



September 2, 2016

TO: Members, Subcommittee on Energy and Power

FROM: Committee Majority and Minority Staff

RE: Hearing entitled “Federal Power Act: Historical Perspectives”

I. INTRODUCTION

On Wednesday, September 7, 2016, at 10:00 a.m. in 2322 Rayburn House Office Building, the Subcommittee on Energy and Power will hold a hearing entitled “Federal Power Act: Historical Perspectives.” The hearing will explore the evolution of the Federal Power Act, with special emphasis on electricity markets over the past twenty years. This is the first in a series of expected hearings on the Federal Power Act.

II. WITNESSES

Panel I

- **Clifford M. (“Mike”) Naeve**, former Commissioner, Federal Energy Regulatory Commission; Partner, Skadden, Arps, Slate, Meagher & Flom LLP;
- **Linda Stuntz**, Deputy Secretary of the U.S. Department of Energy; Partner, Stuntz, Davis & Staffier, P.C.;
- **Susan Tomasky**, former General Counsel, Federal Energy Regulatory Commission; former President-AEP Transmission of American Electric Power Corporation; and
- **Doug Smith**, former General Counsel, Federal Energy Regulatory Commission; Partner, Van Ness Feldman, LLP.

III. BACKGROUND

The history of the Federal Energy Regulatory Commission (FERC) starts with the history of the Federal Power Commission (FPC). Congress established the FPC in 1920 --- not to regulate electricity --- but to sort out who would be authorized to develop hydroelectric projects on public lands and navigable streams that are under federal control. But electricity soon became a critical part of FPC jurisdiction. That is, with heavy demand for electricity in the 1920s, electricity was no longer a purely local product, and utilities started to sell power across state lines. After a state utility commission attempted to regulate the price of these interstate sales, the

U.S. Supreme Court held that only Congress had authority to address wholesale transactions.¹ In response, Congress added Part II of the Federal Power Act (FPA) in 1935 so that the FPC would have authority over these interstate markets. The Supreme Court held a similar view of interstate commerce in natural gas, holding that the states did not have authority to reduce the wholesale prices charged by a pipeline for out-of-state gas.² Congress again acted with passage of the Natural Gas Act in 1938, an act which expanded the jurisdiction of the FPC to the interstate transportation of natural gas.³

With its jurisdiction established, the FPC regulated gas, electricity, and the development of hydropower over many decades. On various occasions, FPC policies had adverse impacts on American consumers, but with the economic growth and success of America after World War II, these regulatory difficulties had little overall impact on our rapidly improving standard of living.⁴

This continued until the 1973 oil embargo, which resulted in dramatic increases in the cost of energy. Higher prices for oil had both direct and indirect impacts on electric prices. Since oil was a source of fuel for many power plants, rates increased as a direct result of higher fuel prices. Indirectly, the inflation associated with higher oil prices resulted in higher financing costs for electric utilities, and higher costs for employee salaries and equipment. Electricity rates began to increase, yet certain utilities were hit harder than others. In general, utilities serving rapidly growing industrial cities were hit hardest. Those utilities faced higher inflation in their construction programs for new power plants, just as the need for new power plants fell due to higher energy costs.⁵ In 1979, the nuclear accident at Three Mile Island further increased cost pressures on nuclear assets.⁶

Aware of the impact of higher energy costs on America's growth and success, in 1977, Congress decided that the authority of the FPC should be transferred to an entirely new federal agency, to be called FERC. This new agency was expected to focus on improving conditions in the energy markets.⁷

With FERC established, Congress passed the National Energy Act of 1978, which included the Natural Gas Policy Act (NGPA). Among its many provisions, this law provided for

¹ *Public Util. Comm'n of R. I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 89-90 (1927).

² *Missouri ex rel. Barrett v. Kansas Natural Gas. Co.*, 265 U.S. 298 (1924).

³ For further discussion, see Lindh, Frank R., "Federal Preemption of State Regulation in the Field of Electricity and Natural Gas: A Supreme Court Chronicle," 10 *Energy Law Journal* 277 (1989). http://eba-net.org/sites/default/files/elj/Energy%20Journals/Vol10_No2_1989_Federal_Preemption_of_State_Regulation.pdf

⁴ For a history of the FPC, see Cantelon, Philip L., "The Regulatory Dilemma of the Federal Power Commission, 1920-1977." *Federal History Journal*, Issue 4 (January 2012). <http://shfg.org/shfg/wp-content/uploads/2012/12/5-Cantelon-FPC-Web-final-2.pdf>

⁵ Richard J. Pierce, Jr., "The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity," 132 *Univ. Penn. Law Review* 497 (1984). http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=4621&context=penn_law_review

⁶ See the "Report of the President's Commission on the Accident at Three Mile Island, the Need for Change: The Legacy of TMI," October 1979. <http://www.threemileisland.org/downloads/188.pdf>

⁷ Edward J. Grenier, Jr., and Robert W. Clark III, "The Relationship Between DOE and FERC: Innovative Government or Inevitable Headache." 1 *Energy Law Journal* 325, 328 (1980) http://www.felj.org/sites/default/files/elj/Energy%20Journals/Vol1_No2_1980_The_Relationship_Between_DOE_and_F.pdf

the gradual deregulation of natural gas pricing. This would free FERC from its obligation to establish prices for interstate natural gas, which at the time were established on a year-to-year basis.⁸

Over the next two decades, FERC dramatically improved the competitiveness of natural gas markets, allowing consumers to pay market prices for gas by removing regulations that had prevented such an opportunity. As a result of these changes, consumers no longer faced shortages of gas when the government set prices too low. That is, competitive markets proved themselves to be highly successful at matching supply with demand at the best possible prices.⁹

At the same time, Congressional action began to open traditional electric utilities to new forms of competition. In 1978, Congress passed the Public Utilities Regulatory Policies Act, which included a requirement that utilities purchase power from certain independent generators of electricity at avoided cost. Congress continued to carefully consider the energy sector, passing the Energy Policy Act of 1992, requiring FERC to improve access to power generated by competitors.

But unlike natural gas, electricity markets are more complex because of the laws of physics. That is, natural gas can be put into a contained space for storage, or it can be pushed through a pipeline so that it can be sold at the point where it is needed. But electricity cannot be stored or transmitted just like natural gas. Instead, electricity travels at nearly the speed of light, traveling almost instantly in every available direction, and electricity cannot be stored in caverns or storage tanks like natural gas.

Beyond the laws of physics, electricity is produced by a wide range of organizations. The hundreds of utilities nationwide are variously owned by shareholders, by cities and towns, by the federal government, or they can be organized as cooperatives --- and all of these various types of utilities can have different regulators and different legal constraints. Because of this complexity, FERC needed to carefully consider what elements of the natural gas markets could be successful in the electricity markets, and which elements needed to be modified.¹⁰

After much debate throughout the nation, in 1996 FERC issued a landmark order for electric markets known as Order No. 888. This order mandated “open access” to the extra-high voltage transmission lines owned by electric utilities, ensuring that sellers of electricity at wholesale could have access to the transmission lines of a competing electric utility. Not only did Order No. 888 require the utility to provide access to its competitors, it also had to do so at a price generally equal to the price it charged itself for the same service. Such access would allow market participants to compete against local utilities in selling power at wholesale. As a result,

⁸ See Nordhaus, Robert R., “Producer Regulation and the Natural Gas Policy Act of 1978,” 19 *Natural Resources Journal* 829 (1979). http://lawschool.unm.edu/nrj/volumes/19/4/04_nordhaus_producer.pdf Also see the U.S. Energy Information Administration, at:

http://www.eia.gov/oil_gas/natural_gas/analysis_publications/ngmajorleg/ngact1978.html

⁹ For a list of those FERC orders, see this webpage of the U.S. Energy Information Administration:

http://www.eia.gov/oil_gas/natural_gas/analysis_publications/ngmajorleg/keyferc.html

¹⁰ For an example of how natural gas and electricity were being compared, see Richard J. Pierce, Jr., “The State of the Transition to Competitive Markets in Natural Gas and Electricity,” 15 *Energy Law Journal* 323 (1994).

http://eba-net.org/sites/default/files/elj/Energy%20Journals/Vol15_No2_1994_article_the_state_of.pdf

even if one electric utility owned all of the transmission lines in a region, electricity could be available from a variety of suppliers, who would compete against each other for customers.¹¹

While open access to transmission lines was critical to improving electric markets, FERC soon began to explore other ways to improve competition. In particular, certain parts of the nation had many utilities, and if a competitor needed to obtain access from each of these local utilities in order to transmit electricity, the cost of all that access could become so high that an otherwise beneficial sale of energy would not occur. This was generally known as the “rate pancaking” problem of a competitor needing to pay one utility for access, and then another for access, and another, etc.

To help solve the problem of rate pancaking, electric utilities could pool their transmission assets so that they would be collectively under the operation of an independent third-party. Over the next decade, groups of electric utilities would voluntarily collaborate, with strong encouragement from FERC, to organize “Independent System Operators” (ISOs) and “Regional Transmission Organizations” (RTOs). These ISOs and RTOs allowed a competitor to purchase electricity transmission from one organization, even if a sale of electricity at wholesale travelled across multiple electric utilities. To formalize the characteristics of an RTO, FERC issued another landmark order, known as Order No. 2000. As stated by FERC, “the elimination of rate pancaking for large regions is a central goal of the Commission's RTO policy.”¹²

With both open access and regional organizations, a strong foundation was established by FERC to improve competition in the wholesale markets. Yet these changes were not sufficient to guarantee success at FERC, and the markets continue to evolve. Because of continuing work by the Committee, the markets were improved again with the Energy Policy Act of 2005. This hearing will explore the early years of electricity restructuring to better understand the markets today.

IV. ISSUES

The following issues may be examined at the hearing:

- Over the past two decades, how did FERC seek to improve wholesale electric markets?
- What were the nationwide expectations for the wholesale markets after restructuring?
- What economic and policy factors were causing electricity prices to change in the years prior to restructuring?
- How were electricity prices impacting American workers, jobs, and economic growth prior to restructuring?
- How were retail consumers of electricity expected to benefit from the changes in the wholesale markets?

¹¹ See FERC’s internet page on Order No. 888, at <http://www.ferc.gov/legal/maj-ord-reg/land-docs/order888.asp>

¹² *Regional Transmission Organizations*, Order No. 2000 (slip opinion at p. 513), 65 FR 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, 65 FR 12088 (Mar. 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff’d sub nom, Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001). <http://www.ferc.gov/legal/maj-ord-reg/land-docs/RM99-2A.pdf>

- What were the concerns of state energy regulators as FERC began to restructure wholesale markets?
- How might this history provide us with guidance for improving wholesale markets in the future?

V. STAFF CONTACTS

If you have any questions regarding this hearing, please contact Annelise Rickert, Robert Ivanauskas, or Tom Hassenboehler of the Committee Majority staff at (202) 225-2927, or Tuley Wright, John Marshall, or Rick Kessler of the Committee Minority staff at (202) 225-4407.