OPENING STATEMENT

The Regulatory Authority of FERC
Chairman Joseph Lieberman
June 20, 2001

Good morning, and welcome to all our witnesses and guests. Thank you for joining us today as the Senate Governmental Affairs Committee continues its hearings into how the federal government has conducted itself in response to the deregulation of U.S. energy industries, with a particular emphasis on the cost and supply of electricity in California and the Western United States.

Last week, we heard from five economists, including Alfred Kahn, the father of deregulation, himself, who agreed the California market was so dysfunctional that the federal government needed to intervene and temporarily regulate. On Monday, the agency that oversees electricity rates - the Federal Energy Regulatory Commission, known here in Washington by its acronym "FERC" - agreed to take action. Today, we will hear about FERC’s latest order and whether or not it adequately carries out the Commission’s statutory responsibility to provide "just and reasonable" rates for electricity consumers in California and the West.

I’m relieved the Commission has asserted itself more aggressively to address the severe problems in Western power markets, although, I am also concerned that even at this late date it has not done all that it could. The price limits established by FERC may still be too high. And ratepayers -- in California and in other states -- may still deserve refunds for overcharges that have been imposed on them.

We’re fortunate to have most of the key participants in this complex matter as witnesses before the Committee today, including Governor Grey Davis, the five FERC Commissioners, the governors of North Dakota and Montana, representatives from the state governments of Oregon and Washington, as well as the ranking Republican on the Senate Energy Committee and Washington state’s two senators.

To put this hearing in historical context, federal oversight of wholesale electricity sales began in 1935, when Congress passed the Federal Power Act mandating that the prices for electricity be "just and reasonable." Originally, these oversight duties were assigned to the Federal Power Commission, which, in the1977 reorganization of the Department of Energy, became the Federal Energy Regulatory Commission.

The Federal Power Act remains the primary statute governing FERC oversight of wholesale electricity sales. The law requires that all rates in connection with the transmission or sale of electric power under the Commission's jurisdiction shall be "just and reasonable and not unduly discriminatory or preferential." FERC is authorized, upon outside complaint or its own initiative, to investigate prices that appear suspect. And if the rates are found to be unjust or unreasonable, the Commission is obligated to take remedial action, including the ordering of refunds to consumers.

Traditionally, FERC has met its obligation to ensure "just and reasonable" rates by ordering rates that provided for cost-recovery, plus a margin of profit. More recently, FERC has allowed "market-based

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pricing," or "proxy pricing," (such as it ordered yesterday) to be the standard for "just and reasonable." No matter what the methodology, FERC remains responsible for ensuring that the wholesale markets operate competitively and that the rates they produce <u>are</u> just and reasonable.

As the committee heard last week, in 1966 California enacted legislation to deregulate its electricity markets beginning in 1998. It has not been an easy transition either for California or other Western states because of record prices for electricity, supply shortages, rolling-blackouts, and price spikes for natural gas. The transition to deregulation prompted the bankruptcy and near-bankruptcy of major investor-owned utilities. And, in an extraordinary development, the state of California has now assumed responsibility for wholesale power purchases.

So, the question today is, has FERC responded adequately to this crisis? Last July, almost a year ago, FERC began a staff investigation into the electricity problems in the West and a formal investigation into California prices. In a December 15 order, FERC concluded that the California market was deeply flawed which, when combined with other factors, had caused electricity prices to be neither just nor reasonable. So, the Commission ordered changes in the California market and established a procedure for refunding excessive charges. Yet in March and April of this year, as the Commission began implementing that procedure, it also significantly limited the number of transactions subject to refund and the circumstances under which prices would be mitigated. In April, the Commission also initiated a formal Federal Power Act investigation of the Western electricity market. Two days ago, FERC expanded upon those actions by setting a "soft cap" on energy prices, round-the-clock, region-wide.

In my opinion, the Commission's record in this matter raises serious questions about whether it will adequately oversee newly deregulated energy markets. It has been very slow in responding to a very real and painful crisis. While the Commission, by its own admission, has had the authority to intervene to ensure just and reasonable rates, it has been surprisingly reluctant to do so. It did not initiate a formal investigation of the Western market, outside of California, until April. In the past, when it has intervened in response to California's problem, the result has fallen short of what the public interest required. I hope that Monday's order will be more successful, but I continue to have substantial concerns. I believe the order addressed the matter of refunds for electricity in an unsatisfactory and unconvincing manner, and it did nothing for customers elsewhere in the west. Monday's order will constrain some price spikes and close some loopholes in the previous FERC order. But will it ensure that electricity prices in the West are just and reasonable? That is not only the bottom line question, it is the law. And it is that question I hope our witnesses will address this morning.