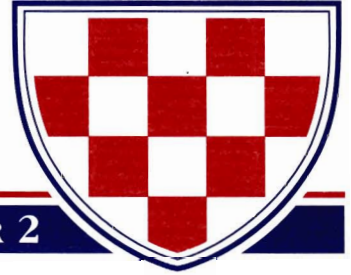


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THE NEED FOR MANDATORY ELECTRIC RELIABILITY STANDARDS
AND GREATER TRANSMISSION INVESTMENT

The Honorable Joseph T. Kelliher

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*The Honorable Joseph T. Kelliher **

Let me start with the usual disclaimer: the views I express are my own and do not necessarily represent the official position of the Federal Energy Regulatory Commission (the “Commission” or “FERC”), the views of other commissioners, or the staff. I appreciate the opportunity to share my views with you on reliability, transmission investment, and industry restructuring.

I. NEED FOR ELECTRICITY LEGISLATION

I would like to begin my remarks by discussing why I believe it is necessary for Congress to pass electricity legislation.

It has been more than a decade since Congress has enacted major electricity legislation,¹ and a lot has changed since that time. Since then, we have witnessed dramatic price spikes in wholesale power markets, followed by equally dramatic price collapses.² There were attempts to manipulate power markets.³ There was a

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1. See Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified at 42 U.S.C. § 13201 (2000 & Supp. I 2003)).

2. See generally OFFICE OF MKT. OVERSIGHT AND INVESTIGATIONS, FED. ENERGY REGULATORY COMM’N, Docket MO4-2-000, STATE OF THE MARKETS REPORT: ASSESSMENT OF ENERGY MARKETS FOR THE PERIOD JANUARY 1, 2002 THROUGH JUNE 30, 2003, at 28–34 (2004) [hereinafter STATE OF THE MARKETS REPORT], available at <http://www.ferc.gov/legal/ferc-regs/land-docs/som-2003.pdf> (last visited Nov. 9, 2004).

3. See FED. ENERGY REGULATORY COMM’N, Docket PA02-2-000, FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS: FACT-FINDING INVESTIGATION OF POTENTIAL MANIPULATION OF ELECTRIC AND NATURAL GAS PRICES, at ES-1, (2003) [hereinafter FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS], available at <http://news.findlaw.com/hdocs/docs/ferc/wstmrkt32603rptpt1.pdf> (last visited Nov. 9, 2004).

large expansion of generation by independent power producers,⁴ followed by an unprecedented financial downturn for energy traders and independents.⁵ Investment in the transmission grid has been stagnant,⁶ and we have suffered three major regional blackouts.⁷

In my view, the time has come to make reforms to the Federal Power Act (the “Act”).⁸ Any law reflects the circumstances of the period in which it was enacted. Congress does not write a law on a mountaintop; it looks around at the world that surrounds it. Ideally, Congress considers that the world may change and provides flexibility in that law.

Consider the circumstances that surrounded enactment of the Act. At the time it was written, there was virtually no interstate commerce in electricity, there was no interstate transmission grid, virtually all generation was built in load centers, and all aspects of the business—generation, transmission, and distribution—were presumed to be natural monopolies.⁹ The Act reflects an unspoken assumption by Congress that none of these circumstances would change.

The electricity market has changed dramatically since 1935. Today, interstate commerce in electricity has exploded: the transmission grid is not only interstate, but international; much generation is located remotely from load centers, not even necessarily in the same state; and it has been demonstrated that there is no natural monopoly in generation.¹⁰

While the electricity market and industry have changed, the Act remains unchanged in many respects. It is clear, however, that many of the assumptions that governed development of the

4. See STATE OF THE MARKETS REPORT, *supra* note 2, at 64.

5. *Id.* at 3.

6. See *id.* at 72–73.

7. N. Am. Elec. Reliability Council, *Examples of Major Bulk Electric System Power Outages* (Aug. 15, 2003) at http://fire.pppl.gov/blackout_history_table.pdf (last visited Nov. 9, 2004) [hereinafter *Examples of Major Power Outages*].

8. Federal Power Act §§ 201–214, 16 U.S.C. §§ 824–824m (2000).

9. See ENERGY INFO. ADMIN., U.S. DEP’T OF ENERGY, PUB. NO. DOE/EIA-0562(00), *THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 2000: AN UPDATE* app. A (2000) [hereinafter *THE CHANGING STRUCTURE*], available at http://www.eia.doe.gov/cneaf/electricity/chg_stru_update/update2000.pdf (last visited Nov. 9, 2004) (History of the U.S. Electric Power Industry, 1882–1991).

10. See *id.* at ix–1.

Act are no longer valid. There is a need to reform federal electricity laws to reflect the dramatic changes that have swept across the industry in the same manner that changes in the telecommunications industry and financial services industry led Congress to make reforms to the federal laws that govern those industries.

The pending energy legislation takes a step in the right direction. While the prospects for legislative action are uncertain, I remain hopeful that Congress will pass comprehensive energy legislation. If Congress fails to pass the pending energy legislation, we will have missed a great opportunity to reform our federal electricity laws.

II. NEED TO ASSURE RELIABILITY OF THE TRANSMISSION GRID

Let me turn now to a discussion of the need to assure reliability of the interstate transmission grid. I will begin with a quote from a report that investigated major regional power blackouts:

There is a sense of urgency throughout this report. . . . [T]he electricity industry is in a transition from a highly regulated industry dominated by monopoly utilities to an industry that will rely, in large part, upon competitive commercial markets at . . . the wholesale . . . level[]. . . . The . . . old institutions for reliability are no longer sufficient. . . . However, the new policies and institutions needed to assure electric reliability are not yet in place. Until such policies and institutions are in place, substantial parts of North America will be exposed to unacceptable risk.¹¹

Those words were written more than five years ago by the task force that investigated the major regional blackouts that occurred in the summer of 1996.¹² The report concluded that the 1996 blackouts were caused by violations of voluntary reliability standards and poor vegetation management.¹³ The report recommended a host of actions, including the enactment of legislation to provide for enforcement of mandatory reliability standards.¹⁴

11. SEC'Y OF ENERGY ADVISORY BD., U.S. DEP'T OF ENERGY, *Preface to MAINTAINING RELIABILITY IN A COMPETITIVE U.S. ELECTRICITY INDUSTRY: FINAL REPORT OF THE TASK FORCE ON ELECTRIC SYSTEM RELIABILITY*, at vii (1998) [hereinafter *MAINTAINING RELIABILITY*], available at <http://www.seab.energy.gov/publications/esrfinal.pdf> (last visited Nov. 9, 2004).

12. *Id.* at ix-x.

13. *Id.* at xi, 1, 25, 58, 95.

14. *Id.* at 25-27.

Unfortunately, very few of the recommendations were actually implemented.¹⁵ It is remarkable how little progress has been made towards improved reliability in the past five years.

In August 2003, we experienced the largest blackout in this country's history.¹⁶ While the final report of the U.S.-Canada Power System Outage Task Force has not yet been released,¹⁷ the causes of the blackout are all too familiar: multiple violations of voluntary reliability standards and poor vegetation management.¹⁸ There were also significant failures in the area of operator training.¹⁹

III. ENFORCEABLE RELIABILITY STANDARDS

One of the recommendations of the task force that investigated the 1996 regional blackouts was that “[r]eliability standards must be clear, transparent, nondiscriminatory, enforceable, and enforced. Compliance must be mandatory for *all* entities using the bulk-power system.”²⁰ These words sound very familiar. In fact, the last three major regional blackouts in this country—the July 1996, August 1996, and August 2003 blackouts—were all caused in part by violations of voluntary reliability standards.²¹ The enforcement of reliability standards is absolutely essential. I do not know how many times we have to learn the same lesson before we make compliance mandatory.

For many years, the industry has relied on voluntary compliance to assure reliability.²² Self-reporting of violations has been a signal failure. Some utilities either do not report violations or re-

15. U.S.-CANADA POWER SYS. OUTAGE TASK FORCE, FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT IN THE UNITED STATES AND CANADA: CAUSES AND RECOMMENDATIONS 139 (2004) [hereinafter FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT], available at <https://reports.energy.gov/BlackoutFinal-web.pdf> (last visited Nov. 9, 2004).

16. John J. Fialka, *Task Force Reports Several Events Led to Worst Blackout*, WALL ST. J., Sept. 15, 2003, at A5; see also FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 179.

17. The final report of the task force was issued on April 5, 2004, three days after the Commissioner's speech.

18. FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 17–22.

19. *Id.* at 156–57.

20. MAINTAINING RELIABILITY, *supra* note 11, at xi.

21. See *Examples of Major Power Outages*, *supra* note 7.

22. FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 21.

port that they are never in violation. Others conscientiously report every minor technical violation.²³ Regional reliability councils can convert general standards proposed by the North American Electric Reliability Council ("NERC").²⁴ Some regions convert a general standard into something tough, resulting in frequent violations, while other regions convert the NERC standard into something so vague that it is almost never violated.²⁵

There are legitimate concerns about whether existing reliability standards are clear enough to be fairly enforced. Let me just say that to the extent that existing reliability standards are not clear, they have been unclear for many years. I must admit to some frustration on this point. For at least five years, the path to enforcement of reliability standards has been well defined. There has been virtual unanimity around the proposal that a self-regulatory organization should be certified by the Commission to develop reliability standards that would ultimately be enforced by the Commission.²⁶ After certification, the self-regulatory organization would submit whatever standards then existed for approval by the Commission.²⁷ Congress has been considering electricity reliability legislation since 1999.²⁸ Frankly, I am dismayed that so little effort has been expended over the past five years on making existing reliability standards clear enough to be fairly enforced.

Let me briefly review the recent history of self-reporting of reliability violations. According to NERC, utilities self-reported 541 violations of reliability standards in 2002,²⁹ 1,967 violations in 2001,³⁰ 683 violations in 2000,³¹ and 496 violations in 1999.³² It is

23. See, e.g., N. AM. ELEC. RELIABILITY COUNCIL, 2002 NERC COMPLIANCE ENFORCEMENT PROGRAM 3, 11 (2003) [hereinafter 2002 NERC COMPLIANCE ENFORCEMENT PROGRAM], available at ftp://www.nerc.com/pub/sys/all_updl/compliance/2002_NERC_Compliance_Report.pdf (last visited Nov. 9, 2004).

24. FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 10–11.

25. See *id.* at 21–22.

26. See, e.g., Order on a Standards Development Organization for the Wholesale Electric Industry, [Apr.–Jun. 2002 Transfer Binder] 99 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,171 (May 16, 2002).

27. E.g., Energy Policy Act of 2004, H.R. 4503, 108th Cong. § 1211 (2004); Energy Policy Act of 2003, S. 2095, 108th Cong. § 1211 (2004).

28. See THE CHANGING STRUCTURE, *supra* note 9, at app. C.

29. 2002 NERC COMPLIANCE ENFORCEMENT PROGRAM, *supra* note 23, at 9.

30. N. AM. ELEC. RELIABILITY COUNCIL, 2001 NERC COMPLIANCE ENFORCEMENT PROGRAM 13 (2002), available at [https://www.npcc.org/PublicFiles/Compliance/NPCC Compliance/Archives/Final2001NERCComplianceReport.pdf](https://www.npcc.org/PublicFiles/Compliance/NPCC%20Compliance/Archives/Final2001NERCComplianceReport.pdf) (last visited Nov. 9, 2004).

difficult to draw conclusions from those numbers, other than that they are pretty large. Some utilities never self-report violations, while others report everything that might constitute technical violations of vague standards.³³ For that reason, it is impossible to determine what the number of violations might be if reliability standards were clear and enforceable. The true number may be higher; it may be lower.

Continued reliance on voluntary compliance with unenforceable standards is no longer sufficient. There is no public confidence in a regime that relies on voluntary compliance, and where the reporting parties have complete discretion to determine whether they have to report violations.

Before we can have enforceable reliability standards, we need standards that are clear enough to be enforced. Due process concerns can arise from enforcement of standards that do not put parties on notice of what constitutes a violation.

Progress is finally being made to make reliability standards clear enough to be enforced. I commend NERC and the industry for their efforts in this regard and urge them to do everything they can to complete this process as soon as possible.

In order to enforce reliability standards, you also need an enforcer. In my view, enforcement is inherently a governmental function. The pending legislation would grant an electric reliability organization the ability to impose penalties for violations of reliability standards.³⁴ However, any such penalties would be subject to review by the Commission, and the Commission would retain the authority to impose penalties directly.³⁵ The Commission is prepared to assume that responsibility and recognizes that regulatory oversight is necessary to ensure compliance.³⁶

31. N. AM. ELEC. RELIABILITY COUNCIL, 2000 NERC COMPLIANCE ENFORCEMENT PROGRAM 12 (2000), available at ftp://ftp.nerc.com/pub/sys/all_updl/compliance/2000_Compliance_Report.pdf (last visited Nov. 9, 2004).

32. *Id.*

33. See, e.g., 2002 NERC COMPLIANCE ENFORCEMENT PROGRAM, *supra* note 23, at 9–11.

34. Energy Policy Act of 2004, H.R. 4503, 108th Cong. § 1211 (2004); S. 2095, 108th Cong. § 1211 (2004).

35. *Id.*

36. See generally MAINTAINING RELIABILITY, *supra* note 11, at xi.

Currently, Commission staff are participating in NERC readiness audits to determine whether control areas and reliability coordinators are able to comply with NERC reliability standards and are capable of reliably operating the grid.³⁷ At the completion of these audits, the Commission plans to hold a conference to determine what was learned.³⁸

The pending energy legislation is silent on the penalties that could be imposed in the event of violations.³⁹ Some have argued there is no need for monetary sanctions because peer pressure will suffice to ensure compliance.⁴⁰ I disagree strongly with that point of view. If peer pressure were sufficient, then there would be no need to enforce reliability standards. If the past three regional blackouts have taught us anything, it is that peer pressure is not enough. I do not know what the right penalties will be for violations of reliability standards, but I suspect a range of penalties for violations of varying significance would be appropriate. Monetary penalties are a common means of enforcement in other regulatory contexts⁴¹ and should be one of the penalties available to the Commission. In addition, violations should be reported to the Commission, and significant violations should be publicly disclosed.

There is a great deal of concern over what might happen in the event the Senate fails to pass the energy legislation. While I am optimistic the legislation will be enacted, it is possible the Senate will fail to act. That raises the question of whether the Commission can take any steps to encourage or require compliance with reliability standards. The Commission is reviewing its legal authority to determine just what options are available.

37. N. Am. Elec. Reliability Council, Readiness Audit Program, at <http://www.nerc.com/~rap> (last visited Nov. 9, 2004) ("The audits will be conducted on a three-year cycle; approximately fifty readiness audits will be completed by the end of 2004.")

38. The Commission held a technical conference on reliability readiness reviews on September 29, 2004. The details of the conference can be accessed at <http://www.ferc.gov> on the September 2004 Monthly Calendar webpage (last visited Nov. 9, 2004).

39. See Energy Policy Act of 2004, H.R. 4503, 108th Cong. (2004); S. 2095, 108th Cong. (2004).

40. See, e.g., *Who's in Charge Here? Industry, FERC, NERC, Pick Their Way Through Reliability Questions*, POWER MAG., Feb. 11, 2004, available at http://www.platts.com/Magazines/POWER/Power%20News/2004/021104_14.xml (last visited Nov. 7, 2004); FacilitiesNet, *FERC, Utilities Head for Court Clash on Rules to Avoid Blackouts*, at <http://www.facilities.net.com/news/Jan30news1.shtml> (last visited Nov. 9, 2004).

41. E.g., Securities Exchange Act of 1934 §§ 21, 21A, 21B, 15 U.S.C. §§ 78u, 78u-1, 78u-2 (2000); Commodity Exchange Act § 6(c), 7 U.S.C. § 9 (2000).

There has also been a great deal of interest in what the relationship would be between the Commission and the self-regulatory organization, the electric reliability organization. I would expect the relationship would operate much as the model it is based on—the self-regulatory organization model in the Securities Exchange Act of 1934.⁴² The relationship between the Securities and Exchange Commission (“SEC”) and the securities exchanges has not been a constant one; it waxes and wanes, depending on the level of confidence the SEC has in the various exchanges.⁴³ I would observe that today the SEC probably has much less confidence in the New York Stock Exchange than in the past, and appropriately gives greater scrutiny to decisions made by the Exchange.

IV. VEGETATION MANAGEMENT

There is an urgent need for clear standards with respect to vegetation management. Contact between trees and power lines was a principal cause of not only the August 2003 blackout, but also the July 1996 and August 1996 blackouts.⁴⁴ They are also the single largest cause of distribution blackouts.⁴⁵

A recent report prepared for the Commission concluded that “[t]he current set of industry rules . . . are [sic] not explicit enough to ensure that utilities will strive toward the elimination of [contact between trees and power lines].”⁴⁶ In fact, the current standard is so vague that it could be argued there is no vegetation management standard at all.⁴⁷ It is clear there is a need to ensure development and enforcement of clear and consistent vegetation management standards.

42. Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78s (2000).

43. See Susanne Craig & Kate Kelly, *Weakened NYSE Must Face Challenges, SEC Is Investigating Governance, and Rivals May Seek to Capitalize; Delicate Framework in Question*, WALL ST. J., Sept. 18, 2003, at C1, 13.

44. *Examples of Major Power Outages*, *supra* note 7.

45. FED. ENERGY REGULATORY COMM’N, *Executive Summary to UTILITY VEGETATION MANAGEMENT FINAL REPORT 1* (2004), available at <http://www.ferc.gov/cust-protect/moi/uvm-final-report.pdf> (last visited Nov. 9, 2004).

46. *Id.* at 67.

47. See *id.* at 2, 8–11.

Since contact between trees and both distribution and transmission facilities is a common problem, I propose we develop a common solution through collaboration between federal and state regulators. Under the Act, the Commission has the authority to establish joint boards composed of federal and state representatives to develop solutions to problems in areas of mixed jurisdiction.⁴⁸ I believe we should establish one or more joint boards to develop a common vegetation management standard for distribution and transmission facilities that could be adopted and enforced at both the federal and state levels.

V. OPERATOR TRAINING

Significant failures in operator training played a major role in the August 2003 blackout. Operators at FirstEnergy were determined to have poor situational awareness and misdiagnosed the problems as they arose. In part, those failures were the result of poor training.⁴⁹ FirstEnergy relied heavily on on-the-job training for its operators, and that approach proved inadequate when operators were presented with a situation they had never experienced before.⁵⁰

This is an area where we could learn from the experience of the nuclear industry. In the nuclear industry, control rooms are not standardized; the same is true for grid control centers.⁵¹ For that reason, nuclear operators are licensed for a particular control room.⁵² Perhaps we should do the same in the electricity industry.

Operators in the nuclear industry are also required to spend a great deal of time in simulators, testing their ability to react to unanticipated situations.⁵³ This testing is designed to improve the ability of operators to quickly and correctly diagnose a situation, in order to avoid the failures of FirstEnergy operators.

48. 16 U.S.C. § 824h (2000); *see also* FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 20–21.

49. FINAL REPORT ON THE AUGUST 14, 2003 BLACKOUT, *supra* note 15, at 157.

50. *See id.*

51. *See, e.g.*, Nuclear Regulatory Commission Regulations, 10 C.F.R. §§ 50.40, 50.120, App. M & N to pt. 50 (2004).

52. *Id.* § 55.53(b)–(c).

53. *See id.* §§ 55.31, 55.45–46.

In the nuclear industry, the Atomic Energy Act of 1954 requires that operators be licensed directly by the Nuclear Regulatory Commission ("NRC").⁵⁴ The NRC has the authority to revoke operator licenses for violations of the Atomic Energy Act or whenever it "deems such action desirable."⁵⁵ Significantly, the NRC has revoked operator licenses, and done so frequently.⁵⁶ I believe a grid operator should have his or her license revoked under similar circumstances.

At the Commission's reliability conference last December, we learned that an operator license issued by NERC does not actually represent that an operator is ready to go into a control room and manage system operations. In fact, a NERC license is probably closer to a learner's permit than a driver's license. I believe the licensing process should be more rigorous. In my view, a license should not be granted until an individual is competent to conduct system operations.

VI. NEED FOR GREATER INVESTMENT IN THE TRANSMISSION GRID

Enforcement of reliability standards, improved vegetation management, and improved operator training are all necessary conditions to assure reliability, but they are not sufficient by themselves. We also need a more robust grid.

Expansion of the transmission grid is needed not only to assure reliability but also to provide a foundation for effective competition in wholesale power markets. As I noted earlier, investment in the transmission grid has been stagnant.⁵⁷ To be precise, according to the State of the Markets Report prepared by Commission staff, transmission investment in circuit miles grew less than 0.5 percent annually between 1998 and 2001.⁵⁸

54. Atomic Energy Act of 1954 § 107, 42 U.S.C. § 2137 (2000).

55. *Id.*

56. See, e.g., U.S. NUCLEAR REGULATORY COMM'N, ENFORCEMENT PROGRAM ANNUAL REPORT: FISCAL YEAR 2003, at xii, 20 (2003), available at <http://www.nrc.gov/reading-rm/doc-collections/enforcement/annual-rpts/03report.pdf> (last visited Nov. 9, 2004). Enforcement programs for fiscal years 1998–2002 are also available at <http://www.nrc.gov/reading-rm/doc-collections/enforcement/annual-rpts> (last visited Nov. 9, 2004).

57. See STATE OF THE MARKETS REPORT, *supra* note 2, at 72–73.

58. *Id.*

I believe the Commission should promote greater investment in the transmission grid. In January 2003, the Commission issued a proposed policy statement designed to encourage grid investment.⁵⁹ Although the policy statement has not yet been finalized, some of the principles in the policy statement have been incorporated into orders.⁶⁰ Granting higher rates of return may indeed induce greater transmission investment.

Encouraging the development of transmission companies ("transcos") may also result in increased grid investment. A recent comparison of the capital expenditures of three transcos indicates that transcos invest five times as much into transmission expansion and upgrades as vertically integrated utilities.⁶¹ That suggests transcos may be a superior vehicle to secure investment in transmission expansion.

For that reason, I would like to see the development of larger transcos. Some of the transcos in the Midwest are small, representing the spinoff of the transmission assets of an individual utility.⁶² However, the development of large transcos is unlikely to occur solely through cash transactions.⁶³ Large transcos may develop through the transfer of transmission assets accompanied by the retention of passive ownership interests, or through the lease of transmission assets.⁶⁴

59. Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid, 68 Fed. Reg. 3842 (proposed Jan. 27, 2003) (to be codified at 18 C.F.R. pt. 35).

60. See, e.g., Am. Transmission Co. and Midwest Indep. Transmission Sys. Operator, Inc., [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,117 (May 6, 2004); ISO New Eng. Inc., [Jan.–Mar. 2004 Transfer Binder] 106 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,280 (Mar. 24, 2004); Mich. Elec. Transmission Co., [Oct.–Dec. 2003 Transfer Binder] 105 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,214 (Nov. 17, 2003); PJM Interconnection, LLC, [July–Sept. 2003 Transfer Binder] 104 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,124 (July 24, 2003).

61. The five to one ratio is based on an analysis by Commission staff of reported capital expenditures of American Transmission Company, International Transmission Company and National Grid Company compared to their predecessors and the U.S. average.

62. STATE OF THE MARKETS REPORT, *supra* note 2, at 6.

63. Comments of National Grid USA on FERC Proposed Pricing Policy for Efficient Operations and Expansion of Transmission Grid 5 (March 13, 2003) [hereinafter *Comments of National Grid USA*] (on file in FERC Rulemaking docket no. PL03-1-000), available at http://elibrary.ferc.gov/idmws/file_list.asp?document_id=4083124 (last visited Nov. 9, 2004). The proposed pricing policy can be found at 68 Fed. Reg. 3842 (Jan. 27, 2003).

64. See *Comments of National Grid USA*, *supra* note 63, at 7–12.

The reality is that for some time we will have both organized and nonorganized wholesale power markets.⁶⁵ For that reason, the Commission's policies designed to encourage grid investment should not be rooted in an assumption that organized markets will be established in all regional power markets in the near future. To date, transco development has been limited to the organized markets.⁶⁶ I would like to see transco development in nonorganized markets as well.

Until transcos develop more fully, vertically integrated utilities will continue to account for the bulk of transmission investment.⁶⁷ The prospect for grid investment by merchant transmission companies appears to be quite limited. Since 2000, the Commission has approved eight merchant transmission projects.⁶⁸ Of those eight projects, only one is operating, the Cross Sound Cable project between Long Island and Connecticut, and that project is operating under emergency orders issued by the Secretary of Energy.⁶⁹ One merchant project was withdrawn due to market uncertainties.⁷⁰ None of the remaining six projects have begun construction, and they are on hold for various reasons.⁷¹

At this point, I am not convinced that vertical integration is the primary barrier to investment in transmission capacity. If it were, we would expect to see significant differences in transmis-

65. See STATE OF THE MARKETS REPORT, *supra* note 2, at 8–9.

66. See *id.*

67. See *id.* at 20–28.

68. See *id.* at 72.

69. U.S. Dep't of Energy Order No. 202-02-01 (Aug. 16, 2002), available at <http://www.energy.gov/engine/doe/files/import/OrderNo202-02-1.pdf> (last visited Nov. 9, 2004); U.S. Dep't of Energy Order No. 202-03-2 (Aug. 28, 2003), available at http://www.energy.gov/engine/content.do?PUBLIC_ID=14068&BT_CODE=PR_PRESSRELEASES&TT_CODE=PRESSRELEASE (last visited Nov. 9, 2004). The emergency order has since been rescinded, U.S. Dep't of Energy Order No. 202-03-4 (May 7, 2004), available at http://www.energy.gov/engine/content.do?PUBLIC_ID=15821&BT_CODE=PR_PRESSRELEASES&TT_CODE=PRESSRELEASES (last visited Nov. 9, 2004), and the project is now operating under a settlement agreement. Order Approving Uncontested Settlement, [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,258 (June 4, 2004).

70. *Letter Order Accepting Withdrawal of Filing, Northeast Utilities Service Company* (FERC Docket No. ER01-2584), March 12, 2003, available at http://elibrary.ferc.gov/idmws/File_list.asp?document_id=4082324 (last visited Nov. 9, 2004).

71. See Neptune Regional Transmission System, LLC, FERC Docket No. ER01-2099; TransCanada Energy Ltd., FERC Docket No. ER02-2389; TransEnergie U.S., Ltd., FERC Docket No. ER02-406; TransEnergie U.S., Ltd., FERC Docket No. ER02-252; Chesapeake Transmission, LLC, FERC Docket No. ER03-1311; Conjunction LLC, FERC Docket No. ER03-452.

sion investment behavior between regions where most of the generation has been divested—New York, New England, and California—and those where vertical integration continues to be the norm. To my knowledge, there is no evidence that transmission investment is more robust in the former areas.

I also believe the Commission should explore adopting performance-based regulatory mechanisms for transmission pricing in order to encourage more efficient transmission operations. Higher returns may encourage additional grid investment, but allowing the transmission operator to retain a portion of the savings realized by efficiency gains may encourage more efficient operations, including the deployment of new technology. That is true whether the transmission operator is a transco or a vertically integrated utility. Performance-based rates have succeeded in other contexts and may better match the economic realities of transmission investment than other financing schemes.⁷² Although the Commission has had a performance-based rate policy statement since 1992,⁷³ to my knowledge no applications have been filed. I would encourage some brave soul to apply.

VII. PROMOTING COMPETITIVE WHOLESALE POWER MARKETS

Let me now turn to the Commission's role in promoting competitive wholesale power markets. I will start with the threshold question of whether the Commission should promote competitive wholesale markets in the first place.

Over the past few years, there has been significant criticism of the Commission for promoting "deregulation."⁷⁴ I think that criticism entirely misses the mark. To my mind, "deregulation" suggests the absence of regulation, the absence of rules. However, the reality is that all markets in this country operate under some kind of rules, whether they are established by an economic regu-

72. Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801, 801-02 (1999) (reviewing J. GREGORY SIDAK & DANIEL F. SPULBER, *DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES* (1997)).

73. Policy Statement on Incentive Regulation, [Oct.-Dec. 1992 Transfer Binder] 61 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,168 (Oct. 30, 1992).

74. See, e.g., MARK COOPER, CONSUMER FED'N OF AM., *ALL PAIN, NO GAIN: RESTRUCTURING AND DEREGULATION IN THE INTERSTATE ELECTRICITY MARKET* (2002), available at <http://www.consumerfed.org/allpain.pdf> (last visited Nov. 9, 2004).

latory body or imposed under antitrust law. The Microsoft litigation shows that even the "New Economy" is subject to rules.⁷⁵ To my knowledge, there is only one exception: major league baseball, which is not subject to regulation and is exempt from antitrust law.⁷⁶ As a Yankee fan by birth, that may not be a bad thing.

To my mind, the policy objective was never deregulation. It was lowering electricity prices by promoting competition among power producers.⁷⁷ By that standard, there has been some solid success.⁷⁸ Unfortunately, this success has been eclipsed by the spectacular failures of California and Enron.⁷⁹

There has been criticism of the Commission for promoting competitive electricity markets. At times, the criticism suggests that competition is some new-fangled theory the Commission developed, and faults the agency for experimenting on the country with its pet theory.⁸⁰ Again, I think this criticism entirely misses the mark. In fact, it is inexplicable. It was Congress that introduced competition in wholesale power markets, not the Commission. And it did so twenty-five years ago with the enactment of the Public Utility Regulatory Policies Act ("PURPA") of 1978.⁸¹ It was Congress that first recognized the linkage between effective competition and open access. Both PURPA and the Energy Policy Act of 1992 included open access provisions.⁸²

In fact, competition has roots in federal electricity law that can be traced back to the 1930s. Federal court decisions reviewing constitutional challenges to the enactment of the Tennessee Valley Authority Act of 1933 and the Rural Electrification Act of 1935 concluded that investor-owned utilities had no constitu-

75. See *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000), *aff'd in part and rev'd in part*, 253 F.3d 34 (D.C. Cir. 2001).

76. See *Fed. Base Ball Club of Balt., Inc. v. Nat'l League of Prof'l Base Ball Clubs*, 259 U.S. 200, 208-09 (1922).

77. See *Policy Statement on Incentive Regulation*, *supra* note 73.

78. STATE OF THE MARKETS REPORT, *supra* note 2, at 76.

79. See *infra* note 91 and accompanying text.

80. See COOPER, *supra* note 74, at 7.

81. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified at 16 U.S.C. §§ 2601-2644 (2000)).

82. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, § 203, 92 Stat. 3117, 3136 (1978) (codified at 16 U.S.C. § 824j (2000)); Energy Policy Act of 1992, Pub. L. No. 102-486, § 721, 106 Stat. 2776, 2915 (1992) (codified at 16 U.S.C. § 824j (2000)).

tional right to be free from competition.⁸³ So, competition has been a part of federal electricity policy from the very beginning.

Some perceive that the pending energy legislation somehow marks a retreat from this longstanding federal policy promoting competitive electricity markets.⁸⁴ I dispute that notion. The bill expressly states it is designed to “promote fair, open access to electric transmission service” and “facilitate wholesale competition.”⁸⁵ The bill promotes open access by granting the Commission additional authority over the unregulated utilities that own a third of the interstate transmission grid.⁸⁶ Siting provisions were included because of congressional concerns that transmission bottlenecks were affecting interstate commerce in electricity.⁸⁷ Market manipulation provisions were included to make wholesale markets operate effectively.⁸⁸

Some have observed that Congress is divided on electricity policy issues.⁸⁹ I do not believe, however, that Congress is divided on the central question of whether we should continue to rely on competition in wholesale power markets.

Unless Congress fundamentally changes federal electricity law in a way not envisioned by the pending energy legislation, the Commission will continue to have a legal duty to ensure that wholesale power markets are effectively competitive, in order to assure just and reasonable prices.⁹⁰

Since it is clear the Commission has a duty to promote competitive wholesale power markets, the question turns to what steps the Commission can take to promote competitive markets. Development of the Commission’s policy initiatives has been made im-

83. *Tenn. Elec. Power Co. v. Tenn. Valley Auth.*, 306 U.S. 118, 143–44 (1939); *Ala. Power Co. v. Ickes*, 302 U.S. 464, 478–81 (1938); *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 339 (1936).

84. *E.g.*, Joel Connelly, *In the Northwest: The Energy Bill Would Be a Hoot if it Wasn't so Sad*, SEATTLE POST-INTELLIGENCER, Nov. 21, 2003, at A2; Editorial, *Depleted Energy*, WASH. POST, Nov. 18, 2003, at A24.

85. Energy Policy Act of 2004, H.R. 4503, 108th Cong. § 1232.

86. *Id.* § 1231.

87. *Id.* § 1221.

88. *Id.* § 1282.

89. *See e.g.*, 150 CONG. REC. S6252 (daily ed. May 21, 2004) (statement of Sen. Domenici).

90. Federal Power Act §§ 205–206, 16 U.S.C. §§ 824d–824e (2000); *see, e.g.*, *Consol. Edison Co. of N.Y. v. FERC*, 347 F.3d 964, 967 (D.C. Cir. 2003).

measurably more difficult by some of the events that have occurred since 1999: namely the California electricity crisis,⁹¹ the collapse of Enron, the subsequent capital crisis facing independent power producers,⁹² and the largest blackout in the history of the country.⁹³

The development of policies designed to promote competition in wholesale power markets is complicated by the nature of our wholesale power markets. The United States does not have a national wholesale power market. Our markets are regional in nature, and there are significant differences among these regional markets.⁹⁴ One of the most significant differences is with respect to structure.⁹⁵ Regional markets in the Northeast, California, and Texas are organized markets, and the Midwest and Southwest Power Pool are moving towards organized markets.⁹⁶ There are significant differences in the rules of the organized markets.⁹⁷ The rest of the regional markets are bilateral markets.⁹⁸

The Commission has been promoting development of regional transmission organizations for a number of years,⁹⁹ and there has been substantial progress. However, the reality is that for some time we will have both organized and bilateral wholesale power markets. That reality will influence Commission policies, and the challenge will be to develop policies that assure effective competition in both organized and bilateral markets.

As I noted earlier, while electricity markets have changed dramatically, the Act has remained largely the same. Ever since 1935, the Commission has had a legal duty to prevent unjust and unreasonable rates;¹⁰⁰ a legal duty to prevent undue discrimina-

91. See generally FED. ENERGY REGULATORY COMM'N, STAFF REPORT TO THE FEDERAL ENERGY REGULATORY COMMISSION ON WESTERN MARKETS AND THE CAUSES OF THE SUMMER 2000 PRICE ABNORMALITIES (2000) (discussing factors affecting electric energy or reliability of service in California and the Western region), available at <http://www.ferc.gov/legal/ferc-regs/land-docs/frontmatter.pdf> (last visited Nov. 9, 2004).

92. See STATE OF THE MARKETS REPORT, *supra* note 2, at 74–76.

93. See *supra* note 16 and accompanying text.

94. See THE CHANGING STRUCTURE, *supra* note 9, at 6–9.

95. See *id.* at 6–9, 17–58.

96. See *id.* at 6.

97. See *id.* at 56–58.

98. See *id.* at 6.

99. See, e.g., Regional Transmission Organizations, 65 Fed. Reg. 12,088 (Mar. 8, 2000) (to be codified at 18 C.F.R. pt. 35).

100. Federal Power Act of 1935 § 205, 16 U.S.C. § 824d (2000).

tion or preference;¹⁰¹ and a legal duty to assure that any disposition of jurisdictional facilities is in the public interest.¹⁰²

Any actions the Commission takes to promote competitive wholesale power markets must be guided by these legal duties. By the same token, Commission policies are limited by the legal authorities granted by Congress, since the Commission has only those tools Congress has chosen to grant it.¹⁰³

The Commission has a legal duty to prevent unjust and unreasonable rates in the sale of wholesale power by jurisdictional sellers.¹⁰⁴ The courts have determined that an unjust and unreasonable rate is a rate that falls outside the “zone of reasonableness,” which is bounded by monopoly rents on the high side and confiscatory prices on the low side.¹⁰⁵

Historically, the Commission has discharged this legal duty by directly setting rates for individual sellers, typically setting a cost-based rate that allows for cost recovery plus a regulated profit margin.¹⁰⁶ The task is more difficult in the context of competitive markets, where instead of setting a rate the Commission establishes policies that govern all jurisdictional power sellers.

When the Commission establishes price caps, as it has in the organized markets and in the West, it does so in order to prevent wholesale power prices from rising to the level of monopoly rents.¹⁰⁷ When it authorizes capacity payments, it does so to provide generators a reasonable opportunity to make a profit.

It is often overlooked that as a legal matter confiscatory prices—prices so low that they effectively guarantee an investor will never recover his investment—are unjust and unreason-

101. *Id.* §§ 824d(a), e(a).

102. *Id.* § 824b(a).

103. *See* 5 U.S.C. § 706(2)(C) (2000).

104. 16 U.S.C. §§ 824d, 824e (2000).

105. *Pac. Gas & Elec. Co. v. FERC*, 306 F.3d 1112, 1116 (D.C. Cir. 2002) (“Absent procedural or methodological flaws, the court may only set aside a rate that is outside a zone of reasonableness, bounded on one end by investor interest and the other by the public interest against excessive rates.”).

106. *See, e.g., Pub. Util. Dist. No. 1 of Snohomish County v. Dynergy Power Mktg., Inc.*, 384 F.3d 756, 758 (9th Cir. 2004).

107. *See generally* *San Diego Gas & Elec. Co.*, [Apr.–June 2001 Transfer Binder] 95 Fed. Energy Reg. Comm’n Rep. (CCH) ¶ 61,418 (June 19, 2001), *reh’g granted in part* [Oct.–Dec. 2001 Transfer Binder] 97 Fed. Energy Reg. Comm’n Rep. (CCH) ¶ 61,275 (Dec. 19, 2001).

able.¹⁰⁸ The Commission does have a legal duty to develop policies that provide investors in existing power plants an opportunity to recover their investment and a reasonable profit, as well as attract investment in new generation.¹⁰⁹ Some question whether our policies accomplish this objective.

Let me briefly discuss some of the Commission's policy initiatives designed to make wholesale power markets more competitive.

Historically, the role of the Commission has been to set rates.¹¹⁰ Increasingly, that role has changed to one of regulating markets.¹¹¹ That is a very different role. The Commission has struggled valiantly to develop market rules to govern competition in wholesale power markets in a manner consistent with its legal duties under the Act.¹¹²

This effort is most obvious in the organized markets, where spot markets are governed by rules approved by the Commission.¹¹³ In some cases, these rules have not worked well. In a perfect world, flaws in market rules in the organized markets will be swiftly identified, either by the market monitor or through complaints, the regional transmission organization would propose changes to the rules, and the Commission would evaluate the proposal and issue a ruling. There are times when actual experience has fallen short of this ideal.

The need for market rules is not limited to the organized markets, however. For example, there is a need for rules to proscribe market manipulation in both the organized markets and bilateral markets. Markets subject to manipulation cannot operate properly, and there is an urgent need to proscribe manipulation of

108. *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942) ("By long standing usage in the field of rate regulation, the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense.")

109. *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) ("Rates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid . . .").

110. 16 U.S.C. § 824d(a) (2000); *Pub. Util. Dist. No. 1 of Snohomish County*, 384 F.3d at 758.

111. *Pub. Util. Dist. No. 1 of Snohomish County*, 384 F.3d at 760-61.

112. *See, e.g., MCI Telecomms. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218 (1994).

113. *See, e.g., San Diego Gas & Elec. Co.*, [Oct.-Dec. 2000 Transfer Binder] 93 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,121 (Nov. 1, 2000).

electricity markets.¹¹⁴ I believe the Commission has adequate legal authority to determine certain marketing practices to be unjust and unreasonable. To be clear, I have not taken a position on the Market Behavior Rule approved by the Commission in November 2003, which is subject to rehearing, and I cannot discuss the order here today. However, I believe market manipulation must be proscribed.

One area that requires legislative action is the Commission's penalty authority. Unlike other economic regulatory agencies, the Commission lacks civil penalty authority for most violations of the Act.¹¹⁵ Under the Act, civil penalties are limited to violations of provisions added by the Energy Policy Act of 1992, principally the wheeling provision.¹¹⁶ The Commission's limited civil penalty authority is a factor in the negotiation of settlements with parties that have violated the Act.

The Commission's criminal penalty authority is also grossly inadequate. Under the Act, a knowing and willful violation is subject to a maximum penalty of \$500 per day,¹¹⁷ an amount set in 1935.¹¹⁸ I think it unlikely that a criminal penalty capped well below the hourly rate of a self-respecting criminal defense attorney will deter market manipulation.

For that reason, I have long supported legislation to impose tougher civil and criminal penalties. In fact, I supported tougher penalties back in 1998, well before the Enron marketing scandal came to light. To me, it seemed obvious that the feeble civil and criminal penalties in the Act would prove inadequate to deter market manipulation. Unfortunately, I was proven right.

114. See FINAL REPORT ON PRICE MANIPULATION IN WESTERN MARKETS, *supra* note 3; Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, [Oct.–Dec. 2003 Transfer Binder] 105 Fed. Reg. Energy Rep. Comm'n Rep. (CCH) ¶ 61,218 (Nov. 17, 2003), *order on reh'g*, [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,175 (May 19, 2004).

115. U.S. GENERAL ACCOUNTING OFFICE, PUB. NO. GAO-02-656, ENERGY MARKETS: CONCERTED ACTIONS NEEDED BY FERC TO CONFRONT CHALLENGES THAT IMPEDE EFFECTIVE OVERSIGHT 48–49 (2002), available at <http://www.gao.gov/new.items/d02656.pdf> (last visited Nov. 9, 2004).

116. Federal Power Act § 316A, 16 U.S.C. § 825o-1(b) (2000).

117. Federal Power Act § 316(b), 16 U.S.C. § 825o(b) (2000).

118. Public Utility Act of 1935, ch. 687, 49 Stat. 862 (1935).

The Commission also takes steps to prevent the exercise of market power, both horizontal and vertical market power.¹¹⁹ Currently, the Commission allows jurisdictional sellers to charge market-based rates when they demonstrate they lack market power, or to mitigate such market power.¹²⁰ The agency is examining the generation market power test it currently uses in market-based rate applications, the Supply Margin Assessment.¹²¹ The test was announced in November 2001, but was subsequently put in abeyance.¹²² Over seventy utilities have failed the test, but no mitigation has yet been imposed.

One of two things must happen: either the test must be reformed or replaced, or it must be applied, and mitigation imposed on those who fail.¹²³ In January 2004, the Commission held a two-day conference on its generation market power test.¹²⁴ There was a very interesting discussion on how to properly measure generation market power, and what mitigation should be imposed in the event a seller is determined to have generation market power.¹²⁵ Some of the presenters argued that vertical market power is a much more serious concern than horizontal market power.¹²⁶

119. STATE OF THE MARKETS REPORT, *supra* note 2, at 21–22.

120. See *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993); *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990); STATE OF THE MARKETS REPORT, *supra* note 2, at 21–22.

121. See Notice of Technical Conference on Supply Margin Assessment Screen and Alternative, 68 Fed. Reg. 75,229 (Dec. 30, 2003); Before Commissioners: Conference on Supply Margin Assessment, AEP Power Marketing, Inc., AEP Service, Corporation, West Services, Inc., Entergy Services, Inc., Southern Company Energy Marketing L.P., Supplemented Notice of Technical Conference on Supply Margin Assessment Screen and Alternatives, 69 Fed. Reg. 2591 (Jan. 16, 2004).

122. Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy, [Oct.–Dec. 2001 Transfer Binder] 97 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,219 (Nov. 20, 2001) [hereinafter "SMA order"]. On December 20, 2001, the Commission issued a *Notice Delaying Effective Date of Mitigation and Announcing Technical Conference*, which deferred the date by which companies were required to implement mitigation for spot market energy sales required by the SMA order.

123. On April 14, 2004, the Commission issued an order on rehearing that modified the generation market power analysis and mitigation policy set forth in the SMA order. Order on Rehearing and Modifying Interim Generation Market Power Analysis and Mitigation Policy, [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,018 (Apr. 14, 2004).

124. Conference on Supply Margin Assessment, 69 Fed. Reg. 2591 (Jan. 16, 2004); Notice of Technical Conference on Supply Margin Assessment Screen and Alternatives, 68 Fed. Reg. 75,229 (Dec. 30, 2003).

125. Transcript of FERC Technical Conference in the Matter of Supply Margin Assessment, Docket No. PL02-8-000, at 7–25, 54–55.

126. *Id.* at 86–92 (presentation of Steven Cornelli).

There may be a broader initiative later this year that looks at both horizontal and vertical market power issues.¹²⁷

The Commission also considers generation market power issues when it reviews proposals by vertically integrated utilities to acquire the generation assets of financially distressed independent power producers. The Commission has great respect for the decisions of states when it comes to the need by a state-regulated utility for new electricity supply. However, if a vertically integrated utility proposes to acquire a power plant from a financially distressed independent, the Commission has a legal duty under the Act to review the impact of the acquisition on competitive markets.¹²⁸ The Commission cannot waive this legal duty. If an acquisition has a negative impact on competitive markets, that does not mean the transaction will necessarily be disapproved; the negative impact may be mitigated through conditions.¹²⁹

If a vertically integrated utility proposes to buy power from an affiliate, that sale is also subject to review by the Commission. The Commission has a legal duty under the Act to assure that there is no abuse of self-dealing, and that there is no undue discrimination or preference.¹³⁰ Again, the Commission cannot waive this legal duty.

There is a perception that the Commission is unalterably opposed to these acquisitions. That perception is simply incorrect. If the Commission were unalterably opposed to these transactions, it would have uniformly rejected utility applications to acquire independent generation. It has not done so.¹³¹

127. See Initiation of Rulemaking Proceeding on Market-Based Rates and Notice of Technical Conference, [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,019 (Apr. 14, 2004).

128. Federal Power Act § 203, 16 U.S.C. § 824b (2000); Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act; Policy Statement, 61 Fed. Reg. 68,595, 68,596 (Dec. 30 1996).

129. Ameren Energy Generating Co., [July–Sep. 2004 Transfer Binder] 108 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,081 (July 29, 2004).

130. Federal Power Act §§ 205–206, 16 U.S.C. §§ 824d–824e (2000).

131. Ameren Corp., [July–Sep. 2004 Transfer Binder] 108 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,094 (July 29, 2004); Oklahoma Gas & Elec. Co., [July–Sep. 2004 Transfer Binder] 108 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,004 (July 2, 2004); Puget Sound Energy, Inc., [Apr.–June 2004 Transfer Binder] 107 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,082 (Apr. 23, 2004); S. Cal. Edison Co., [Jan.–Mar. 2004 Transfer Binder] 106 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,183 (Feb. 25, 2004); Cinergy Services, Inc., [Jan.–Mar. 2003 Transfer Binder] 102 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,128 (Feb. 4,

VIII. FEDERAL AND STATE RELATIONSHIP

I would like to briefly touch on the relationship between federal and state regulators. Richmond is probably the perfect setting for such a discussion. I recognize the difference between the electricity regulatory regime and other energy regulatory regimes. In other regimes, such as nuclear regulation, there is no state role—states are completely preempted.¹³² Electricity regulation is different. The electricity regulatory scheme is federalist in nature, and the state role is very important. Thomas Jefferson would probably have approved of our electricity regulation scheme; Alexander Hamilton would likely have preferred the nuclear regulatory scheme.

I respect the important role of the states in electricity regulation. The division of labor between the federal government and the states in the area of electricity regulation is defined in the Act. States are granted jurisdiction over retail sales and local distribution, while the Commission is granted authority over wholesale power sales and the interstate transmission grid.¹³³ I think the boundaries established by the Act still work today.

On occasion, there will be conflict between federal and state regulators.¹³⁴ I think it will not be common; rather, it will be the exception to the norm, although probably inevitable. Our legal duties are different, and the customers we are charged by law to protect are different. When there is conflict, I would like to think it is because of the conflict between our legal duties, not any other reason.

2003).

132. See, e.g., *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190 (1983).

133. Federal Power Act, § 201(a)–(b), 16 U.S.C. §§ 824a–b (2000).

134. See Frank A. Wolak, *The Crisis in Electricity Re-Structuring (And How to Fix It)*, at <http://www-hoover.stanford.edu/research/conferences/calelectricity/wolakslides2.pdf> (last visited Nov. 9, 2004).