Perspective From the First RTO: The Future of Industry Regulation

The Impact of Competition publisher, Nick Smith, talks with Phillip G. Harris, the President and CEO of PJM Interconnection, to get his take on how his company is thriving in this new environment and what will and should be the future role of the RTOs and the FERC in managing energy industry change.

In the summer and fall of 2001, PJM Interconnection President and CEO Phillip G. Harris testified three times about electric system reliability issues before legislative committees. Harris first testified before the U.S. Senate Committee on Governmental Affairs and then before the U.S. House of Representatives Subcommittee on Energy Policy, Natural Resources and Regulatory affairs. Finally, he testified before the U.S. House of Representatives Subcommittee on Energy and Air Quality.

In an environment of public mistrust and disillusionment, the utilities sector has its work cut out. Each customer-oriented company is going to have to deliver more than just the power – it will need to balance the needs of the marketplace with reliability while delivering innovative, customer-centric solutions and products, and all in a highly competitive environment.

Smith: What is the greatest challenge facing the energy industry today?
Harris: We find ourselves at a key decision point in the history of the electric industry. Our institutions can function only if they earn the trust of the public. And, more than ever, the public is demanding affordability, reliability and environmental sensitivity. If the public is to have trust in the marketplace, the public demands that the marketplace produce real, fair and just results. We must roll up our sleeves and reaffirm our commitment to finding the best market-based solutions that deliver real value to the customer. And we need 21st Century tools to do the job.

Smith: What are the key ingredients of success?
Harris: The critical test remains the test of use. Competition in the supply of electricity in the mid-Atlantic region is working and is producing significant benefits to the consumer. With strong and visionary leadership from the FERC (Federal Energy Regulatory Commission), with its having adequate resources to do its job and with its willingness to take bold action to get critical market structures in place, it can, and most recently has, taken on a vital and appropriate role as a regulator to protect the public interest. Our story in the mid-Atlantic is one of success – not as a result of any special magic but rather as a result of our commitment to reliability and market-based solutions driven by a clear commitment from the regulators, both state and federal, to take the critical steps needed to make the markets work.

PJM is governed by an independent Board that is guided by three unique fiduciary duties. First, to create and operate robust competitive bulk power markets; second, to maintain the reliability of the network; and third, to avoid undue influence by any one sector of the marketplace.

Each of these responsibilities is co-dependent on each other and each work to make the markets work. Our history is one of complete openness and transparency – openness of our actions and openness of the markets. PJM posts prices every five minutes on our Web site. We have a transparent process to maintain reliability and to undertake regional planning. And it works. In 2000, our spot market prices cleared below $100/MWh 99 percent of the time and more than 70 percent of the time those prices were less than $30/MWh.

Smith: What is the FERC’s role in all this?
Harris: We need a strong regulator with adequate resources – funding, advanced technology and skilled personnel – to work with the RTOs (Regional Transmission Organizations) to monitor these markets and make critical design corrections. We have made over 140 such design changes to our markets and have sought and received the FERC’s support when our Board or the members identified needed changes.

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out that vision. We applaud the FERC’s recent actions to create large RTOs in the country as setting forth an important vision. At PJM, we believe we are well poised, working with our colleagues and market participants in the Northeast, to take the critical and bold steps needed to make that vision a reality. We are well aware of the challenges that lie ahead. We’ve been through many of these issues before. But PJM as we know it today was born out of a vision to create a robust competitive wholesale market. We believe we’ve delivered on that vision and the American consumer in our region is better off as a result.

**Smith:** What are some of the specific ways PJM has delivered on the vision?

**Harris:** We view our responsibility for reliability as job one. Restructuring cannot and need not mean any compromise to the reliability we have come to count on. We also understand that, unlike the old paradigm, we can develop market solutions that both ensure reliability and enhance the marketplace. Our reliability is stronger now than it has ever been. That has only occurred because we have integrated the workings of the market and the maintenance of reliability. You cannot separate out the two.

The market monitoring function of the RTO is critical to maintaining the robustness of our marketplace. PJM’s Market Monitoring Unit has authority to review the marketplace, to issue cease and desist letters and to go to the FERC to seek enforcement actions. We believe that an independent market monitor that works alongside the system operator provides the needed daily interaction that is critical to understanding the workings of the market rules and ensures that the market remains competitive. We see a strong market monitor working with the RTO board and with the Commission as key to this vital task. This function is very much akin to the role of an auditor acting under SEC guidelines and advising a corporate board of directors. We envision board guidelines, approved by the FERC and carried out in accordance with FERC directives to guide this important task.

**Smith:** What concerns do you have when you take in the current landscape?

**Harris:** We are concerned that some of the proposed RTOs being formed around the country are simply grid operators with little responsibility for operating critical markets. We think the lack of a neutral transparent spot market will cause significant problems in those regions in the future. In order to jump-start such markets, our members have authorized us to make our market rules available at nominal cost to newly developing RTOs around the country. We are undertaking this effort because we firmly believe that we should all learn from our past experiences rather than reinvent the wheel on costly untested systems that have not withstood the test of use.

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**Smith:** What are issues PJM believes are important for Congress’ consideration?

**Harris:** We have proposed before Congress that the FERC be granted the authority and flexibility to adopt and enforce solutions that balance the needs of the marketplace and reliability. We remain concerned that the reliability legislation submitted by the North American Electric Reliability Council seeks to codify outdated tools and cumbersome structures when nimbleness and agility are needed to meet the speed and integrated nature of the 21st Century marketplace. We don’t think we should lock into stone yesterday’s solution, which only address one half of the equation and therefore urge the Congress’ consideration of a more simplified and balanced approach.

We also need to ensure that the FERC’s regulatory toolbox is filled appropriately to oversee the workings of the marketplace. To that end, we recommended several initiatives. The FERC should employ tools to work with the states to ensure the smooth operation of the marketplace. Through joint boards and deference to regional solutions, an appropriate balance can be reached that respects the rights of the states while also recognizing the interstate nature of the grid. The FERC should be able to ensure that cooperatives, municipals and federal power marketing agencies provide comparable access to their transmission grids that they provide to themselves.

The FERC should be empowered to require all transmission entities to participate in RTOs to ensure a synchronous market and holistic regional planning. Legislation should require the FERC to promote competitive markets, including the deployment of demand response tools. The FERC should have the authority to encourage and defer to regional siting decisions made by states through an open transparent regional planning process. Mandatory and enforceable reliability rules, established by the FERC with input and advise from the industry, should be applied to all system operators and subsequently enforced through RTOs. The FERC should have the unfettered ability, in the first instance, to balance competing ability, in the first instance, to balance competing market and reliability issues.