S/C/W/27).
- <sup>44</sup> GATS art. XIII.1.
- <sup>45</sup> WTO Secretariat, Energy Services: Background Note by the Secretariat, 3, September 9, 1998 (S/C/W/52) 3; Communication from the United States, Classification of Energy Services, 7, May 18, 2000 (S/C/W/27).

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- <sup>46</sup> WTO Secretariat, Background Note, *id.*
- <sup>47</sup> WTO, Committee on Specific Commitments, Note by the Secretariat, Report of the Meeting Held on 28 September 2004, S/CSC/M/34 (Nov. 11, 2004) ¶ 38.
- <sup>48</sup> See WTO, Report of the Panel, *United States – Measures Affecting the Supply of Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, 10 November 2004, ¶¶ 6.288-290.
- <sup>49</sup> WTO, Committee on Specific Commitments, Note by the Secretariat, Report of the Meeting Held on 28 September 2004, S/CSC/M/34 (Nov. 11, 2004) ¶ 38; WTO, Committee on Specific Commitments, Note by the Secretariat, Report of the Meeting Held on 4 September 2003, S/CSC/M/31 (Jan. 14, 2004) ¶ 19.
- <sup>50</sup> Communication from the United States, Energy Services, 18 December 2000 (S/CSS/W/24); Communication from the United States, Classification of Energy Services, 18 May 2000 (S/CSC/W/27); see Lana Ekimoff, An Overview of the Negotiating Proposals on Energy Services under the GATS Negotiations, in *Energy and Environmental Services: Negotiating Objectives and Development Priorities* (UNCTAD 2003, UNCTAD/DITC/TNCD/2003/3) 105.
- <sup>51</sup> See, e.g., NCSL, Policy on Electric Industry Restructuring, in 2004-2005 Policies for the Jurisdiction of the Energy and Electric Utilities Committee, available at <http://www.ncsl.org/statefed/energy.htm#electricrestructuring>, viewed Feb. 20, 2005.
- <sup>52</sup> For an overview of state-level restructuring of electricity markets, see Energy Information Administration, Status of State Electric Industry Activity – as of February 2003 (February 2003 was the last update. No further updates are planned.), available at [http://www.eia.doe.gov/cneaf/electricity/chg\\_str/restructure.pdf](http://www.eia.doe.gov/cneaf/electricity/chg_str/restructure.pdf), viewed Feb. 20, 2005. See also Electric Power Supply Association, “EPSA State Proceedings / Legislation Matrix on Electric Industry Restructuring (Aug. 30, 2004), available at <http://www.espa.org/Competition/3.PDF>, viewed Feb. 20, 2005.
- <sup>53</sup> See GATS art. I.3.
- <sup>54</sup> WTO, U.S. Schedule of Specific Commitments, GATS/SC/90 (April 1994) 40.
- <sup>55</sup> Communication from the United States, Initial Offer, TN/S/O/USA (April 9, 2003) 42.
- <sup>56</sup> See Communication from Indonesia, Proposal on Classification of Energy Services (Revision), S/CSC/W/42/Rev.1 (Nov. 23, 2004) 8.
- <sup>57</sup> WTO, *GATS – Fact and Fiction* (undated) 12, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/gats\\_factfiction\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/gats_factfiction_e.htm), viewed Feb. 20, 2005.
- <sup>58</sup> WTO Secretariat, Energy Services: Background Note by the Secretariat, 3, September 9, 1998 (S/C/W/52) 3; Communication from the United States, Classification of Energy Services, 7, May 18, 2000 (S/C/W/27).
- <sup>59</sup> WTO Secretariat, Background Note, *id.*
- <sup>60</sup> GATS art. XVI.1.
- <sup>61</sup> GATS art. VIII.4.
- <sup>62</sup> Massachusetts Electric, About Us, available at [http://www.nationalgridus.com/masselectric/about\\_us/aboutus.asp](http://www.nationalgridus.com/masselectric/about_us/aboutus.asp), viewed Mar. 3, 2005.
- <sup>63</sup> See Harrison Institute for Public Law, *Comparison of Selected Ancillary Serviced Definitions in the United States* (December 2004). This chart compares definitions from FERC orders, selected transmission tariffs, and various private consultant reports. The chart demonstrates the lack of standard definitions and classifications for these services.
- <sup>64</sup> See Order No. 888, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1997), order on reh’g, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274 (1997), order on

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reh'g, Order No. 888-B, 81 FERC Stats. & Regs. ¶ 61,248, 62 Fed. Reg. 64,688 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998) (“The *interconnected operations services* identified by NERC incorporate all of the *ancillary services* proposed in the NOPR.”) (emphasis added) (hereafter, Order 888). *See also*, FERC Declaratory Order On Regional Transmission Organization Proposal, at ¶180 (Sept. 18, 2002), *available at* [http://www.rtowest.com/Doc/FERCOrder\\_Stage2Filing\\_Sep182002.pdf](http://www.rtowest.com/Doc/FERCOrder_Stage2Filing_Sep182002.pdf), viewed Mar. 21, 2005.

<sup>65</sup> FERC Order 888.

<sup>66</sup> FERC Order 888.

<sup>67</sup> FERC Order 888.

<sup>68</sup> Order No. 2000, Regional Transmission Organizations, FERC Stats. & Regs. ¶ 31,089, 65 Fed. Reg. 809 (2000), order on reh'g, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092, 65 Fed. Reg. 12088 (2000). For purposes of this report, we use “RTO” to refer to RTOs, ISOs, and similar independent transmission entities.

<sup>69</sup> *See* GATS art. I.3.

<sup>70</sup> *See e.g.*, PJM Open Access Transmission Tariff, *available at* <http://www.pjm.com/documents/downloads/agreements/tariff.pdf>, visited Mar. 20, 2005 (PJM OATT) (“The charges for Scheduling, System Control and Dispatch Service from PJM Interconnection, L.L.C. are set forth on an unbundled basis among the subsidiary schedules of Schedule 9, ‘PJM Interconnection, L.L.C. Administrative Services,’ of this Tariff.”)

<sup>71</sup> WTO Secretariat, Energy Services: Background Note by the Secretariat, 3, September 9, 1998 (S/C/W/52) 3; Communication from the United States, Classification of Energy Services, 7, May 18, 2000 (S/C/W/27).

<sup>72</sup> *See* Council for Trade in Services, Special Session, Communication from the United States, Energy Services, S/CSS/W/ 24, Dec. 18, 2000.

<sup>73</sup> *Id.*

<sup>74</sup> *See, e.g.*, Communication from Indonesia, Proposal on Classification of Energy Services (Revision), S/CSC/W/42/Rev.1 (Nov. 23, 2004) 8.

<sup>75</sup> GATS art. XVI.2(a).

<sup>76</sup> FERC Order 888.

<sup>77</sup> *See* MISO, Independent Transmission Company Agreement, Appendix I, Schedule 6 (Oct. 24, 2002), available at [http://www.midwestiso.org/documents/ITC\\_Agreement\\_10-25-2002.pdf](http://www.midwestiso.org/documents/ITC_Agreement_10-25-2002.pdf), viewed Mar. 4, 2005; and PJM OATT, Schedule 1A.

<sup>78</sup> National Grid, About US, Our Business, available at [http://www.nationalgridus.com/aboutus/a2-1\\_business.asp](http://www.nationalgridus.com/aboutus/a2-1_business.asp), viewed Feb. 20, 2005; MISO, “Ameren, FirstEnergy, NIPSCO to form transco under Midwest ISO (June 21, 2002), *available at* [http://www.midwestiso.org/news/2002/GridAmerica\\_0621\\_final.pdf](http://www.midwestiso.org/news/2002/GridAmerica_0621_final.pdf), viewed Mar. 4, 2005

<sup>79</sup> *See* California Independent System Operator Corporation FERC Electric Tariff, 2.5 Ancillary Services, available at <http://www.caiso.com/docs/2005/02/17/200502171216371245.pdf>, viewed Mar. 20, 2005.

<sup>80</sup> *See, e.g.*, Idaho Code §§ 61-302, 51-501, 61-508, 61-526, 61-527, 61-528.

<sup>81</sup> Pacific Northwest Electric Power Planning and Conservation Act, 16 USC § 839(c) (preference to public bodies and cooperatives).

<sup>82</sup> *See*, Idaho Code § 61-332D (Wheeling services); *Snake River Valley Elec. Ass'n v. PacifiCorp*, 357 F.3d 1042 (9th Cir. 2004).

<sup>83</sup> *See Arizona Public Service Company v. Idaho Power Company*, Docket Nos. EL99-44-006, EL99-44-007, FEDERAL ENERGY REGULATORY COMMISSION – COMMISSION, 105 F.E.R.C. P61,079;

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2003 FERC LEXIS 2068, ORDER DENYING REHEARING AND CONDITIONALLY ACCEPTING COMPLIANCE FILING (October 22, 2003); *Arizona Public Service Company v. Idaho Power Company*, aff'g initial decision & denying rehearing, 100 FERC P 61,253, 2002 WL 3134205 (FERC) (Sept. 5, 2002); *Arizona Public Service Company v. Idaho Power Company*, initial decision, 91 FERC P 63,004, 2000 WL 490942 (FERC) (Apr. 26, 2000).

<sup>84</sup> *Id.*

<sup>85</sup> *The New PJM Companies, American Electric Power Service Corp., Commonwealth Edison Co., Dayton Power and Light Co. and PJM Interconnection, LLC*, Docket No. ER03-262-009, FEDERAL ENERGY REGULATORY COMMISSION - ALJ, 106 F.E.R.C. P63,029; 2004 FERC LEXIS 487, March 12, 2004, as Amended March 25, 2004, ¶ 189 (citing a conflict between Kentucky native load preferences and the PJM curtailment tariff); see "ALJ says AEP should join PJM, *Platts T&D Magazine* (Mar. 25, 2004); see also, e.g., *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Docket No. RM95-8-000, Docket No. RM94-7-001, FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION, 75 F.E.R.C. P61,080; 1996 FERC LEXIS 777, ORDER NO. 888; FINAL RULE, April 24, 1996, 98-100.

<sup>86</sup> See GATS art. I.3.

<sup>87</sup> WTO, U.S. Schedule of Specific Commitments, Supplement 2 (Telecommunications), Attachment - Reference Paper, GATS/SC/90/Suppl.2 (Apr. 11, 1997) ¶2.2; WTO, Services Agreement, *Annex on Telecommunications*, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/12-tel\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/12-tel_e.htm), viewed Mar. 4, 2005.

<sup>88</sup> *Mexico - Measures Affecting Telecommunications Services*, Report of the Panel, WTO, WT/DS204/R (Apr. 2, 2004) 175.

<sup>89</sup> See "Denied SMD by Energy Bill, FERC to Focus on Market Power Test - Brownell, *Platts T&D Magazine* (2003 Features), available at [http://www.platts.com/Magazines/Platts%20T&D/Features/feat2\\_2003.xml](http://www.platts.com/Magazines/Platts%20T&D/Features/feat2_2003.xml), viewed Mar. 4, 2005.

<sup>90</sup> WTO, U.S. Schedule of Specific Commitments, Supplement 2 (Telecommunications), Attachment - Reference Paper, GATS/SC/90/Suppl.2 (Apr. 11, 1997) ¶2.2; WTO, Services Agreement, *Annex on Telecommunications*, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/12-tel\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/12-tel_e.htm), viewed Mar. 4, 2005.

<sup>91</sup> The WTO panel found that "rates which exceed cost-based rates to this extent, and whose uniform nature excludes price competition in the relevant market of the telecommunications services bound under Mexico's Schedule, do not provide access to and use of public telecommunications transport networks and services in Mexico 'on reasonable ... terms.'" *Mexico - Measures Affecting Telecommunications Services*, Report of the Panel, WTO, WT/DS204/R (Apr. 2, 2004) ¶¶ 7.328-7.335.

<sup>92</sup> Western Governors Association, Clean and Diversified Energy Initiative for the West, WGA Resolution 04-14 (June 22, 2004, sponsored by Governors Richardson and Schwarzenegger), available at <http://www.westgov.org/wga/policy/04/clean-energy.pdf>, viewed Mar. 4, 2005.

<sup>93</sup> Union of Concerned Scientists, "Fact Sheet: Renewable Energy Standards at Work in the States," (Sept. 28, 2004), available at [http://www.ucsusa.org/clean\\_energy/renewable\\_energy/page.cfm?pageID=47](http://www.ucsusa.org/clean_energy/renewable_energy/page.cfm?pageID=47), viewed Feb. 19, 2005.

<sup>94</sup> See Jeff Deyette, "Powerful Solutions: Seven Ways to Switch America to Renewable Electricity," Union of Concerned Scientists, January 1999, available at [http://www.ucsusa.org/clean\\_energy/renewable\\_energy/page.cfm?pageID=47](http://www.ucsusa.org/clean_energy/renewable_energy/page.cfm?pageID=47) (tables updated December 2004), viewed March 2, 2005; Western Governors Association, Clean and Diversified Energy Initiative for the West, WGA Resolution 04-14 (June 22, 2004, sponsored by Governors Richardson and Schwarzenegger) 4 (hydro is not one of the resources listed), available at <http://www.westgov.org/wga/policy/04/clean-energy.pdf>, viewed Mar. 4, 2005.

- <sup>95</sup> Union of Concerned Scientists, fact sheet, “Renewable Electricity Standards at Work in the States,” available at [http://www.ucsusa.org/clean\\_energy/renewable\\_energy/page.cfm?pageID=47](http://www.ucsusa.org/clean_energy/renewable_energy/page.cfm?pageID=47), viewed Mar 2, 2005; Union of Concerned Scientists, Summary of State Renewable Energy Policies (as of December 2004), available at [http://www.ucsusa.org/clean\\_energy/renewable\\_energy/page.cfm?pageID=114](http://www.ucsusa.org/clean_energy/renewable_energy/page.cfm?pageID=114), viewed Mar. 4, 2005.
- <sup>96</sup> Gary Horlick, Howard Mann and Christiane Schuchhardt, “NAFTA Provisions and the Electricity Sector,” Background Paper No. 4 to the Secretariat of the North American Agreement on Environmental Cooperation, June 2002, 7.
- <sup>97</sup> See GATS art. I.3.
- <sup>98</sup> European Commission, Summary of the EC’s Revised Requests to Third Countries in the Services Negotiations under the DDA (Brussels, Jan. 24, 2005) 8, available at [http://trade-info.cec.eu.int/doclib/cfm/doclib\\_type.cfm?type=10](http://trade-info.cec.eu.int/doclib/cfm/doclib_type.cfm?type=10), viewed March 2, 2005.
- <sup>99</sup> Communication from the United States, Classification of Energy Services, 18 May 2000 (S/CSC/W/27) 12-13; Communication from the United States, Energy Services, 18 December 2000 (S/CSS/W/24), Annex A.
- <sup>100</sup> GATS art. XXVII.3.
- <sup>101</sup> Communication from the United States, Energy Services, 18 December 2000 (S/CSS/W/24) 3.
- <sup>102</sup> See Parliament of Canada, *Report of the Canadian Delegation of the Canada-United States Inter-Parliamentary Group to the Forty-Third Annual Meeting*, Committee I – Trade and Economic Issues, Energy section A.3, Renewable Resources (May 16, 2002), available at [http://www.parl.gc.ca/information/InterParl/Associations/U\\_S/mai03/04-page-e.htm#1](http://www.parl.gc.ca/information/InterParl/Associations/U_S/mai03/04-page-e.htm#1), viewed Mar. 3, 2005; Department of Foreign and International Affairs, *Opening Doors to the World: Canada’s International Market Access Priorities 2001*, (4) Opening Doors to the Americas, United States, Electricity, available at <http://www.dfait-maeci.gc.ca/tna-nac/2001/4-en.asp>, viewed Mar. 3, 2005; see also Barry Appleton, Opinion letter on the impact of Ontario’s proposed Electricity Restructuring Act, 2004 (“Bill 100) on Canada’s international law commitments under the NAFTA, the GATT and the GATS (December 21, 2004) 34, released on February 14, 2005 by the Society of Energy Professionals. A summary of the opinion letter is available at <http://www.thesociety.ca/pages/news.html>, viewed Feb. 20, 2005; Gary Horlick and Christiane Schuchhardt, *NAFTA Provisions and the Electricity Sector*, Secretariat Report to Council under Article 13 of the North American Agreement on Environmental Cooperation, (June 2002) 9, available at <http://www.cec.org/files/PDF/nfta5-final-e2.pdf>, viewed Feb. 27, 2005.
- <sup>103</sup> Renewable Energy Policy Project (REPP), “RPS New Jersey,” (Sept. 28, 2004), available at [http://www.repp.org/articles/static/1/New\\_Jersey\\_RPS.html](http://www.repp.org/articles/static/1/New_Jersey_RPS.html), viewed Feb. 19, 2005.
- <sup>104</sup> Canadian Electricity Association, *Electric Power in Canada 1998-1999*, (2000) 68.
- <sup>105</sup> GATS art. XVII.3. GATS art. XVII on National Treatment is likely to be interpreted in light of WTO Appellate Body interpretations of National Treatment under GATT arts. III.1 and III.4, which apply to non-fiscal measures. See WTO Analytic Index, GATT Art. III (National Treatment), ¶¶ 198-241, available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gatt1994\\_03\\_e.htm#articleIIIC4](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_03_e.htm#articleIIIC4), viewed Mar. 3, 2005. See WTO, Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, AB-2000-11, WT/DS135/AB/R, 12 March 2001, ¶¶ 98-99 (regarding the competitive relationship between like products); WTO, Report of the Panel, *Japan – Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, 31 March 1998, ¶ 10.379 (regarding effective equality of competitive conditions); WTO, Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 4 October 1996, 16 (“... it is irrelevant that ‘the trade effects’ of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.”).

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- <sup>106</sup> Scott Hempling and Nancy Rader, *Comments of the Union of Concerned Scientists to the Commission for Environmental Cooperation in Response to its "NAFTA Provisions and the Electricity Sector" Background Paper to its October 22, 2001, Working Paper Entitled, "Environmental Challenges and Opportunities of the Evolving North American Electricity Market,"* (Jan. 31, 2002) 10.
- <sup>107</sup> GATS, art. XVI.2(c), fn. 9.
- <sup>108</sup> GAO fact sheet, "Federal Electric Power - Operating and Financial Status of DOE's Power Marketing Administrators" October 13, 1995 (GAO/RECD/AIMD 96-9FS) available at <http://www.gao.gov/archive/1996/r196009f.pdf>, viewed Mar. 2, 2005.
- <sup>109</sup> GAO Report to Congressional Requesters, "Federal Power: Regional Effects of Changes in PMA Rates," Jan 28, 1999 (GAO/RECD 99-55), available at <http://www.gao.gov/archive/1999/rc99055.pdf> viewed on Mar 2, 2005.
- <sup>110</sup> Bonneville Power Administration, "About BPA, BPA: Focusing on the Northwest," available at [http://www.bpa.gov/corporate/About\\_BPA/](http://www.bpa.gov/corporate/About_BPA/), viewed Feb. 23, 2005.
- <sup>111</sup> See GATS art. I.3.
- <sup>112</sup> Pacific Northwest Electric Power Planning and Conservation Act, 16 USC §§ 832(f) (elements in determining rates) and 839(c) (preference to public bodies and cooperatives).
- <sup>113</sup> GATS, art. XVII.3.
- <sup>114</sup> Pacific Northwest Electric Power Planning and Conservation Act, 16 USC §§ 832(f) (elements in determining rates) and 839(c) (preference to public bodies and cooperatives).
- <sup>115</sup> Jeff Kosseff, Bush wants market rates for BPA, *The Oregonian*, Feb. 8, 2005, available at [http://www.oregonlive.com/news/oregonian/index.ssf?/base/front\\_page/1107867325315371.xml](http://www.oregonlive.com/news/oregonian/index.ssf?/base/front_page/1107867325315371.xml), viewed Feb. 22, 2005.
- <sup>116</sup> See GAO Testimony, Federal Power – The Role of the Federal Power Administrations in a Restructured Electricity Industry, Statement of Victor S. Rezendes, Director of Energy, Resources and Science Issues of the Resources, Community and Economic Development Division of the General Accounting Office, June 14, 1999 (GAO/T-RECD/AIMD-99-229) 4-5, available at <http://www.gao.gov/archive/1999/r199229t.pdf>, viewed Feb. 22, 2005.
- <sup>117</sup> See, e.g., letter to Mr. Joshua Bolten, Director, Office of Management and Budget, from Peter Defazio, et al., 17 Members of Congress (Feb. 10, 2005) 2.
- <sup>118</sup> APPA, "PMA rates are unfair subsidy, Bodman tells Western governors," *Public Power Daily* (March 3, 2005), available at <http://www.appanet.org/newsletters/PublicPowerDailyList.cfm?ItemNumber=12192&sn.ItemNumber=2053>, viewed March 3, 2005.
- <sup>119</sup> See Letter to Mr. Joshua Bolten, Director, Office of Management and Budget, from Peter Defazio, et al., 17 Members of Congress (Feb. 10, 2005) 2; Christopher Schwartz, "Senators block Bush plan to boost Northwest power rates," *Seattle Times*, Mar. 3, 2005, available at <http://seattletimes.nwsourc.com/>, viewed Mar. 10, 2005; Jeff Kosseff, Bush wants market rates for BPA, *The Oregonian*, Feb. 8, 2005, available at [http://www.oregonlive.com/news/oregonian/index.ssf?/base/front\\_page/1107867325315371.xml](http://www.oregonlive.com/news/oregonian/index.ssf?/base/front_page/1107867325315371.xml), viewed Feb. 22, 2005.
- <sup>120</sup> See, e.g., West's Ann.Cal.Pub.Util.Code § 854. Acquisition or control of public utility; approval by commission.
- <sup>121</sup> See G. Philip Nowak and Sharon L. Taylor, *Energy Law and Transactions* (Matthew Bender and Co. 2004) § 2.02 Goals of Public Utility Regulation, [2] To Protect the Public Interest.
- <sup>122</sup> See GATS art. I.3.

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- <sup>123</sup> See G. Philip Nowak and Sharon L. Taylor, *Energy Law and Transactions* (Matthew Bender and Co. 2004) § 2.03 State Regulation of Public Utilities.
- <sup>124</sup> See Energy Information Administration, Status of State Electric Industry Activity – as of February 2003 (February 2003 was the last update. No further updates are planned.), available at [http://www.eia.doe.gov/cneaf/electricity/chg\\_str/restructure.pdf](http://www.eia.doe.gov/cneaf/electricity/chg_str/restructure.pdf), viewed Feb. 20, 2005.
- <sup>125</sup> United States of America, Schedule of Specific Commitments, GATS/SC/90 (April 1994) 40.
- <sup>126</sup> Communication from the United States, Initial Offer, TN/S/O/USA (April 9, 2003) 42.
- <sup>127</sup> GATS art. VI.4.
- <sup>128</sup> Communication from the United States, Initial Offer, TN/S/O/USA (April 9, 2003) 93.
- <sup>129</sup> Communication from the United States, Initial Offer, TN/S/O/USA (April 9, 2003) 96, 100 (11.G Pipeline transportation of fuels; 11.H.b Storage and warehouse services: Bulk storage services of liquids and gases).





# **ATTACHMENT 4**



COMMONWEALTH OF KENTUCKY  
OFFICE OF THE ATTORNEY GENERAL

GREGORY D. STUMBO  
ATTORNEY GENERAL

1024 CAPITAL CENTER DRIVE  
SUITE 200  
FRANKFORT, KY 40601-8204

December 8, 2004

Mr. Andrew V. McNeill  
Chief of Staff  
Commerce Cabinet  
500 Mero Street, 24<sup>th</sup> Floor  
Frankfort, Kentucky 40601

Re: Written Comments by the Attorney General's Office to the  
Commonwealth Energy Policy Task Force

Dear Mr. McNeill:

As promised prior to the Thanksgiving holiday, I tender these written comments on behalf of the Office of the Attorney General, Commonwealth of Kentucky, to the Commonwealth Energy Policy Task Force. These comments and observations are tendered with the understanding that the Attorney General is required under KRS Chapter 367 to advance the interests of consumers in many areas, including but not limited to matters related to energy consumption. Given this statutory mandate, I offer these written remarks. Furthermore, I adopt and incorporate as if fully stated herein those comments which I provided to the Task Force on November 12, 2004. (Please see Attachment A.)

- Pursuant to KRS 278.285, a mechanism exists for the creation and implementation of demand-side management plans. In theory, these plans are to be designed to reduce the demands on a utility's services and, hence, avoid the need for additions to plant generating capacity. The statute clearly indicates this intent with language referring to "specific changes in customers' consumption patterns" and "any net revenues lost due to reduced sales resulting from demand-side management programs." In light of this, it may be beneficial to require more exhaustive audits and/or reviews of the programs in order to make sure that the intent is being realized. While my office is not opposed to the granting of financial assistance to individuals in need of same, it is a commonsense approach to make sure that moneys are not simply being handed out for assistance; rather, moneys are spent under these programs to decrease the demand on a utility company's services.



Mr. Andrew V. McNeill

December 8, 2004

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My office does not oppose the grant of financial assistance to the needy concerning the use of and payment for their utilities when the authority to do so is set out by statute. But, it does believe that where the statutory purpose of a DSM program is to reduce usage, care must be taken to assure that no program is simply a financial handout that does not reduce usage.

- Given the increased volatility in the energy commodities markets, it is imperative that the states approach their Congressional delegates to impress upon them the need to increase LIHEAP allocations to states, including the Commonwealth of Kentucky. Regardless of whether the seasonal temperatures remain average or above normal, the record and near-record energy prices are putting an additional financial burden on consumers.
  - Congressional delegates also need to be encouraged to reschedule LIHEAP distributions to take advantage of seasonal fuel pricing. Consider the propane consumer. Historically, prices for propane decrease during the summertime and experience significant spikes during the wintertime—the time when LIHEAP funds are available. If Congress were to allow states to tap into the LIHEAP funds during the summer months for propane consumers, those consumers would be able to consume propane at more advantageous prices. At first blush one may dismiss this request as being insignificant. However, approximately 10 percent of Kentucky's households use propane for heating their homes.
- The Attorney General's Office is now receiving an increased volume of telephone calls and correspondence, and is witnessing significant media coverage concerning what appears to be a Public Service Commission that is no longer concerned about the plight of consumers. Consumers complain constantly that they believe the Commission is now geared toward maintaining the profitability, and perhaps excessive profitability, of the utility industry. My office shares the concerns that the rates being granted to the utility companies appear to be excessive. Under the regulatory schedule, consumers are to be given safe, adequate, and reliable services, in return for which the utility companies receive fair, just, and reasonable rates. With the many mergers that have taken place over the past several years, it has become questionable whether safe, adequate, and reliable services are being provided.
- With the volatility in the energy market, legislation should be considered to impose upon the Commission the requirement that it also review the affordability of any increase forced upon the consumers. While the utility companies should receive a reasonable profit, greater scrutiny should be applied when the prices no longer become affordable to their *captive* ratepayers.

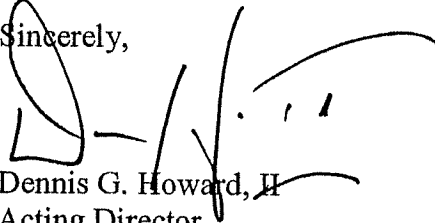
- The many mergers that have taken place over the past several years should cause some alarm for the Commonwealth. The notion that “bigger is better” does not appear to inure to the benefit of the ratepayers. Throughout the mergers, various general economic benefits have been promised. However, my office has yet to see anything tangible result to the consumers’ favor. Outages have occurred which have seemingly lasted much longer than necessary. Customers calling for customer service now are speaking with representatives in other states who have minimal knowledge of their special circumstances. The surviving entity continues to seek rate increases, notwithstanding promises made when seeking the authority to merge that customer savings would be a benefit of the merger. A possible remedy for this problem may be to require that the Commission find that any transfer will result in quantifiable and tangible benefits for the consumer under KRS 278.020(5).
- Whether at the state or federal level, significant efforts ought to be considered to educate the public on energy conservation. While this comment should probably be addressed by the Department of Energy, I suggest that attempts should be made by all state agencies whose efforts touch these areas to inform the public of the means by which one can weatherize a home, purchase energy efficient equipment and fixtures, etc. By demonstrating that these efforts will ultimately result in cost savings, more people are likely to participate in such measures.
- The following point is an observation; and, unfortunately, I have no recommendation to cure the current problem. Specifically, energy has become a commodity that is traded on the market. This results in the creation of additional costs for the end use consumer consequent to the introduction of middlemen, traders who neither produce nor supply energy to captive customers, into the price stream of energy. Indeed, it is axiomatic that with the appearance of at least one, if not more, individuals in the trading process, suppliers will be forced to ultimately pay a higher price for the product. These costs come to, of course, or are ultimately borne, by the ratepayer or end user depending on the type of commodity.

In conclusion, the Attorney General’s Office offers these written comments pursuant to its statutory mandate as a consumer advocate to advance the interests of the citizens of the Commonwealth of Kentucky. Given the time constraints, I have expedited this endeavor to cover several important areas. However, this letter should not be

Mr. Andrew V. McNeill  
December 8, 2004  
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considered as a comprehensive undertaking by my office. Indeed, I would caution the task force that if it intends to hastily finalize a comprehensive energy strategy, it may experience a situation similar to that of California Governor Gray Davis in the recent past.

Sincerely,



Dennis G. Howard, II  
Acting Director

DGH/lfr

CC: Dr. Allyson Handley, Secretary of the Executive Cabinet  
Jim Host, Secretary of Commerce  
LaJuana Wilcher, Secretary of Environmental and Public Protection  
Gene Strong, Secretary of Economic Development  
Robbie Rudolph, Secretary of Finance and Administration  
Virginia Fox, Secretary of Education  
Senator Robert Stivers  
Representative Tanya Pullin

Enclosure: Attachment A

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On behalf of General Stumbo, I would like to thank you for the invitation to appear here today to respond to your request that I speak to the role of the Attorney General in energy issues facing Kentucky.

For several decades the Attorney General's office has advanced the interests of the consumers of the Commonwealth of Kentucky in matters related to the consumption of energy. Using the authority given to the Attorney General's office under the consumer protection act, my unit, the Office of Rate Intervention, has focused its efforts on issues specifically related to regulated utilities and the rates they charge the consuming public. The Attorney General's Office in general has covered an even wider spectrum of matters related to energy consumption, addressing, to the extent possible, issues relating to unregulated forms of energy. Because there is specific statutory authority vested in the Attorney General concerning regulated utilities and their rates, let me describe our role there in more detail.

- Without question, energy prices are now near, or at, record highs.

Because of this, the Attorney General's role as the consumer

advocate in proceedings before the Public Service Commission, the agency that governs regulated utilities and their rates, to seek the lowest rates possible for necessary electric, water, gas and telephone services remains crucial. It incumbent upon us to convince the regulators of those energy providers that are regulated to secure the cheapest rates possible.

Not every utility is regulated. For instance, city owned and operated utilities are not regulated. But, the large investor-owned utilities and rural electric coops that provide electric, water, and gas service and some forms of telephone service are regulated. A long history of legal decisions requires that these regulated utility companies must make a reasonable profit. Nonetheless, it is critical to make sure that those rates are as low as they reasonably can be without jeopardizing the health of the regulated companies.

Between corporate abuses that have become apparent through the actions of Enron and others and the purchase of energy companies by ever larger and more distant corporations, the health of the regulated

enterprises is of a lesser concern to the average citizen today than it was in previous years. Because the consumers continue to see rate increases and declining service despite promises of non-quantifiable benefits tied to the gobbling up of the smaller utility companies by the larger ones, the Attorney General continues to question whether "bigger is better" when faced with merger and acquisition issues in which ever larger and often foreign owned companies buy up local companies

- The Attorney General, together with the Public Service Commission and other groups representing Kentucky consumers, is involved in the war between the federal government to create an unregulated energy market and the efforts of Kentucky to hang on to the lower rates it can retain for its retail customers only through continued regulation of rates. One of those battlegrounds involves who owns and pays for transmission now in place and soon to be built as this transmission is critical to sending electricity from any generator across the nation to any buyer. The federal government



is currently forcing electric companies to transfer their transmission assets to independently-owned transmission organizations. Whether these organizations are for-profit or not-for-profit, the entities nonetheless control the dispatch of the electricity across the United States. My office has concerns about this forced transfer of control.

The federal government likens control of the transmission system to the control of federal highways wherein the federal government is in charge. That analogy is somewhat misguided because all transmission is being taken, not just the transmission that was built to move electricity from state to state. The transmission that is being taken is transmission that was found necessary to service the consumers of Kentucky and was paid for by Kentucky consumers to secure service to them. The service was not paid for by all citizens of all states, as the interstate highways have been, but by the citizens of Kentucky to serve their needs.

Nevertheless, if the federal government has its way, a utility company in Kentucky serving its captive ratepayers could be required to

curtail, or otherwise cut off service, to its captive ratepayers because of transmission problems arising in other states or in the service of customers in other states. If this happens, it will be the equivalent of being required to pull over on a Kentucky Parkway in order to allow other businesses from other states to send their goods down the road. Kentucky consumers may find themselves sitting in the cold or in the heat in order to allow customers in other states to get electricity being transmitted over Kentucky transmission lines. Kentucky's ratepayers have built and paid for those transmission lines. To the extent possible the Attorney General is working to see that Kentucky customers continue to have the full right to use of those transmission assets.

- The Attorney General does not have statutory authority that allows it to do much to help the consumer where the energy source involved is not regulated. The Department of Energy, through John Davies and Greg Guess, has been kind enough to forward information relative to petroleum prices. This information shows that the price of petroleum products and other energy commodities

are going through the roof. As far as the petroleum products, there is little that can be done under our current governmental regulations. Likewise, natural gas prices are not regulated by any governmental authority. For most problems arising around and complaints received concerning the high cost of gasoline and natural gas, all the Attorney General's office can do is lend an ear. The Consumer Protection Division is currently unable to tackle price gouging complaints relative to gasoline prices. As long as there is competition, there is no way to proceed with a complaint on price gouging. Similarly, natural gas prices that are direct flow-throughs, meaning that the utility company does not make a profit on the actual price for natural gas, are also a cause for concern but, because they are not regulated, are nevertheless out of the reach of the Attorney General. The Attorney General also has no role in the location of merchant energy plants in Kentucky, except to the extent that those plants burden the transmission lines built and paid for to serve Kentucky consumers.

- After years of building only peaking power, utilities serving Kentucky customers are now planning to add substantial amounts of capital intensive base load capacity. The addition of base load capacity is lumpy, capacity additions are larger than the current needs of the consumers when made. The Attorney General will be involved in those cases, which will be decided by the Public Service Commission, to try to ensure that Kentucky consumers get charged for only that capacity needed to serve them and that to the extent that more capacity than needed is built, the consumers, not the owners of the utilities, get the benefits of any sales made from that excess capacity.
- Finally, the Attorney General tries to assure that the rates paid by all classes of customers are fair. If other groups such as industrial representative or representatives of the low income groups step into a case, the Attorney General continues to represent those customers not otherwise represented. Pressure is exerted on the residential and the small commercial customer from both ends of

the customer spectrum, the large industrial customers, the large commercial customers, and the low income residential customers, to take a large part of the burden of rates. It is the Attorney General's job to fight for fair rates for all customers, particularly for those without specialized advocates. Who will bear the cost of energy used to serve this state, as well as who will profit from the maximization of the energy resources of the state are equally important in your development of a comprehensive energy policy for Kentucky.

Given the time constraints, I have only touched on highlights.

I anticipate filing more extensive comments in the future.

Do you have any questions?