

Policy Statement, and the guidance herein concerning ancillary services.⁵⁵²

A final jurisdictional issue raised in the Open Access NOPR concerns buy-sell transactions. We remain concerned, just as we were with buy-sell arrangements in the gas industry, that buy-sell arrangements can be used by parties to obfuscate the true transactions taking place and thereby allow parties to circumvent Commission regulation of transmission in interstate commerce. Thus, we reaffirm our conclusion that we have jurisdiction over the interstate transmission component of transactions in which an end user arranges for the purchase of generation from a third party. However, we recognize that there is a wide range of programs and transactions that might or might not fall within this category. We will address these on a case-by-case basis.

In summary, the Commission reaffirms and clarifies its prior jurisdictional conclusions and tests for determining the demarcation between federal and state jurisdiction over transmission in interstate commerce and local distribution. We have attempted to address these issues in a way that provides for flexibility and recognition of legitimate state concerns. With regard to retail services, we recognize the states' concerns that the unbundling of retail transactions would result in changes from what historically has been regulated by the states (principally, the rates of transmission assets previously included in retail rate base). However, the decision to provide unbundled retail wheeling is not the Commission's to make because we have no authority to order transmission directly to an ultimate consumer. In addition, even if a retail access program occurs, we do not believe the unbundling of retail transactions will radically change fundamental state authorities, including authority to regulate the vast majority of generation asset costs, the siting and maintenance of generation facilities and transmission lines, and decisions regarding retail ser-

vice territories. Further, the Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. As the electric industry and state regulatory authorities continue to develop new competitive market structures and consider retail wheeling programs, we believe that the tests and mechanisms we have provided in this Rule will accommodate both Federal and state interests and will help provide jurisdictional certainty to market participants.

J. Stranded Costs

1. Justification for Allowing Recovery of Stranded Costs

In the Supplemental Stranded Cost NOPR, the Commission noted that the Open Access Rule would give a utility's historical wholesale customers greatly enhanced opportunities to reach new suppliers.⁵⁵³ This would affect the way in which utilities have recovered costs under the traditional regulatory system that, on the one hand, imposed an obligation to serve,⁵⁵⁴ and, on the other hand, permitted recovery of all prudently incurred costs. We noted that if customers leave their utilities' generation systems without paying a share of these costs, the costs will become stranded unless they can be recovered from other customers. The Commission stated in the NOPR that we must address the costs of the transition to a competitive industry by allowing utilities to recover their legitimate, prudent and verifiable stranded costs simultaneously with any final rule we adopt requiring open access transmission.⁵⁵⁵

Virtually all of the investor-owned utility commenters as well as commenters representing state commissions and other constituencies support the NOPR's premise that stranded costs can be created when a customer switches suppliers. They endorse the proposal to allow the recovery of legitimate and verifiable stranded

⁵⁵² In applying the principles of the Final Rule to retail transmission tariffs, the Commission clearly cannot order retail wheeling directly to an ultimate consumer. See FPA section 212(h).

⁵⁵³ *FERC Statutes and Regulations* ¶ 32,514 at p. 33,095.

⁵⁵⁴ The Supplemental Stranded Cost NOPR described such an obligation as explicit at retail and arguably implicit at wholesale. *FERC Statutes and Regulations* ¶ 32,514 at p. 33,101.

⁵⁵⁵ *Id.* at p. 33,095-96, 33,101.

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costs.⁵⁵⁶ Numerous commenters also support the Commission's proposal to link stranded cost recovery with open access tariffs. These commenters agree that the recovery of stranded costs is critical to the successful transition of the industry to an open transmission access, competitive industry.⁵⁵⁷ Commenters such as EEI and NU submit that open access and stranded cost recovery should be implemented simultaneously; that unbundled transmission service should not be required until a stranded cost recovery mechanism is in place. Some commenters propose that if the full recovery of stranded costs is disallowed as a result of rehearing or judicial review, utilities that have filed open access transmission tariffs should be permitted to withdraw them, or the Commission should otherwise reconsider its rule on open access transmission in light of such a reversal.⁵⁵⁸

Commenters representing the financial community reiterate their strong support for the full recovery of stranded costs, noting that the prospect of not recovering stranded costs could erode a utility's ability to attract capital which, in turn, could impede the long-term goal of achieving competitive wholesale markets.⁵⁵⁹ Several commenters also argue that stranded cost

recovery is economically efficient and is necessary to ensure parity among competitors and to avoid uneconomic bypass.⁵⁶⁰

The commenters that oppose allowing utilities to recover legitimate and verifiable stranded costs repeat many of the arguments that were raised in response to the initial Stranded Cost NOPR. For example, a number of commenters argue that the risk that a utility could lose customers (and thereby incur stranded costs) is not a new phenomenon created by regulatory and statutory initiatives that utilities could not have anticipated.⁵⁶¹ Some commenters argue that there was never an implied obligation to serve at wholesale.⁵⁶² According to TDU Systems, monopoly power, not regulatory obligation, has kept wholesale customers captive over the years.

Other commenters argue that allowing the recovery of stranded costs would make it uneconomic for customers to seek alternative sources of power and that the prospect of liability for and protracted litigation over stranded cost claims would create paralyzing uncertainty for customers, uncertainty that may dissuade them from taking advantage of new opportunities in the wholesale power market.⁵⁶³ Some commenters also argue that

⁵⁵⁶ See, e.g., EEI, Atlantic City, Arizona, Carolina P&L, Centenor, Central Hudson, Detroit Edison, Duke, Duquesne, Entergy, Florida Power Corp., El Paso, Houston, NIPSCO, NU, Oklahoma G&E, Otter Tail, PG&E, Puget, Southern, San Diego G&E, SCE&G, SoCal Edison, Montana, Montana-Dakota Utilities, NSP, Utilities For Improved Transition, NC Com, PA Com, Electric Consumers Alliance, American National Power, NE Public Power District, MEAC, OH Coops, Seattle, NY Energy Buyers, SBA, TVA, Utility Workers Union, Big Rivers EC, Central EC, Citizens Lehman, NGS, AGA, Montaup, NIEP.

⁵⁵⁷ See, e.g., EEI, Coalition for Economic Competition, EGA, CINergy, Electric Consumers Alliance, Atlantic City, Com Ed, Consumers Power, Dayton P&L, Dominion, Duke, El Paso, NEPCO, NIMO, NIPSCO, Ohio Edison, Florida Power Corp., PECO, Pennsylvania P&L, PSNM, Public Service Co of CO, Southern, SCE&G, VEPCO, Texas Utilities, DOE, CA Energy Com, CO Com, PA Com, NE Public Power District, SMUD, Brazos, Sunflower, PJM, Utility Workers Union, Utility Investors Analysts, Nuclear Energy Institute, SoCal Gas, AGA, Utility Shareholders, LPPC. Although DOD agrees that addressing stranded costs is a critical part of the transition to a more competitive industry, it

submits that there is nothing in the Open Access NOPR that should affect the treatment of stranded costs because the Open Access NOPR would not change the contracts that govern existing wholesale transactions. It argues that the Commission will have ample opportunity to decide these matters before the present wholesale long-term contracts expire.

⁵⁵⁸ E.g., Utilities For Improved Transition, PECO, Utility Workers Union, Dayton P&L.

⁵⁵⁹ Utility Investors Analysts, Utility Shareholders.

⁵⁶⁰ See, e.g., EEI, SCE&G, Montana, Com Ed.

⁵⁶¹ E.g., TAPS, IN Industrials, Air Liquide, Texas Industrials, Detroit Edison Customers, AMP-Ohio.

⁵⁶² E.g., TDU Systems, Competitive Enterprise.

⁵⁶³ See, e.g., Missouri Joint Commission, Omaha PFD, American Forest & Paper, TAPS, AMP-Ohio, Kansas Commission, VA Com, Nucor, Torco, IPALCO, DE Muni, Municipal Energy Agency Nebraska, Air Liquide, Arkansas Cities, Detroit Edison Customers, Cleveland, Texas-New Mexico, Blue Ridge, Suffolk County, NM Industrials, PA Munis, Caparo, ABATE, NRRI, Building Owners, Alma, WEPCO, Total

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stranded cost recovery would be a disincentive to efficient operation by affording the greatest protection to utilities that made the worst investment decisions.⁵⁶⁴

Commenters also argue that the scope of the proposed rule is overbroad; that stranded cost recovery should be allowed, if at all, on a case-by-case basis; that there should be no presumption that every utility will experience stranded costs; and that utilities should not be allowed to recover 100 percent of prudently incurred stranded costs.⁵⁶⁵

Several commenters suggest that there is no factual basis for the stranded cost rule, citing a lack of evidence of a wholesale stranded cost problem.⁵⁶⁶ TDU Systems refers to a Resource Data International study that shows that, of \$114 billion in potential investor-owned utility stranded investment, only \$10.4 billion is associated with wholesale transactions.⁵⁶⁷ Others submit that the Commission should obtain more current data concerning the magnitude of potential stranded cost recovery before issuing the final rule.⁵⁶⁸ In reference to the statement in the Supplemental NOPR that the Commission will continue to gather infor-

mation on the magnitude of potential stranded costs,⁵⁶⁹ DE Muni states that the Commission must commit to making public all the data it obtains so that all can evaluate the impact of the recovery of stranded costs on an ongoing basis.

NRRI submits that the Commission has drawn the wrong conclusion from its natural gas industry experience. According to NRRI, pipelines were "caught in an unusual transition" by changes caused by Congress and the Commission. In the case of the electric industry, NRRI submits that although there are uneconomic wholesale power contracts, the Commission is not responsible for this situation.⁵⁷⁰

Several commenters suggest that the Commission condition a utility's ability to recover stranded costs upon the utility agreeing to take certain actions (such as reducing environmental effects⁵⁷¹ or ensuring the payment of costs that are stranded if the utility commences direct service to an end-use customer that was previously a wholesale customer of a transmission dependent utility⁵⁷²), or agreeing to refrain from certain actions (such as seeking unilaterally to terminate

(Footnote Continued)

Petroleum. SC Public Service Authority asserts that the Commission has not adequately addressed the anticompetitive potential of exit fees and the potential shifting of losses from high-cost to low-cost producers. It says that the Commission should renounce any further proposal that it develops to permit a reasoned analysis of anticompetitive concerns.

⁵⁶⁴ E.g., TAPS, AMP-Ohio, IPALCO, Suffolk County, Competitive Enterprise, NY Energy Buyers, Supervised Housing, Central Illinois Light, WP&L, SC Public Service Authority, KS Com.

⁵⁶⁵ E.g., Alma, IPALCO, Suffolk County, CO Consumers Counsel, Arkansas Cities, Central Illinois Light, NY AG, NASUCA, VA Com, NY Energy Buyers, UT Industrials, NM Industrials, NJ Ratepayer Advocate, WEPCO, IN Industrials, ABATE, AZ Com.

⁵⁶⁶ E.g., ELCON, TDU Systems, Texas-New Mexico, Central Illinois Light.

⁵⁶⁷ However, Utilities for Improved Transition refers to a report by Moody's Investor Service estimating that the stranded costs of the Nation's 114 largest electric utilities under open access transmission will be \$135 billion in the next ten years (13 to 14 times greater than the costs stranded by the introduction of open access transportation of natural gas). It notes that

this estimate covers costs stranded by transmission in interstate commerce of both wholesale and retail power, and submits that both types of costs are relevant to this proceeding because of the Commission's jurisdiction over the transmission rates for wheeling to both wholesale and retail customers.

⁵⁶⁸ E.g., Central Illinois Light, Utility Workers Union, Alcoa.

⁵⁶⁹ See *FERC Statutes and Regulations* ¶ 32,514 at p. 33,105.

⁵⁷⁰ According to NRRI, the Commission did not "berate" electric utility management to sign uneconomic contracts in the manner that NRRI contends the Commission and Congress "berated" pipeline management. NRRI Initial Comments at p. 6. NRRI also objects that the proposed rule is a departure from what occurred in other deregulated industries (where no stranded cost recovery was allowed) and that the Commission should provide a fuller explanation as to why it believes allowing utilities full recovery of legitimate and verifiable stranded costs is the correct course of action.

⁵⁷¹ E.g., Legal Environmental Assistance, Conservation Law Foundation.

⁵⁷² E.g., TDU Systems.

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or modify IPP contracts).⁵⁷³ CCEM proposes that open access, conversion rights, and divestiture should each be a precondition to a utility's eligibility for any stranded cost recovery. VT DPS submits that, if the Commission adopts a stranded cost rule, it should limit utility stranded cost claims to those cases where the utility can demonstrate that its costs have been rendered unrecoverable as a direct result of the final rule.⁵⁷⁴

A number of commenters object that the proposed rule contains no provisions for non-transmission-owning utilities to collect stranded costs.⁵⁷⁵ Illinois Municipal Electric Agency asks the Commission to consider providing a forum for municipals to recover stranded costs from their customers under the same guidelines as investor-owned utilities. Recognizing that the FPA gives the Commission no general jurisdiction over municipalities for purposes of rate regulation,⁵⁷⁶ Illinois Municipal Electric Agency argues that the FPA nevertheless does not prevent the Commission from providing a forum for municipalities that may experience stranded costs as a result of new federal regulations. NE Public Power District, RUS, and rural electric cooperative commenters object that the NOPR gives public utilities a greater chance than other transmitting utilities to recover stranded costs from departing customers by offering public utilities two avenues of recovery (an exit fee under a power sales contract or a transmission surcharge) but offering other transmitting utilities only one avenue (a transmission surcharge).⁵⁷⁷

PA Munis objects that the Commission's proposal to impose stranded costs only on wholesale requirements customers (and not on other wholesale customers) is unduly discriminatory and counter to the goals of the Open Access NOPR. It submits that the Commission's proposal, by subjecting a wholesale requirements customer to increased transmission rates for stranded costs not levied on other wholesale customers, is indistinguishable in substance from the pre-Order 436 plan held to be discriminatory in *Maryland People's Counsel v. FERC*.⁵⁷⁸

ELCON and others⁵⁷⁹ urge the Commission to clarify that stranded costs do not arise when a customer leaves a system because its plant becomes uneconomic or the customer wishes to co-generate or self-generate. They note that "[t]hese alternatives have always existed and do not arise from new opportunities for wholesale and retail wheeling."⁵⁸⁰

Commission Conclusion

We reaffirm our preliminary determination that the recovery of legitimate, prudent and verifiable stranded costs should be allowed. Having considered the arguments raised by the commenters that oppose stranded cost recovery, we continue to believe that utilities that entered into contracts to make wholesale requirements sales under an entirely different regulatory regime should have an opportunity to recover stranded costs that occur as a result of customers leaving the utilities' generation systems through Commission-jurisdictional open access tariffs or FPA section 211 orders,⁵⁸¹ in

⁵⁷³ E.g., EGA, LG&E. EGA and LG&E further argue that if a utility is able to abrogate a QF contract, a QF should be entitled to recover its costs based upon the same equities of reliance upon governmental approvals, changed regulatory regimes, and reasonable expectation.

⁵⁷⁴ VT DPS argues that under Order No. 636, the Commission allowed recovery of costs that would be rendered "unrecoverable" because the costs would not be incurred to provide transportation service and because there would be no wholesale load from which to recover the costs. It suggests that when a utility loses wholesale load or a municipality establishes a new distribution system, the utility's costs are not necessarily rendered unrecoverable.

⁵⁷⁵ E.g., PA Munis, Missouri Joint Commission, TAPS, Municipal Energy Agency Nebraska.

⁵⁷⁶ But see FPA section 212(a), 16 U.S.C. 824k(a).

⁵⁷⁷ RUS objects that, at the same time, an RUS-financed cooperative that is a transmitting utility would be required to provide reciprocal open access to its public utility supplier, which is also its customer and its competitor.

⁵⁷⁸ 761 F.2d 768 (D.C. Cir. 1985).

⁵⁷⁹ E.g., VA Com, DE Muni, LG&E, Mountain States Petroleum Assoc.

⁵⁸⁰ ELCON July 25, 1995 Comments at p. 6.

⁵⁸¹ Hereafter referred to collectively as the "new open access" or "open access transmission."

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order to reach other power suppliers. As we indicated in the Supplemental Stranded Cost NOPR, we do not believe that utilities that made large capital expenditures or long-term contractual commitments to buy power years ago should now be held responsible for failing to foresee the actions this Commission would take to alter the use of their transmission systems in response to the fundamental changes that are taking place in the industry.⁵⁸² We will not ignore the effects of recent significant statutory and regulatory changes on the past investment decisions of utilities.⁵⁸³ While, as some commenters point out, there has always been some risk that a utility would lose a particular customer, in the past that risk was smaller. It was not unreasonable for the utility to plan to continue serving the needs of its wholesale requirements customers and retail customers, and for those customers to expect the utility to plan to meet future customer needs. With the new open access, the risk of losing a customer is radically increased. If a former wholesale requirements customer or a former retail customer uses the new open access to reach a new supplier, we believe that the utility is entitled to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime to serve that customer.⁵⁸⁴

We learned from our experience with natural gas that, as both a legal and a policy matter, we cannot ignore these costs. During the 1980s and early 1990s, the Commission undertook a series of actions that contributed to the impetus for restructuring of the gas pipeline industry. The introduction of competitive forces in the natural gas supply market as a result of the Natural Gas Policy Act of 1978⁵⁸⁵ and the subsequent restructuring of the natural gas industry left many pipelines holding uneconomic take-or-pay contracts

with gas producers. When the Commission initially declined to take direct action to alleviate that burden, the U.S. Court of Appeals for the District of Columbia Circuit faulted the Commission for failing to do so.⁵⁸⁶ The court noted that pipelines were "caught in an unusual transition" as a result of regulatory changes beyond their control.⁵⁸⁷

As we stated in the Supplemental NOPR, the court's reasoning in the gas context applies to the current move to a competitive bulk power industry. Indeed, because the Commission failed to deal with the take-or-pay situation in the gas context, the court invalidated the Commission's first open access rule for gas pipelines. Once again, we are faced with an industry transition in which there is the possibility that certain utilities will be left with large unrecoverable costs or that those costs will be unfairly shifted to other (remaining) customers. That is why we must directly and timely address the costs of the transition by allowing utilities to seek recovery of legitimate, prudent and verifiable stranded costs. At the same time, however, this Rule will not insulate a utility from the normal risks of competition, such as self-generation, cogeneration, or industrial plant closure, that do not arise from the new availability of non-discriminatory open access transmission. Any such costs would not constitute stranded costs for purposes of this Rule.

We are issuing the Stranded Cost Final Rule simultaneously with the Open Access Final Rule because we believe that the recovery of legitimate, prudent and verifiable stranded costs is critical to the successful transition of the electric industry to a competitive, open access environment. We believe that our decision today will be upheld by the courts. While the D.C. Circuit is still considering the vari-

⁵⁸² FERC Statutes and Regulations ¶ 32.514 at p. 33.101-02.

⁵⁸³ Contrary to NRRI's claim, and as explained in the NOPR (See, e.g., FERC Statutes and Regulations ¶ 32.514 at p. 33.063-68), the electric industry's transition to a more competitive market is driven in large part by statutory and regulatory changes beyond the utilities' control.

⁵⁸⁴ As a result, the opportunity for wholesale stranded cost recovery under this Rule is limited to utilities that provided sales of generation and

transmission under wholesale requirements contracts, and to utilities that provided service to retail customers that convert to wholesale customer status, and that face the potential inability to recover costs when their customers are able to reach new suppliers through open access transmission.

⁵⁸⁵ 15 U.S.C. 3301 et seq.

⁵⁸⁶ AGD. 824 F.2d at p. 1021.

⁵⁸⁷ Id. at p. 1027.

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ous appeals of Order No. 636,⁵⁸⁸ it has already upheld, in at least two instances, our ultimate decision to allow the recovery of costs stranded in the transition to a competitive natural gas industry.⁵⁸⁹ As a result, we reject the suggestions of some commenters that a utility's obligation to comply with the provisions of the Open Access Final Rule should be conditioned upon final court approval of the Stranded Cost Final Rule. We also decline otherwise to condition a utility's ability to recover its stranded costs. As described in greater detail in Section IV.J.8, if a utility can make the necessary evidentiary showings, it will be eligible for stranded cost recovery.

With regard to the magnitude of potential wholesale stranded costs, as the Supplemental Stranded Cost NOPR recognizes, the level may be small relative to that of retail stranded costs. Nevertheless, wholesale costs may be stranded as a result of open access transmission. Because the significance of such costs to the utilities that would face them may be great (and the prospect of not recovering such costs could erode utilities' ability to attract capital and be very detrimental to a diverse array of utility shareholders), we believe that we have a responsibility to allow for the recovery of such costs.

We disagree with the commenters who contend that this Rule would discriminate against certain segments of the industry, such as non-transmission-owning utilities (who would not be allowed to collect stranded costs) or wholesale requirements customers (who would be subject to stranded cost charges while other wholesale customers would not). These commenters misconstrue the purpose of this Rule and the nature of the stranded costs for which this Rule would allow recovery. This rule is designed to address a new and

specific problem: The fact that a utility that historically has supplied bundled generation and transmission services to a wholesale requirements customer and incurred costs to meet reasonably expected customer demand may experience stranded costs when its customer is able to reach a new generation supplier due to the availability of open access transmission. This rule proposes a solution to that problem by allowing the recovery of legitimate, prudent and verifiable costs incurred by a utility to provide service to a wholesale requirements customer that subsequently becomes, in whole or in part, an unbundled wholesale transmission services customer of the utility. The opportunity for extra-contractual wholesale stranded cost recovery is allowed for only a discrete set of requirements contracts for which the utility can demonstrate that it had a reasonable expectation of continuing service, as well as for retail-turned-wholesale situations in which the utility satisfies the necessary evidentiary criteria. Thus, the fundamental premise of this rule—namely, that a utility should have an opportunity to recover reasonably-incurred costs that arise because open access use of the utility's transmission system enables a generation customer to shop for power—would not apply to a non-transmission-owning utility that, by definition, has no transmission by which its generation customer can escape to another supplier.

The same historical relationship discussed above, including the expectation of continued service, justifies imposing the stranded costs covered by this rule on wholesale requirements customers only (not on non-requirements customers that contract separately for transmission services to deliver their purchased power). Requirements customers historically were

⁵⁸⁸ Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, 57 FR 13267 (April 16, 1992), *FERC Statutes and Regulations* § 30,939 (1992), order on reh'g, Order No. 636-A, 57 FR 36128 (August 12, 1992), *FERC Statutes and Regulations* § 30,950 (1992); order on reh'g, Order No. 636-B, 57 FR 57911 (December 8, 1992), 61 *FERC* ¶ 61,272 (1993), reh'g denied, 62 *FERC* ¶ 61,007 (1993), appeal pending *United Distribution Companies, et al. v. FERC*,

No. 92-1485, et al., (D.C. Cir. Oral Argument Held Feb. 21, 1996).

⁵⁸⁹ See, e.g., *Public Utilities Commission of the State of California v. FERC*, 988 F.2d 154, 166 (D.C. Cir. 1993) ("FERC, with the backing of this court, has been at pains to permit pipelines to recover these (take-or-pay) costs, which have accumulated less through mismanagement or miscalculation by the pipelines than through an otherwise beneficial transition to competitive gas markets."); *Western Resources, Inc. v. FERC*, 72 F.3d 147 (D.C. Cir. 1995).

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long-term customers who typically did not expect to take service from other suppliers. Utilities thus assumed they would continue serving these customers and may have made significant investments based on that long-term expectation. In contrast, utilities did not (and do not today) generally make investments for short-term economy-type transactions. Rather, such transactions were entered into only when the utility temporarily had available capacity or energy that could be provided to the buyer at a price lower than the buyer's decremental cost. The utility was not obligated in any way—either explicitly or implicitly—to provide for the needs of non-requirements customers. Because coordination transactions were not the cause of stranded investment decisions, it would be inappropriate to allocate such costs to non-requirements customers.

Further, although some commenters object that the Rule would give public utilities a greater opportunity than other transmitting utilities to recover stranded costs, our jurisdiction over transmitting utilities that are not also public utilities is limited. If the selling utility under an existing contract is a transmitting utility that is not also a public utility, its wholesale requirements contracts are not subject to this Commission's jurisdiction. Thus, we can allow such a transmitting utility to recover stranded costs only through Commission-jurisdictional transmission rates under sections 211 and 212 of the FPA. Nevertheless, in the context of a specific section 211 case, we would expect to apply similar principles to the extent possible to assure full stranded cost recovery. We also encourage such transmitting utilities to negotiate mutually agreeable stranded cost provisions with their customers.

⁵⁹⁰ In the Supplemental Stranded Cost NOPR, the Commission made a preliminary finding that the Cajun court decision does not bar the recovery of

stranded costs as proposed in the NOPR and set forth our reasoning in support of that finding.⁵⁹¹

Various commenters contend that the proposal to permit recovery of stranded costs at all, or particularly through transmission rates of departing customers, fails to address the Cajun court's concerns.⁵⁹² These commenters repeat many of the same arguments previously raised in this proceeding, which we have already addressed. Some commenters argue that including generation-based stranded costs in transmission rates is an anticompetitive tying arrangement and that Cajun compels the Commission to abandon this aspect of its stranded cost proposal or, at a minimum, to explain how the chosen method of recovery differs from that mandated in Cajun.⁵⁹³

Several commenters⁵⁹⁴ question whether the NOPR's stranded cost provisions would undermine the "meaningful" access to alternative suppliers referenced by the Cajun court.⁵⁹⁵ For example, Arkansas Cities asserts that the Commission has failed to address whether a transmitting utility retains market power over transmission even after imposition of an open access tariff. It contends that this question is vital to determining whether imposition of stranded costs would interfere with a wholesale transmission customer's meaningful access to other power suppliers.

Some commenters also submit that the proposed procedures for a customer to obtain an estimate of its stranded cost liability are inadequate because they do not ameliorate the uncertainty confronting the customer, which was a concern of the court in Cajun. They suggest that a customer would still face the prospect of litigation concerning whether a proposed stranded cost charge is appropriate.⁵⁹⁶

Other commenters argue that Cajun requires a trial-type evidentiary hearing before stranded costs may be recovered.

⁵⁹⁰ 28 F.3d 173 (D.C. Cir. 1994) (Cajun).

⁵⁹¹ FERC Statutes and Regulations § 32,514 at p. 33,105-06.

⁵⁹² E.g., APPA, ABATE, ELCON, Central Illinois Light, IL Com, VT DPS.

⁵⁹³ See, e.g., ELCON, American Forest & Paper, MMWEC, Cajun, IL Com, PA Com, VT DPS, Education, DE Muni, IN Industrials,

Texas-New Mexico, Las Cruces, ~~Delaware~~, Suffolk County, Total Petroleum, NM Industrials, PA Muni.

⁵⁹⁴ E.g., Arkansas Cities, PA Muni, NM Industrials.

⁵⁹⁵ See Cajun, 28 F.3d at p. 179.

⁵⁹⁶ See, e.g., Suffolk County, Arkansas Cities, Education.

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They question whether the Commission's generic proposals on open access and the Commission's statements about the need to recover stranded costs are adequate.⁵⁹⁷ ELCON references the Cajun court's statement that "if the Commission is wrong at the outset concerning the possibility of legitimate stranded investment cost, it is not fair or reasonable to create such a mechanism for recovery."⁵⁹⁸ ELCON submits that the factual record does not demonstrate any significant wholesale stranded cost problem and, as a result, a final rule allowing recovery of such costs would not be "fair or reasonable."

Many other commenters, in contrast, believe that the NOPR is distinguishable from the case that was before the court in Cajun and that the Commission has fully addressed the Cajun court's concerns. According to the Coalition for Economic Competition, this proceeding is very different from the Cajun proceeding because the proposed rule would not automatically permit utilities to charge market-based rates. The Coalition for Economic Competition states that in the absence of generic market-based rate authorization, there is no basis in Cajun for barring the recovery of stranded investment in transmission tariffs.⁵⁹⁹

A number of commenters agree with the Commission that the Cajun court was concerned with the need for a more complete explanation of the basis for stranded cost recovery and the mechanism selected for such recovery. These commenters believe that the NOPR provides both the

evidentiary record for addressing these concerns on a generic basis and the opportunity for all participants to present evidence and arguments.⁶⁰⁰

Noting the Cajun court's concern as to whether the wholesale customer in that case had "meaningful" access to alternative suppliers, a number of commenters agree that the Commission, through the open access provisions of the NOPR, is in fact providing wholesale customers meaningful, "reasonable access to alternative suppliers."⁶⁰¹

As evidence that the Cajun court was concerned with inadequate explanation and procedures and did not find that stranded costs could never be justified, several commenters point out that the Cajun court did not mention the D.C. Circuit's landmark decision in AGD, which strongly supports stranded cost recovery.⁶⁰² For example, Coalition for Economic Competition suggests that construing Cajun to hold that stranded cost recovery is always anticompetitive would be at odds with AGD and other decisions that have upheld the Commission's policy of allowing recovery of the costs of the transition to competitive markets.⁶⁰³

Numerous commenters also support the Commission's conclusion that stranded cost recovery through transmission rates is not a tying arrangement.⁶⁰⁴ Among other things, these commenters argue that a tying claim requires that the defendant force the sale of a separate product with the sale of a product over which

⁵⁹⁷ E.g., PA Com, NY Com, RUS.

⁵⁹⁸ Cajun, 28 F.3d at p. 179 (emphasis in original).

⁵⁹⁹ SC Public Service Authority notes this distinction as well (Initial Comments at p. 78): "In Cajun, the court was not criticizing the recovery of stranded assets as an abstract matter, but specifically as an integral part of a set of tariffs designed to justify market-based rates on the basis that the open access tariff adequately mitigated market power despite the provision permitting recovery of stranded assets." It suggests that if the Commission decides to allow utilities to recover stranded costs from departing customers, any utility recovering such costs should not be allowed to charge market-based rates.

⁶⁰⁰ See, e.g., EEI, NEPCO, Centerior, Electric Consumers Alliance, Southern.

⁶⁰¹ E.g., Omaha PPD, Com Ed, Florida Power Corp. Com Ed also submits that the argument

by the petitioners in Cajun that "there really is no such thing as stranded investment, only a failure to compete" ignored the circumstances under which the investments were made. It states that electric utilities did not incur the costs of generation facilities (and long-term fuel and power supply contracts) because they were less efficient competitors, but to satisfy their obligation in a fully-regulated market to provide service to all who request it.

⁶⁰² See, e.g., Com Ed, Coalition for Economic Competition, NYSEG, Entergy.

⁶⁰³ See, e.g., KN Energy, Inc., 968 F.2d 1295 at p. 1301 (D.C. Cir. 1992), *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 874 (D.C. Cir. 1993).

⁶⁰⁴ E.g., EEI, Com Ed, Consumers Power, SoCal Edison, Salt River, Entergy.

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it has market power, and that here there is no second product being tied to transmission. Several commenters also suggest that, in any event, stranded cost recovery as proposed in the NOPR would be considered a legitimate business justification under the antitrust laws.⁶⁰⁵ *Com Ed* explains that the Commission, as part of its effort to enhance competition in generation by opening up the transmission network, is avoiding placing on utilities the entire burden of the stranded costs resulting from their past regulatory obligations; it is not permitting utilities to maintain a monopoly of power sales.

Commission Conclusion

We reaffirm that we do not interpret the *Cajun* court decision as barring the recovery of stranded costs. The court in that case did not bar stranded cost recovery, as some commenters suggest; it instead found that the Commission had not provided adequate proceedings and had not fully explained its decision. The Commission had failed to hold an evidentiary hearing concerning whether the inclusion of a stranded cost recovery provision in a particular utility's transmission tariff, along with other provisions in the tariff, resulted in the adequate mitigation of Entergy's market power so as to justify market-based rates. The court also found that the Commission had failed to explain adequately its approval of the stranded cost provision, among other provisions. In contrast, as discussed below, we have addressed in this consolidated proceeding (the Stranded Cost NOPR, the Supplemental Stranded Cost NOPR, the Open Access NOPR, and the Open Access/Stranded Cost Final Rule) all of the *Cajun* court's concerns.

Our interpretation of *Cajun* is bolstered by a recent opinion of the Court of Ap-

peals for the D.C. Circuit (the same circuit that decided *Cajun*) that confirms the validity of Commission imposed stranded cost recovery mechanisms in the transition to competitive markets. In *Western Resources, Inc. v. FERC*,⁶⁰⁶ the court affirmed the Commission's decision to allow the recovery of costs stranded in the transition of the natural gas industry to a competitive market.⁶⁰⁷ We believe that, by this decision, the court has again affirmed the Commission's ability to allow stranded cost recovery, as long as we follow adequate procedures and explain our decision.⁶⁰⁸

We are providing in this proceeding the evidentiary record to support our decision to allow the recovery of legitimate, prudent and verifiable stranded costs on a generic basis. We also are ensuring the "meaningful" access to alternative suppliers that was identified as a concern of the *Cajun* court. The Open Access Final Rule is designed to attack one essential element of market power—namely, control over transmission access. The standard we are adopting for transmission service is far stricter than the standard we used at the time *Cajun* was decided; we now require non-discriminatory open access transmission, as well as a code of conduct and non-discriminatory sharing of transmission information (OASIS). The collective effect of these actions is that public utilities that own, control or operate interstate transmission facilities will not be able to favor their own generation and will have to compete on an equal basis with other suppliers.⁶⁰⁹ All public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce will have tariffs on file that offer to any eligible customer any transmission services that the public

⁶⁰⁵ See *State of Illinois ex rel. Burris v. Panhandle Eastern Pipe Line Co.*, 935 F.2d 1469, 1483 (7th Cir. 1991), cert. denied, 502 U.S. 1094 (1992) (pipeline's refusal to transport gas that an LDC customer purchased from another supplier was "genuinely and reasonably motivated by the need to limit its potential take-or-pay liability, not by a desire to maintain its monopoly position by excluding competition in the sale of natural gas"); *City of Chanute v. Williams Natural Gas Company*, 743 F. Supp. 1437 (D. Kan.), aff'd, 955 F.2d 641 (7th Cir. 1990) (pipeline's refusal to transport third-party gas was motivated by legitimate business concerns, in-

cluding desire to prevent take-or-pay liability, not by an anticompetitive motive).

⁶⁰⁶ 72 F.3d 147 (D.C. Cir. 1995).

⁶⁰⁷ *Id.* at p. 152.

⁶⁰⁸ As we noted in the Supplemental NOPR, the same court had earlier instructed the Commission in the AGD case that the Commission must consider the transition costs borne by regulated utilities when the Commission changes the regulatory rules of the game. *FERC Statutes and Regulations* ¶ 32,514 at p. 33,106.

⁶⁰⁹ *Id.* at p. 33,065-67.

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utility could provide to itself, and under comparable terms and conditions.

We note that the Cajun court identified several provisions in Entergy's proposed tariff as potentially restraining competition: Entergy's retention of sole discretion to determine the amount of transmission capability available for its competitors' use;⁶¹⁰ the point-to-point service limitation;⁶¹¹ the failure to impose reasonable time limits on Entergy's response to requests for transmission service;⁶¹² and Entergy's reservation of the right to cancel service in certain instances,⁶¹³ even where a customer had paid for transmission system modifications.⁶¹⁴ These types of provisions, which have the potential to restrain competition, will not be allowed under the Open Access Rule. On the contrary, the Final Rule pro forma tariff contains terms and conditions to ensure the provision of non-discriminatory transmission service. In addition, the requirements that a public utility take service under its own tariff, adopt a non-discriminatory transmission information network, and separate power marketing and transmission functions further ensure non-discrimination and remove constraints to fair competition. Thus, the nondiscriminatory open access transmission that is the hallmark of this Rule is designed to ensure meaningful access to alternative suppliers and goes far beyond that which

was offered in the transmission tariff that was under review in Cajun.

We also have addressed the Cajun court's concern over the method of recovery. In that case, Entergy proposed to include a charge in the departing customer's transmission rate to recover its stranded investment costs. The court said that this might constitute an anticompetitive tying arrangement.⁶¹⁵ As we explained in the Supplemental NOPR, the stranded cost recovery procedure we prescribe in this Rule is a transitional mechanism only that is intended to enable utilities to recover costs prudently incurred under a different regulatory regime. The purpose and effect of the stranded cost recovery mechanism that we approve in this Rule is to facilitate the transition to competitive wholesale power markets. Although we recognized in the Supplemental NOPR that stranded cost recovery may delay some of the benefits of competitive bulk power markets for some customers, such transition costs must nevertheless be addressed at an early stage if we are to fulfill our regulatory responsibilities in moving to competitive markets. The stranded cost recovery mechanism that we direct here is a necessary step to achieve pro-competitive results. In the long term, the Commission's rule will result in more competitive prices and lower rates for consumers.

⁶¹⁰ In contrast to the tariff under review in Cajun, the Final Rule pro forma tariff provides that available transmission capability (ATC) must be calculated and posted on the transmission provider's Open Access Same-time Information System (OASIS) pursuant to new Part 37—OPEN ACCESS SAME-TIME INFORMATION SYSTEM AND STANDARDS OF CONDUCT FOR PUBLIC UTILITIES of the Commission's regulations. Section 37.6 provides in pertinent part that along with posting its ATC on its OASIS node, a public utility must make all data used in the calculation publicly available, on request. Section 37.4 provides that employees of the public utility and any affiliate that are engaged in merchant functions are prohibited from having preferential access to any transmission-related information. Additionally, the regulations provide auditing and monitoring procedures to safeguard against discriminatory practices.

⁶¹¹ In contrast to the tariff under review in Cajun, the Final Rule pro forma tariff requires the provision of point-to-point and network service.

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⁶¹² In contrast to the tariff under review in Cajun, the Final Rule pro forma tariff requires reasonable time limits for responses to transmission requests. Specifically, Section 17.5 provides that a transmission provider must respond to a request for firm service as soon as practicable, but not later than thirty days after the date of receipt of a completed application.

⁶¹³ In contrast to the tariff under review in Cajun, the Final Rule pro forma tariff does not allow firm transmission service to be cancelled after the service has been commenced. However, Section 7.3 of the Final Rule pro forma tariff does provide that in the event of a customer default, the transmission provider may, in accordance with Commission policy, file and initiate a proceeding with the Commission to terminate service.

⁶¹⁴ Cajun, 28 F.3d at p. 179-80.

⁶¹⁵ Notably, the court stated: "This is, in essence, a tying arrangement, (citation omitted), and it might be fine if the purpose of the arrangement were not to cabin Entergy's market power." *Id.* at p. 177-78 (emphasis added).

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The Commission's approach also is consistent with the traditional regulatory concept of cost causation. We do not believe it is an illegal tying arrangement to hold a customer accountable for the consequences of leaving an incumbent supplier if, under our rules, the incumbent supplier must show a reasonable expectation of continuing service before it can recover stranded costs from the customer.

Further, in response to the Cajun court's concern that the Commission had failed in that case to explain adequately its approval of the stranded cost provision and other provisions, we have provided in this proceeding a detailed explanation of the fundamental industry and regulatory changes that have given rise to the potential for stranded costs; the transitional nature of stranded costs; the critical need to deal with these costs in order to reach more competitive wholesale markets; and the consumer benefits that will result from competitive generation markets. We also have provided a detailed explanation of the terms and conditions in the Final Rule pro forma tariff that will meet the non-discriminatory open access service requirement.

Several commenters (and the Cajun court) express concern for the need to provide as much certainty as possible for departing customers concerning their potential stranded cost obligation. Without some certainty, customers may be unable to shop for alternative suppliers. In response to these concerns, we have modified the stranded cost recovery mechanism to include a formula for calculating a departing customer's potential stranded cost obligation. As discussed in greater detail in Section IV.J.9, the revenues lost formula is designed to provide certainty for departing customers and to create incentives for the parties to address stranded cost claims between themselves without resort to litigation.

We conclude that we have fully explained our decision to allow the recovery of legitimate, prudent and verifiable costs that are stranded in the transition to competitive wholesale bulk power markets. We also have provided ample opportunity for all concerned to present arguments and evidence on the issue. Further, we have significantly strengthened our open access requirements to ensure mitigation of transmission market power. Thus, we have fully addressed the concerns of the Cajun court.

3. Responsibility for Wholesale Stranded Costs (Whether To Adopt Direct Assignment to Departing Customers)

In the Supplemental Stranded Cost NOPR, the Commission made a preliminary finding that direct assignment of stranded costs to the departing wholesale generation customer is the appropriate method for recovery of such costs.⁶¹⁶

Numerous parties representing all constituencies support direct assignment of stranded costs to the departing generation customer.⁶¹⁷ These commenters argue, among other things, that direct assignment is consistent with the cost causation principle and preferable to increasing the delivered price of electricity to a whole region through the imposition of a wires charge, and that recovery of stranded costs from remaining customers would not be in the public interest. Several state commenters seek assurance from the Commission that native load customers will be held harmless from stranded costs resulting from other customers leaving the system.⁶¹⁸ KY Com submits that the possible results of a broader assessment of stranded costs, with the related uncertainty of its impact on the utilities' cost of capital, is more problematic in the long run than the possibility that the direct assignment of stranded costs would deter customers from shopping for power.

⁶¹⁶ FERC Statutes and Regulations § 32,514 n. 33,108.

⁶¹⁷ See, e.g., EEL, Atlantic City, Arizona, Carolina P&L, Centenor, Com Ed, Duke, Evers, Duquesne, Florida Power Corp, Omaha PPD, Alcoa, AEC & SMEPA, BG&E, Central Electric, Detroit Edison, El Paso, Montana-Dakota Utilities, Ohio Edison, PECO, PSNM, Southern, Sierra, SoCal Edison, Tucson Power, Utilities For

Improved Transition, Cajun, NRECA, EGA, Electric Consumers Alliance, FL Com, PA Com, Knoxville, Salt River, KY Com, ND Com, California DWR, LA DWP, TVA, Utility Investors Analysts, Texas Utilities, LG&E, Utility Shareholders.

⁶¹⁸ E.g., NC Com, UT Com, NJ Ratepayer Advocate.

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Although TAPS opposes stranded cost recovery in general, it submits that, if the Commission decides to allow recovery, the Commission should directly assign stranded costs and not spread them across the board to all transmission users.

Several commenters also oppose any allocation of stranded cost liability to shareholders.⁶¹⁹

Some commenters state that direct assignment of stranded costs sends the correct pricing signals during the transition to a competitive regime. For example, Electric Consumers Alliance states that a wholesale customer should be able to obtain power elsewhere, but that the motive to do so should not be to escape responsibility for sunk investments made on its behalf. El Paso submits that failure to make the departing generation customer liable for stranded cost recovery would create a "first-off" incentive; the customers that leave the system first would not suffer from higher future rates designed to recover prudently incurred costs from the reduced base of remaining customers.

Some commenters support direct assignment but oppose recovery of stranded costs through transmission rates. These commenters prefer an exit fee or lump-

sum approach that would reflect cost causation in an unbundled fashion.⁶²⁰ DOJ maintains that a transmission adder is analogous to an excise tax and that the excise tax approach would distort pricing signals and customers' decisions on the use of electric power. It submits that the lump-sum approach, on the other hand, would establish a fixed, sunk liability that would not depend upon how much transmission service the departing customer takes in the future.⁶²¹

Other commenters oppose direct assignment as being inconsistent with wholesale competition.⁶²² They argue that placing all of the responsibility for stranded costs on departing generation customers would discourage customers from switching to other generation providers and would thereby inhibit competition.⁶²³ Some commenters also assert that departing generation customers are not the sole "cause" of stranded costs.⁶²⁴ VT DPS contends that direct assignment cannot be reconciled with the Commission's refusal to allow the imposition of exit fees by gas pipelines when their wholesale customers depart.⁶²⁵

Some commenters support spreading the burden of stranded costs broadly among departing customers, shareholders,

⁶¹⁹ E.g., SCE&G, Com Ed, Ky Com, NC Com. SCE&G states that the Commission misinterpreted its previous comments by suggesting in the Supplemental NOFR that SCE&G believed shareholders should bear part of the costs.

⁶²⁰ E.g., Texas Utilities, DOJ.

⁶²¹ In its reply comments, Utility Working Group disputes DOJ's arguments that a transmission adder is analogous to an excise tax and would distort competition. It argues that DOJ's claim of price distortion ignores the fact that the costs that would be associated with a transmission adder consist of a portion of the previous wholesale power price—the markup above the utility's marginal cost that had regulatory approval. Utility Working Group says that because the utility's price and its competitor's price will contain this same charge for the utility's sunk and regulatory costs (the difference between the utility's regulated rate and its incremental cost), they will compete on the basis of their respective incremental costs. It also suggests that transmission adders can be designed on a lump-sum basis so that they are not tied to the amount of electricity purchased.

⁶²² E.g., ELCON, NYMEX, IL Industrials, Missouri-Kansas Industrials, Philip Morris, Fertilizer Institute, Coalition on Federal-State Issues.

⁶²³ Some commenters also oppose the Commission's proposal to allow the recovery of generation-related costs through transmission rates as being in contravention of cost-causation principles (e.g., VT DPS) or in violation of section 212(a) of the FPA, which they contend limits cost recovery to transmission-related costs (e.g., IL Industrials, Las Cruces).

⁶²⁴ E.g., ELCON, IL Industrials, NY Energy Buyers, TX Industrials, Missouri-Kansas Industrials, Caparo, IBM, PA Munis, Education. For example, Caparo submits that business decisions by incumbent utilities are the cause of stranded costs.

⁶²⁵ In support of this proposition, the VT DPS cites Transwestern Pipeline Co., 44 FERC ¶61,164 at p. 61,536 (1988); El Paso Natural Gas Co., 47 FERC ¶61,108 at p. 61,314 (1989); El Paso Natural Gas Co., 72 FERC ¶61,063 (1995). It also contends that the Commission recently treated a notice provision in an El Paso contract as a conclusive, rather than a rebuttable, presumption. VT DPS cites other differences between the Commission's treatment of the natural gas and the electric utility industries. It notes that the Commission has not proposed to allow existing wholesale electric customers to get out of their contracts early, as it did in the gas area.

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and remaining wholesale customers on the basis that it would be equitable for all industry stakeholders to share both the benefits and the costs of the transition to competition.⁶²⁶

Others support spreading the costs to all customers through, for example, a meter charge to all utilities (to be passed on to customers), a one-time charge across the total market base, an access fee on the transmission system, or a component of transmission rates.⁶²⁷ Nordhaus proposes a uniform national tax on all customers, at a rate that declines over time in a predetermined manner. He submits that this approach would remove "gaming" between utilities and potential exiters, would ensure that the stranded costs are not disproportionately loaded on price-sensitive demanders (that is, exiting customers), and would gradually disappear over time in a predictable fashion, thereby increasing the predictability of the new market.

PA Munis disputes the Commission's assertion in the Supplemental Stranded Cost NOPR that there is no compelling reason to assess costs broadly. It argues that a broad-based recovery mechanism that distributes uneconomic stranded costs to all power users would minimize the competition-inhibiting aspects of the Commission's proposed surcharge on departing generation customers. In a similar fashion, NSP states that across-the-board recovery from all users of the grid would recognize the societal benefits to be achieved from the transition to a competitive bulk power market and would reflect precedent set during the move to competition in the natural gas and telephone

industries. It submits that the cost per service unit would be lower than exit fees assigned to particular customers and would eliminate the need for detailing stranded cost exposure for each customer contemplating leaving the system.

FTC submits that some investments that now appear as stranded costs may have been intended to benefit customers over a wider area than a single utility. It suggests that national regional assessment methods could recover stranded costs undertaken to benefit these wider groups of customers.

We also received comments suggesting that less than full recovery of stranded costs should be allowed. A number of commenters urge the Commission to require some shareholder liability for stranded cost recovery to give utilities an incentive to mitigate.⁶²⁸ Several of these commenters assert that utility shareholders should be required to pay a portion of any stranded costs (such as 25-50 percent) because at least some of the responsibility for stranded costs lies with poor business decisions by utility management.⁶²⁹ Occidental Chemical proposes that the Commission grant utilities a "presumption of prudence" in return for requiring them to absorb a minimum of 25 percent (up to 50 percent) of stranded costs, citing as support the Commission's precedent in the natural gas industry.

Commission Conclusion

We reaffirm our decision that direct assignment of stranded costs to the departing wholesale generation customer through either an exit fee⁶³⁰ or a surcharge on transmission is the appropri-

⁶²⁶ E.g., ELCON, IN Industrials, Reynolds, Philip Morris, ABATE, Missouri-Kansas Industrials, Aluminum.

⁶²⁷ See, e.g., American National Power, NIEP, NSP, SBA, Coalition on Federal-State Issues, Pennsylvania P&L, Consolidated Natural Gas, Nordhaus, PA Munis. Consumers Power states that it does not oppose direct assignment, but asks that the final rule not preclude utilities from proposing alternative recovery mechanisms, including those that assess stranded costs on all transmission customers as part of the transmission rate. It suggests that utilities should not be precluded from showing that there may be countervailing reasons to assess stranded costs broadly among all transmission customers (e.g., where the costs assignable to a particular customer or group of customers may

be so high as to create a dispute as to the propriety of direct assignment).

⁶²⁸ See, e.g., American Forest & Paper, Torco, Philip Morris, DE Muni, MT Com, IL Com, KS Com, Fertilizer Institute, Caparo, Las Cruces, IN Com, PA Munis, San Francisco, NRR1, Competitive Enterprise, ELCON, IN Industrials, UT Industrials, NY Energy Buyers, ABATE, CA Energy Co, Caparo, Education, Reynolds.

⁶²⁹ See, e.g., Fertilizer Institute, Caparo, DE Muni, PA Munis, MT Com, San Francisco, ELCON, IN Industrials, NY Energy Buyers.

⁶³⁰ As used in this Rule, "exit fee" refers to the charge that will be payable by a departing generation customer upon the termination of its requirements contract with a utility (if the utility is able to demonstrate that it reasonably

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ate method for recovery of such costs. We believe it is appropriate that the departing generation customer, and not the remaining generation or transmission customers (or shareholders), bear its fair share of the legitimate and prudent obligations that the utility undertook on that customer's behalf.

In reaching this decision, we have carefully weighed the arguments supporting direct assignment of stranded costs against those supporting a more broad-based approach, such as spreading stranded costs to all transmission users of a utility's system. Recognizing that each approach has advantages and disadvantages, we conclude that, on balance, direct assignment is the preferable approach for both legal and policy reasons.

One of the main reasons to adopt direct assignment of stranded costs is that direct assignment is consistent with the well-established principle of cost causation, namely, that the party who has caused a cost to be incurred should pay it. Direct assignment of stranded costs to departing generation customers is particularly appropriate given the nature of the stranded cost recovery mechanism contained in this Rule, which links the incurrence of stranded costs to the decision of a particular generation customer to use open access transmission to leave the utility's generation system and shop for power, and which bases the prospect of stranded cost recovery on the utility's ability to demonstrate that it incurred costs with the reasonable expectation that the customer would remain on its generation system.

A broad-based approach, in contrast, would violate the cost causation principle by shifting costs to customers (such as transmission users of the utility's system) that had no responsibility for stranding the costs in the first place. In addition, if the Commission were to adopt a broad-based approach, it would have to determine whether to base the transmission surcharge on all users of a utility's transmission system on a one-time, up-front estimate of stranded costs (that is, each

utility claiming stranded costs would make a one-time, comprehensive determination of stranded costs for the utility as a whole) or on an as-realized basis (the surcharge would be based on actual customer departures and would be adjusted each time a customer departs). Each option would have disadvantages that are not present in the direct cost causation approach we are adopting.

For example, a major disadvantage of an up-front, broad-based transmission surcharge is that it in effect would charge customers for costs before the costs are incurred (i.e., before customers have even decided to leave the utility's generation system) and could charge for costs that may never be incurred (e.g., some customers may decide to stay on the utility's system as requirements customers). The other option, a broad-based transmission surcharge that would be adjusted as customers leave the utility's system, also has disadvantages. While this option might recover stranded costs that are closer to the actual amount incurred by the utility, it could produce variability in transmission rates every time stranded costs from a newly-departed customer are included in the transmission surcharge and, in turn, could possibly hamper efficient power supply choices and efficient generator location decisions. These disadvantages are not present in the direct assignment approach.

Direct assignment will result in a more accurate determination of a utility's stranded costs than would an up-front, broad-based transmission surcharge. This is because the stranded cost for any customer is finally determined only if that customer actually leaves a utility. Moreover, there is no stranded cost unless the then-current market price of power for the period that the utility reasonably expected to continue serving the customer is below the utility's cost. Thus, because the circumstances of each departing customer will be known, the amount of any stranded cost liability can be determined with reasonable accuracy. Further, if a customer does not leave the utility or leaves at some future time when the util-

(Footnote Continued)

expected to continue serving the customer beyond the term of the contract), whether payable in a lump-sum payment or an amortization of a

lump-sum payment. (The same charge also can be paid as a surcharge on the customer's transmission rate.)

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ity's costs are competitive, the issue need not be addressed.

On this basis, the direct assignment approach is more suited to the recovery of stranded costs as defined in this Rule (including the reasonable expectation standard and open access transmission causation requirement) than is a broad-based approach. We expect that a utility would have difficulty estimating in advance all of its stranded costs for purposes of an up-front, broad-based transmission surcharge. In the face of this uncertainty, the utility's best strategy likely would be to try to recover through the broad-based surcharge as much of its uneconomic assets as possible by claiming that all of its wholesale customers are likely to depart and to leave large stranded costs. In this regard, the broad-based approach would provide an incentive for a utility to try to recover the costs of all of its uneconomic assets whether or not they were prudently incurred. This is in contrast to what this Rule provides, which is for recovery of only those legitimate, prudent and verifiable costs that were incurred on behalf of a specific customer based on a reasonable expectation that the utility would continue to serve the customer and that are stranded when the customer departs the utility's generation system by using the utility's open access transmission.

The direct assignment approach also can be readily applied to both wholesale and retail-turned-wholesale departing customers. It also can be adapted for retail customers. Further, it works for costs stranded by a section 211 order requiring either a public utility, or a transmitting utility that is not also a public utility, to provide transmission service. However, this is not the case for a broad-based approach, particularly an up-front, broad-based approach. Assuming that a principal motivation for an up-front, broad-based approach would be to recover all of a utility's stranded costs as quickly as possible, retail-turned-wholesale stranded costs nevertheless are not susceptible of being collected on an up-front basis. It is not possible to make a realistic up-front estimate of costs stranded by municipalizations that may occur in the future. Thus, even if we were to adopt an up-front, broad-based approach for recovering costs that are stranded when wholesale requirements customers use their former supplier's transmission system to

reach a new supplier, retail-turned-wholesale stranded costs would have to be identified as they occur and the stranded cost surcharge on transmission users adjusted accordingly. Similarly, the broad-based approach is not easily adaptable to transmitting utilities that are not also public utilities. It is doubtful that, in establishing the rate for a section 211 applicant, the Commission could also set transmission surcharges for customers that were not section 211 applicants; this is what a broad-based approach, in effect, would require us to do.

Direct assignment by means of an exit fee or a transmission surcharge that is not dependent on any subsequent power or transmission purchases by the customer is also an economically efficient way to collect stranded costs. The customer may make a lump-sum stranded cost payment, amortize the lump-sum payment, or spread the payment as a surcharge in addition to its transmission rate. The total amount of stranded costs that the directly-assigned customer ultimately pays would not depend on how much transmission service it takes and thus would not influence the customer's subsequent transmission purchase decisions.

With a broad-based surcharge (which could be demand- or usage-based), on the other hand, the surcharge for transmission users would depend on how much transmission service the users take. A broad-based approach also would be inefficient as it would raise the price of transmission service for all customers, thereby potentially cutting off some beneficial power trading that would otherwise occur for all unbundled transmission customers. The surcharge also could convert some profitable existing power purchase contracts into unprofitable contracts. In addition, it could reduce economy trading because the surcharge would be added to the price of transmission. In this context, a broad-based surcharge would constitute a cross-subsidy that could distort the market.

We recognize that direct assignment is not without its potential drawbacks. For example, when compared to an up-front, broad-based transmission surcharge approach, direct assignment may entail a longer stranded cost recovery period. The transition period for stranded cost recovery under a direct assignment approach

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would depend on the length of the remaining terms of the wholesale requirements contracts for which this Rule provides an opportunity for recovery (contracts executed on or before July 11, 1994 that do not contain an exit fee or explicit stranded cost provision).

On the other hand, a broad-based approach could identify and recover stranded costs earlier than the direct assignment approach; recovery of stranded costs for all of a utility's wholesale requirements customers could begin as soon as the utility's up-front stranded cost amount for departing wholesale customers is determined (through litigation or settlement). However, this potential advantage of a broad-based approach (the shorter transition period) is outweighed by what we believe to be a serious infirmity, namely, the possibility that the broad-based transmission surcharge could end up including costs that have not yet been incurred and may never be incurred.

In addition, another potential drawback to the direct assignment approach is that the departing generation customer may see little or no savings in the short-term by switching power suppliers once its stranded cost exit fee is added to its lower power price from a new supplier. Direct assignment may leave the customer uncertain about the benefits of shopping for power because of the customer's potential stranded cost liability and, in turn, may bias the customer toward staying with its existing power supplier.⁶³¹

In the case of a broad-based approach, in contrast, much of the customer's direct assignment stranded costs are spread to others through a transmission surcharge. As a result, the departing generation customer's power cost savings may more than offset the customer's stranded cost transmission surcharge. The customer

may therefore see earlier power cost savings if a broad-based approach were adopted.⁶³² Once again, however, we believe that this potential benefit to a broad-based approach is outweighed by a significant countervailing disadvantage. In particular, the potential power cost savings to the departing generation customer would be realized only by shifting costs (that are directly attributable to the departing generation customer) to the other users of the utility's transmission system. We believe that this negative aspect of a broad-based approach—its violation of the cost causation principle—is too great a price to pay for allowing a departing generation customer to realize power cost savings as early as possible.

Thus, we recognize that under direct assignment, it is possible that some customers may not be able to afford to leave as soon as they would like. This in turn could mean that lower cost suppliers would not be able to make sales to those customers as soon as they would like. However, this would occur only during a transition period, and it would ensure that, consistent with strict cost causation principles, the burden of these transition costs is not unfairly spread to other customers. Once the existing uneconomic assets and contracts are behind us, all wholesale customers will be better able to shop for power and reap the long-term benefits of competitive supply markets.

Although this direct assignment approach is different from the approach taken in the natural gas industry, we believe that the difference is justified. The transition of the electric industry to an open transmission access, competitive industry (including our proposal to allow an opportunity for extra-contractual recovery of stranded costs associated with a discrete set of wholesale requirements contracts) is different in a number of re-

⁶³¹ To counteract this potential disadvantage, we have provided procedures in this Rule, including a formula that the utility is to use to calculate a departing generation customer's stranded cost obligation, that allow a customer considering switching power suppliers to request a stranded cost determination from the utility at any time before the expiration of the customer's wholesale requirements contract. See Section IV.J.9.

⁶³² In addition, because the customer would already know its stranded cost transmission

surcharge, it presumably would have some certainty as to the costs of shopping for power. However, the stranded cost surcharge in its transmission rates subsequently may be adjusted upward if the utility providing transmission becomes eligible to recover retail-turned-wholesale stranded costs. Also, if the broad-based stranded cost surcharge is adjusted on an as-realized basis, the potential departing generation customer's surcharge may increase as a result of other customers leaving the utility's system.

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spects from the natural gas industry's transition to open access transportation service by interstate natural gas pipelines. The gas industry underwent a long period of open access transition, starting with Order No. 436 in 1985 and culminating with Order No. 636 in 1992. In the gas context, prior to addressing potential stranded costs, the Commission in Order No. 436 allowed customers receiving bundled gas sales and transportation service from a pipeline the option to convert to transportation-only service, or to reduce their contract demand for gas service, before the termination of their contracts with the pipeline.⁶³³ As a result, most of the former bundled customers of the pipeline had already departed the pipeline's sales service before the Commission addressed the recovery of take-or-pay costs in Order Nos. 500 and 528. In addition, by the time that the Commission addressed the remaining transition costs in Order No. 636, the commodity or well-head natural gas market was already competitive and the majority of gas was already being sold on an unbundled basis.

Thus, changes in the natural gas industry had progressed to such a point (i.e., the departure of customers from bundled sales) that it was not possible for the Commission to use a strict cost causation approach. We noted in the Supplemental Stranded Cost NOPR that

Many natural gas customers had already left their historical pipeline suppliers' systems. Others had converted from sales and transportation customers to transportation-only customers. Others were in a transition stage having had opportunities to lower their contract demands or otherwise become partial service customers. Significant take-or-pay and other costs had accumulated.⁶³⁴

Under those circumstances, the Commission determined that it was appropriate to spread the majority of the remaining transition costs associated with take-or-pay and other supply contracts to all customers (both existing and new) us-

ing the interstate natural gas transportation system. Moreover, because of the changes in contractual relationships that had already occurred among pipelines and their customers, it was no longer possible for the Commission to follow a strict cost causation approach to recovering take-or-pay costs. The Commission-prescribed remedy for the recovery of transition costs in the natural gas industry thus was tailored to fit the needs of that industry given the stage of development at the time.

However, such a broad-based approach to recovery of natural gas transition costs was an exception to the time-honored principle that rates should reflect cost causation, and because of this it was necessary for the Commission to justify its departure from that principle. As the court said in *K N Energy v. FERC*,⁶³⁵ "[I]t has been this Commission's long standing policy that rates must be cost supported. Properly designed rates should produce revenues from each class of customers which match, as closely as practicable, the costs to serve each class or individual customer." In that case, the court found the Commission's departure from cost-causation justified "given the unusual circumstances surrounding the take-or-pay problem, and the limited nature—both in time and scope—of the Commission's departure from the cost-causation principle."⁶³⁶ It continues to be Commission policy to follow the cost-causation principle to the extent possible.

The factors described above are not present in the electric industry. At this time, the vast majority of customers remain on their bundled suppliers' systems and generation is not yet fully competitive. Because the situation facing the electric industry today is different from that which the natural gas industry faced, the Commission must tailor its approach differently. In the case of the electric industry today, we have the opportunity to address the stranded cost recovery issue up front, before customers leave their

⁶³³ As discussed in Section IV.A.5, we are not providing for a similar conversion right in this Rule.

⁶³⁴ *FERC Statutes and Regulations* § 32.514 at p. 33,108.

⁶³⁵ 968 F.2d 1295, 1300-01 (D.C. Cir. 1992) (quoting *Alabama Electric Cooperative, Inc. v.*

FERC, 684 F.2d 20, 27 (D.C. Cir. 1982) (emphasis in original).

⁶³⁶ *Id.* at p. 1301. See also *Public Utilities Commission of State of California v. FERC*, 988 F.2d 154, 169 (D.C. Cir. 1993).

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suppliers' systems. We thus are able to use the cost causation approach that has been fundamental to our regulation since 1935.⁶³⁷

The Commission disagrees with commenters' arguments that we cannot impose an exit fee to recover stranded costs because we did not do so in the gas context. As discussed in Section IV.J.9, this Rule establishes procedures for providing a potential departing generation customer advance notice (before it leaves its existing supplier) of the stranded cost charge (whether it is to be paid as an exit fee or a transmission surcharge) that will be applied if the customer decides to buy power elsewhere. In the natural gas context, in contrast, the Commission has prohibited pipelines from developing and charging an "exit fee" after a customer had implemented its gas purchase decision, noting that otherwise, the customer would not know in advance the full cost consequences of its nomination decision.⁶³⁸ The "exit fee" that the Commission rejected in *El Paso Natural Gas Company*⁶³⁹ is also factually distinguishable from the "exit fee" discussed in this rule. In that case, the Commission rejected a pipeline's attempt post-restructuring to impose an "exit fee" on firm transportation-only customers (that were

converted sales customers) who in the future elect either to terminate their firm transportation service upon expiration of the service agreement, or to reduce their firm transportation services level by more than 10 percent pursuant to an existing contractual reduction right. Such a scenario is quite different from the limited opportunity for stranded cost recovery provided in this Rule, which is based on a utility's reasonable expectation of continuing generation service to a bundled (sales and transmission) requirements customer.

We also will decline to require a utility seeking stranded cost recovery to shoulder a portion of its stranded costs. Such a requirement would be a major deviation from the traditional principle that a utility should have a reasonable opportunity to recover its prudently incurred costs.⁶⁴⁰ Although the Commission allowed such an approach with regard to a natural gas pipeline's take-or-pay costs,⁶⁴¹ we did so only as an extraordinary measure given the nature of the take-or-pay problem and the prevailing environment at that time. We returned to traditional principles when, in issuing Order No. 636, we authorized pipelines to recover all of their prudently incurred gas supply realignment costs (the costs pipelines incur in

⁶³⁷ Moreover, as we explained in the Supplemental Stranded Cost NOPR, the shifting of generation costs to transmission rates does not violate Commission policy where, as here, the customer that caused the costs to be incurred and stranded will continue to pay those costs. As we indicated, the only difference is that in some instances the customer will pay the costs through an adder to its transmission rate instead of through a generation rate. See *FERC Statutes and Regulations* § 32,514 at p. 33,108 n.269.

⁶³⁸ See, e.g., *Transwestern Pipeline Company*, 43 FERC ¶ 61,240 at p. 61,654, order on rehearing, 44 FERC ¶ 61,164 at p. 61,536 (1988), relevant petitions for review dismissed as moot, *Transwestern Pipeline Company v. FERC*, 897 F.2d 570, 575-76 (D.C. Cir. 1990); *El Paso Natural Gas Company*, 47 FERC ¶ 61,108 at p. 61,314 (1989).

⁶³⁹ 72 FERC ¶ 61,083 (1995). Further, VT DPS misinterprets the Commission's reference to the NOPR in that case. The Commission did not treat a notice of termination provision in *El Paso's* contract as a conclusive presumption that *El Paso* had no reasonable expectation of continuing to serve certain customers, as VT DPS contends. The Commission merely stated

that "[e]ven if the rules proposed in [the Supplemental Stranded Cost] NOPR were applied here, *El Paso* would have difficulty justifying the exit fee proposed in light of the existence of the notice of termination provision in the contract." 72 FERC at p. 61,441.

⁶⁴⁰ See, e.g., *Maryland v. Louisiana*, 451 U.S. 725, 748 (1981); *Office of Consumers' Counsel v. FERC*, 914 F.2d 292 (D.C. 1990); *National Fuel Gas Supply Corporation v. FERC*, 900 F.2d 340, 342, 347-51 (D.C. Cir. 1990).

⁶⁴¹ In Order No. 500, the Commission provided that if pipelines absorbed from 25 to 50 percent of their take-or-pay settlement costs, they could recover an equal amount from their firm sales customers in the form of fixed charges. Any balance could be recovered in the form of a commodity rate surcharge or a volumetric surcharge on total pipeline throughput. Order No. 500, *FERC Statutes and Regulations* § 30,761 at p. 30,787 (1987). See also Order No. 528, 53 FERC ¶ 61,163 at p. 61,597 (1990). Moreover, we offered pipelines an important quid pro quo for absorbing take-or-pay costs under Order Nos. 500 and 528—a special presumption that they had been prudent in incurring their take-or-pay liabilities.

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realigning, renegotiating, or terminating their portfolio of gas supply contracts to adjust to their sales customers' decisions to exercise their unilateral right under the rule to reduce or end their commodity purchase obligations to the pipelines).⁶⁴² In the case of the open access transmission required by this Rule, we believe that a utility is entitled to an opportunity to recover all legitimate, prudent and verifiable costs incurred by the utility when the availability of open access transmission enables a requirements customer to reach a new generation supplier.

Although the alternatives of either spreading the stranded costs to all transmission users or requiring the utility shareholders to share the costs with departing customers might enable a wholesale customer to leave sooner than would the direct assignment approach, the departing customer would be able to do so only at the expense of others who had no responsibility for causing the legitimate, prudent and verifiable costs to be incurred. Although we departed from strict cost causation principles in the gas context and required a broad spreading of the costs given the particular circumstances presented by the gas industry's transition to open access, we ultimately returned to the more traditional approach of allowing utilities to recover all of their prudently incurred transition costs in Order No. 636. At this juncture in the evolution of competition in the electric industry we need not make such a departure from cost causation principles; utilities can identify and seek to charge the customers who caused the costs to be incurred in the first place, before those customers leave the utility's generation system. Accordingly, we believe that a broader spreading of the costs to entities who are not responsible for the incurrence of the stranded costs would not be equitable.

4. Recovery of Stranded Costs Associated With New Wholesale Requirements Contracts

In the Supplemental Stranded Cost NOPR, the Commission preliminarily concluded that future wholesale contracts

must explicitly address the obligations of the seller and buyer, including the seller's obligation to continue to serve the buyer, if any, and the buyer's obligation, if any, if it changes suppliers. We stated that utilities will be allowed stranded cost recovery associated with "new" wholesale requirements contracts (executed after July 11, 1994) only if explicit stranded cost provisions are contained in the contract. We indicated that recovery of wholesale stranded costs associated with any such new contract will not be allowed unless such recovery is provided for in the contract.⁶⁴³ We also stated that a contract that is extended or renegotiated for an effective date after July 11, 1994 becomes a "new" contract for which stranded cost recovery will be allowed only if explicitly provided for in the contract.⁶⁴⁴

We also stated that it is not appropriate to impose on a wholesale requirements supplier a regulatory obligation to continue to serve its existing requirements customer beyond the end of the contract term. We proposed to retain the § 35.15 prior notice of termination filing requirement only for: (i) All contracts required to be filed under sections 205 and 206 of the FPA that were executed before the effective date of the Final Rule pro forma tariffs; and (ii) any unexecuted contracts that were filed before the effective date of the Final Rule pro forma tariffs. With regard to any power sales contract executed on or after that date, we proposed to no longer require prior notice of termination under § 35.15, but to require (for administrative reasons) written notification of the termination of such contract within 30 days after termination takes place. We requested comments on whether this proposal should also be applied to transmission contracts.⁶⁴⁵

Numerous commenters support our preliminary conclusion that new wholesale requirements contracts should explicitly address the obligations of the seller and buyer and that it is not appropriate to impose on wholesale requirements suppliers a regulatory obligation to continue to serve their existing requirements custom-

⁶⁴² Order No. 636, *FERC Statutes and Regulations* ¶ 30.939 at p. 30.461.

⁶⁴³ *FERC Statutes and Regulations* ¶ 32.514 at p. 33.110.

⁶⁴⁴ *Id.* at p. 33.118.

⁶⁴⁵ *Id.* and nn.273, 274.

ers beyond the end of the contract term.⁶⁴⁶ However, Arkansas Cities expresses concern that this could undermine obligations to serve that have been included in certain contracts with utilities. It asks the Commission to state that, unless a utility has undertaken an obligation to serve via contract, there is no obligation to serve beyond the contract term. Arkansas Cities asks the Commission to clarify that contracts establishing an obligation to serve will be enforced.

Several other commenters argue that if a wholesale customer elects to switch suppliers, the previous supplier should be under no obligation to take the customer back onto its system at embedded cost rates.⁶⁴⁷ Sierra asks the Commission to endorse a host utility's ability to insist on protective contract provisions before reestablishing service, including a predetermined period (such as five years—a commonly-used planning period) before the customer could seek to leave the system again.

A number of commenters support the Commission's proposal to eliminate the prior notice of termination requirement for power sales contracts executed after the date on which the final rule pro forma tariffs become effective.⁶⁴⁸ Southern states that, because of the opportunities for power purchasers that will exist after the proposed rules take effect, the Commission also should eliminate § 35.15 as it applies to old contracts.

Several commenters support eliminating the § 35.15 filing requirement for transmission contracts as well.⁶⁴⁹ This change is needed, some assert, to provide certainty in commercial arrangements in the more competitive environment and as a matter of fairness. CSW suggests that all § 35.15 filing requirements for existing contracts (wholesale and transmission contracts) be phased out over three years

and that only contracts that expire within three years after the final rule should be subject to the requirement to file a notice of termination.

Nevertheless, several other commenters oppose the Commission's proposal to no longer require prior notice of termination for power sales contracts executed on or after the effective date of the generic tariffs.⁶⁵⁰ TDU Systems opposes elimination of § 35.15 as tantamount to a finding that termination of all contracts is just and reasonable. TDU Systems and NRECA submit that the market power exercised by supplying utilities will not disappear the instant the rule becomes final and that it may be possible for a utility to exercise monopoly power even with regard to "new" contracts. They propose that if the Commission nevertheless decides to allow contract termination under § 35.15, the Commission should require a public utility to pay "stranded benefit" costs to former wholesale power customers if the customers show that they had a reasonable expectation that the power sales would continue past the end of the agreement at the prior rate.

Several commenters also oppose eliminating the § 35.15 filing requirement for transmission contracts.⁶⁵¹ FL Com asserts that because the Commission has imposed an obligation to serve for transmission service, § 35.15 should be retained for new and existing transmission contracts.

Commission Conclusion

We reaffirm our preliminary determination that future wholesale requirements contracts should explicitly address the mutual obligations of the seller and buyer, including the seller's obligation to continue to serve the buyer, if any, and the buyer's obligation, if any, if it changes suppliers. As we indicated in the Supplemental Stranded Cost NOPR, now that

⁶⁴⁶ E.g., PA Com, FL Com, PSNM, Southern, NC Com, Duke, Public Service Co of CO, SoCal Edison, PacifiCorp, Carolina P&L, NYSEG.

⁶⁴⁷ E.g., Sunflower, Sierra, Public Service Co of CO, Duke.

⁶⁴⁸ E.g., EEI, NYSEG, Southern, PA Com, SoCal Edison, PacifiCorp, El Paso.

⁶⁴⁹ E.g., EEI, Public Service Co of CO, PA Com, Entergy, Florida Power Corp.

⁶⁵⁰ E.g., TDU Systems, NRECA, TAPS, Redding, Southwest TDU Group. VT DPS sees no

urgent need for elimination of the § 35.15 requirement or for automatic termination of sales service under a wholesale contract of more than three years duration. However, it supports pregranted authorization of service termination upon expiration of sales contracts with terms of less than three years. Among other things, it submits that the pregranted authority to terminate short-term service would relieve the utility of a planning uncertainty and allow it to maximize use of uncommitted transmission capacity.

⁶⁵¹ TAPS, TDU Systems, FL Com, MMWEC.

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utilities have been placed on explicit notice that the risk of losing customers through increased wholesale competition must be addressed through contractual means only, they must address stranded cost issues when negotiating new contracts or be held strictly accountable for the failure to do so.

We accordingly will allow recovery of wholesale stranded costs associated with any new requirements contract (executed after July 11, 1994) only if explicit stranded cost provisions are contained in the contract. By "explicit stranded cost provision" (for contracts executed after July 11, 1994) we mean a provision that identifies the specific amount of stranded cost liability of the customer(s) and a specific method for calculating the stranded cost charge or rate. For purposes of requirements contracts executed after July 11, 1994 but before the date on which this Final Rule is published in the Federal Register, however, we clarify that a provision that specifically reserved the right to seek stranded cost recovery consistent with what the Commission permits in this Rule (without identifying the specific amount of stranded cost liability of the customer(s) and calculation method) nevertheless will be deemed an "explicit stranded cost provision." However, a provision in a requirements contract executed after July 11, 1994 but before the date on which this Final Rule is published in the Federal Register that merely postpones the issue of stranded cost recovery without specifically providing for such recovery will not be considered an "explicit stranded cost provision." After the date on which this Final Rule is published in the Federal Register, a provision must identify the specific amount of stranded cost liability of the customer(s) and a specific method for calculating the stranded cost charge or rate in order to constitute an "explicit stranded cost provision."

We reaffirm that a requirements contract that is extended or renegotiated for an effective date after July 11, 1994 becomes a "new" requirements contract for which stranded cost recovery will be allowed only if explicitly provided for in the contract.

We also reaffirm our preliminary determination not to impose a regulatory obligation on wholesale requirements suppliers to continue to serve their existing requirements customers beyond the end of the contract term. The only exception to this would be if the customer decides to remain a requirements customer for the period for which the Commission finds that the supplying utility reasonably expected to continue serving the customer. In such a case, the supplying utility will be obligated to offer continuing service to the requirements customer for the period the utility reasonably expected to continue serving the customer.

A requirements customer will be responsible for planning to meet its power needs beyond the end of the contract term by either building its own generation, signing a new power sales contract with its existing supplier, or contracting with new suppliers in conjunction with obtaining transmission service under its existing supplier's open access transmission tariff or another utility's transmission system. In so holding, it is not our intent to undermine any obligations specifically contained in a contract. Thus, if a contract explicitly establishes an obligation to serve beyond the end of the contract term, such a contractually-imposed obligation to serve (as distinguished from a regulatory obligation to serve) would be enforceable as a term of the contract. If a wholesale customer that switches suppliers later seeks to reestablish service with its former supplier, it will be up to the parties to negotiate their respective obligations.

We also reaffirm our preliminary determination to no longer require prior notice of termination under §35.15 for any power sales contract executed on or after the effective date of the Final Rule pro forma tariff (but to require written notification of the termination of such contract within 30 days after termination takes places). This determination goes hand-in-hand with our determination (discussed above) not to impose a regulatory obligation on wholesale requirements suppliers to continue to serve their existing requirements customers beyond the end of the contract term.⁶⁵² We clarify, however,

⁶⁵² Although several commenters have asked the Commission to retain the prior notice of

termination filing requirement due to concern that a utility nevertheless may be able to exer-

that this decision applies only to a power sales contract that is to terminate by its own terms (such as on the contract's expiration date). We have revised § 35.15 accordingly. We will, however, continue to require prior notice of cancellation or termination for any power sales contract that is proposed to be cancelled or terminated for a reason other than by the contract's own terms (such as a self-help provision related to, for example, a billing dispute), regardless of when the contract was executed. We also will continue to require prior notice of the proposed termination of any power sales contract executed before the effective date of the Final Rule pro forma tariff (even if the contract is to terminate by its own terms) as well as any unexecuted power sales contract that was filed before that date.

Further, we will retain the § 35.15 filing requirement for all transmission contracts. The reason for retaining the § 35.15 requirement for transmission contracts is that transmission will continue to be provided under conditions of potential market power, and the Commission must be assured that transmission owners are not exerting market power in termination of transmission contracts. In addition, this filing requirement will provide the customer an opportunity to notify the Commission if the termination terms are disputed or if the customer was not given adequate opportunity to exercise its limited right of first refusal under the Final Rule (see Section IV.A.5).

5. Recovery of Stranded Costs Associated With Existing Wholesale Requirements Contracts

In the Supplemental Stranded Cost NOPR, the Commission reaffirmed its proposal to permit the recovery of legitimate, prudent and verifiable stranded costs for a discrete set of "existing" wholesale requirements contracts (exe-

cuted on or before July 11, 1994)—those that do not already contain exit fees or other explicit stranded cost provisions. We encouraged the parties to such contracts to renegotiate them to address stranded costs. In the case of existing contracts that already contain an exit fee or explicit stranded cost provision, however, we proposed to reject a unilateral stranded cost amendment; that is, we stated we would reject an amendment unless the contract permits renegotiation of the existing stranded cost provision or the parties to the contract mutually agree to renegotiate the contract.⁶⁵³ In so doing, we proposed to drop the three year mandatory negotiation period suggested in the initial Stranded Cost NOPR.⁶⁵⁴

If an existing requirements contract does not contain an exit fee or other explicit stranded cost provision (and is not renegotiated to add such a provision), we proposed that before the expiration of the contract: (1) A public utility or its customer may file a proposed stranded cost amendment to the contract under section 205 or 206; or (2) a public utility or transmitting utility may file a proposal to recover stranded costs associated with any such existing contract through its transmission rates for a customer that uses the utility's transmission system to reach another generation supplier.

In the Supplemental Stranded Cost NOPR, we reaffirmed our proposal in the initial Stranded Cost NOPR that, even if the contract contains an explicit Mobile-Sierra⁶⁵⁵ provision, it is in the public interest to permit public utilities to seek unilateral amendments to add stranded cost provisions if the contracts do not in essence forbid such recovery by containing exit fees or other explicit stranded cost provisions.⁶⁵⁶ Under these circumstances, if neither of the parties seeks and obtains acceptance or approval of a

(Footnote Continued)

cise generation market power with regard to a "new" wholesale requirements contract, we do not believe that retention of that provision is necessary to address these commenters' concerns. Instead, any party claiming to be aggrieved by a utility's alleged abuse of generation market power under a wholesale requirements contract can file a complaint with the Commission under section 206 of the FPA.

⁶⁵³ *FERC Statutes and Regulations* § 32.514 at p. 33.113.

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⁶⁵⁴ We invited comments on this proposal. *Id.* at p. 33.115.

⁶⁵⁵ See *United Gas Pipeline Company v. Mobile Gas Service Corporation*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Company*, 350 U.S. 348 (1956).

⁶⁵⁶ *FERC Statutes and Regulations* § 32.514 at p. 33.113-14. We noted that under the Mobile-Sierra doctrine, a customer may waive its right to challenge the contract and/or the utility

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stranded cost amendment, we propose to permit the public utility to seek recovery of stranded costs through its wholesale transmission rates.

We also proposed procedures for providing an existing wholesale requirements customer advance notice of how the utility would propose to calculate costs that the utility claims would be stranded by the customer's departure.⁶⁵⁷

a. July 11, 1994 Cut-Off Date

A number of commenters ask the Commission to reconsider the July 11, 1994 cut-off date for distinguishing between "existing" and "new" requirements contracts. Some commenters⁶⁵⁸ support October 24, 1992 (the date of passage of the Energy Policy Act) as the cut-off date on the basis that anyone entering into a wholesale requirements contract after that date should have recognized the greatly increased possibility of the customer terminating or not renewing the contract.

Other commenters⁶⁵⁹ support a later date for defining "new" requirements contracts, such as the date on which the final rule open access tariffs become effective. Utilities For Improved Transition argues that the Commission cannot retroactively adopt the July 11, 1994 cut-off date, but must wait until the final rule is issued before setting the date after which requirements contracts must contain stranded cost provisions in order for stranded cost recovery to be allowed.

Commenters representing electric cooperatives also oppose the July 11, 1994 cut-off date.⁶⁶⁰ They contend that RUS borrowers were not free to negotiate stranded cost amendments to wholesale power con-

tracts as soon as the Commission warned them to do so because their wholesale power contracts are mandated both as to form and substance by the RUS.⁶⁶¹

PA Munis asks the Commission to treat certain contracts that were executed before July 11, 1994 (but not approved by the Commission until after that date) as "new" contracts. PA Munis argues that the utility, after issuance of the initial NOPR, could have withdrawn its filing of the contract and sought to negotiate an exit fee at that time. It submits that the utility's failure to do so would justify a finding by the Commission that contracts approved after July 11, 1994 be treated similarly to contracts executed after that date.

b. Stranded Cost Recovery for Existing Requirements Contracts

A number of commenters express support for the Commission's proposal to permit modification of existing requirements contracts that do not already contain exit fees or other explicit stranded cost provisions.⁶⁶² NEPCO states its interpretation that the NOPR does not consider notice provisions to be "explicit stranded cost provisions;" it argues that the presence of a notice provision in a contract, while bearing on the supplier's ability to demonstrate the duration of its reasonable expectation of continued service, should not foreclose the amendment of a wholesale contract to add an exit fee or similar payment provision. Several other commenters ask the Commission to clarify that contracts that contain notice provisions and that preclude recovery for termination or reduction of service (but that do not necessarily use the terms

(Footnote Continued)

may waive its right to make unilateral rate changes. However, the parties may not waive the indefeasible right of the Commission to alter rates that are contrary to the public interest. *Id.* at p. 33,111.

⁶⁵⁷ *Id.* at p. 33,114-15.

⁶⁵⁸ *E.g.*, ELCON, TAPS, Alcoa, Utilicorp.

⁶⁵⁹ *E.g.*, Utilities For Improved Transition, Atlantic City.

⁶⁶⁰ *E.g.*, Basin, Tri-County EC, NW Iowa Cooperative, Baker EC, Big Horn EC, Black Hills EC, Bon Homme Yankton EC, Carbon Power, Central EC, Douglas EC, East River EC, Ida County REC, James Valley EC, Lincoln-Union EC, McKenzie EC, North Dakota RECs, Oahe

EC, Oliver-Mercer EC, Panhandle Coop, Rushmore EC, San Luis Valley EC, Slope EC, Spink EC, Turner-Hutchinson EC, Traverse EC, Union County EC, West River EC, Whetstone Valley EC, Woodbury County REC, Yellowstone Valley EC.

⁶⁶¹ Basin indicates that all such contracts for the sale of more than 1,000 kW and any amendments thereto must be specifically approved by the RUS.

⁶⁶² *E.g.*, EEL, PSNM, AEP, Consumers Power. Consumers Power suggests that the language of proposed § 35.26(c)(1)(iv) be modified to recite the Commission's public interest finding.

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"exit fee" or "stranded cost"), or that expressly provide that stranded costs shall not be charged, cannot be reopened for a stranded cost claim.⁶⁶³

A number of other commenters oppose the Commission's proposal to permit amendment of wholesale requirements contracts that do not address stranded cost recovery, for reasons previously raised in this proceeding.⁶⁶⁴ They argue, among other things, that contracts should stand on their own. RUS asserts that the integrity of its Federal loan program is to a large extent predicated on honoring the long-term requirements wholesale power contracts between G&Ts and their distribution members.

Several commenters also challenge the Commission's proposed determination that it is in the public interest to permit utilities to seek unilateral amendments to add stranded cost provisions to requirements contracts. These commenters argue that the NOPR's assumptions concerning the financial stability of public utilities are unsupported and thus do not meet the burden of proof required for the public interest finding under the Mobile-Sierra doctrine. They urge the Commission to require a utility-specific finding of imminent financial jeopardy before overriding a Mobile-Sierra contract.⁶⁶⁵

ELCON argues that the recent *Northeast Utilities Service Company v. FERC*⁶⁶⁶ case reaffirms the traditional high threshold for overriding Mobile-Sierra clauses in the "classic Mobile-Sierra situation" in which one of the parties seeks modification of a contract that has already been reviewed and approved by the Commission. It submits that a utility seeking to add a stranded cost provision to an existing contract would fall within

the "classic situation." ELCON also argues that the First Circuit strongly implied that to satisfy Mobile-Sierra, the Commission must identify specifically those aspects of a contract that are contrary to the public interest and why. On this basis, ELCON argues that the case supports its position that a utility-specific finding of imminent financial jeopardy is necessary to override an existing Mobile-Sierra contract.⁶⁶⁷

Some commenters argue that if utilities are to be granted industry-wide Mobile-Sierra relief, then the Commission should give wholesale customers the reciprocal right to convert their wholesale power contracts to transmission-only service.⁶⁶⁸ However, EEI contends that the Commission is barred by section 211(c)(2) of the FPA from ordering wheeling where a customer is taking service under a contract or under a rate tariff on file with the Commission.

Several commenters ask the Commission to require renegotiation of the notice and/or term of all existing contracts with long lead-time cancellation provisions in order to allow all wholesale customers access to the market at the same time.⁶⁶⁹ They submit that customers with short notice provisions will be the first to enjoy the benefits of open access and will have an effective "first right of refusal" of the most economical transmission paths and low cost suppliers, putting customers with long lead-time cancellations at a competitive disadvantage.

c. Transition Period

A number of commenters support the Commission's proposal not to mandate a three-year time limit for renegotiation of existing wholesale requirements contracts. They note that existing contracts

⁶⁶³ E.g., *Concord, Chugach, ME Consumer-Owned Utilities*.

⁶⁶⁴ E.g., *Utilicorp, AMP-Ohio, Environmental Action, DE Muni, Arkansas Cities, Direct Service Industries, PA Munis, ABATE, APPA*.

⁶⁶⁵ See, e.g., *American Forest & Paper, VT DPS, PA Munis, ABATE, ELCON, APPA, Environmental Action*.

⁶⁶⁶ 55 F.3d 686 (1st Cir. 1995) (*Northeast Utilities*).

⁶⁶⁷ PA Munis argues that *Northeast Utilities* provides no support for the Commission's proposed Mobile-Sierra finding because *Northeast Utilities* involved the effect of disputed contrac-

tual terms on third parties, not the alleged financial effect on the utility. It argues that the court found that the Commission had adequately explained how the disputed contractual terms may harm third parties to the contract (which PA Munis says the Commission has failed to do here). PA Munis also submits that the court went out of its way to emphasize the narrow scope of its order affirming the Commission.

⁶⁶⁸ E.g., *ELCON, CCEM, VT DPS, OK Com, TDU Systems, LG&E, ABATE, Portland, Utilicorp, TAPS*.

⁶⁶⁹ E.g., *Knoxville, Memphis*.

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have unique characteristics and complexities that affect the time required to renegotiate the contract bilaterally, to file a unilateral amendment with the Commission, or to file for stranded cost recovery through transmission rates.⁶⁷⁰

On the other hand, some commenters object that the proposal to replace the previously proposed three-year window with an opportunity to raise stranded cost claims throughout the existing contract term creates a virtually unlimited transition period.⁶⁷¹ For example, ELCON asserts that because the NOPR would allow utilities to seek amendment of an existing contract any time prior to its expiration, stranded cost issues could extend through the life of existing facilities (30 years or more). Portland suggests that the Commission set a schedule now for proceedings to determine transmission costs and stranded costs for each utility with wholesale requirements customers.

Commenters propose various limits to the period within which stranded cost recovery could be raised, such as: (i) Three to five years;⁶⁷² (ii) the lesser of three years from the effective date of the final rule or the remaining term of the contract;⁶⁷³ (iii) one year from the effective date of the final rule;⁶⁷⁴ and (iv) December 31, 1998 (20 years after PURPA).⁶⁷⁵

Commission Conclusion

a. July 11, 1994 Contract Cut-Off Date

We reaffirm our proposal to permit the recovery of legitimate, prudent and verifiable stranded costs for "existing" wholesale requirements contracts (executed on or before July 11, 1994) that do not already contain exit fees or other explicit

stranded cost provisions. We believe that July 11, 1994—the date on which the initial Stranded Cost NOPR was published and, thus, on which the industry was put on notice of the proposal to disallow prospectively extra-contractual recovery of stranded costs—is the appropriate date for distinguishing "existing" requirements contracts from "new" requirements contracts. Because all parties were put on notice in the initial Stranded Cost NOPR that July 11, 1994 would be the operable date for the "existing"/"new" contract distinction, utilities that executed requirements contracts after that date could have had no reasonable expectation that they would be permitted to recover any costs extra-contractually.

Moreover, because the costs at issue are extra-contractual costs, the Commission's notice to all parties that contracts executed after July 11, 1994 will be enforced by their terms as far as stranded cost recovery is concerned does not constitute "retroactive rulemaking." Contrary to UFIT's contention, the Commission is not "requir[ing]" utilities to include stranded cost recovery provisions in all contracts executed after July 11, 1994.⁶⁷⁶ The Commission has merely put all parties on notice that the opportunity for extra-contractual stranded cost recovery (which will be allowed on a prospective basis upon the effective date of the Rule) will not be available for any requirements contracts executed after July 11, 1994. The parties to requirements contracts executed after July 11, 1994 have been free to provide for stranded cost recovery in the contract, or not.⁶⁷⁷ The point is that, for requirements contracts executed after

⁶⁷⁰ E.g., EEI, Florida Power Corp. PA Com. WP&L, Consumers Power, FL Com. TVA, SoCal Edison, Texas Utilities.

⁶⁷¹ E.g., TAPS, TDU Systems, DOD, ELCON, APPA.

⁶⁷² E.g., Serra, Central Illinois Light, NY Energy Buyers, American Forest & Paper, WEPSCO, EGA. Education proposes either a transition period that ends five years after the effective date of the final rule or a phase-out of the utility's authority to recover stranded costs from departing customers by gradually reducing (for instance, over a ten year period from the date of the final rule) the percentage of stranded costs that the utility could recover.

⁶⁷³ E.g., TAPS, Missouri Joint Commission.

⁶⁷⁴ E.g., TDU Systems.

⁶⁷⁵ E.g., DOD, ABATE.

⁶⁷⁶ See UFIT Initial Comments at p. 34. Moreover, the cases that UFIT cites, in which the Commission rejected parties' efforts to devise rates based on methods or formulas contained in proposed rules, are inapposite. By establishing the July 11, 1994 cutoff date, the Commission is not "fix[ing] rates under section 206" or otherwise making "a Section 206 'determination,'" as UFIT suggests. *Id.* at p. 35, 36. The Commission has not proposed a change in the way that utilities compute their rates; it has simply put all parties on notice of the limited nature and opportunity for extra-contractual stranded cost recovery.

⁶⁷⁷ In response to the commenters representing electric cooperatives that object to the July