

**The
Energy Bar Association
Fifty-Seventh Annual Meeting**

**Remarks by
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Federal Energy Regulatory Commission**

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Good Morning. It is my honor to have the opportunity to give the keynote address at this gathering of distinguished friends and fellow lawyers.

Keynote address! That sounds important. I thought, wow, I am really honored to have this opportunity. You know, Mike Stosser called to invite me to do this, and I thought EBA must know something I don't know about my quest for re-appointment. Why would Stosser invite me when my term expires in 60 days? Maybe the collective wisdom within EBA is that I'll get re-appointed! That's encouraging, I thought. They figure I'll be around for another five years, and they want to engratiate themselves.

Then I thought, no, they actually think I don't have a chance. This invitation is more like a pity dance at the senior prom, or one more trot around the track before the old nag is put out to pasture.

The Commission has been restructuring something the entire time I've been at FERC. In fact, at my first Senate confirmation hearing ten years ago, virtually all of the questions from Senators were about Order No. 636. We were peppered by questions about SFV rate design and small customer protection.

Now, of course, the hard political issues are arising in the debate over electric restructuring. And it's much tougher. The bulk of the assets are in retail rates under state control, yet markets are regional. The entire 6.5 gigawatt grid of the Eastern Interconnection operates as one big machine. The physics of the grid mean that a wholesale transaction in Pennsylvania can create congestion 1000 miles away in Missouri. That congestion has economic and reliability

consequences. In an interstate market, interstate institutions are necessary to manage these problems. Yet, they can't be successfully created without state cooperation, and states want to be persuaded that these new institutions will provide value to their retail consumers. This is the thorny problem we have been working through for the past 3 ½ years, ever since Order No. 2000 was issued in December, 1999.

All over the country, producers and transporters of energy want federal and state policies that encourage investment in critical infrastructure such as production wells, pipelines, high voltage electric transmission capacity, electric generation, and demand resources. Customers want the same things, plus assurances of reliability and reasonable prices. All seem to want a level playing field where everyone gets fair treatment. State regulators want their views respected. They want to be co-equal partners in regulatory policy, and they insist on being in charge of ensuring reasonable prices and fair treatment for end use consumers of natural gas and electricity.

My fellow Commissioners and I agree with all of these goals and we hope that it has been clear to you that we are working to achieve them.

Broadly stated, the Commission's mission is to make electricity and natural gas markets work for consumers. This has required a steady evolution of Federal regulatory policies. The issue is no longer – and has not been for quite a number of years – whether to have wholesale markets for electricity and natural gas. They are a fact of life. Electricity and gas are extensively traded in markets in all regions of the country, and what happens in these markets affects customers' pocketbooks and the competitiveness of our national economy every day. Electricity and natural gas are a \$275 billion industry, so these issues matter a lot.

In the wake of the California melt down, the issue now is this – will we tolerate poorly structured markets, or will we insist on good markets, well structured markets that provide customer benefits?

This is an important question, because achieving well functioning wholesale markets requires regulatory initiative. Markets don't automatically structure themselves with fair behavioral rules nor automatically provide a level playing field for market participants. Market don't fix themselves when they're broken,

nor do they oversee and monitor themselves. And markets don't establish or enforce the rules. These are all the responsibilities of regulators. Our proposal last summer for a standard market design drew on the experiences in this country and around the world in electric market design, and was made with these responsibilities in mind.

It was a muscular proposal, admittedly, and we have spent nine months listening to the comments we have received. Although our proposal enjoyed broad support in many regions of the country, state regulators and transmission owners in other regions did not believe we struck the right chord. A number of Senators and Congressmen raised questions as well, and we made a commitment to address concerns and questions in a White Paper, which we issued on Monday.

We maintain a principled approach. We still believe certain features of a viable wholesale market platform are essential. Yet, we commit to recognize and respect regional differences and regional timing constraints.

The first point to underscore is that our goals remain the same. The wholesale market platform will rely primarily on long term contracts negotiated in the context of a transparent spot market that is producing just and reasonable prices and locational price signals. We believe that independent grid and independent market operation are essential to create a level playing field on which all resources – supply and demand resources, renewable resources, and distributed generation – can compete. We want wholesale markets that do not tolerate affiliate abuse; where clear rules define acceptable and unacceptable behavior; where customer protections, up front price mitigation measures, and solid market power screens are built in to the market design. We want wholesale markets where there is potential for a price moderating demand response, and where there is a highly professional and aggressive market monitoring unit on the ground to serve as an early warning device should problems arise.

A second important point is that we will continue to focus on RTOs as the foundation of the wholesale market platform. We will build on the good work we did in Order No. 2000 as the basic framework to recognize recent learning. All public utilities will be required to join an RTO or an ISO. The Commission concluded that it's inescapable that such membership is necessary to ensure good regional markets, and virtually all utilities are members of RTOs or ISOs in any

event. We also propose that ISOs satisfy all of the Order No. 2000 requirements except for scope and configuration.

We recognize that the various regions are in different stages of market development and those differences must be respected. The Commission will hold a series of regional technical conferences with state commissions and market participants to discuss the unique needs of each region and to agree on time lines for implementing an appropriate market platform.

We have heard a chorus of comments that some aspects of our SMD proposal simply may not be cost effective in some regions. Thus, to the extent that the costs of implementing any feature of the platform outweigh its benefits, we will not require the RTO or ISO to implement that feature.

A critical aspect of a good market structure is that all uses of the transmission grid must be provided under a single tariff administered by the RTO or ISO. This would include the transmission needed for bundled retail service. All customers must be under the same rules of the road. We are mindful, however, of the important jurisdictional issues surrounding rates for bundled retail service. In recognition of this, the Commission proposes to continue our present approach of asserting jurisdiction over the terms and conditions of transmission service to bundled retail load under the single RTO tariff, but we will not assert jurisdiction over the bundled transmission rates. To accomplish this, transmission owners would be free to seek a transmission rate from the RTO or ISO that is equal to the transmission component of the bundled retail rate set by the state.

This brings me to the point number three, the important role of the states. Each RTO would be required to provide a forum for the participation of state representatives in its decision making process. We refer to this forum as a regional state committee. And we do not envision these committees as mere debating societies. Instead, the regional state committees would actually determine the regional proposal for a number of critical implementation issues. For example, the regional committee would propose the basic pricing scheme for the region. This would include whether to use the participant funding approach to cost responsibility for grid enhancements, and, if so, the criteria for which projects would qualify for such treatment. The regional committee would also propose the form of the basic transmission access charge. The basic access charge is the way

the RTO recovers those grid costs that are deemed appropriate for all grid users to pay. The access charge could be either a license plate charge for each transmission owner's area or a single postage stamp charge for the entire RTO. Our sole requirement is that customers pay only one charge to access the entire regional grid.

Each regional state committee would also decide how to allocate the firm transmission rights (FTRs) that protect customers from congestion charges in a market that uses locational pricing. Our SMD NOPR proposed that FTRs be auctioned, but we went back to the drawing board. We now propose that the state committees decide how to assign these critical customer protection instruments. Here's another example. The Commission continues to believe that resource adequacy is key to both reliability and to mitigating market power. It's not important, however, that the level be set in accordance with FERC criteria. Thus, we propose for each regional state committee to determine its region's approach to assuring resource adequacy.

And finally, regional planning. Here again the region makes the plan, under the guidance of the state regional committees, transmission owners and market participants.

So, we've listened. Not all states are satisfied. Not all transmission owners are satisfied. On the other side, some market participants believe we have conceded too much of the plan's original muscularity.

As I've said, we've adopted a principled approach. We've looked for common ground with those who have objected. We will obviously follow the wishes of Congress as those become clear.

But the fundamental issue is the same. Will we tolerate regional market designs that we now know won't work? Applying the principle of regional deference in 1996 and 1997, we approved the original California market design. It was legislated by the General Assembly, and endorsed by the California PUC and the then Governor. That particular application of regional deference was ultimately a disaster.

So I would characterize our White Paper as a more principled approach. Our standards are more flexible, but we believe that each region should move forward with a plan that benefits consumers.