

Transcript of State of US Competitive Wholesale Power Markets CERAWEEK 2008 – Quest for Security: Strategies for a New Energy Future

Introduction of Chairman Joseph T. Kelliher by Daniel Yergin

“We have a very strong day today for Day 2, Power Day of CERA Week. I’ll describe in a minute. But first I’d like to express our thanks again to Ahlstrom, which is our global energy partner all week at CERA week, and to Lazard, which has been our global financial partner all week.

We have as I say a very good program and I just want to tell you how it’s going to unfold in the day. After we hear our keynote speaker this morning, we will then have a major plenary on the promise and peril of clean energy. And I promise you it will be a 360 degree look at the subject.

After that, we’ll hear from Nuclear Regulatory Commissioner Peter Lyons. And then we’ll have three sessions, three strategic sessions. First, it’s our turn now, on rising capital costs of power. Secondly, the question of whether plug in hybrids are a game changing opportunity for the power sector. And thirdly, power sector investment, global capital, local strategies. And then on policy, the rates for renewable energy, new policies on global markets. And then to bring it all together, we’ll have the CERA Electric Power Insight from CERA’s Electric Power Team.

To start this morning, I’ll going to be here with my colleague Larry Makovich, who is part of the discussion.

We’re really pleased to have Joseph Kelliher, the Chairman of the Federal Energy Regulatory Commission. He was sworn in on the FERC in November 2003, and he was designated Chairman in 2005. Before that, he’d been a senior policy advisor to Secretary of Energy Spencer Abraham, played a key role in development of national energy policy. He also worked in Congress, including for Congressman Joe Barton, and also has extensive experience in the private sector in energy, and so brings the perspectives of the FERC, and a broader perspective over the energy sector. And we’re really pleased that Chairman Kelliher has been with us for over a day now. The platform is yours, sir.”

Chairman Joseph T. Kelliher

“I want to thank you for inviting me to speak today. I appreciate the opportunity to discuss U.S. wholesale power market competition policy.

Before I begin, let me offer the usual disclaimer. The views I am about to express do not necessarily represent the views of the Federal Energy Regulatory Commission (FERC), my colleagues on the Commission, or the FERC staff. I speak only for myself.

In my view, U.S. competitive wholesale power markets are working well, and wholesale competition policy has been a success. This is true notwithstanding the pressure from higher fuel prices, principally coal and natural gas, which put upward pressure on wholesale power prices.

I want to be clear that U.S. wholesale power policy is not “deregulation”. To me, “deregulation” suggests the absence of regulation. Since we are here in Texas, I will say that “deregulation” brings to mind images of a Clint Eastwood Western movie, with gunfighters shooting it out in the street in a town that has no sheriff and no laws. There is a sheriff in wholesale power markets, and there are rules that govern U.S. wholesale power markets.

The United States relies on a mixture of competition and regulation to govern wholesale power markets. Our goal is perfect competition, textbook competition, competition that is so beautiful it would make an economist weep.

I accept that we may not achieve that goal, and that perfect competition may not exist outside the textbook. In our pursuit of perfect competition we may fall short. But if so we will at least have achieved more perfect competition.

What is the proper measure of success for U.S. wholesale power competition policy? Not movements in retail prices, which are driven largely by movements in fuel prices. The truest measure of success would be a counterfactual – what would power prices be absent the adoption of competition policy 25 years ago? But that could never be demonstrated to complete satisfaction.

In my view, the proper measure of success is whether wholesale power markets have the characteristics of perfect or textbook competition. Wholesale markets currently reflect most of these characteristics, but not all, and there is room for improvement.

One reason it is clear that U.S. wholesale policy is not now and has never been deregulation is that FERC never stopped regulating wholesale power markets. FERC's regulatory role has certainly changed over time. Twenty-five years ago FERC wholesale power regulation largely constituted setting a host of wholesale power sales rates for individual sellers through traditional cost of service rate regulation. Now FERC approves market rules, prevents market power exercise through our market based rate test and ratemaking authority, polices market manipulation, and enforces its rules through exercise of its civil penalty authority. I would submit the current FERC regulatory role is different, but not smaller, than it was 25 years ago.

Higher fuel prices are leading some to question wholesale competition policy, and we hear the siren song of reregulation. But it is not entirely clear what the advocates of reregulation are proposing, and to some extent their position is inchoate. But the logic of their position suggests total reliance on regulation and the total absence of competition. It wishes away the independent power producers that have added most U.S. electricity supply over the past 25 years. It presumes that interstate commerce in power disappears, that utilities become walled cities, and that the U.S. relies on pure vertical integration.

In my view, such a scenario is clearly impossible. We cannot put the competition genie back into the bottle, even if there was a will to do so. But if this impossible scenario were actually realized it would produce terrible outcomes for consumers. It would also vastly complicate U.S. efforts to meet the security of electricity supply challenge and make it nearly impossible to meet the climate change challenge.

It is important to appreciate that U.S. wholesale competition policy was not inadvertent. It was a deliberate choice reflected in three major federal laws enacted over the past 30 years. The U.S. consciously embraced competition policy after the comprehensive failure of traditional regulation to assure security of supply at reasonable cost.

Calls for reregulation are essentially a cry for lower electricity prices. But there is little that reregulation can do to change the underlying fuel costs that are the principal driver on power prices. Traditional rate regulation cannot readily change the price of natural gas and coal.

FERC is not complacent about the state of wholesale power markets. We seek steady reform to strengthen wholesale competition, encourage generation entry, improve market access and grid access, establish good market rules, prevent market power exercise and market manipulation, assure effective enforcement, improve market transparency, provide contract certainty, reinforce the power grid, and improve demand response.

We have pursued a series of reforms over the past two years, most of which were initiated by the Commission itself. We are currently in the midst of a competition proceeding that began a year ago. This effort is not our first step in promoting effective competition, and it will not be the last word.

As I stated earlier, we are searching for the perfect mixture of competition and regulation. But U.S. electricity markets are highly dynamic, and if we achieve that perfect mixture, the market will change and require a further adjustment in policy.

U.S. policy supporting competitive wholesale power markets will not change. With that in mind, our focus at FERC is making wholesale markets more competitive.

There are two great challenges facing U.S. electricity markets – security of electricity supply and climate change. I would like to discuss how the U.S. is addressing these challenges.

Competition policy has assured security of U.S. electricity supply at a reasonable cost for 25 years, and independent power producers have accounted for most generation additions during this period.

The U.S. is poised on the edge of a large generation build, perhaps larger than the generation build between 1996 and [2004]. The U.S. also needs significant investment in our transmission and distribution infrastructure. The cost of new generation will likely be higher than installed generation.

As we confront the security of supply challenge, there are some threshold questions. Will the U.S. build enough additional electricity supply? Who will build? What will we build – what will the generation mixture of our new electricity supply be?

I believe the United States will build enough electricity supply to meet demand, but probably not as much as we should, and reserve margins may tighten.

With respect to “Who will build?” I believe the answer will vary by region. In some regions, vertically integrated utilities may account for most new electricity supply additions. In other regions, the answer may be independent power producers. This reflects the hybrid nature of U.S. wholesale power markets.

The answer to ‘What will be built?’ may be more natural gas fired generation than is ideal, at least over the next ten years. Natural gas has many advantages as a primary fuel for electric generation, but dependence on a single fuel for incremental electricity supply can run great risks. In the past 18 months, 54 percent of the coal generating capacity ordered since 2000 has been cancelled. There has been a revival of interest in nuclear generation, but additional nuclear units are unlikely to be operating within the next ten years. Wind generation produces a different product than a baseload coal plant, and wind cannot substitute easily for cancelled coal power plants.

The end result is the U.S. is likely to rely very heavily on natural gas for generation additions over the next ten years. That may place upward pressure on electricity prices.

The last dash for gas for power generation took place when natural gas prices were low. A new dash for gas would occur when gas prices are relatively high. This new dash for gas would not be driven by low prices, but by the prospect of change in U.S. climate change policy. Given the tremendous regulatory uncertainty regarding new coal projects, and the length of nuclear plant licensing and construction, gas may be the best baseload option for new generation additions over the next ten years.

This has important energy policy implications. It is important to recognize that climate change is not just environmental policy – it is also energy policy. At one level, climate change policy

involves decisions regarding the size of U.S. electricity supply and the fuel mixture used to generate that supply.

There are many options on how to approach climate change. Some approaches may be sound energy policy, some may be acceptable energy policy. But others may be profoundly unwise or reckless energy policy.

It is essential to balance energy and environmental policy as the U.S. confronts climate change.

In conclusion, the U.S. is committed to competition policy. There will be no change in policy. Our focus is on strengthening wholesale competitive markets, through steady reform, and our goal is perfect competition. And we believe that competitive markets are best suited to meet the security of supply and climate change challenges.”