6.0. INTRODUCTION

Volume I of this report provides background on IGCC as a clean coal technology and discusses why it is an important electricity generation technology that yields energy, environmental, national security, and economic development public benefits and what economic and financing hurdles exist to near-term, commercial IGCC deployment. Volume I also describes in detail the 3Party Covenant financing and regulatory program, including the economics of IGCC under the 3Party Covenant and the components of federal legislation recommended for implementation of the program.

This Volume II provides background on the legal and regulatory framework for implementing the 3Party Covenant and addresses important implementation issues regarding: state PUC regulatory authority, procedures, and policies; application of the 3Party Covenant in states with more traditional utility regulatory systems and states with retail electric competition; and the interaction of state PUC and FERC jurisdiction.

In particular, Section 7.0 (the first section of Volume II) begins with an overview of the traditional electric industry regulatory system and how it impacts the allocation of risk in the development of new electricity generating plants, such as new IGCC plants. This section provides a foundation for understanding how utility regulatory commissions' ratemaking and cost recovery procedures and policies affect the allocation of construction, operating, and market risk between investors and ratepayers. A critical aspect of the 3Party Covenant is that it re-allocates risk among the federal government, investors, and ratepayers in a manner that reduces capital costs (and thus the cost of electricity produced) and creates a risk tolerant investment structure, while assuring protection of the interests of ratepayers and the federal loan guarantor.

Section 8.0 provides a detailed review of the electric industry regulatory systems in three states with a more traditional regulatory approach (Indiana, Kentucky, and New Mexico) and two states with retail electric competition (Ohio and Texas). This detailed review highlights a number of important legal requirements and policies (e.g., as applicable, the review of costs and determination of rates, the treatment of cancelled plants, the use of adjustment clauses, and special provisions for different types of generation) that affect the treatment and pass-through of costs, and the allocation of risks, associated with developing new electricity generating plants. The discussion focuses on aspects of each state's regulatory system that will make the system suitable for implementing the 3Party Covenant and those aspects that will need clarification or modification (e.g., through state legislation) for 3Party Covenant implementation.

Section 9.0 provides a model state PUC regulatory mechanism for review, approval, and recovery of IGCC project costs. This mechanism is at the heart of the 3Party Covenant financing and regulatory program. It is through state PUC review, approval, and recovery processes that an assured revenue stream is established for IGCC project costs in order to reduce the risk (and cost) of the federal loan guarantee under the 3Party Covenant. Several scenarios for development of new IGCC plants are described and used in discussing the application of the model regulatory mechanism. This section also describes the state statutory changes that may be necessary for application of the model regulatory mechanism. Finally, this section discusses FERC rate jurisdiction over new IGCC plants and the potential interaction between the FERC and a state PUC in the review, approval, and recovery of IGCC project costs under the 3Party Covenant.