

Remarks of  
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## "Electric Restructuring: Macro-Policies With Micro-Impacts"

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I.

It is gratifying to appear again before NASEO. Since we first became acquainted at your Hershey, Pennsylvania meeting in 1992, I have come to regard the voice of state energy offices as critically important to a balanced energy policy. The irony for me has always been that, despite our mutual interest in consumers and the electric and gas industries, we tend to approach the transition to competitive energy markets from different perspectives. The FERC, for its part, has spent the last decade opening wholesale markets for gas and electricity -- in particular, the delivery network that brings those commodities to market -- to the forces of competition. The Commission has increasingly focused its attention on non-discrimination, market power issues, and structural concerns about the future management and operations of the electric transmission and gas pipeline networks. The Commission is currently grappling with new tariff filings, revised service agreements, and merger applications. The next set of issues looming before us relates to how the Commission can make progress on grid reliability and regional transmission operations, especially if Congress fails to act in those areas.

NASEO and its members, on the other hand, continue their excellent job of promoting energy efficiency, renewables, and clean-burning domestic energy resources at the level where the finances and welfare of energy consumers are more immediately at stake. Because our roles and objectives are so different, it is very important that we try to bridge the gap between the national policies aimed simply at getting rates down, ensuring recovery for a generation of investments that could be stranded, and establishing new market structures, and the numerous local retail consumer service concerns that will inevitably become involved in restructuring. Nevertheless, restructuring is still thought of in Washington primarily in terms of macro-policies, not micro-impacts. In this highly uncertain moment of economic transition, advocacy on behalf of residential and commercial energy conservation, technology transfer, pollution abatement, and home-grown least cost energy strategies continues to be a key ingredient of the debate. I hope Congress and your state legislatures are listening to you and those you represent.

II.

We now hear so much praise for competition, the wisdom of the marketplace, and "deregulation" of key portions of the infrastructure including gas pipelines and electric utilities, that it is easy to be misled about what restructuring will mean for consumers. Even as head of an agency that is second to none in its determination to foster competitive markets for natural gas and electric power, I find it occasionally necessary to cry, "Not so

fast!" At the Commission, and perhaps in every intelligent discussion about the future of competitive energy markets, participants ought to begin their deliberations about the marvels of the market with a cold shower. In other words, as we eagerly contemplate changes in traditional regulation and competition's salutary impact on productivity, customer choice, the price of power and natural gas, service offerings, or even the prospect of gas-electric convergence, we should be mindful of the complexities associated with the move to competition and wary of misleading generalizations that color much of the restructuring debate.

So, let us take a moment for some tough love when it comes to competition. There are three important factors that we all should keep in mind.

First, notwithstanding the commoditization of energy products and services that began twenty years ago with the advent of natural gas wellhead price decontrol and the arrival of independent power and the gas turbine, competitive energy industries are still not mature in many respects. Market power and natural monopoly structures persist, and they must be decisively dealt with.

Second, most of today's regulators and their economists are becoming persuaded that competitive markets are better suited to promoting greater economic efficiency and equity than are governmental prescriptions and controls. Nevertheless, competition is not an end in itself. It is a means to attaining the benefits of efficient markets. Markets, even competitive markets, possess flaws, however. There is no formula for ensuring that, left to operate freely, they will always produce efficient and fair results for either consumers or regulated companies.

Third, one should be mindful of the fact that no state or federal legislature of which I am aware is proposing to discard energy regulation and its practitioners in their entirety. This is important, if for no other reason than that it illustrates how oversimplified, if not inaccurate, the label "deregulation" is. Electric restructuring is a dynamic and complex phenomenon, which includes important technological developments and corporate strategies, as well as the pruning of regulation. As this process unfolds, there are macro-issues such as stranded cost recovery and market structure as well as more familiar concerns that will continue to struggle to be taken into account. Among those concerns are environment and the future of research and development, low-income assistance, and demand-side management programs.

III.

Amidst all the macro-policymaking and comprehensive legislation, the voice of the consumer is all too frequently the missing ingredient. The much-discussed issue of retail customer choice will remain largely an empty promise in the gas and electric businesses until further experience and education change the basic relationship between consumers who are free to choose (most are not) and the monopoly suppliers of essential services. To obtain a great consumer commitment and enthusiasm about changing something so basic as how electric service is provided, it seems to me there must be greater assurances that the benefits of competition will be widely shared.

I tend to think of the evolving course of electric restructuring this way: we are now undergoing the Supplier Revolution, rethinking what utilities are and how they and their competitors as well as other market entrants will participate in the competitive environment in the future. Next comes the Consumer Revolution, a slower and perhaps more conservative movement but no less creative. The demand side is where innovation originates. For example, cell phones were at one time purchased by men primarily for their

wives' safety, not as a powerful network designed to compete with hard-wire business communications. Consumer needs changed that. All Alexander Graham Bell wanted to do with his phone was to play opera music for large numbers of people at local theaters. The demand for other services changed that as well. Edison invented his graphophone to record sound, but his initial proposal was to send the wax cylinder recordings to customers by Pony Express! The marketplace altered that strategy quickly. In other words, the pull of customer needs will determine much about the dynamics of future power markets. But the precise shape of those needs is not yet well understood within the electric industry or the regulatory community. That means that real creativity will await consumer demand. First, however, that demand has to be systematically created.

Thus far, very little except apprehension is being heard from the consuming public in the restructuring debate. Ironically, customer choice has not yet become an issue for consumers! This may be attributable to relative satisfaction with the status quo or to being turned off by competitive telephone solicitations. However, I suspect we should look deeper than that. I believe that there is a fundamental lack of understanding of what is at stake in an economic environment that is bound to undergo substantial change in the years to come. While consumers instinctively recognize the risks associated with shaking up the local monopoly, they are still not persuaded that competition will in fact yield a great deal extra with respect to improving their quality of life.

Public policymakers must therefore ask themselves how to bring the ultimate consumer into this process and how to ensure that it is not only industrials which will profit from restructuring activities. It has already been recognized, even in a high-cost jurisdiction like California where restructuring has advanced tremendously, that customer choice can be a tough sell. But if either the states or Congress start down the road of retail access, then "selling" consumers on the merits of participating in a competitive market is all the more important. I believe that support for energy efficiency, conservation, research and development, and low-income assistance will be integral to the success of that effort. Such programs have been supported painlessly through utility rates, but the available options in a competitive environment are not so clear. I can think of no more compelling reason for Congressional involvement in the restructuring process than to give the broadest possible voice to consumer interests and to devise a competitively neutral way to address the future status of these programs.

#### IV.

There is no better place than the Rayburn Building to focus on the legislative agenda of electric restructuring. You are all aware of the range of issues in the restructuring debate, as well as the difficulty Congress has had sorting through them all and getting down to making decisions. Indeed, state legislative activity has encouraged many here in Washington simply to wait and see -- not a bad idea if power markets could be depended on to stand still. They will not. So far, the federal legislative prognosis for 1998 is not good. The reasons are complex. But if the Congress is determined only to legislate comprehensively, then restructuring measures will not reach the President's desk soon. There may be another option, however.

When I was asked to appear before the House Energy and Power Subcommittee last October, I offered some legislative priorities, fully acknowledging that a federal retail competition mandate, stranded costs, the environment, and numerous other matters deserve the most serious consideration in the next Congress. For now, I recommend trying to deal with four specific pieces of the puzzle, based on the general recognition that if the Congress intends to do anything on restructuring in 1998, it will have to keep its objectives limited and its energies focused. Here is a modest package for them to consider. If it seems rather FERC-friendly, I plead guilty.

First, Congress should require all utilities that own, control, or operate transmission facilities to open their systems under the same rules. Considering that the federal power marketing administrations, the Tennessee Valley Authority, the Electric Reliability Council of Texas, municipal utilities and most electric power cooperatives are not subject to the Commission's jurisdiction, approximately one-third of the nation's transmission grid is not subject to the Commission's open access rule.

This 30 percent gap raises serious questions about the future competitiveness and efficiency of the interstate power marketplace. Federal legislation can close this gap without a sweeping intrusion into the activities of public power entities or an implicit attack on their mode of financing. But, we will not have nationwide open access and competitive wholesale power markets unless these utilities open up their systems.

Second, the Congress should clarify the Commission's authority to order the establishment of, and participation in, regional transmission institutions. It is becoming increasingly clear that regional approaches to operating and planning the nation's transmission grid can bring greater efficiencies in our power supply. An Independent System Operator (ISO) that is properly structured and regional in size can create better incentives for transmission operation, establish non-discriminatory access, promote efficient industry restructuring and regional governance, enhance reliability, and allow better transmission pricing and rate structures.

The Commission has strongly encouraged regional institutions but has not yet actually required them. Because of pressure from independent generators and marketers, the principles of our transmission access rules, and state retail access programs, transmission owners in many parts of the country are already beginning to voluntarily turn over control of their facilities to an ISO. It is nevertheless clear to the Commission that not all utilities in a region will participate if the ISO is not required. Therefore, federal legislation would be most useful if it provided the Commission with clearer authority to order regional institutions and also left the Commission with sufficient flexibility to take into account the regional needs and historical structure of the transmission system in various parts of the country.

Third, the Congress should make compliance with reliability standards mandatory and should appoint a single federal regulatory entity such as FERC to oversee and enforce those standards. Reliability, in particular the security of the transmission system, is the issue that transcends all others in the restructuring debate. While states have jurisdiction over the reliability of local distribution, there is no clear federal authority for establishing reliability standards for the bulk power transmission grid or for enforcing such standards.

Historically, the industry has done a good job in this area on a voluntary basis. Now, however, in light of the number of market participants and transactions and the changing relationships among them, reliability standards must be mandatory. Industry should continue to set initial reliability standards so long as all segments of industry participate in the process. The enforcing regulatory agency could defer where appropriate to a properly constituted and diverse private reliability standards organization. I think that the Commission's experience with the industry makes it a likely candidate for the job of enforcing compliance.

Finally, the Public Utility Holding Company Act (PUHCA) should be amended or repealed provided that the Commission and states have adequate authority to protect consumers. As currently structured, PUHCA is no longer necessary and is incompatible with competitive markets. However, any PUHCA-related legislation must protect against affiliate abuse and ensure that captive customers do not cross-subsidize entrepreneurial ventures.

Although I took no position in my testimony on the desirability of retail access, I identified three issues associated with retail access that touch upon the Commission's jurisdiction. First, if a retail mandate is chosen, then the Congress should order such access by a date certain but leave the details of such programs to the states. If, however, Congress chooses not to mandate access, then it should clarify the authority of the states to order retail transmission access. Second, the Congress should clarify the federal/state jurisdictional split, i.e., that the Commission has authority over facilities used for unbundled retail transmission and that the states have authority over local distribution facilities and services. Finally, Congress should clarify that, if states order retail customer choice programs, the Commission has the authority to order whatever transmission is necessary to move power from the seller to the state with the retail choice program.

V.

As each of us thinks about state and federal restructuring legislation, we must ask ourselves whether they move us toward an electric power industry that can meet the needs of the Nation and its citizens. You more than anyone recognize that this goal is considerably broader than fostering lower electric rates. NASEO is unquestionably concerned about long-term quality of service issues and social issues affecting the responsible use of energy, not to mention the responsible treatment of energy consumers. All I would urge is that you remain engaged in the debate over the macro-issues because they will invariably have micro-impacts. To make consumers the creative driving force behind restructuring, they need to be educated and involved. If research and development and energy efficiency programs are to remain integral to the policy outcomes, consumers cannot be missing in action.

Thank you