FOREWORD

By The Honorable Joseph T. Kelliher

This book is published at an interesting time in the course of electricity law and policy. The casual observer may assume electricity law is an ossified or static field. The electricity industry was established more than 100 years ago, and is a mature industry. The basic industry structure, with a heavy reliance on vertical integration, was laid down decades ago. The principal federal law that governs electricity markets, Part II of the Federal Power Act, was enacted nearly 75 years ago. State laws governing regulation of state regulated electric utilities have a similar vintage.

However, electricity law is not a static area. A closer look reveals that changes to electricity law have been very significant in recent years, that the pace of change is increasing, and there is a prospect of sweeping change in the near future. I would submit that electricity law has changed more significantly in recent years than in the prior half century or more. Electricity law is truly a dynamic area of law.

Electricity law is poised for even greater change in the future. The United States has a carbon based economy, and our electricity sector relies heavily on fossil fuel combustion. However, it seems evident that the United States will commit itself to making major carbon reductions in carbon emissions. Any carbon reduction regulatory scheme will have profound implications for electricity policy and law, and may shift the center of gravity of electricity law, leading to a larger federal role. The federalist scheme adopted in 1935 for electricity regulation may become more Hamiltonian, and less Jeffersonian, as a result.

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This book examines some of the most important legal and policy issues associated with electricity law. Central among these is competition policy, both wholesale and retail competition. The U.S. has a federalist scheme for electricity regulation, and federal and state regulators have taken different approaches with respect to competition policy. The overall direction of federal electricity law and policy has been constant for many years. Competition policy has been the foundation for federal electricity law and policy for the past 30 years, reflecting the belief that reliance on a mixture of competition and regulation will best assure adequacy of electricity supply at a reasonable cost. The primary task of the Federal Energy Regulatory Commission (FERC) with respect to economic regulation of electricity markets is to “guard the consumer from exploitation.” That was true in 1935; it remains true today. However, the agency believes competition policy is the best way to protect the consumer. While policy direction has been constant, competition policy is not static. FERC competition policy seeks to find the best possible mixture between reliance on competition and regulation. Since electricity markets are highly dynamic, that mixture will evolve.

This book follows the course of competition policy over this period, the development of FERC open access policy and market based rate policy, the development of regional transmission organizations and independent system operators and their administration of complex wholesale power markets, and the need for new regulatory authority to prevent market manipulation and market power exercise, made apparent by the California and Western Power Crisis.

In my view, wholesale competition policy has been a success. It has assured adequacy of U.S. electricity supply at a reasonable cost for 30 years. It has fostered a more efficient industry and benefited consumers. In my view, competition policy must remain the foundation for federal electricity policy, or else there is little prospect we will achieve significant carbon reductions at a reasonable cost.

While competition policy at the federal level has been a success, it has more of a mixed record at the state level and movement towards
retail competition has been at best uneven. Retail competition appears to have been a success in some states, while in others – such as California – the result has been failure. At the same time, states have shown leadership on renewable energy standards and carbon policy, taking action well before the federal government. These state initiatives have spurred action at the federal level, and states deserve credit for being the crucible of energy and environmental policy.

Various factors have driven changes in electricity law in recent years. First, electricity markets are not static, they are highly dynamic. There have been striking changes in electricity markets since the Federal Power Act was enacted more 70 years ago. In 1935, electricity markets were local in nature, with power plants located in major cities selling power to nearby areas through the distribution system. There was very little interstate commerce in electricity. Today, with the development of the interstate power grid, electricity markets are not only interstate, but also international.

Industry structure has also changed significantly over the past 25 years. While vertical integration was the norm for many years, reliance on vertical integration was never absolute. The entry of independent power producers and traders and marketers created new classes of competitors. There are different kinds of wholesale power markets. Large parts of the interstate power grid are operated by regional transmission organizations and independent system operators, some of which also operate centralized power auctions. Typically structured as nonprofit corporations, these entities did not exist in 1935, and nothing in Part II of the Federal Power Act belies any anticipation that these institutions would develop.

Congress did not anticipate these market developments in 1935, but it is hard to fault it. Congress implicitly assumed that electricity markets would remain local in nature, which explains to a large extent the federalist regulatory scheme for electricity markets laid down in 1935. Similarly, reliance on state and local governments to site transmission facilities loudly suggests Congress did not foresee the development of the interstate and international power grid.
Second, technological change has also spurred changes in electricity law and policy. When federal electricity law was conceived in the 1930s it was assumed there was a natural monopoly in electricity generation. Technological changes destroyed that assumption and independent power producers have accounted for most electricity supply additions over the past 25 years. Many of these new entrants also developed or deployed new or improved technologies such as wind power, solar power, and other renewable energy sources.

This factor – technology – may play an even larger role in the future, as a result of dynamics that will be unleashed by adoption of carbon emissions limitations in the U.S. and abroad. Technological breakthroughs in electricity storage, demand response and energy efficiency, transmission, hydrokinetics, carbon capture and sequestration, and other areas will create pressures for further changes in federal and state electricity law; to the extent those laws fail to accommodate new technologies that will help the country meet aggressive carbon reduction targets at a reasonable cost.

Third, is the tension between energy and environmental law and policy. This is another area where the distinction between legal regimes has become increasingly artificial, if not entirely abstract. Climate change is not just environmental policy; it is also energy policy. At one level, climate change policy involves critical decisions about the future level of U.S. electricity supply, the future price of electricity, and the future electricity supply mix, principally to what extent we will rely on coal, nuclear, natural gas, and renewable energy to meet our future electricity supply needs. It also involves related issues regarding the power grid of the future, the grid that will deliver our future electricity supply. The reality is that the grid the U.S. will need to deliver clean energy in the future will be very different than the current interstate power grid.

It seems evident that the United States will commit itself to making major carbon reductions in some manner. It is absolutely necessary that U.S. climate change policy reflect a balance between sound
energy and environmental policy. There is tension between energy and environmental policy in this area. Energy policy generally is designed to assure adequacy of electricity supply at a reasonable cost. Environmental policy is interested largely in the future level of carbon emissions. These goals are different, but not necessarily inconsistent. A balanced approach can achieve significant carbon emissions reductions at a reasonable cost, while assuring adequate U.S. electricity supply. But it will not be easy.

A U.S. commitment to mandatory carbon emissions will create pressures to change electricity law. It may prove necessary to revise transmission siting law and provide for exclusive federal siting if the U.S. is to develop an interstate power grid that delivers clean energy, assures reliability, and supports competitive markets that will exert a downward pressure on wholesale power prices. It may also be necessary to provide for broad cost allocation of transmission investment. The pressure to lower carbon emissions by reducing electricity demand may call into question fundamental decisions about federal and state jurisdiction made many years ago.

Some changes in electricity law were the result of the enactment of new legislation. The Energy Policy Act of 2005 represented the greatest expansion of FERC regulatory authority since the New Deal. It gave FERC new missions in the area of electricity regulation, such as reliability, enforcement, and infrastructure development, and granted the agency new regulatory tools to prevent market manipulation and market power exercise. The reliability provisions represented a significant shift in FERC responsibilities, expanding the agency’s regulatory role with respect to the electricity sector beyond economic regulation. I view reliability regulation as more like safety regulation than economic regulation, and FERC has studied models for safety regulation at other agencies. The reliability regime is different in another respect, in its reliance on self regulating organizations. In its implementation of this new role, FERC has studied self regulating organizations in other sectors. The enforcement provisions turned FERC into an enforcement agency for
the first time, and FERC has acted to implement its new enforcement authority in a manner that promotes compliance.

Other changes in electricity law result from reinterpretation of existing law by administrative agencies charged with their administration. Interpretation of a statute by an agency is more of an art than a science, resulting in different possible interpretations that involve varying degrees of legal risk. The question of which interpretation an agency chooses involves a balancing between a fair reading of the statute, an assessment of the legal risk involved in different interpretations, and policy considerations. A rational balancing would accept an interpretation that entails a higher degree of legal risk if necessary to advance important policy goals.

Many of the signal changes in federal electricity law over the past 25 years have been accomplished by agency reinterpretation rather than enactment of new legislation. For example, the legal foundation for FERC’s wholesale competition policies was the agency’s reinterpretation of Part II of the Federal Power Act to authorize it to grant market based wholesale power rates and require public utilities to provide open access to their transmission systems. In both areas, FERC reinterpreted statutory provisions originally enacted in 1935 that had not been substantially revised by Congress and discovered new authority, previously masked. Both the courts and the Congress essentially accepted FERC’s reinterpretation.

The pressures that drive changes in electricity law are unlikely to dissipate, and changes in electricity law will probably continue to develop in different ways.

This book makes an important contribution to an understanding of the current state of electricity law and policy.