

Commentary

## **Electricity Is a Federal Issue**

Walls Street Journal, August 18, 2003

By WILLIAM W. HOGAN

The electricity blackout that cascaded through the Midwest, Canada and New York was not supposed to happen. President Bush, Gov. Pataki and Congress have demanded a full explanation. Gov. Richardson of New Mexico already knows the answer must be that we have "a Third World electricity grid." Ouch! That's a bit of a leap. Experts were surprised by the blackout, and couldn't immediately pinpoint the backbreaking straw. The autopsy will take a bit of time to marshal and diagnose the evidence. With good sense, longer-term changes in the electric grid may be undertaken to make future blackouts less likely.

One conclusion is evident: The electricity grid is highly interconnected and interdependent. What happens in Ohio affects New York City, and vice versa. Given this complexity, the electricity system requires carefully designed and consistent rules of the road governing use of the existing grid. Electrical engineers have long known this, but the political and commercial classes have been wrangling over who should set the rules, and how. Despite the claims of Enron, the market cannot solve the problem of designing the rules governing use of the transmission grid. Which governments -- state or federal -- should set the rules? Now we cannot fail to see that policies at the state level are not the answer. This is a federal issue.

\*\*\*

The Federal Energy Regulatory Commission has been struggling with appropriate restructuring of the electricity industry since the Energy Policy Act of 1992, signed by the earlier President Bush, required fundamental changes in policies for access to the grid. In 1996, with some reluctance and great deference to state preferences, the Commission approved the basic framework of a new electricity market developed for and by California. Inconsistencies with the real electricity system were dismissed as academic. But experience showed that the California design was fundamentally flawed. Deference to the state, as present Commission members now understand, was a mistake.

In the next few years, the Commission let a thousand flowers bloom. Regions could choose their own designs for grid management to support wholesale electricity markets. The hope was that practice would outperform theory. The anticipated flowers proved to be mostly expensive weeds. And lost in those weeds, a seemingly endless process of delay could be exploited by those who opposed the policy of nondiscrimination and open access to the transmission grid, the sine qua non of the intended wholesale electricity market.

One flower did appear. Following a false start, the basic electricity market design embraced in the Mid-Atlantic states in 1998 -- shortly later in New York, then just last March in New England, and planned for the Midwest for next year, but only talked about in Canada -- showed why it is so necessary to have consistent rules. This design, with market rules carefully constructed to reflect the realities of the electricity system, is the only design that works in theory and practice. But even here, given connection to other regions, a well-designed system can be brought down by flaws in another part of the grid.

The Commission learned from this experience and saw the need for coordination and standardization. Unfortunately, the Commission's resulting proposal for transmission access and a "standard market design" overreached. The too expansive plan set off alarms, especially among regulators in the Western and Southeastern states. A noisy political battle ensued over the seemingly arcane issues of control of the grid, wholesale electricity market design and regulatory turf.

Objections from the West cited the Commission's earlier role in the California debacle, which caused major problems throughout the region. Hence, in the West wholesale electricity markets transcend the boundaries of individual states. The blackout in the East confirms the painful lesson that policy must be made above the state level.

With fortuitous timing, the House and Senate are negotiating a compromise between their recently passed energy bills to produce a new Energy Policy Act for the current President Bush to sign this fall. Deluged with parochial complaints from many states or individual commercial interests, Congress has been under great pressure to stop the Commission from going forward with its new, standardized rules to coordinate use of the electricity grid. The Senate Energy Committee in particular recently voted to bar the Commission from proceeding with its plan for at least another two years. Arguably, such a prohibition would compromise other mandates, such as for transmission expansion and cost allocation. The House bill includes policy guidance but no such restriction on the Commission.

The blackout should change the game. A focus on the core elements governing use of the transmission grid under what the Commission now calls its "wholesale power market platform" is necessary and urgent. Respect for the principles of nondiscrimination and open access, applied to the complex transmission grid, dictates the essence of this platform. Without this efficient design and consistent rules across the grid, there is little hope that electricity markets will work well under stress.

Before last week, the consumer crisis of high electricity prices in the West in 2000-2001 had been followed by a producer crisis of excess capacity and credit crunch. But for most of us those economic issues seemed remote and confusing. A cascading blackout is not a

good thing. But there is a clarity that gets our attention. The resulting calls to upgrade the grid point towards long-term improvements. However, the most immediate task is to implement sensible policies with consistent rules for coordinating transmission use across the interconnected grid we have today. The Commission knows what to do. Congress, feeling pain, should recognize the cascading blackout as conclusive evidence that we can no longer placate the competing commercial and political interests by ignoring the strong interactions in the grid. Congress should seize every opportunity to support the agenda laid out by its Federal Energy Regulatory Commission.

Mr. Hogan , research director of the Harvard Electricity Policy Group, is professor of Public Policy and Administration at Harvard's John F. Kennedy School of Government.