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The United States Senate

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The Role of FERC
Associated with the Restructuring of Energy Industries
Chairman Joe Lieberman
June 27, 2001

Good morning and welcome to all our witnesses and guests. This morning I am pleased to continue this Committee's examination of the federal government's response to the deregulation of the energy industry. This is the third hearing we've held on this issue in as many weeks. In our first two hearings, we focused on the problems of electricity deregulation in California and the West, and the need for more vigorous oversight and intervention by the Federal Energy Regulatory Commission (FERC). Fortunately, last week the commission did step up its role in addressing the western power crisis. This committee will continue to keep a close watch on those efforts and to determine whether they bring adequate price relief to besieged energy consumers.

Today, we turn to a related concern and that's the reliability of the electric grid. The grid is our energy lifeline – a vast network of transmission lines that carry electricity from a myriad of energy producers, large and small, to the utilities, and, ultimately, into our homes and businesses. It is a lifeline we take for granted every time we switch on the lights, sit down at a computer, or open the refrigerator.

The national electric grid is vital to our lives and our livelihoods, and it has been greatly affected by the deregulation of electric utilities. So today, we're going to ask: who is operating the grid? And who is watching what is happening on the grid on behalf of electricity consumers?

Who is it that keeps the lights on or -- as people in California no doubt have been asking – who is to blame when the lights go off? Not long ago, that was an easy question to answer. Local electric utilities ran the show, top to bottom. They produced the power for homes and businesses in a given part of the country, made sure there was enough of it, and saw to it that the electricity ran in the proper voltages and frequencies to be transported and used safely. Utilities built and ran the transmission lines to get power from their plants to their customers and they built interconnecting lines to neighboring utilities that allowed for modest trading in times of shortage.

But the deregulation of electricity markets has scrambled this picture.

Utilities no longer make the power they sell to retail consumers. Instead, electricity generators compete on the market to sell to utilities, and sometimes even directly to retail customers. Nor do utilities always control the interstate transmission lines anymore. In several regions of the country, independent system operators, known as ISOs, act as electricity "traffic cops," routing power from sellers to buyers. That means the ISOs are responsible for keeping the system up and running. So, what was once a relatively sleepy, largely local network has been transformed into a fast-moving and extremely congested, national electricity delivery superhighway.

While deregulation offers potential economic benefits, they also pose real risks to the reliability of the electric grid. In fact, a Department of Energy task force concluded in 1998 that the current configuration – devised in an age of far less usage of the transmission grid and far more regulation of the utility industry – is "clearly unsustainable" in the newly decentralized and competitive electricity industry.

In fact, problems have already occurred. A November 2000 staff report by FERC describes a disturbing incident from July 1999, when power was tight and prices were high. As I understand it, engineers monitoring the Midwest electricity grid noticed something unusual and troubling: some of the electricity that should have been in the system just wasn't there. What happened? According to a later FERC report, Cinergy, a large Midwestern utility, just took power off the grid, when it apparently had no right to, to supply its own customers, rather than disconnecting them, or buying the extra power it needed. Another account of the incident in the *Wall Street Journal* notes that the utility put power back into the system later, but only after demand - and prices - had dropped. The utility was never punished for this behavior because the system has historically depended on voluntary industry standards rather than a regime of federal regulation and enforcement.

Grid reliability has also been an issue in California, where the grid is managed not by the local utilities, but again by an independent system operator. To fulfill its responsibility to keep the lights on in the Spring of last year, the California system operator contracted to buy extra power in times of severe shortage from, what's known in the industry as "reliability must-run" units or RMRs. But, as a FERC order in April of this year describes it, when the ISO needed the backup supply, some of the power plants didn't cooperate. In other words, the RMRs were not reliable and they didn't run. According to the FERC order, to keep the lights on the ISO was forced to scramble to fill demand on the spot market at much higher prices. FERC subsequently investigated and approved a settlement with generators paying for the $8 million difference in price.

Although FERC has jurisdiction over the interstate transmission system under the Federal Power Act, it has not historically regulated reliability. Instead, FERC has deferred this responsibility to regional, voluntary, electric reliability councils which include all of the electric systems in the continental United States, Canada, and part of Mexico. Industry has relied upon the voluntary standards set by these councils through their governing body – the North American Energy Reliability Council or NERC. With the changing structure of the electric industry, however, we now need to ask whether the federal government should play a more active role in maintaining and policing the national electricity grid. Indeed, Congress has actively considered amending the Federal Power Act to require FERC to establish electric reliability standards and a system for enforcement, although no such proposal has yet been enacted.

And that's the issue we're going to explore today. Some questions I'd like to ask are does the shift from heavily-regulated utility systems to competitive markets threaten reliability of the grid? If so, does FERC have adequate statutory and regulatory authority to protect the public interest in a totally reliable electric transmission system? What is the proper division of responsibility between federal and state regulators concerning electricity reliability overall? I look forward to hearing from all our witnesses and thank them for taking the time to join us this morning.

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