NATIONAL ELECTRICITY POLICY: FEDERAL GOVERNMENT PERSPECTIVES

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

OF THE

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HOUSE OF REPRESENTATIVES

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NATIONAL ELECTRICITY POLICY: FEDERAL GOVERNMENT PERSPECTIVES

THURSDAY, SEPTEMBER 20, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND AIR QUALITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2123, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Members present: Representatives Barton, Ganske, Norwood, Shimkus, Shadegg, Bryant, Walden, Tauzin (ex officio), Boucher, Hall, Sawyer, Wynn, John, Waxman, Markey, Barrett, Luther, and Strickland.

Staff present: Sean Cunningham, majority counsel; Jason Bentley, majority counsel; Andy Black, policy coordinator; Peter Kielty, legislative clerk; Sue Sheridan, minority counsel; and Erik Kessler, minority professional staff.

Mr. BARTON. The subcommittee will come to order. We are going to start the hearing and immediately recess until we get the ranking minority member or a minority member, but I do want to start on time. So we are in session subject to a quorum, and the Chair would note that there is an absence of a quorum at this time.

[Brief recess.]

Mr. BARTON. The subcommittee will now come to order and the Chair would note that there is a quorum. The Chair would recognize himself for an opening statement.

This is the subcommittee's first hearing since what I call "Day of Decision" which was Tuesday, September 11. As Chairman of this subcommittee, I think for all members of the subcommittee, we want to offer our condolences to all of the families who had people injured, killed, or who are missing.

We want to give special prayers to Congressman Vito Fossella of this subcommittee who had a large number of constituents at the World Trade Center. He has one of his staffers, Ms. Julie Walker, who has a cousin who is missing and is yet unaccounted for. So we are with all of those in our prayers and in our thoughts.

As a result of last Tuesday, our Nation's focus has fundamentally shifted. The issues before this subcommittee and this Congress and this country that were so important on September 10 are not nearly as important today. We must pay much more attention to our national security, and that includes our energy infrastructure.

This subcommittee stands ready to help the President and the administration, on a bipartisan basis, to guarantee to the largest

extent possible the security and safety of our infrastructure and the people that use that infrastructure and maintain it. Energy is the lifeblood of our Nation's economy. We have to do everything we can to protect our power plants, transmission assets, pipelines, terminals, production facilities, and the list is endless.

I have already spoken with the full committee chairman, Mr. Tauzin, who is with us today; at the staff level with Mr. Dingell; the ranking Democrat, Mr. Boucher, who is here; and we were as a united subcommittee, ready and willing to help. If there is legislation that the President feels is needed, we will do our very best to act quickly in a bipartisan fashion without partisanship. We are ready to hold public and private briefings or hearings necessary to help the President and the American people on the immediate issues that are within our jurisdiction.

Today we are going to go ahead with a hearing that is important to the future of our electricity industry. This is a hearing that has been planned for several months and the decision was made to go ahead with it, although we know that, as I said, the focus has changed. We have our Deputy Secretary of Energy, Mr. Blake, with us and we want to thank him.

We also have on the second panel, I think, all the current commissioners of the Federal Energy Regulatory Commission, including its new chairman, Mr. Wood, and we want to thank you for being here, as well as Ms. Brownell who is a new commissioner in the purple, and our two stalwarts, Ms. Breathitt and Mr. Massey, who are still doing yeoman's work at the Commission.

When we discuss electricity restructuring, the goals are the same. We want to use restructuring and do restructuring in such a way that we increase the supply of electricity, that we improve the effective operation of our transmission grid and that we also increase the capacity of our transmission grid.

There are a number of questions that we are going to ask today. We want to give the Deputy Secretary and the Commission the opportunity to enlighten us on their thoughts concerning regional transmission organizations, better known as RTOs; whether that needs to be a voluntary system, a mandatory system. If we need to give FERC the authority to mandate participation; exactly how should we go about getting that adequate and full participation? Is there a magic number of RTOs for the country? Is 4 the magic number? Is 6 the magic number? Is 8 the magic number? Is there a magic number.

What do we do to encourage private sector investments in new generation and transmission. How important and to what detail should Congress be prescriptive in legislation determining how to set the structure of RTOs, if any.

Those are some of the questions that we are going to offer today for consideration to the administration and to the FERC Commission. Again I want to thank our witnesses, the Deputy Secretary and the FERC commissioners, and we look forward to hearing from you.

[The prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, SUBCOMMITTEE ON ENERGY AND AIR QUALITY

This is this Subcommittee's first hearing since last Tuesday. Let me first offer my own condolences to all those who were injured, or who have family or friends missing. I want to specifically offer my thoughts to Congressman Vito Fossella of Staten Island, whose district was heavily affected, and to his energy staffer, one of my favorites, Julie Walker, who is missing a cousin. My prayers are with you all.

As a result of last Tuesday, our Nation's focus has fundamentally shifted. We must pay more attention to security—of the American people and of our critical infrastructure. This Subcommittee will help Congress and the Nation promote the security of our assets. Energy remains the lifeblood of our economy. We must do all we can to protect our power plants, transmission assets, and pipelines.

I will work with Chairman Tauzin, Ranking Member Dingell and Ranking Member Boucher, as well as other Subcommittee Members, to determine how this Subcommittee can help. If Federal agencies need legislation to deal with this emergency, we will review their requests quickly and without partisanship. We will hold whatever briefings or hearings necessary to help the President and the American people on immediate issues within our jurisdiction. We will also work together on an appropriate pace to resume our traditional legislative activities.

This hearing on the future of our electric industry was planned before the events of last Tuesday. But it is even more timely now. I appreciate this star cast of witnesses coming at such a crucial time. Deputy Secretary Blake, thank you for returning, and for offering the Subcommittee an energy security update in your testimony, as well as your perspective on national electricity policy. As I have said, we stand ready to help in any way.

I want to also welcome the Commissioners of the Federal Energy Regulatory Commission. In addition to frequent guests Bill Massey and Linda Breathitt, I see we have two new characters—both familiar faces. Nora Brownell was well known for her work on the Pennsylvania Public Utilities Commission, and you have been helpful to this Subcommittee before on electricity issues. Welcome to the Commission and to Washington.

Finally, I want to welcome my good friend, another Texas Aggie, Pat Wood. Thank you for accepting this mission, and I'm glad you are here at such a crucial time. I look forward to working with you, and I commend to you a Subcommittee Membership, both Republican and Democrat, who are good people to work with and take their responsibilities seriously.

Our goals with electricity restructuring should be many. Among them are:

1. Increasing the supply of electricity
2. Improving the effective operation of our transmission grid
3. Increasing the capacity of our transmission grid.

Among the many questions you have each been asked to discuss, I am particularly interested in your thoughts concerning Regional Transmission Organizations (RTOs).

- Is the current voluntary system adequate in getting full participation?
- What is the magic in 3 RTOs in the Eastern interconnect and 1 RTO in the Western interconnect?
- Also, how can we encourage private sector investment in new generation and transmission?
- Finally, how prescriptive does Congress need to be concerning enforceable standards for reliability?

Thank you again for being here during a busy time.

Mr. BARTON. The Chair would now recognize the ranking member on the minority side, Mr. Boucher of Virginia, for an opening statement.

Mr. BOUCHER. Thank you very much, Mr. Chairman. I share your commitment to taking such steps as it is appropriate for this subcommittee to take as we seek to address the national security needs that now confront the Nation, and I want to compliment the chairman on his very appropriate statement in that regard and his comments on that subject.

With today's hearing, we examine the areas in which strengthening is needed in the Nation's electricity system and how Congress can promote that strengthening through appropriate legisla-

tion. It is proper that we begin this examination through the assistance of the witnesses we have present today from the U.S. Department of Energy and from the Federal Energy Regulatory Commission. And I want to extend a welcome to the witnesses.

I also went to take the opportunity of these remarks this morning to note the singular persistence of Chairman Barton in his longstanding efforts to address this particular set of energy policy challenges. During the last Congress he drafted and built a broad base of support for a major electricity restructuring measure, and while all members of the subcommittee found provisions in his measure both to like and dislike, he received universal approval from the members for the collaborative and the bipartisan process that he undertook as his comprehensive measure was constructed and brought to this subcommittee for markup. I am pleased that the chairman has indicated that a similarly inclusive process will be undertaken for the electricity legislation that it is our goal to consider this year.

Some issues that were central to the debate last year are simply no longer on the agenda. For example, in the wake of the California experience, there appears to be no appetite today for the enactment of a national requirement for access to transmission lines to accommodate retail competition. I think that, unlike the last Congress, when the lack of agreement on a retail wheeling mandate stalled the consideration of this subcommittee's bill at the full committee, we are unlikely to give serious consideration to retail competition matters as a part of our conversation this year.

Instead, our debate will now focus on transmission issues relating to system adequacy, reliability, and appropriate access for electricity generated for the wholesale market. We will ask how best to assure a proper allocation of existing capacity, and whether and by what means the Federal Government should encourage the construction of new capacity.

We will also inquire regarding the proper balance between Federal and State authorities for the regulation of the transmission grid. And in conducting this phase of the inquiry, I think that we should be mindful that some of the most fundamental questions regarding the balance between State and Federal jurisdiction will be argued before the Supreme Court on October 3, with the anticipation that a Supreme Court decision may be forthcoming on these very important matters during the spring of next year, or perhaps earlier.

We will also be asking a number of other important questions. Does the Federal Energy Regulatory Commission, which is under new leadership, believe that it has sufficient authority under the Federal Power Act and other statutes to fulfill its responsibilities? And, if not, what precise new statutory authority does the FERC need and to what purpose would those new authorities, if granted, be applied?

Does the administration believe that a time has now arrived for the passage of a comprehensive electricity measure and, if so, does the administration have legislative proposals for this subcommittee to consider?

As we determine the best path forward, we also invite the consultation of all externally interested parties, and we would very

much welcome the advice and recommendation of stakeholders as we consider legislation.

I look forward to working with Chairman Barton and with all members of this subcommittee as we take the steps this fall to strengthen our Nation's electricity system.

Finally, I want to extend a word of welcome to today's witnesses and offer a particular welcome and congratulations on their appointments to Chairman Wood and to Commissioner Brownell of the Federal Energy Regulatory Commission. We very much look forward to hearing from them and from the other commissioners as well.

Thank you, Mr. Chairman and I look forward to today's testimony.

Mr. BARTON. We thank you, Mr. Boucher.

The gentleman from Louisiana, Mr. Tauzin is recognized for an opening statement.

Chairman TAUZIN. Thank you Mr. Chairman. Let me thank you for continuing during these most unsettling days at our Nation's Capitol these most important hearings on the Nation's continuing efforts to improve its electricity policy and to establish a more reliable and secure general energy program for our country.

You made the point, but let me make it again: This tragedy last week touched every one of us. One of my good friend's—Russell Keen from Lake Charles, Louisiana—son was in an elevator in one of the buildings in New York at the time the second plane hit and the elevator crashed downward. He survived that, along with another gentleman and two ladies who worked with him. And you may have seen him on CNN. The ladies escaped through a 15-inch crack in the space that they could come out of the elevator. Russell Keen, Jr. didn't make it out. In fact, the firemen who were arriving at the scene to help get him out of that elevator were probably lost along with him as the building came down at that moment.

We think of him and we think of the firemen and all at the Pentagon and the unfortunate passengers who were aboard those planes today. And we pray for them and we pray for our country.

But we also recognize that perhaps the most important thing we can do for all of them is to continue the work of this committee and the Congress in securing our national security. And part of that is in energy and is in the electric grids in the systems that keep our country strong and powerful and powered.

In that regard, this hearing is just one more step in a long series of hearings, Mr. Chairman, that you have already embarked upon to examine the reliability of the Nation's infrastructure.

I want to thank your ranking member for his excellent statement as well, as usual. The cooperation and understanding that we have with you and Members on the other side as we go forward in this area are going to be critical if we are to address legislation to the floor. And I want to thank you again, Rick, for that effort.

And I also want to thank the ranking member of the full committee, Mr. Dingell, who, as you know—I want to make this announcement to all the members—last week joined me in a letter not only to the FERC and also to DOE, but to every agency under our jurisdiction, inviting them to communicate with us in an internal review as to all the agency operations, to examine those agency

operations, the security of those operations, and the potential vulnerabilities of any of those assets so that we might work collaboratively to better protect and insure for our Nation's security those assets.

As that information comes back to us, it is beginning to filter back. I have also assigned our vice chairman, Richard Burr, to the job of working with each one of our subcommittee chairs, including Mr. Barton, and the committees response to those evaluations delivered to us by all the agencies, some of whom are testifying today. Obviously, some of the specific legislative proposals and some of the findings in that review are not ready for public discussion, and we will not have that today. But internally, our committee is working with these agencies and all the agencies under our jurisdiction in that process. And I have asked Mr. Burr to coordinate that effort, and all the subcommittee chairs have been instructed to work with Mr. Burr in that effort.

As you know, our vice chairman serves on the Intelligence Committee and is a member of the Special Committee on Terrorism and has a very special knowledge of the potential threats that might continue to exist within our country. So our committee will continue with this work without necessarily holding public hearings on it. And more importantly, we will move forward in this public arena with the work of our committee, particularly this important work in securing the Nation's electric grids.

Again, I want to thank this subcommittee for the work it has already put into beginning to establish for America a more competitive and reliable system of electricity. We have witnesses today from the FERC, who are returning members of course, Commissioners Massey and Breathitt, and I want to thank both of them and the chairman for the excellent cooperation the FERC extended to us as they assisted in a way we found suitable with the crisis that was building in California. I think our committee and the FERC's effort in that regard as we worked together, with a few good breaks from the weather and from the Almighty, helped to stave off some very serious consequences in California, and I want to thank the commissioners for there efforts during that time.

I also want to welcome, of course, the new chairman, Pat Wood and the new commissioner, Ms. Brownell, to the service of the Commission. Mr. Wood comes from my neighboring State. I have come to know him in some of the telecommunication battlefields that have been waged around some of the big issues that I chaired as the Telecommunications Subcommittee Chair, and he brings a wealth of talent and capabilities to the office of chairman of the Federal Energy Regulatory Commission. We are delighted, Pat, to welcome you to the committee. Ms. Brownell, likewise, for your extraordinary experience in communications and finances. I know that you will bring indeed a great new talent to the Commission. We welcome you both.

To Deputy Secretary Blake, I know this is your second visit. You appeared on the Price-Anderson Act, but I want to thank you again for the excellent relationship already building between the Secretary and your office and our committee.

As the Secretary announces the administration's position on emergency electric grid concerns, I want you to know that the

chairman of this subcommittee and the full committee is prepared to work with you to expedite that before we leave session this year.

Again, Mr. Chairman, you have done incredible work and this committee has done incredible work. I think we honor again the lives of our fellow citizens who were lost last week by demonstrating that we are going to carry on this Nation's business and we will secure this Nation's power grids and its power systems, and that the work you do will help immeasurably to that end. And I yield back the balance of my time.

[The prepared statement of Hon. W.J. "Billy" Tauzin follows:]

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

I would like to thank Chairman Barton for continuing—during these unsettling days—with these important hearings into our Nation's Electricity Policy.

I should note at the outset that the tragic events of last week make it critically important that we continue to examine the reliability of our Nation's energy infrastructure (and I use that term "reliability" in a broader sense than just electricity). Several months ago, the Committee embarked upon this review, and most recently Ranking Member Dingell and I sent letters to the FERC and DOE, along with the other agencies within our jurisdiction, requesting specific legislative proposals that will enable them to respond fully to the recent attacks. I'm sure our audience will understand if our witnesses are not able to discuss publicly, at this time, what some of those recommendations may contain.

As we move forward, however, we must also maintain focus on vital long-term policies. The electric power industry is an essential component of our Nation's energy infrastructure. And, as legislators, it is up to us to put in place a legal structure that outlines our vision for a 21st Century version of this industry.

For the past century, the power industry has consisted of heavily regulated, vertically-integrated monopolies. Yet the industry is changing, opening to competition. We now see on a daily basis that competitive wholesale power markets are the superior model. Over the past decade, for example, the number of wholesale power transactions has increased 400% while wholesale prices have steadily declined. Technologies have reduced the cost of generating electricity as well as the size of generating facilities.

To carry this success further, we in Congress need to ensure that American consumers have access to the most efficient, cleanest and most affordable electric power the market is able to produce—irrespective of who produces it. Whether you're in a state that allows retail choice or you rely on your utility to go out into the wholesale market to buy your power, there are better sources of electricity available today because of competition.

To extend competition's great benefits, we must still overcome certain, anti-competitive barriers. We still do not have the seamless interstate networks of transmission needed to support truly efficient wholesale markets. Because of this, consumers aren't fully enjoying the benefits and savings of competition. We're also not building new transmission infrastructure, in part because of regulatory uncertainty, but also because we can't get it sited.

We have made tremendous leaps in recent years in technology and our ability to process information. It's time we make sure that technology is applied to generating, transmitting, distributing and using electricity.

I am anxious to hear today what our governmental witnesses have to say about the direction of our Nation's electricity policy. This is Deputy Secretary Blake's first visit to our Committee—and I congratulate you on your appointment and look forward to hearing the Administration's views. For Chairman Wood and Commissioner Brownell, this is their first time appearing before the Energy & Air Quality Subcommittee, also, and I welcome you both. For Commissioners Massey and Breathitt, I welcome you back.

Thank you once again, Mr. Chairman.

Mr. BARTON. We thank the gentleman from Louisiana. We are not going to limit members on their opening statements. I don't think this is a day to adhere to regular protocol. But we would encourage members to attempt to be somewhat precise in their comments.

The gentleman from Ohio, Mr. Sawyer is recognized for an opening statement.

Mr. SAWYER. Mr. Chairman, I appreciate what you just said and will attempt to do precisely that. In that regard, let me associate myself with your remarks, those of Mr. Boucher and the chairman of the full committee, particularly with regard to the observations of the latter two regarding your leadership of this effort in the last Congress.

Just by way of observation, I remember 7 and even 5 years ago when we were still talking largely about deregulation, and today we are almost always refer to restructuring, and the growth in the recognition of the importance of the transmission grid and how we go about the business of growing and nurturing and maintaining a modern structure for a working set of regional markets in this country continues to be central to our discussions.

In that regard, I thank you for your openness to ideas from both your left and your right, and look forward to our continuing to work together this year.

[The prepared statement of Hon. Tom Sawyer follows:]

PREPARED STATEMENT OF HON. TOM SAWYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Mr. Chairman. I am grateful that we have the chance to take up these hearings again after last week's horrendous events. Those events are, of course, at the front of our minds, but we must also try to continue with the important work that we must do in this committee. I believe that no effort to solve this country's energy problems will be effective if we do not also tackle electricity issues. That is why I am glad that we will have the chance to hear from Deputy Secretary Blake and all the FERC commissioners. I hope that we can learn more about what we should be doing at the federal level to finish the job of restructuring this country's electricity system.

With the Energy Policy Act of 1992, Congress altered the direction of the electricity industry. We now have widespread merchant generators, long-distance wheeling of electricity across transmission lines, and the development of a new business organization: the regional transmission organization. We started down this road, away from the vertically integrated local utilities of old, but today we still do not a have a clear vision of where, ultimately, we are headed. The transition that started over a decade ago is far from complete, nor is it clear what the final form of the transition will be.

It would be understandable to look at the example of California, or to see the slow progress in some other states and think that perhaps we should try to go back to the old way of doing things. I myself supported such a temporary retreat to allow California to redraft its rules to allow for a functional retail market. But a broader return to vertical utilities would be neither feasible nor wise.

Rather, we in the federal government should marshal the will to put together the kind of federal framework that will allow the retail electricity markets that are developing in some of the states to work properly. A significant part of that effort will be to provide the regional transmission systems that will allow for the easy flow of electricity between markets. Without such a measure the promise of competitive wholesale and retail electricity markets will not be realized.

I look forward to the testimony of these witnesses and the work that we have ahead of us in this committee.

Mr. BARTON. We thank the gentleman for those kind words. The gentleman from Illinois, Mr. Shimkus is recognized for an opening statement.

Mr. SHIMKUS. Thank you, Mr. Chair. I would ask unanimous consent that the full opening statements be submitted into the record. And would just——

Mr. BARTON. Without objection.

Mr. SHIMKUS. [continuing] like to add that what we do here is important, and we have all followed the energy debate. It is even more so important now as some—we have new national security concerns. The transmission grid needs to be part of the entire discussion as we talk about energy security.

I will be concerned with looking at the siting issues and we have to address the States rights issue, the private property rights issue, regional coordination and, as I got in trouble for a while ago, talking about Federal land siting. I think that is doable, and there is a lot more Federal land than pristine national parks that are available out there to help us grow the grid.

RTOs has been a big issue on my plate and I know there is a proposal for maybe four nationally in Illinois. We had a time when there are three right now—or parts of three. It is very, very confusing. And I am open to a debate on discussion on how we need to move in that direction. Again, the most important thing is that power generation and transmission is really critical to the livelihood of us as an economic power, and even more important in these tough times that we are experiencing right now. Hopefully we can move with due diligence and work together to move something that will be beneficial for the country.

And with that, Mr. Chairman, I yield back my time.

Mr. BARTON. We thank the gentleman. The Chair now recognizes the ranking member of the full Science Committee, one of the most distinguished members of this committee, a veteran of World War II where he flew fighter planes, I believe in the Pacific, but I wouldn't swear to that; one of the very best examples of what a Congressman is really all about, and working for his constituents in his State, the very honorable Ralph Hall of Texas.

Mr. HALL. Thank you, Senator. Mr. Chairman, thank you for your tenacity and your pursuit of a decent bill. You have really worked hard on it. And I associate myself with Chairman Tauzin, and when he tells me that he has gotten together with former Chairman Dingell, I always have a real sense of satisfaction as well as some kind of a pang of fear until I have read the small print. But you get those two together, that is great leadership, combined with our Chairman.

I will be brief, too. I certainly thank Francis Blake for her time of planning to get here, being here, and then testifying and then answering questions that we will submit later.

I just basically want to say that while terrorist attacks are foremost on our minds, I think it is important that we also think offensively rather than defensively about the future of the bulk power transmission system, that is something that I have great concern over, and the overall architecture of electrical restructuring. It is reasonably clear what the structure of the distribution companies will be and it is also reasonably clear as to what the structure of the generation sector is going to be. What is not clear is what the structure of the transmission sector will be. And I think it is fair to say that some of the best minds in the industry have changed their minds about what it should look like, probably more than once.

I think our overreaching goal should be that whatever legislation we eventually write will not prohibit the evolution of the trans-

mission sector. The wisdom of also the Deputy Secretary and the chairman and members of the FERC is certainly going to be very welcome.

I would be remiss if I didn't take an opportunity to welcome a fellow Texan, as others have welcomed him. While this is Pat Wood's first appearance before this subcommittee as chairman of the FERC, he has been before us before. We all know him. He is very capable. He was a logical selection and also a guy capable of personal friendship. I think it is good to have someone like that that we can reach. I yield back my time.

Mr. BARTON. We thank the gentleman from Texas. The distinguished gentleman from Georgia, Mr. Norwood, is recognized for an opening statement.

Mr. NORWOOD. Thank you very much Mr. Chairman. I would like to commend you for holding this hearing today to obtain important input from Federal Governmental entities on the subject of electricity as part of a continuing coordination to craft a real, coherent national energy policy. I appreciate your selection of witnesses and an opportunity to hear their perspective on a variety of issues today. Especially, Mr. Chairman, I appreciate your remarks and your opening statement; and, Chairman Tauzin, they are very easy to align yourself with those remarks and I think all of us on this committee do.

It is a time when I think you are doing the right thing. I think we need to stand up, though we are in pain, and we need to move forward with the people's business. And I think the thing that you could do, or we could do, that would most please the terrorists is us not to deal with the people's business. And this is a time when it sort of like reminds me of my old football coach who used to say, sometimes you just have to play hurt.

And though we are all hurting for the American people and so many people that have been associated with this disaster, we need to move on with the American people's business while at the same time we very quietly and steadily, with a steel resolve, prepare to deal with Osama bin Laden and other terrorists around the world.

Clearly our electricity system is changing, Mr. Chairman. One thing, however, that is not is the need to protect reliability. Over the last 10 years, through measures enacted by both the Congress and the FERC, this country's electricity network has undergone significant changes. Evolving from what used to be historically small wholesale power sales that insured reliability, today's current wholesale megamarket allows many different buyers and sellers to transfer power back and forth from one end of the grid to the other. In fact, the wholesale market alone is approximately 400 percent larger today than it was just 10 years ago. With a growing and ever changing market, Congress certainly faces new challenges to maintain reliable operability of the system.

Reliability is even more on my mind in the wake of last week's malicious attack on both the World Trade Center towers and the Pentagon, just a few miles from here. In fact, I have probably, like many of you, wondered about many potential targets that might exist in the minds of evil folks responsible for such heinous and incomprehensible acts. The several substations, many transformers, and a number of transmission lines located near the twin towers

were either destroyed or heavily damaged, leaving thousands of residents without power. I am certain that other members of this committee have considered the widespread damage that could potentially be left by a similar well-designed attack against specific and critical points of the energy infrastructure within the United States.

As we all know, secure and reliable operation of our oil refineries, pipelines, transmission networks, and generating facilities are of paramount interest to the security of this Nation. With many of my constituents working at the Savannah River site just across the Savannah River that borders my district, and that work at our nuclear power plant at Vogtle, this is a major concern of mine. On a national scale, effects could be catastrophic.

I am pleased to see that the witnesses are prepared to discuss safety and security measures that have been put in place to guard against and prevent against such a scenario.

Thank you very much, Chairman Barton, for your leadership of this committee. I, for one, appreciate the fact that you are moving forward today.

Mr. BARTON. Thank you. Thank you. The gentleman from Texas wishes to be recognized out of order to make a correction to his opening statement.

Mr. HALL. Yeah. Mr. Chairman, I just had a note from Chairman Tauzin that, "Ralph, you have been out of Texas so long, you can't tell the difference between one Francis and another." And I think I have always been told that it is better to remain silent and be thought a fool as to open your mouth and remove all doubt. But I want to tell you that the next time I see Francis will be my second time, and when they kept alluding to Mr. Blake, I kept looking at these three ladies and trying to figure out which one you were.

I yield back my time. And I will always remember Francis Blake.

Mr. BARTON. The gentleman from Louisiana, who has one of the strategic petroleum reserve facilities in his district, is recognized for an opening statement.

Mr. JOHN. Thank you, Mr. Chairman. First of all, let me commend you on your tenacity and your leadership with this committee, not only with this hearing here today, but since we commenced this Congress and began focusing on energy-related issues. I think these issues are very important. And also the chairman and my fellow Louisianan, Mr. Tauzin, for his leadership. And of course on our side, Mr. Boucher and Mr. Dingell.

I believe that the events that took place just over a week ago have really shed a whole new light on energy and on its role in our national security. You know, I believe in the area of electricity you have to have three components that must work well together. You must be able to recover the natural resource through exploration and production, you must be able to generate, and you must be able also to transmit the power. And I think that those three components must work very well together.

But in light of all of the issues that we have addressed up to this point relative to energy, I think with the actions that happened just last week, it gives us a whole new focus; and we will debate and redebate the role that energy, especially, electricity will play in our national security.

So I look forward to the testimony from the Department of Energy and also from the Federal Energy and Regulatory Commission because this is a new era; not an old issue, but a new era with a new focus as we move on from here.

So, thank you Mr. Chairman. I appreciate it.

Mr. BARTON. We thank the gentleman from Louisiana. We would recognize the distinguished gentleman from Tennessee, Mr. Bryant, for an opening statement.

Mr. BRYANT. Thank you, Mr. Chairman, for your series of hearings and your continuation of bringing very qualified people before this committee, subcommittee, to listen to testimony or to give testimony to us.

Three quick points I would like to make. We are all commenting about the events of September 11, and I simply want to say, obviously I would echo everything that has been said, but I want to say, beyond that, I hope we are very careful as a Department and as a Congress and the entire administration; and I hope, too, that the media will be responsible in the discussion, the dissemination of any kind of information regarding our electricity system in particular, but our entire power system, our natural gas pipelines and so forth, but today electricity and discussing those in detail and particularly just laying out for the public and everybody to see what is out there and where there may be vulnerabilities or weaknesses.

Too often we are seeing today so-called experts, retired military people, on television disclosing in their opinion what we will do as a military strategy, and there aren't that many out there, and laying it out in detail or disclosing that we are separating the President and Vice President for security reasons, and we are sending one to Camp David. And if you need directions we will be happy to, you know, go to our Web site and we will tell you.

So again, in this particular area of security, I hope we can keep that in mind and limit—and I hope we don't ask the type of questions that will bring out responses that, you know, where are we weak and where are we vulnerable and so forth. At least make them do some work if they are going to do it.

Second point, Mr. Secretary. I want to thank you on behalf of my constituents for you and the Department, those there that very quickly acted, what we used to call sui sponte in the court, on your own to, when we first heard of these people raising the price of gasoline, price gouging that occurred, going out on your own initiative and making that determination that there was no supply problem, and warning—putting out that word to people who could then warn these people that we would not accept that type of conduct under these circumstances. And again, I think that was something that really worked.

I know in my State of Tennessee that occurred around and that lasted about 1 day until we got the Secretary letter out to our Governor and other people in our State with enforcement power. So I thank you for that.

And my third point and final point is that as one from the Tennessee Valley Authority region, I have been very conscious of how we look at any legislation that involves deregulation. And I want to commend your—particularly the folks that I have dealt with in

your Department in this issue, who have been very open and responsive to the work that we are trying to do as a part of that process of potentially deregulating the wholesale of electricity around this country. We have worked hard with the stakeholders in the Tennessee Valley over the last 2 years to develop consensus language, something that we can all live with. Nobody is completely happy with it.

But again, the various parties have compromised and that consensus language was a part of the bill—well, basically that consensus language was a part of the bill that passed out of the subcommittee last year, and should anything move in the nature of a deregulation bill this year, we are going to be seeking that same language. And again we have worked with people in your Department on this. While we don't see exactly the same on every point, there are just a few minor differences out there, and we will continue to work.

And again, I would encourage you to work with us on that and I just thank you for the work that you have done with us in the past and would yield back the balance of my time.

Mr. BARTON. I thank the gentleman from Tennessee and recognize the distinguished gentleman from Maryland, Mr. Wynn, for an opening statement.

Mr. WYNN. Thank you very much, Mr. Chairman. I too would like to comment and commend you on your "tenacity," I think was the word used by one of my colleagues, in pursuing these issues and bringing together very effective, I believe, hearings on this subject.

I am particularly interested in the witnesses from FERC and particularly with respect to the July 12 order which directed the combination of—I believe it was four RTOs in the northeastern region, including the PJM which serves my own State of Maryland.

I basically have two issues that I am anxiously looking forward to hearing about. The first is, what is the problem that they were attempting to address in this order? There is a reference to seams in the transmission system that needed to be smoothed out. I think that is very delicate and diplomatic language. But I would specifically like to know what was the problem they are trying to correct.

And then I think second and, more importantly, I would like to know the basis for their authority; because I believe it is Ms. Woods that suggests that—Mr. Wood. Excuse me. That was bad. All right, Mr. Wood. What I want to know is, you make reference to perhaps the need for clarification of that authority which suggests that you are not sure, the Commission is not sure whether in fact you have the authority to order these mandatory RTOs. And my own public utility commission in Maryland which has worked with PJM and had great success, we have had very good levels of reserves, we are wondering why—whether you have the authority to do this.

So if you would elaborate on that, I would certainly appreciate it. And again, Mr. Chairman, I thank you for convening the hearing and relinquish the balance of my time.

Mr. BARTON. I thank the gentleman. We now recognize the distinguished gentleman from Iowa, Congressman Ganske, for an opening statement.

Mr. GANSKE. Mr. Chairman, the tragic events of last week have changed our focus today. I believe the Deputy Secretary will address security issues related to last week's attack and response by the Department of Energy. I would encourage him to advise us on steps which could be taken to further the Department's ability to help secure our Nation's power supplies either in today's forum or in future communications.

We all have an obligation to assure that our power supply is safe and secure. Special attention must be paid to facilities such as our national dams and nuclear power plants. And I know the Department is aware of and sensitive to these concerns.

I would like the Deputy Secretary's assessment that all necessary and proper steps are being taken to provide for appropriate security precautions. The transmission system in our country is just as important as the production facilities in guaranteeing a consistent and uninterrupted flow of power to our cities, towns and rural communities. Recent events have magnified the concerns we have with our power supply. But even before those events, there were steps which needed to be taken to improve our power grid and our transmission capabilities.

Our electricity power grid is an essential part of the national economy. With the slowdown in the economy, it is appropriate for us to move forward on this issue. I yield back my time.

Mr. BARTON. We thank the next Senator from Iowa for those comments. Mr. Waxman of California.

Mr. WAXMAN. Have you done everybody?

Mr. BARTON. I think so, Henry. I think you are next.

Mr. WAXMAN. Thank you very much, Mr. Chair. Today the subcommittee is going to hear testimony from the Department of Energy and the commissioners of the Federal Energy Regulatory Commission regarding the national electricity policy.

I am uncomfortable about turning to this issue so quickly after the tragic events of last week. Today's testimony raises a number of very controversial issues and I would prefer to focus on actions that bring us together rather than immediately jumping into divisive policy debates. Having said that, I can see that the chairman is intent on moving forward, and we cannot down play or gloss over the very significant policy disagreements that underlie electricity legislation.

First, we must insure that we do no harm. California electricity restructuring legislation was hurried through the State legislature and the flaws became evident only much later. Many other States have since acted with equal speed, and I am not sure that anyone fully understands how those laws will turn out. So we must be careful. And we also must learn from recent experience.

As California and other western States struggled through their electricity crisis over the past year, the Department of Energy sat on its hands. The Secretary even embarked on a public relations campaign to convince the American people that the Federal Government could not meaningfully assist western families. FERC refused to help until it was confronted with the very real possibility of congressional action. Throughout the West, we became painfully aware of how Federal inaction could harm consumers and the States.

Ultimately President Bush ended up endorsing FERC action to restrain runaway electricity prices. But for those of us from the West, that action came too late to prevent major economic hemorrhaging.

I remain concerned that FERC's actions did not go far enough. And we now begin to discuss legislation on electricity policy. As we do that, it is clear that we need to insure that FERC is more responsive to consumers. It must become more effective at addressing market power and preventing market manipulation. We cannot allow the intransigence of one commissioner to prevent meaningful Federal action when it is desperately needed. Western States are certainly opposed to greater authority at FERC, at the expense of the States.

And I would like to submit for the record two letters from the Western Governors Association, dated September 6 and September 12 on this issue.

Mr. BARTON. Without objection.

[The information referred to follows:]

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September 6, 2001

The Honorable Jeff Bingaman
Chairman
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Washington, DC 20510-6150

The Honorable Frank Murkowski
Ranking Minority Member
Senate Committee on Energy and Natural Resources
SD-312 Dirksen Senate Office Building
Washington, DC 20510-6150

Dear Senators Bingaman and Murkowski:

Thank you for your continued leadership in addressing the nation's energy needs. There are many areas that require remedy, and the Western Governors look forward to working with you. Many of these areas are addressed in the attached policy resolution: *A Western States' Energy Policy Roadmap,* which we adopted at our recent annual meeting. A key theme in our resolution is the central role of the states in solving many of our nation's energy problems.

As you know, Western states are already responding to our energy problems. Last winter we initiated extensive conservation efforts, and we are rapidly siting and permitting new generation capacity in our states. We estimate that between 2001 and 2004, nearly 35,000 megawatts of new capacity will be available if demand is sustained. Of that amount, 24,000 megawatts either came on line this summer or is under construction. The balance has received all necessary permits. We also have taken on the task of transmission financing and siting and intend to have a smart, efficient system for evaluating and meeting these needs in place as soon as possible.

Ensuring that citizens have access to reliable and affordable energy will require coordinated and consistent action by states, provinces and the Federal Energy Regulatory Commission (FERC) within the geographic boundaries of the market. It does not require federal preemption of state authority over transmission siting and does not require unilateral FERC authority to set and enforce reliability standards in the West.

We must build on the principle that decisions are best made at the smallest appropriate multistate area, provided that such decisions do not affect other parties. In the case of electricity, this means the maximum geographic reach of any advisory or decision-making body should be the electrically distinct Western Interconnection.

Any backstop role for FERC or Department of Energy must be framed in such a way that those agencies are obligated to adopt and implement the recommendations of a regional body of states. We oppose any schemes to empower FERC or DOE and relegate states to an advisory role to those distant federal agencies.

The West has a sterling record in transmission line siting:

- No state within the Western Interconnection has ever denied a permit for an interstate transmission line.
- Western Governors have initiated the first proactive transmission planning process in the West, which produced a report this month entitled, *Western Interconnection Conceptual Transmission Plans*.
- At the recent annual meeting of the Western Governors' Association, we proposed that the Governors in the Western Interconnection streamline and coordinate interstate transmission siting. We intend to have that process agreed to no later than next June.
- Western Governors have signed a Memorandum of Understanding with five federal agencies, and we hope the MOU will be the framework for these agencies to cooperate with states in the review of any proposed transmission lines. The major challenges in siting long distance transmission lines in the West have typically involved crossing federal lands. Through the MOU, we are hoping the federal agencies will join the states in a cooperative process to coordinate reviews of transmission line applications.
- We have supported Bonneville Power Administration's request for new borrowing authority to enable that federal agency to build transmission to reinforce its system, and we hope the federal government will grant such authority.

Regarding electric system reliability, the maximum geographic limit of reliability problems is the boundary of the Western Interconnection, which extends to all or parts of 14 western states, two Canadian provinces, and northwest Mexico. Decisions on reliability

standards and enforcement of such standards should be made by the affected region, not by FERC.

Western states and provinces have worked with the Western industry to develop a proposed Western Electricity Coordinating Council, which would set and enforce reliability standards in the Western Interconnection. We have asked FERC to approve the Council. We also have supported legislation that passed the Senate last year to: require delegation of standard setting and enforcement authority to the Western organization; require deference to decisions made in the West; and enable the establishment of state advisory bodies to which FERC may defer. This legislation was the product of a significant consensus building process, and provides a workable framework for ensuring reliability.

- We oppose proposals to give FERC unfettered authority to set and enforce reliability standards. The agency does not have the expertise, resources or local knowledge to successfully execute such responsibilities.

- Congress should require FERC to defer to standards adopted in the West and to the advice received from states that represent an entire electrical interconnection.

We thank you for your attention to these matters. They are of utmost importance to our region and to meeting our nation's energy needs. States are well situated to be leaders and partners with the federal government in these matters. Smart energy legislation can help ensure that this partnership succeeds.

Sincerely,

Jane Dee Hull
Governor of Arizona

Dirk Kempthorne
Governor of Idaho

John A. Kitzhaber, M.D.
Governor of Oregon

Gary E. Johnson
Governor of New Mexico

Jim Geringer
Governor of Wyoming

Michael O. Leavitt
Governor of Utah

Gary Locke
Governor of Washington

Tony Knowles
Governor of Alaska

Mike Johanns
Governor of Nebraska

William J. Janklow
Governor of South Dakota

Gray Davis
Governor of California

Kenny Guinn
Governor of Nevada

cc: Members of the Senate Energy & Natural Resources Committee
Western Senators

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Western
Governors'
Association

WGA Policy Resolution 01 - 01

Western States' Energy Policy Roadmap

August 14, 2001
Coeur d'Alene, Idaho

SPONSORS: Governors Geringer, Hull, Hoeven, Johnson, Leavitt, Kempthorne, Kitzhaber and Martz

A. BACKGROUND

1. In the last year, much of the West has experienced significant volatility in natural gas prices, increases in electricity prices, and power shortages. This has touched many peoples' lives, and has triggered a significant ripple effect through many of the western states' economies. It has also highlighted that the western electric power system has inextricably linked the energy futures of western states.

2. Extraordinary wholesale electricity prices in the western wholesale power market have spawned much-needed power plant construction for the first time in a decade. Some plants may come on-line soon to mitigate the high prices and shortages in parts of the West.

3. States have been and should continue to shape their energy futures through cooperative action among themselves with the support of the federal government.

4. Governors across the West have already called for and implemented energy conservation measures. They have also taken action to address the short-term problem, while working towards developing and implementing a long-term energy policy to avoid future problems. The governors have done this individually in their states, and collectively through the Western Governors' Association (WGA).

5. Through the WGA, the governors have articulated bipartisan policies on renewable energy, natural gas, coal and energy for the Americas. On February 1-2, 2001, the Western Governors held an Energy Policy Roundtable followed by a May 9 Electric Transmission Roundtable. A roadmap of needed actions has evolved. Additionally, in April 2001, the Bush Administration released the National Energy Policy addressing many of the same issues. On August 13, 2001, the Western Governors and the Bush Administration executed a Memorandum of Understanding to enable needed collaborative action to address the energy challenges in the West.

B. GOVERNORS' POLICY STATEMENT

1. To address the ongoing western electricity problems, Western Governors:

   a. Find that states must continue to play a pivotal role in electric power decisions. Specifically, the governors believe that –
      i. The existing authority of states over retail electric power sales must be retained and all transmission to and from any retail entity should remain subject to the jurisdiction of the states.
      ii. To accommodate the regional and international nature of electricity markets, Congress should allow states to create regional mechanisms to decide regional power issues, including but not limited to, the creation and operation of regional transmission organizations, reliability of the Western power grid, transmission system planning and expansion, maintenance requirements and market monitoring. The Federal Energy Regulatory Commission (FERC) should be required to defer to such decisions.

   b. Encourage retail power suppliers and power generators to enter into power supply contracts to reduce dependence on the spot electricity market. A mix of short-term and long-term power contracts will reduce reliance on the volatile wholesale spot market and stabilize prices to consumers. Utilities and direct end-use customers that rely extensively on the spot market should also reexamine their power purchase practices in order to appropriately hedge themselves against future price spikes.

   c. Request utilities and state and tribal public utility commissions to adopt rate reforms that send more accurate price signals (or a proxy for such price signals) to consumers. This is the first step in empowering customers to make wise decisions about their energy use and to make investments that reduce their total use and cost. This means developing and deploying technologies that allow building owners and other consumers to receive more accurate price signals that encourage them to reduce or shift consumption to off-peak times.

   d. Ask that federal agencies, in their implementation of the Administration's National Energy Policy and other federal actions, work with the Western Governors and

tribal leaders to streamline regulatory processes to enable retired generation to be reactivated, existing generation to increase production, and new generation and natural gas and electricity transmission to come on-line while protecting public health, safety and the environment. States, tribes and federal regulatory agencies need to expedite the review of any permits required to bring retired generation on line. States should continue to have flexibility to use existing and new back-up generation during short term energy shortfalls without violating human health and environmental standards.

e. Ask state and tribal public utility commissions and all non-jurisdictional utilities to approve demand-exchange tariffs under which customers can voluntarily agree to reduce demand in exchange for compensation. A number of utilities have demand-exchange programs underway and more utilities need to implement them.

f. Ask state and tribal public utility commissions and non-jurisdictional utilities to eliminate barriers to clean distributed generation that can be in place in the next 12-24 months. Distributed generation includes small turbines, high efficiency co-generation, fuels cells, etc., that are typically installed on the consumer's property. Utilities have frequently blocked the installation of such technologies through cumbersome business practices or complex and inconsistent requirements for connecting such generation to the transmission grid. Requirements to ensure safety and reliability of the grid should remain in place.

g. Ask utility distribution companies and state and tribal energy agencies to promptly develop energy efficiency measures that provide savings through technical assistance, financial incentives, accelerated penetration of new technologies, and appropriate regulation. Ask PUCs, state legislatures and tribal councils to take steps necessary to encourage funding of such measures (e.g., including recovery of utility costs in rates, and adopting system benefit charges which are a non-bypassable fee on each kilowatthour sold).

h. Where states and tribes have not already acted, ask state and tribal agencies to accelerate the implementation of efficiency practices and investments in state and tribal buildings and ask the federal government and local government to take similar action.

i. Ask Congress, state legislatures and tribal councils to expand assistance to low income families and families and individuals with fixed incomes to help pay high energy bills.

j. Encourage Congress to enact federal legislation consistent with WGA resolution 00-009 that would: enable the establishment of enforceable system reliability rules; provide for delegation and deference to the West; and, enable the creation of regional advisory bodies of states and provinces.

k. Encourage the creation of a centralized grid-wide database that tracks prospective demand, and tracks generation and transmission facilities under construction, whether they are permitted, in the permitting process, or under consideration.

l. Support efforts to ensure the availability of information on loads, transmission, and generation where necessary for ensuring the adequacy, efficiency and reliability of the grid.

m. Will continue to implement the region's short-term conservation strategy adopted January 10, 2001.

n. Will conduct a regional assessment of whether and how gas supplies and transmission can be increased in time to meet seasonal peak load demand.

2. To maintain the Western Governors' commitment to a viable economy and a clean and healthy environment in the West, we need to pursue a national energy policy that will result in a diverse energy portfolio that will include conventional and alternative energy resource development, energy efficiency and conservation. All of the following energy supply and demand options should be pursued.

a. **New energy development** – Enable exploration and development of promising domestic oil, gas, coal, geothermal or wind resources where lands, air, water, fish and wildlife and other environmental resources can be protected.

b. **Coal** – Implement R&D and tax incentives to promote the development and deployment of new technologies to increase the efficiency and lower the emissions from coal-based generation. (See WGA Policy Resolution 00-037.)

c. **Renewables** – Accelerate the development and deployment of promising renewable energy technologies through the extension and expansion of state and federal production tax credits and state and tribal policies such as system benefit charges, portfolio standards, renewable resource-based utility tariffs and/or creative new incentives. Western Governors believe that the development and deployment of renewable energy technologies can benefit the region by:

i. Diversifying the region's energy supply;
ii. Promoting the development of new technologies and Western companies in a growing global market;
iii. Reducing air pollutants from energy production;
iv. Providing a safety net in the event reductions in greenhouse gases are required; and
v. Meeting our obligation for careful stewardship of our natural resources.

Western Governors recognize the contribution that the National Renewable Energy Laboratory and other federal labs have made in developing technologies which enable the cost-effective use of an increasing portion of the western renewable energy resource. Western Governors will promote renewable energy, including efforts of the National Renewable Energy Laboratory and other federal labs to continue outreach to western states to ensure that their research and development efforts are germane to the western resource base and thereby offer technology options that can contribute to increasing the availability of renewable power generation.

Western Governors support the development of renewables such as wind generation that could offset, through emissions trading, additional emissions as fossil-fueled plants come on line. Such joint resource generation could be an important part of a comprehensive energy strategy in the West that would enable the West to capitalize on its wind and coal resources. Western Governors realize that substantial increases in power transmission lines would be critical.

d. **Environmental Regulation** – Review environmental and natural resource policies to ensure they are as efficient as possible. These policies include the air quality regulations for health and regional haze. See WGA resolutions 99-013 *Principles for Environmental Management in the West*; 99-012, *Air Quality Reform and Flexibility - Western Air Quality Initiative*; and 00-015, *Regional Haze*. These policies advocate collaboration, flexibility to achieve compliance, and implementation of economic incentives. Economic incentive-based programs should be implemented where found to be appropriate alternatives to command and control.

e. **Permitting Energy Facilities** – Streamline state, tribal and federal processes for siting new generation, electric transmission and natural gas pipelines while protecting public health, safety and the environment.

f. **Energy Infrastructure** – Support economic and environmentally sound energy infrastructure investments to transport energy to markets, including the following:

i. Pending completion of environmental review, the governors urge: (1) construction of a pipeline to move natural gas from Prudhoe Bay along the Alaska Highway to the lower 48 states while ensuring full pipeline safety to protect the public and the environment (see WGA Policy Resolution 00-033); (2) the expansion of natural gas pipeline systems in the lower 48 states, and, (3) the expansion of electrical transmission capacity from areas rich in energy resources to load centers.

ii. Encourage a stable economic environment conducive to construction of needed electrical generation.

iii. To assure the construction of needed electricity transmission additions: (a) ask industry and states to undertake the more detailed studies identified in the *Conceptual Transmission Plans* report, including potential additional transfer capacity between western and eastern interconnections; (b) urge the industry, states, provinces to implement immediately a pro-active Western Interconnection transmission planning process; and (c) ask FERC to adopt policies that enable the integration of individual transmission requests made of utilities into more comprehensive transmission plans.

iv. Urge Congress to reject, as unwarranted and inappropriate, proposals to grant FERC the power of eminent domain for transmission facilities. No western state has ever denied a permit for an interstate electric transmission line. Gaining approval for new transmission facilities across federal lands is typically the major challenge to siting new transmission facilities in the West.

v. Ask FERC to act expeditiously to approve the proposed Western Electricity Coordinating Council that will consolidate the functions of the existing reliability organization and regional transmission associations in the Western Interconnection.

g. **Energy efficiency and conservation** – At a minimum:

i. Encourage rate structures that give utilities and customers an incentive to reduce consumption.

ii. Encourage long-term stability of government and utility conservation programs.

iii. Accelerate the development and deployment of new, more energy efficient products in the market place. Such efforts are best implemented at the state, tribal and regional level often with the assistance of the federal government.

iv. Review and improve the energy efficiency of building codes in Western states and tribal lands.

v. Accelerate the development of federal government appliance efficiency

standards that are cost-effective standards and recognize the unique conditions in the West (e.g., dry climates).

vi. Support federal R&D that maximizes the development of energy efficiency technologies applicable to the growing Western region.

vii. Support federal, state and tribal tax incentives to accelerate the introduction of new energy efficient technologies.

viii. Develop mechanisms to encourage energy efficiency measures in air quality planning documents.

C. **GOVERNORS' MANAGEMENT DIRECTIVE**

1. The governors direct the WGA to focus their efforts in implementing the provisions of this resolution in the following six areas:
   a. Demand response, including an inventory of current price signals to western consumers, evaluation of the experience with demand exchange programs, real-time pricing, time-of-use pricing and conservation block rates, and development of a plan to send better price signals;
   b. A real-time, quality information system to provide decision-makers and market participants better information on western energy demand, supply and infrastructure;
   c. Rapid deployment of energy efficiency technologies on a multi-state basis;
   d. Supply technology assessment and deployment to identify economic, institutional and environmental barriers to new technologies and actions to overcome such barriers;
   e. Streamlined permitting of energy infrastructure that includes the use of new technologies, such as visualization, in permit review processes; and,
   f. Improved integration of energy and air quality review processes.

2. Direct WGA to identify and evaluate options available for financing investments in new transmission capacity.

3. This resolution shall be conveyed to the President, Vice-President, Secretaries of Energy, Interior and Agriculture, the Administrator of the Environmental Protection Agency, the Federal Energy Regulatory Commission, and appropriate committees of Congress.

Approval of a WGA resolution requires an affirmative vote of two-thirds of the Board of the Directors present at the meeting. Dissenting votes, if any, are indicated in the resolution. The Board of Directors is comprised of the governors of Alaska, American Samoa, Arizona, California, Colorado, Guam, Hawaii, Idaho, Kansas, Montana, Nebraska, Nevada, New Mexico, North Dakota, Northern Mariana Islands, Oregon, South Dakota, Texas, Utah, Washington and Wyoming.

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September 12, 2001

The Honorable Jeff Bingaman
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The Honorable Frank Murkowski
Ranking Minority Member
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Washington, DC 20510-6150

Dear Senators Bingaman and Murkowski:

This follows our letter of last week, which was sent before the legislative proposal, *DIVISION B – RELIABLE, AND DIVERSE POWER GENERATION AND TRANSMISSION*, became available. At this point, we think it is necessary to reaffirm several key positions of the Governors, which are included in the attached policy resolution: *A Western States' Energy Policy Roadmap*.

- The existing authority of states over retail electric power sales must be retained, and all transmission to and from any retail entity should remain subject to the jurisdiction of the states. We oppose provisions giving the Federal Energy Regulatory Commission (FERC) authority to set retail transmission rates.

- We oppose proposals to give FERC authority to set and enforce reliability standards. The agency does not have the expertise, resources or local knowledge to successfully execute such responsibilities.

- Congress should require FERC to defer to reliability standards adopted in the West and to the advice received from states that represent an entire electrical interconnection.

- We oppose granting FERC the authority to preempt state authority to site transmission lines. FERC does not have the expertise, resources or local knowledge to successfully undertake these tasks. Western states have an excellent record in balancing the competing land use demands while enabling the siting and permitting of interstate transmission. In lieu of giving FERC the power of eminent domain in the West, we

recommend that Congress direct federal agencies to join the states in a cooperative process to coordinate reviews of transmission line applications and resolve siting issues.

We do not think it is necessary to duplicate or displace the states' capabilities, which have been developed over the past half-century with respect to the complex issues of assuring adequate and reliable supplies of electricity, at affordable prices, within the Western interconnection. We encourage you to restrain from providing new authorization to FERC for those activities that are traditionally under the jurisdiction of the States.

We welcome the opportunity to work with you to fashion legislation that respects the authorities and strengths of the states, while providing for adjustments in FERC's national oversight necessitated by changes in the electricity sector.

Sincerely,

Jane Dee Hull
Governor of Arizona

John A. Kitzhaber, M.D.
Governor of Oregon

Jim Geringer
Governor of Wyoming

cc: Members of the Senate Energy & Natural Resources Committee
Western Senators

Attachment

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Mr. WAXMAN. Additionally, there are a number of other critical issues that must be addressed in the context of electricity restructuring. For example, we must take energy conservation seriously. DOE has estimated that investments in energy efficiency have generated a 30 to 1 rate of return. Efficiency and load management measures also directly improve system reliability by reducing demand and strain on our delivery systems. But with the deregulation of the industry, utility investments in energy efficiency and load management programs have dropped by roughly 50 percent since 1993. We must reverse this trend.

We must also seek to spur investment in distributive generation and renewable generation. This approach will best protect the environment while also creating a more secure electricity infrastructure. I look forward to hearing today's witnesses and hope we can act in a thoughtful bipartisan manner.

Thank you Mr. Chairman.

Mr. BARTON. Thank the gentleman. I will just comment on your opening statement. I think it is well taken. We really thought whether we ought to do this hearing or not. It was not an easy decision. But since this does impact energy security, the Chair's decision was to go ahead and do the hearing, and then work with the minority to determine what specific hearings on more specific energy security issues could be scheduled, whether they be open hearings or private briefings. So I think your opening statement was well taken.

I want you to know it is not a trivial decision to do what we are doing today. The gentleman from Oregon is recognized for an opening statement.

Mr. Walden.

Mr. WALDEN. Thank you very much, Mr. Chairman. I appreciate your holding this hearing today. I will keep my remarks brief. I think you can really sum it up in about three words: reliability, security, and self sufficiency. And if there was ever a time for us to explore all three of those, this is it.

Clearly, in the wake of the events of last week and the roller coaster of our economy today, it is more clear than ever that we need to have self-sufficiency when it comes to our energy policy; that we need to make sure that the grid is secure and reliable.

I think the other issue we need to continue to focus on is domestic production, especially of natural gas and oil. With the industrial downturn that is underway, we are seeing prices come down both in terms of electricity in the western market as well as prices of natural gas. That is a false security from the price side, because when our economy does turn around, we are going to have the same shortages we had before we went into this downturn and yet we probably won't have any additional supply.

So I think we now need to focus on how do we add to supply, how do we add to distribution, how do we make sure our sites are secure. Otherwise, about the time we try and crawl up on out of this economic downturn, we are going to run smack dab into high energy costs, rolling blackouts, and the lack of energy and higher costs certainly for consumers.

So I thank you for the hearing. I appreciate your willingness to work with us on the Northwest title. And I also want to thank the

full committee chairman for his efforts on the price gouging issue as well. It is an unconscionable act in my mind if we do have businesses out there who engage in price gouging. They, in my mind are aiding and abetting the goals of the terrorist organization, and I say that without regret.

Thank you, Mr. Chairman.

Mr. BARTON. Thank the gentleman. The gentleman from Arizona, Mr. Shadegg, is recognized for an opening statement.

Mr. SHADEGG. I thank you, Mr. Chairman, and I do commend you for holding this hearing today. I also appreciate your remarks indicating the thoughtful consideration that went into whether or not we should go forward.

Since the events of last Tuesday, I have urged my constituents that, as much as possible, America needs to get back to life as normal. I have urged them that our airplanes must fly and we must use them. Our sports teams must play and we must attend. Our commerce must continue and we must participate. I think that is extremely important. And in that regard, this Congress has work to do. And I think we should be doing our work in every area.

I would say, however, that there is a new element brought to this debate. It seems to me that security now becomes vastly more important and something we should focus on, something that perhaps we should have been focusing on to a greater extent before last Tuesday's events.

I commend the full committee chairman for the effort he is undertaking to survey all of the agencies that we oversee and to have them come back to us with information with regard to security efforts or measures that they could take and anything this committee could do legislatively to assist in those efforts.

With regard specifically to the energy issue, I would associate myself with the comments of others who have pointed out that this is a long-term crisis. We recognize that, for example, the California energy crisis that we struggled with over the last several months did not occur in a day. It occurred because people did not look farsightedly into the future. They, for example, stopped building power plants when they were needed. They underestimated the demand increase that was a part of the overall economy.

And so I think it is very appropriate that this committee do its job. There is work that needs to be done in assessing our production capacity and whether we have enough new power plants coming on line. There is work to be done in assessing our transmission facilities. Those are clearly deficient. So I think we should be doing what we can do.

At the same time our economy is in fact struggling, and I think with regard to any dramatic restructuring I think we have to proceed with some additional element of caution at this point in time, as I am sure every member of this committee is aware. And I commend the chairman for his comments indicating that he is much aware of that, and I yield back the balance of my time.

Chairman TAUZIN. Will the gentleman yield briefly?

Mr. WALDEN. Certainly.

Chairman TAUZIN. I thank the gentleman. I asked the gentleman to yield simply to inform the members who perhaps were not here when we started that next week we are scheduling intense private

briefings from some of the more important agency heads under our jurisdiction, including the Department of Energy, who will have a chance to privately discuss some of the things we are finding. So all of the members should be prepared. Next week, I think next Tuesday is the day we are trying to do it, to schedule these hearings. So stay in touch and we will inform on you the date and time.

Mr. SHADEGG. Reclaiming my time, that was precisely what I was complimenting you for, Mr. Chairman, and so I appreciate that and yield back the balance of my time.

Mr. BARTON. Seeing no other members present who have not yet had an opportunity to make an opening statement, the Chair would ask unanimous consent that all members not present have the opportunity to put their opening statements in the record. Hearing no objection, so ordered.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. MIKE DOYLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman, thank you for convening this hearing to further examine our current national electricity policy and to identify what steps should be taken to improve the efficiency, reliability and competitiveness of our facilities and markets. While the events of September 11th remain omnipresent and are at the forefront of Congressional priorities, we can ill-afford to ignore the critical role that electric power plays in our national security.

As we are all aware, Congress passed the Energy Policy Act of 1992 during the Persian Gulf War and it would appear that Congress is once again charged with the responsibility of responding in like fashion. The House has already accomplished a great deal with the passage of H.R. 4 and we should proceed with the task at hand regarding comprehensive electricity policy.

Obviously, we need to focus on structural and jurisdictional matters. I am personally interested in amending the Federal Power Act to enhance the advancement of combined heat and power. But like many of my colleagues I am most eager to discuss the security of our systems. We will hear in greater detail from Secretary Blake that the attack on the Pentagon had no direct impact on the Washington metropolitan energy infrastructure and that outside of lower Manhattan our energy infrastructure was not affected. Without question this is good news and should help to calm concerns. But we also know that security issues have become a top priority at our nation's nuclear power plants and water treatment facilities. And we also know that numerous reviews that have examined potential terrorist acts that could debilitate our nation's infrastructure identify damage to electric power among the top physical threats.

Our schedule of regular order may feel a bit awkward, but is important that we move ahead with completing the work on all facets of our national energy policy. I appreciate Chairman Barton's efforts in this regard and look forward to working with all members of the Committee in reaching this imperative goal.

Thank you Mr. Chairman.

PREPARED STATEMENT OF HON. BILL LUTHER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Thank you Mr. Chairman for holding this wide-ranging hearing designed to hear the views of the Administration and the FERC with regard to the electric power industry. Coming from a state that has not adopted deregulation at the state level, I urge a deliberative approach to any mandated federal legislation. I also urge that any proposal considered by this committee have the best interests of electricity consumers in mind including the promotion of conservation and renewable and innovative energy sources. Considering the tragic events of last week, I am also interested in any comments or views from the Administration with regard to energy security issues and would urge this subcommittee to begin looking at this subject in greater detail. Thank you Mr. Chairman.

Mr. BARTON. We would like to welcome our first witness, the Honorable Deputy Secretary of Energy, Mr. Francis Blake. If you

would come forward. Welcome back. We are glad to have on you on this very busy day. We know how pressing your duties are as the chief operating officer of the Department of Energy. We are going to give you 10 minutes to summarize your written testimony. If you need a little bit longer, or take a little bit less, that is fine. Welcome to the committee, and your full statement is in the record in its entirety.

STATEMENT OF HON. FRANCIS BLAKE, DEPUTY SECRETARY, U.S. DEPARTMENT OF ENERGY

Mr. BLAKE. Thank you Mr. Chairman, members of the committee. I would just briefly summarize my statement, and in light of all of your opening comments, I thought I would just start with a few observations on the security of our energy infrastructure.

Last week's terrorist attack did not disrupt our energy infrastructure. With the exception of the devastation in lower Manhattan, the electricity grid was unaffected. Trading in oil and gas proceeded largely without disruption. And under the circumstances, the energy markets have remained remarkably stable, with the exception of a few isolated instances of price gouging and price spikes.

At DOE we have an emergency operation headed by General McBroom, a retired Air Force major general, who led combat units during the Gulf War and has planned and executed responses to numerous emergencies and natural disasters. Our operation team works with other Federal agencies, State and local government, and industry to respond in the event of emergencies.

Let me give you just a sense of the process. Last week on the electricity grid, the National Electric Reliability Counsel, NERC, issued the highest threat advisory to their electrical industry security coordinators who, in turn, notified all the electrical control centers, who, in turn, notified all 3,000 individual utilities around the country and Canada and in Mexico. Representative security measures taken include increased guards, restricted access, moving system operators to alternate control centers, and taking appropriate cyber security measures.

At DOE, we were in regular contact with FERC and the National Infrastructure Protection Center of the FBI. Cooperation and communication with the industry with other forms of government have been excellent. But we are going to look for ways to improve and we are in the process of evaluating lessons learned. I look forward to keeping the committee informed. And obviously, we will have an opportunity next week and to keep you advised as we go forward with our assessments.

Now, let me turn to today's specific topic, the comprehensive electric legislation. We are very pleased that the committee is considering comprehensive electric legislation. The Federal Power Act was written in 1935 at a time when there was virtually no interstate commerce in electricity. Electricity markets were local, and power generation was considered a natural monopoly. Today the transmission grid is both interstate and national, and the notion of a natural monopoly in generation is a thing of the past. The administration believes we need to modernize our electricity laws. Comprehensive legislation can make wholesale markets more competi-

tive, lower prices, improve reliability and benefit consumers. The administration very much respects the role of the State in electricity controlling legislation, but we also believe that there are a few core Federal issues. And in that respect, we believe the goals of comprehensive legislation should be first to make the markets more competitive, finish the job of opening the transmission system and remove transmission bottlenecks, lower barriers to entry for new electricity supply, for example, through uniform interconnection standards, promotion of reliability to enforceable standards developed by self regulating organizations, increased protection for the consumers through uniform information disclosure requirements, promotion of additional investment, for example, in repealing the Public Utility Holding Company Act.

We also believe legislation can help promote energy efficiency, for example, by developing realtime pricing programs and giving FERC authority over demand options.

There are additional elements in this legislation. I won't go through them all item by item, but we very much applaud the committee's attention to this legislation, and we look forward to working with you. Thank you very much.

[The prepared statemment of Hon. Francis Blake follows:]

PREPARED STATEMENT OF HON. FRANCIS BLAKE, DEPUTY SECRETARY OF ENERGY

Mr. Chairman and Members of the Subcommittee, I welcome the opportunity to testify before you today on national electricity legislation.

LAST WEEK'S TERRORIST ATTACK

Before I address the subject of this hearing, I would like to briefly address the energy issues arising out of the vicious and cowardly attack on our country last week.

The terrorist attack on our country had a significant impact on the energy infrastructure in lower Manhattan. The fire and building collapses destroyed two substations located under the World Trade Center as well as power transformers, circuit breakers, underground cable and other distribution equipment. Multiple transmission lines were damaged, resulting in the outage of a third substation. Con Edison is restoring limited temporary service by deploying mobile generators and reconfiguring portions of the effected distribution system. New power lines are being installed above ground to replace damaged underground cable. Normal electricity service in areas where there is limited physical damage is being restored, but restoration to areas where there is significant damage will take much longer. There also has been a disruption to natural gas service in lower Manhattan. The attack on the Pentagon had no impact on the energy infrastructure in the Washington, D.C. area.

Last week's attack raises issues relating to the security of our energy infrastructure. Outside of lower Manhattan, our energy infrastructure was not affected, and there were no specific threats to oil refineries, oil and gas pipelines, electric transmission lines, and generation facilities, including nuclear power plants.

Notwithstanding, the security of our energy infrastructure was upgraded in the wake of the attack. Commercial nuclear power plants were placed on their highest alert status, the North American Electric Reliability Council, an industry organization responsible for maintaining bulk power system reliability, recommended that transmission operators implement heightened security measures, pipeline owners were put on high alert after the attacks, and security at oil refineries was upgraded.

As you know, there were isolated reports of gasoline price gouging in the wake of the attack last week. In response, the Secretary of Energy determined there was no supply disruption to justify reported prices and issued a public statement that these high prices were unjustified. The Federal Trade Commission also threatened to take enforcement action. Gasoline price spikes receded in wake of these actions.

The Department is conducting an assessment of the security of our energy infrastructure. When this assessment is complete, the Department will recommend appropriate action.

NEED FOR FEDERAL ELECTRICITY LEGISLATION

I commend you for holding this hearing. Earlier in the year, many believed there was little likelihood Congress would consider electricity legislation. The view was that the California electricity crisis would discourage both the Administration and Congress from dealing with electricity legislation. Your hearing disproves this common wisdom.

The Administration believes the opposite is true—the electricity crisis in California and the West demonstrates the need for Congress to act. This experience shows there is a need to make wholesale electricity markets more competitive, to strengthen the transmission grid, to increase electricity supply, to protect consumers, and to improve reliability. The California electricity crisis is a dramatic demonstration of problems that exist under the status quo—problems that Congress should address.

The Administration recognizes the need for Congress to pass comprehensive electricity legislation. The National Energy Policy included a recommendation that the "Secretary of Energy propose comprehensive electricity legislation that promotes competition, protects consumers, enhances reliability, promotes renewable energy, improves efficiency, repeals the Public Utility Holding Company Act of 1935, and reforms the Public Utility Regulatory Policies Act of 1978."

Since 1995, Congress has been grappling with electricity legislation. Initial efforts sought to require States to open their retail electricity market by a date certain. Subsequent legislation focused on promoting competition in electricity markets and complementin—not commanding—State retail competition programs.

We clearly need to revise Federal electricity laws to recognize changes in electricity markets. The principal Federal electricity law—the Federal Power Act—was written in 1935. At the time, there was virtually no interstate commerce in electricity, there was no interstate transmission grid, electricity markets were local, power plants were built right next to consumers, and electricity generation was perceived to be a natural monopoly.

The Federal Power Act was enacted to fill a regulatory gap, out of recognition that States cannot regulate interstate commerce. Initially, the Federal role was modest, since there was very little interstate commerce in electricity. As interstate commerce in electricity expanded, it was only natural that the Federal role would also expand.

Today, the transmission grid is both interstate and international, electricity markets encompass entire regions, almost all wholesale electricity sales are in interstate commerce, and the natural monopoly in generation has long since been disproved.

The Administration believes the time has come to make changes to Federal electricity law to reflect changes that have occurred over the past 66 years, and the sweeping changes that are underway in the industry. The Administration believes there is a need to modernize our electricity laws.

The Administration believes it is essential that Congress pass comprehensive electricity legislation. Electricity legislation can make wholesale electricity markets more competitive, lower prices, strengthen the transmission grid, increase electricity supplies, protect consumers, and improve reliability.

I want to make it very clear that the Administration respects the State role in electricity regulation. For example, the Administration does not support proposals to require that States open their retail electricity markets by a date certain. It believes that it is a State responsibility to determine whether and when to open retail electricity markets to competition. At the same time, the Administration recognizes that since 1935 the Federal government has been charged with responsibility over wholesale electricity markets and the transmission of electricity in interstate commerce.

The Administration believes that electricity legislation should focus on core Federal issues that are beyond State authority.

Regulation of Interstate Commerce

Electricity markets are increasingly regional in nature. Under the Constitution, States have no authority to regulate interstate commerce and regulation of interstate commerce is a Federal responsibility. The California experience shows that actions taken by one State can have regional consequences.

Transmission

Assuring that our transmission system can deliver reliable electricity supplies is a core Federal issue. As the National Energy Policy noted, investment in new transmission capacity has failed to keep pace with growth in demand and with changes in the industry's structure. Since 1989, electricity sales have increased by 2.1 percent per year, yet transmission capacity has increased by only 0.8 percent per year. There is widespread recognition that there is a need to expand the transmission sys-

tem, remove bottlenecks, and provide for open access. Since the transmission system is both interstate and international, regulation of the grid is a Federal responsibility.

There are various reasons why transmission constraints exist. In some cases, the problem is a lack of economic incentive. The national energy policy proposes a solution to that problem: encouraging the Federal Energy Regulatory Commission (FERC) to develop incentive rates to promote transmission expansion. FERC has great flexibility under current law to set transmission rates at a level to attract investment. Recently, FERC has shown flexibility in considering nontraditional transmission rates. For those reasons, it does not appear legislation is needed to address transmission pricing.

In other cases, the problem is the siting process itself. Under current law, transmission siting is an exclusively State function. That law was written 66 years ago, at a time when power plants were located right next to customers, and decades before transmission lines interconnected States and regions. Congress did not provide for transmission siting by the Federal government because it did not foresee the transmission system would develop into not only an interstate but also an international grid.

Much has changed since 1935. The transmission grid is the interstate highway system for electricity. It should not be a system of local toll roads.

Electricity legislation can remove transmission bottlenecks by providing for siting by the Federal government of transmission facilities used for interstate transmission. The Administration believes legislation should preserve State transmission siting authority, but should provide for Federal siting of transmission facilities that are in the national interest, based on effects on reliability, interstate commerce in electricity, and on competition in wholesale electricity markets. We believe Federal siting decisions should rely in large part on recommendations made by regional siting boards.

We also believe that Federal electricity legislation should grant FERC authority to require State and municipal utilities and rural electric cooperatives to provide open access to their transmission systems, in the same manner as jurisdictional transmitting utilities. This is a step towards establishing one set of rules to govern the transmission grid.

Reliability

Ensuring the reliability of the interstate transmission system is also a Federal responsibility. Since the 1960s, the reliability of our transmission system has been based on voluntary compliance with unenforceable reliability standards. That is no longer tenable, and Federal legislation is needed to provide for enforceable standards developed by a self-regulating organization subject to FERC oversight.

Market Power

The Administration believes that FERC needs to be able to mitigate market power. However, the debate about market power often starts with a misunderstanding about FERC authority under current law. Under the Federal Power Act, FERC is responsible for ensuring that rates charged by public utilities are just and reasonable. As a general matter, the ability to set rates is the ability to prevent the exercise of market power. An exercise of market power generally entails charging rates that are higher than those produced in a truly competitive market. For that reason, FERC can prevent the exercise of market power through its authority over wholesale rates and by ordering refunds of unjust and unreasonable rates.

In our view, a discussion of market power issues must start with an understanding of FERC authority under existing law and a determination of whether existing FERC authority to address market power is inadequate.

Legislation can strengthen FERC authority to address market power. For example, the Administration believes legislation should amend the refund provisions of the Federal Power Act and provide that refunds are effective on the date of complaint, not 60 days later. The Administration believes there is a need to increase the penalties for criminal violations of the Federal Power Act and expand the scope of the civil penalty provisions to include any violation of the Federal Power Act, not just the provisions added by the Energy Policy Act of 1992.

The Administration believes that FERC should retain its authority to approve mergers and asset dispositions, given its expertise on the electricity industry. We also believe it is appropriate to clarify FERC authority to approve holding company mergers and mergers and asset dispositions involving generation facilities.

Electricity Supply

The lack of uniform interconnection standards appears to have contributed to the difficulty in developing independent power plants in some regions of the country.

Federal legislation can help assure adequate electricity supplies, by providing for uniform interconnection standards and reforming FERC authority to issue interconnection orders.

Consumer Protection

Electricity markets are regional in nature, and are no longer confined neatly within individual States. For that reason, there is a need for electricity legislation that protects consumers against "slamming" and "cramming," strengthens the bargaining power of consumers through aggregation, protects consumer privacy, and ensures that consumers have the information to make informed decisions to meet their needs.

Federal Electric Utilities

Another core Federal issue is defining the role of Federal electric utilities like the Tennessee Valley Authority (TVA) and Bonneville Power Administration in competitive electricity markets. Obviously, States have no authority over Federal electric utilities. Legislation is needed to provide open access to transmission systems operated by the Federal electric utilities and ensure that one set of rules governs the entire interstate transmission system. There is a need for other specific TVA and Bonneville reforms. I assure the Subcommittee that the Administration intends to work closely with the Congressional delegations from these regions on these reforms.

Reform of Federal Electricity Laws

There is a need to reform Federal electricity laws, such as the Public Utility Holding Company Act of 1935 (PUHCA) and the Public Utility Regulatory Policies Act of 1978 (PURPA). With respect to PUHCA, each of the past four presidents has supported PUHCA repeal. PUHCA repeal is an idea whose time came a long time ago. There is also a need to repeal the PURPA mandatory purchase obligation prospectively.

Jurisdiction

Federal legislation should also clarify Federal and State jurisdiction. One jurisdictional issue is State authority to charge public purpose fees. The Administration believes that States are in the best position to develop public purpose programs to suit their needs. Some States may prefer to develop strong low-income assistance, while others focus on rural assistance, while still others concentrate on conservation. States have different needs, and need the flexibility to craft programs to suit those needs. These programs can be funded through the distribution charges—an area where States have exclusive jurisdiction—or charges on retail sales of electricity.

Electricity legislation can clarify the authority of States to impose fees to fund public purpose programs that meet their needs and avoid bypass of State fees. We believe this is a better approach than imposing a Federal tax to fund a Public Benefits Fund. One concern relating to a Public Benefits Fund that has not received much attention is equities in allocating funds. There is no assurance that fees raised in one State to finance a Public Benefits Fund will not be spent in other States.

Energy Efficiency and Renewable Energy

A stable power supply should consist of a clean and diverse portfolio of domestic energy supplies—including renewable and alternative supplies—that are available right here in the United States. The National Energy Policy includes several recommendations on ways that new and emerging technologies can help us provide for increased generation of electricity while protecting the environment, as well as on ways to increase use of renewable and alternative energy supplies. These recommendations should be considered as electricity legislation is developed.

By no means is this intended to be an exclusive list and there are other issues that may be appropriate to address in Federal electricity legislation.

CONCLUSION

We have a rare opportunity to learn a lesson from the California experience and act to prevent a future electricity crisis. Congress normally passes energy legislation in the wake of a crisis, and it is rare for Congress to act to prevent an energy crisis.

Mr. Chairman, Congress has been slowly reforming Federal electricity laws for over twenty years. This process began with the Public Utility Regulatory Policies Act of 1978, which the encouraged the development of independent power producers. This process continued with enactment of the Energy Policy Act of 1992, which provided greater access to the transmission system and further encouraged the development of independent power producers. The time has come for Congress to take an-

other step, a bigger step, one that can make electricity markets more competitive and result in lower electricity prices, and ample and reliable electricity suppliers.

The Administration looks forward to working closely with the Committee to develop comprehensive electricity legislation.

I appreciate the opportunity to testify before you today.

Mr. BARTON. We thank you. The Chair would recognize himself for the first 5-minute question round. Has the Department decided, Mr. Secretary, whether to put forward an electricity legislative package of its own?

Mr. BLAKE. We are developing legislative principles and we should be able to share those within the week.

Mr. BARTON. But legislative principles may not be the same as legislative language; is that correct?

Mr. BLAKE. I think we look forward to working with this committee and your staff on the language itself.

Mr. BARTON. It is my understanding that the administration has made a decision to encourage the Senate to move companion to H.R. 4, the Comprehensive Energy Enhancement Act that passed the House in early August. Is that true or not true?

Mr. BLAKE. That is my understanding.

Mr. BARTON. If that happens and our colleagues in the Senate that act, obviously, we would attempt to have a conference between the House and the Senate in the very near future. Does the administration have a position on whether we should attempt to put in an electricity restructuring component in a conference between the House and the Senate on the pending bill that has passed the House?

Mr. BLAKE. We would like to see—I am not entirely sure I understand the question.

Mr. BARTON. It is a good thing if you don't entirely understand the question.

Mr. BLAKE. We would like to see that as part of the overall——

Mr. BARTON. Regular order for us, to move the electricity restructuring bill as a stand-alone through subcommittee, full committee, to the floor and the Senate have a separate conference. But if the House and the Senate are going to adjourn in the middle of October, which is a possibility, we might want to speed up the electricity component into a bill that has already cleared the two legislative Chambers.

Mr. BLAKE. I understand. We would support prompt action on it.

Mr. BARTON. Does the administration have a position on the thorny issue of mandatory RTOs versus voluntary RTOs? And if you do, can you enunciate that position today?

Mr. BLAKE. I think the administration's view is FERC has the authority that it now needs.

Mr. BARTON. So the administration would be silent on——

Mr. BLAKE. Yes.

Mr. BARTON. But is willing to take instruction from the subcommittee if we have a different view?

Mr. BLAKE. Always.

Mr. BARTON. Remember the answer to that now—always. We don't have you under oath, but that is a very good answer from the chairman's viewpoint. In your opinion, given what happened last week, would it be helpful to have a restructuring package in any bill that the President signs on energy? Would that, in your opin-

ion, tend to enhance our ability to react and prevent future terrorists' attacks or to minimize the damage? Do you have a position on that?

Mr. BLAKE. I think there are linkages between reliability and security that we need to think through, particularly in light of the attacks last week. And that is something we are, in the process in the department are doing now. And I think this legislation would be helpful.

Mr. BARTON. I am going to yield the balance of my time and let Mr. Boucher ask questions. Thank you.

Mr. BOUCHER. Well, thank you very much, Mr. Chairman. And Mr. Blake, welcome. We are glad to have you with you us this afternoon. Let me ask a question of you concerning the violence between State and Federal regulatory with regard to transmission. I presume you are familiar with the contents of the Federal Energy Regulatory Commission's order 888?

Mr. BLAKE. In a general sense.

Mr. BOUCHER. That order asserted FERC authority over the transmission component of unbundled transactions for transmission and the sale of electricity in States that are open to retail competition. And no sooner had the FERC issued that order that it was sued from both directions. It was sued by one set of parties claiming that the FERC did not have the statutory authority to go as far as it went. And then it was sued by a group of energy marketers claiming that it had not only the statutory authority, but a legal mandate to go even further and to assert jurisdiction over transmission even in States that are closed to retail competition and even with regard to bundled transactions.

And I have a series of questions for you concerning that circumstance. First, a procedural question. The U.S. Supreme Court is scheduled to have arguments on October 3 on both of these lawsuits. And we can probably anticipate a decision from the Supreme Court either later this year or perhaps at the latest in the spring of next year on this rather complicated set of jurisdictional questions that really go to the heart of the balance between Federal and State authorities.

And so as the first question, I would be interested in knowing whether you would advise us, given the uncertainties of the legislative process and the potential perhaps that even an effort to legislate in one direction or the other should it not be successful, might have some bearing on the Court's interpretation of these statutory authorities. I wonder, if given those circumstances, you have any advice for us on whether we would be well advised to wait until the Supreme Court has rendered a judgment on these questions or whether we should go forward and attempt to pronounce what we believe the proper measure of FERC authority in these situations should be?

Mr. BLAKE. Since the Supreme Court will be looking to try to discern Congress's intent, if prior to that decision Congress can clarify that intent and can make clear in the administration's view that FERC did have the authority to issue that order, that would be preferable from the administration's perspective.

Mr. BOUCHER. So your advice would be go forward and legislate in our own time and make our own decisions, notwithstanding the impending decision of the Supreme Court on these matters?

Mr. BLAKE. Yes, sir.

Mr. BOUCHER. Could you pull that microphone a bit closer. I am having a little bit of trouble. I heard your answer to Chairman Barton's question with regard to the authority of the FERC with respect to regional transmission organizations. And I would just like to ask for some clarification with regard to one aspect of that. Your basic advice is don't legislate on this subject. I think I heard that clearly. Was I correct in that interpretation?

Mr. BLAKE. We think FERC has the authority now as appropriate.

Mr. BOUCHER. There are really two aspects to that FERC authority, and this is the question I want to pose to you. The FERC has issued several orders with regard to regional transmission organizations. One of those orders encouraged investor-owned utilities to seek memberships in RTOs.

Another of the orders, the most recent order, addresses the structure of RTOs and imposes some Federal requirements with regard to structure. Do you believe that the FERC has sufficient authority to order a particular structuring of RTOs? Does the FERC have sufficient authority, for example, to buttress the order that it issued recently addressing structure? And do you believe that the FERC has authority to order participation in RTOs by the investor-owned utilities? And as a further question, do you believe that the FERC should order participation in RTOs by investor-owned utilities?

Mr. BLAKE. The first response is I would also be interested in Chairman Woods' answer to those questions.

Mr. BOUCHER. We are going to ask him the same question.

Mr. BLAKE. I am sure. I would not hold myself out as an expert on where the boundary lines are of FERC's authority. From the administration's perspective, as we look at the RTO structuring, and what we see in the larger sense, is adequate authority in the current statute and a view that that is best resolved at the technical level through the comment process and the input from the stakeholders, the exact process that FERC is going through now.

Mr. NORWOOD [presiding]. The time has expired.

Mr. BOUCHER. Let me thank you very much, Mr. Blake. We appreciate your participation here. Mr. Chairman, I would like to ask that the record of this hearing remain open for an appropriate time within which we might submit some additional questions in writing to Mr. Blake concerning the administration's position on this complex and very important set of issues. I do have some additional questions and I will send them to you, Mr. Blake.

Mr. NORWOOD. So ordered. I would like to recognize the chairman of the Commerce Committee, Mr. Tauzin.

Chairman TAUZIN. Mr. Blake, we have noted that since the NES was adopted, the National Energy Strategy that opened the wholesale markets in electricity, the wholesale market, has increased by 400 percent and prices have steadily declined in the wholesale market during that period of time. Is it this administration's position that the NES and wholesale marketing changes the laws we made

in that period of time that worked successfully and were a model for what we should go forward with?

Mr. BLAKE. I think the opening of the wholesale market has worked, on the whole, very successfully.

Chairman TAUZIN. The second question—I know we just went through a pretty technical series of questions, but I want to get something perhaps even more basic than that. The whole of the electric laws in America, electric policy laws, pricing and transmission, have been built around the notion that electricity gets transmitted from a point of origin to the point of use. That isn't the way the system really works, is it?

Mr. BLAKE. No.

Chairman TAUZIN. Explain to this committee and the listening audience how it really works.

Mr. BLAKE. The actual electrical flow is often quite different than what is called the contract path flow. And part of this restructuring legislation, I think, is an effort to match——

Mr. NORWOOD. Mr. Blake, would you try to speak directly into that microphone.

Chairman TAUZIN. We are doing some nice work in this room and it will be a lot better when you come back.

Mr. BLAKE. Your question goes to the point of to better match what is actually happening as we move to regional and national grid structure.

Chairman TAUZIN. And it is in the Nation's interest that we move to regional and national grids, is it not, in the same way that we move to national pipeline systems so that buyers could deal directly with producers and actually negotiate better prices and delivery terms; is that correct?

Mr. BLAKE. That is absolutely correct.

Chairman TAUZIN. And if it is correct, it requires us to rethink policy in the light of reality. There was a great article written about the notion that if you think of electricity grids as lakes of electricity—and it doesn't matter where the water comes in, you are only going to take it out from where you are. You are not going to pipe it across the lake to get to that water that was introduced to the other side of the lake. You are going to take water from the lake wherever you are. But the policy, the pricing structures, the regulatory structures, are all built around the notion that we have pipelines running across the lake going from point of production to the point of use and delivery, when that isn't the way the systems works or electrons work. And basically the argument that our committee has made, and I hope the administration will join us in, is that it is time for us to think about making our policy and our pricing and our delivery and our markets look like the physics, the reality of the way electricity is introduced and the way it is used within a grid; is that correct?

Mr. BLAKE. Yes, sir.

Chairman TAUZIN. So I hope you are going to be very supportive of this committee's efforts to find a way to move us from this almost dark-age view of the way electricity functions in a society to the way it really does function and the way it should operate in a free market. And in doing that, we have to worry about a transition and we have to worry about the fact that this old system of

pricing and of delivery and regulation have created situations where some people are paying much too much for electricity, and other people are paying quite a good price. Isn't that our political dilemma how we move from that old system to a new one where there is more uniformity in the market price?

Mr. BLAKE. Greater liquidity will help and that is what the legislation is designed to promote.

Chairman TAUZIN. And if I could echo the chairman's concern, this is pretty tough business. I mean, we don't really have consensus yet whether the RTOs ought to be mandatory or voluntary. This is the kind of transition stuff we are talking about. And we are going to need the guidance of the new administration in that area, and I know you said you would take guidance from us and you know we need those principles so we can come to some recommendations that make sense. I understand the chairman is going to very soon release a working draft so we can begin the intricate discussions of how to make that transition to this working marketplace.

In that regard, I would hope that the administration, as well as all our friends in the industry, take that as a cue that time is running on this issue. And we may not dispose of it in the next couple of weeks, but it will be disposed of relatively soon at this committee level. I would encourage you to work very hard toward a consensus that Chairman Barton and indeed Mr. Boucher pointed out, yet need to be resolved. Thank you.

Mr. NORWOOD. Thank you, Mr. Chairman. I recognize Mr. Shimkus for 5 minutes.

Mr. SHIMKUS. Thank you, thank you, Mr. Chairman, and Mr. Blake it is good to have you. What elements of a comprehensive electricity package, if any, are so critical to the security of our Nation that they should be enacted into law immediately, i.e., in the next several weeks or at the end of this year?

Mr. BLAKE. On the physical security of the infrastructure?

Mr. SHIMKUS. Just the whole restructuring debate.

Mr. BLAKE. On the physical security side, we are, as I indicated, now looking and taking another look at those sets of issues and hope to give you some recommendations or the result of our review very soon, but I am not in a position today to respond to that. On the reliability issues, I think there is a wide consensus that one of the things you want to move toward are standards that are enforceable through private organization, much like, you know, the stock exchange or something like that.

Mr. SHIMKUS. As a basis of the comments on the FERC, which we will get a chance to talk to next, is it your position that they currently have the authority to do what needs to be done under their jurisdiction? What is the administration's position on FERC's authority to order divestiture?

Mr. BLAKE. I am just being advised they can condition mergers which would be consistent with the similar authority of Justice or FTC. But they can't order divestiture on their own.

Mr. SHIMKUS. Do you see that as an important element in restructuring?

Mr. BLAKE. I don't think we would support an independent authority different than what regular antitrust reviewing authorities have.

Mr. SHIMKUS. So you feel that that is not needed?

Mr. BLAKE. Right. Exactly.

Mr. SHIMKUS. And don't worry. Joe used to do that to us all the time. So you are in good hands. Your testimony also goes on to list some legislation reforms that could strengthen FERC's ability to address the market power issue, you know, in the chairman's comments on how we price and it is not a pipe delay that is the analogy I have been taught. But then people would turn back to the old regional monopoly standard of saying, well, those—when there was a lake, there was, you know, one producer and one—and the consumer and it was all one happy family. When we deregulated into the wholesale aspects of selling of power, now we have to change how we account for—how do we allow the grid to operate hopefully more effectively and efficiently.

And we just have come out of a—dealt a blow with some movement by the administration, some movement by the State, some interest by us on what occurred on the western grid and the western prices in California. So talk to me about the market procedure authority.

Mr. BLAKE. The administration's view is largely—the principal issue around market power does go to the rates charged. You would retain—there is no change in FERC authority on just and reasonable rates. The only changes we see on market power are really more along the edges.

You mentioned the merger authority. We see some value in clarifying some of that authority that they have over mergers and divestitures. But the larger issue that you are going to, I think we see is already encompassed within the statute.

Mr. SHIMKUS. Do you feel that an expansion of the transmission grid would ease up some of those market power concerns and open up the ability to contract and receive power? I mean, that is probably the best way to address the market power concerns if I am having an expanded grid.

Mr. BLAKE. It would definitely help in terms of getting low cost power to more places, the better access that you have.

Mr. NORWOOD. I thank the gentleman.

Mr. SHIMKUS. Let me just finish. That is one of the important things of addressing the States' rights issue, the property rights' issue and the coordination across State lines which will be a tremendous hurdle to overcome on regional RTOs and transmission grid.

Mr. NORWOOD. I thank the gentlemen and I yield myself 5 minutes for questioning.

Mr. Blake, I want to talk a minute about RTOs just for a second. Could you describe for us some of the criteria that you have used in determining what type of RTO structure might work best?

Mr. BLAKE. Congressman, that is really a matter that we feel lies within the expertise of the Commission. And the Department has not yet taken a position on here, you know, what is the size of the RTO.

Mr. NORWOOD. Haven't you stated publicly that you thought we needed more and larger RTOs?

Mr. BLAKE. We publicly supported BPAs——

Mr. NORWOOD. I want to ask you another question and I want to keep in mind what Congressman Bryant said. I don't want to know how to make the clock, but I want you to make me feel better because I felt like your response wasn't enthusiastic when the question came up about what DOE is doing or talking about to protect our infrastructure.

Now I want to emphasize to you, I don't want to hear every little detail, but I want to go away from here feeling better that you are at work on this problem. So I want to give you another opportunity to make me feel better that you guys are giving serious consideration to what a lot of us are very concerned about.

Mr. BLAKE. Yes. You should feel comfortable. We actually, as I mentioned in my opening comments, we have around the clock, emergency operation center, that is designed to respond directly to emergencies. On the broader issue of the security of our energy infrastructure, we are taking the lessons learned over the last week and we are in the process of identifying vulnerability assessments, what are the right responses and we should be to give you a more detailed answer on that than I am in a position to give today.

Mr. NORWOOD. How long do you think it might be before you could give us a more detailed answer?

Mr. BLAKE. I think the answer is going to have a lot of different elements to it, but we will be in a position next week.

Mr. NORWOOD. Is this something you are going to tell me or you are going to be going public with?

Mr. BLAKE. I think there are elements that we would not go public with.

Mr. NORWOOD. But parts of it will be?

Mr. BLAKE. Yes.

Mr. NORWOOD. Part of the concern here is that we have—we don't want to tell everybody how we are going to make the clock, but we also have to comfort the public, that is close to a lot of DOE facilities that there are changes being made in view of what happened on the 11th.

Mr. BLAKE. So with respect to the DOE facilities themselves—and I was responding more toward our look across the entire energy infrastructure, which is quite a large undertaking. With respect to the DOE facilities themselves, we have had them in highest alert throughout the last week. We are again, as we think is prudent to do, after any event, making a reassessment, always looking at how we can do things better and how we can assess the risks and threats correctly but I can absolutely assure we have highest confidence around the security of those facilities.

Mr. NORWOOD. Do you agree with me that security at some of these facilities over the last 10 years has perhaps not been taken as seriously as it has been 10 years prior to that?

Mr. BLAKE. I am not in a position to respond historically. I can tell you how seriously we take it now, and we take it completely seriously.

Mr. NORWOOD. And we are in the process of considering how to upgrade that security.

Mr. BLAKE. We are——

Mr. NORWOOD. If you didn't have anything to work with, then just making that alert doesn't get the job done.

Mr. BLAKE. No, sir. We have excellent security systems around these facilities.

Mr. NORWOOD. We could talk later, couldn't we? We need to do lunch. That will work. My time has expired. Mr. Chairman——

Mr. BARTON. You are doing good.

Mr. NORWOOD. I also got to leave.

Mr. BARTON. I recognize——

Mr. NORWOOD. Mr. Ganske, you are recognized for 5 minutes for questioning.

Mr. GANSKE. Thank you, Mr. Chairman.

Mr. Blake, I want you to share with us a little bit what happened at the Department of Energy on Tuesday, September 11. When did you find out that we had a multiple terrorist attack on the United States?

Mr. BLAKE. I don't know the specific time, but it was clearly in the—9 to 10 o'clock in the morning—9:15, sometime around there. We went down to—as I said, we have an emergency response center. We went down to our emergency response center. We assessed the advisability of increasing the security status at all of our DOE facilities. We did that. We obviously——

Mr. GANSKE. What time was that?

Mr. BLAKE. Congressman, I can provide that to you for the record. But it would have been in the morning of the 11th.

[The following was received for the record:]

CHRONOLOGY, DOE RESPONSE TO EVENTS OF SEPTEMBER 11, 2001

BACKGROUND

THE DEPARTMENT OF ENERGY SECURITY CONDITIONS: The DOE Security Conditions (SECONs) system (DOE N 473.6.) describes a progressive level of common sense protective measures that may be implemented in response to a malevolent or terrorist threat to any or all DOE facilities, assets, and personnel. The purpose of the SECON system is to establish standardized, protective measures for a wide range of threats and to help disseminate appropriate and timely information for the coordination and support of DOE crisis or contingency activities. A description of each SECON including the necessary circumstances for implementing, the impact on operations, and the purpose of each protective posture, is outlined below.

- SECON-5: **Threat Negligible.** This condition exists when a general threat of possible terrorist activity exists, but warrants only routine security measures associated with daily operations.

- SECON-4: **Threat Low.** This condition applies to a possible general threat of terrorist activities and generally enhances security awareness responsibilities. It may be necessary to implement certain selected measures from higher SECONs to address intelligence received or to act as a deterrent.

- SECON-3: **Threat Medium**. This condition is used when an increased and more predictable threat of terrorist activity exists and may increase access controls to include additional personnel and vehicle barriers.

- SECON-2: **Threat High**. This condition is set when a terrorist incident occurs or intelligence information is received indicating that some form of terrorist action is imminent, and requires specific protection measures to be put in place.

- SECON-1: **Threat Critical**. This most serious condition is declared in the immediate area where a terrorist attack has occurred which may effect the site or when an attack is initiated on the site. This significantly increases protective measures and requires an additional protective element along with those in SECON-2.

DOE EXECUTION

At 10:57 AM, EDT, on September 11, 2001 DOE advanced Department-wide to SECON 2. (*SECON 2 is the highest state of security alert absent a specific threat to or attack on a specific activity*)

- DOE sites were notified by Flash Priority.
- Sites were encouraged to enact additional security measures at their discretion.
- All shipments of nuclear material were stopped.

At 12:00 PM, EDT, on September 18, DOE sites were ordered to SECON 3 modified. *(SECON 2 measures designed to detect or deter vehicular-borne explosives were retained)* Normal shipments of nuclear material were resumed with the exception of Special Nuclear Material.

On October 7, 2001 when U.S. military actions began, DOE site were ordered to resume SECON 2.

At 12:00 PM, EDT, on October 15, DOE sites were ordered to resume SECON 3 modified.

ENERGY SECTOR EXECUTION

Presidential Decision Directive 63, May 1998, designated DOE as Lead Federal Agency for liaison with the private sector for protection of the electric power, oil and gas production and storage elements of the National energy sector.

DOE communication/coordination with the private energy industry Infrastructure protection during increased security situations is accomplished through the designated Energy Sector Coordinators; the *North American Electric Reliability Council* for electric power and the *National Petroleum Council* for gas and oil.

When DOE assumed SECON 2 on September 11, 2001 communications were established with security coordinators for the electric, gas, and oil industry.

- Representative security measures included the following:
  - Executive response teams activated.
  - Command Posts established at field sites around the world.
  - Extra security at HQs and field locations.
  - Emergency evacuation plans reviewed and readied.
  - All personnel restricted travel, essential business only.
  - Stringent ID checks at all sites
  - Local site specific security upgrades

The gas and oil industry followed the DOE lead in assuming security postures throughout the crisis.

COMMENTS

Cooperation and communication with the electric, gas and oil industry has been excellent; these industries have to this point been fully willing to share information. DOE has provided guidance, assistance, and ongoing threat assessment to these industries, based on coordination with the Intelligence Community, the FBI, and other Federal, State and local law enforcement agencies. Industry representatives have requested and obtained copies of DOE formal Security Conditions (SECONS). DOE coordination and response has been specific to this contingency.

Prepared by Patrick Daly, SO-1, October 22, 2001
Revised 11/8/01

NNSA Reviewer and concurrences

John Todd, 10/30
C. Eberwein, 10/29
D. Jonas, 10/26
Jon Ventura, 10/29
Rob Hood, 11/9
J. McBroom, 11/9
E. McGinnis, 11/9
Bill Barker, 11/13
Anson Franklin, 11/14

S Reviewer and concurrence
Paul Longsworth, 11/20

DOE Reviewers and concurrences
Mike Wisniewski, CI-40 11/26
Dorothy Hamid, GC-12 1/18/02

Mr. GANSKE. Well, was it within 15 minutes of the second airplane hitting the World Trade Center?

Mr. BLAKE. Congressman, let me provide that on the record for you.

Mr. GANSKE. When you say we go to the highest alert, what does that mean?

Mr. BLAKE. Actually, it is what we call condition 2. There is a condition 1 that would apply in the circumstances of a direct attack.

Mr. GANSKE. What does that mean? What does condition 2 mean?

Mr. BLAKE. Condition 2 means full readiness. And in the case of our facilities, it is extra guards. As you know, in the case of our facilities, we have nuclear material. It is securing the nuclear material. It is restricting access. There are a set of steps that are well known, thought out in advance that go into place automatically on that——

Mr. GANSKE. Does that communication go out from the emergency center——

Mr. BLAKE. Yes, sir.

Mr. GANSKE. [continuing] to all of the DOE facilities?

Mr. BLAKE. Yes, sir.

Mr. GANSKE. And then they have in place plans for that level of alert. Who makes that decision?

Mr. BLAKE. In that instance,—in that particular instance, it was the Secretary. I mean we had a briefing and decided to go to the higher alert status.

Mr. GANSKE. Explain to me, then, the chain of information that the Secretary would get for that—for making that decision or for getting the information from other agencies?

Mr. BLAKE. If I understand the question, we do have our intelligence operations. They are in communication with the intelligence operations of other parts of the government, including the FBI.

Mr. GANSKE. So does the FBI have a call list? Who makes that decision to call you?

Mr. BLAKE. Sir, I am not sure who makes the decision. The FBI doesn't—the FBI informs us of key data and information.

Mr. GANSKE. Would you be waiting for that information before you would make a decision to call an alert?

Mr. BLAKE. And it would depend on the circumstances. In this particular case, I don't believe we waited for a particular piece of data from the FBI or from anyone else.

Mr. GANSKE. I think much has been made of the fact that there are many different agencies that deal with security issues. Yours is one as related to the nuclear power plants and things like that, weapons production facilities, things like that. Is there an overall communications coordinating governing body for this type of—for an emergency like this?

Mr. BLAKE. There is the national infrastructure protection center, run by the FBI. And just as a clarification, the security status for nuclear plants—commercial nuclear plants is decided by the NRC, although we are—as is the case on that Tuesday, we were in communication with them.

Mr. GANSKE. Is part of your ongoing evaluation in terms of a response looking at the issue of interagency communication? Is that——

Mr. BLAKE. That would be one of the things we would look at. There was no issue.

Mr. GANSKE. I am not saying there was a problem.

Mr. BLAKE. But that is one of the things we look at. Yes, sir.

Mr. GANSKE. How do you—at DOE, do you have responsibility for security at, say, large dams, like the Hoover Dam? Who has responsibility for security like that?

Mr. BLAKE. I would think that would be with the Corps of Engineers. I believe they maintain—and the Bureau of Reclamation.

Mr. BARTON. I couldn't hear your answer.

Mr. BLAKE. Corps of Engineers and the Bureau of Reclamation.

Mr. BARTON. Gentleman's time has expired. If you have one more question——

Mr. GANSKE. There are a lot of questions that I think we are going to be dealing with.

Mr. BARTON. We are going to do private briefings and we may do some public hearings, so there will be plenty opportunity for questioning. The gentleman from Ohio is recognized for 5 minutes for questions.

Mr. STRICKLAND. Thank you, Mr. Chairman. Mr. Deputy Secretary, on September 18, in the Federal Register, the Department of Energy issued a notice of intent to prepare an environmental im-

pact statement for the depleted uranium hexafluoride conversion facilities. I note in that publication, that there is an indication that the preferred alternative would be a 2 conversion facility plan. But there is also a list of alternatives laid out, for example, 1 plant, instead of 2 plants and all the way down to doing nothing and simply maintaining the cannisters as they exist now.

Now I compare that with the law, which says, the Secretary of Energy shall prepare and the President shall include on—for fiscal year 2000, a plan and proposed legislation to ensure that all amounts accrued on the books of the United States Enrichment Corporation for the disposal of depleted uranium hexafluoride will be used to commence construction of not later than January 31, 2004, and to operate an onsite facility at each of the gassiest diffusion plants at Paducah, Kentucky and Portsmouth, Ohio to treat and recycle depleted uranium hexafluoride.

I am puzzled that it seems that the law was very clear in calling for two facilities to be built; one at Paducah and one at Portsmouth. And this notice in the Federal Registry implies that there may be other acceptable alternatives. And I was wondering if you could speak to that seeming contradiction.

Mr. BLAKE. Congressman, I am not familiar with that, so let me provide a response to you on the record.

Mr. STRICKLAND. If you would, I would certainly appreciate it, sir.

[The following was received for the record:]

The Department recognizes that P.L. 105-204 requires the Department to develop a plan for construction and operation of a facility at each of the gaseous diffusion plants for the disposition of depleted uranium hexafluoride. It also required that the Department's actions regarding the conversion of depleted uranium be consistent with the National Environmental Policy Act (NEPA). Under NEPA, an agency must examine reasonable alternatives for accomplishing the underlying goal of the proposed action, the conversion of DOE's uranium hexafluoride, as well as a "no action" alternative. Since Public Law 105-204 did not specify that DOE was to implement a specific approach but only to develop a plan for one, and even though DOE has identified the construction of conversion facilities at both Portsmouth and Paducah as its current preferred alternative, DOE is obligated by law to consider and analyze other alternatives that would allow DOE to accomplish the goal of converting the depleted uranium hexafluoride before it can proceed with construction of any facility.

Mr. STRICKLAND. Second question, sir, in the National Energy Policy Report, there is an inclusion of a recommendation that DOE and EPA review the so-called New Source Review Program, including administrative interpretations and implementations of that program. I was wondering if you could tell me when that review is likely to be completed, or if it has been completed and will the administration move forward with administrative reform of that program, which many believe, and certainly I believe to be broken?

Mr. BLAKE. Sir, I know that the review is ongoing. It was obviously the events of the last week that have thrown it off schedule a little bit. But I know they are working on that. And that the administration's intent is to propose improvements to that program.

Mr. STRICKLAND. Thank you. I would just urge you to make sure that the NSR not be interpreted or used in a way as to discourage routine maintenance. I know maintenance—I have been told by both industry folks as well as members of the labor unions that maintenance is essential in terms of energy efficiency and pollution

decreasing and workplace safety. I think this is an important issue that is facing the industry. Certainly, I have written letters to the department about it in the past and it is something that I would hope the department would move expeditiously to deal with. With that, Mr. Chairman, I yield back the remainder of my time.

Mr. BARTON. Thank the gentleman. And the gentleman from Oregon is recognized for 5 minutes.

Mr. WALDEN. Is that closing bell on the Stock Exchange, which only dropped 310 points today? Mr. Chairman, I just have a couple of questions as they relate regionally for the Secretary to—specifically the northwest, since we are somewhat unique out there with the Bonneville Power Administration. Can you describe for me the administration's view about congestion in our distribution system in the northwest?

Mr. BLAKE. For the transmission system, as pointed out in the energy policy and the President's energy policy, we see the need to have additional transmission in the northwest. There is a great deal of power generation that is planned to go on line, and that will need access to the transmission grid.

Mr. WALDEN. And presently, I am told there are some 40 choke points in the northwest in the power grid, the way it is configured. Is that pretty much——

Mr. BLAKE. I know there are a number of them. I don't know if 40 is exactly the right answer.

Mr. WALDEN. And what do you think it is going to take and what is the administration's view on trying to build out that system?

Mr. BLAKE. We are, at the Department, are working with Bonneville to try to understand exactly what would be required for construction activity on the new lines. It will be a substantial—be a substantial investment.

Mr. WALDEN. And it is my understanding that the ratepayers of that region will pay back whatever the borrowing authority is with some level of interest?

Mr. BLAKE. That's correct.

Mr. WALDEN. Is it the administration's position that it is not a subsidy then?

Mr. BLAKE. I hope we will be able to work out the increased borrowing authority issue.

Mr. WALDEN. I am curious about as we go down this road on changing energy policy in the country, what, if any, requirements there would be to make sure that—using the lake analogy that there are streams flowing in, or do people sort of migrate away from certain sectors of the industry to go to the more profitable sectors?

Do you see or envision any kind of wholesale energy reform legislation—any kind of requirement for supply, surplus capacity?

Mr. BLAKE. I think the only way that would come in is through reliability standards. And as I mentioned, one of the elements of the legislation would be enforceable reliability standards.

Mr. WALDEN. And you would see some sort of requirement then for capacity production?

Mr. BLAKE. It will differ region to region. But to the extent that is part of the reliability concerns in that region, yes.

Mr. WALDEN. Because that is an issue that I have. It seems like if we evaluate the situation in California, it didn't seem like they were adding a lot of supply, at the same time, doing great conservation efforts, but also increasing demand. And so I get concerned about creating a system where you have these choke points that could result, in effect, congestion pricing that would create wonderful profit centers at areas of congestion. I have yet to figure out how the consumer benefits from that.

Mr. BLAKE. Exactly one of the things that the legislation should attempt to address is eliminating those kinds of bottlenecks that allow that pricing.

Mr. WALDEN. And is there a sequence between getting those eliminated before we go into opening the market up that ought to occur? Are you looking at that?

Mr. BLAKE. One of the things we are doing in response to the energy policy is conducting a national grid assessment, trying to identify where are the key choke points in the system and then identify the national interest in removing those choke points.

Mr. WALDEN. The other issue in terms of my region, we are fortunate in having a very effective hydropower system which is the most renewable, first of all, and cheapest, second of all, electric power system. And I know with hydro relicensing coming up, there is wide range of estimates about how much power generation capacity will be lost through that process because of the various laws involved and could be, some say, a couple of percent, to 6 or 8 percent loss. Where do you see us going on that on hydro relicensing?

Mr. BLAKE. Again, the energy policy identified exactly that as an issue. DOE, in conjunction with other agencies because there are a number of other Federal agencies that have more direct authority over this, such as FERC and others, are trying to look at how we improve the hydro relicensing process.

Mr. WALDEN. I know my time is up, Mr. Chairman. Thank you very much.

Mr. BARTON. Gentleman from Arizona is recognized for 5 minutes.

Mr. SHADEGG. I appreciate your testimony here today and I really want to focus on just two points and see if I can't coax you into elaborating a little bit further. You have mentioned reliability legislation. And in response to my colleague's, Mr. Walden's questions, you referenced enforceable reliability standards. Can you give the committee a broad outline of what the administration is seeking in terms of reliability legislation and go perhaps deeper into the issue of enforceable reliability standards?

Mr. BLAKE. I think the notion that the administration has is that you have entities like NERC that have set reliability standards and these standards should be made enforceable. FERC would be able to delegate some measure of enforcement authority so that you would have a structure similar, as I mentioned, to what you have with the stock exchange.

Mr. SHADEGG. And do you see the administration coming forward with that in the immediate future?

Mr. BLAKE. Excuse me?

Mr. SHADEGG. How soon can we expect to see specifically what the administration——

Mr. BLAKE. I think next week.

Mr. SHADEGG. With regard to enforceable reliability standards, how—do you have any idea specifically what enforcement measures would be in place? Would you be able to order plants to take specific steps? Can you go into any further detail on that?

Mr. BLAKE. I haven't thought through and I don't know that we are going to have specific proposals on where—what level of enforcement authority. I think that is something we want to work through on the details with the committee.

Mr. SHADEGG. Second, in reference to I believe your opening remarks, a set of principles you anticipate revealing, as you know, Senator Bingaman recently revealed a set of principles. Are you in a position today to give us a highlight of how the principles you anticipate releasing will differ from those he released?

Mr. BLAKE. I think there will actually be a good deal of common ground between our principles and what is in Senator Bingaman's bill, making wholesale power markets open through open transmission access, strengthening FERC authority in the areas on market abuse, lowering buyers on electricity supply through interconnection standards. Some of the areas of disagreement, there are provisions in his bill for, as I understand it, sort of a national surcharge that would get placed through the transmission grid that we have a problem with and some other issues. But we are largely along the same lines as Senator Bingaman.

Mr. SHADEGG. Do you think it will be substantially similar with that one exception? Are there others that you can identify for us now?

Mr. BLAKE. We will in the process next week. We will give you a good breakout of where we differ from Senator Bingaman's legislation.

Mr. SHADEGG. Thank you for your testimony and yield back the balance of my time.

Mr. BARTON. Mr. Boucher, any further questions?

Mr. BOUCHER. No questions.

Mr. BARTON. The only question I have, in our California specific legislation, we put in an authorization for Federal funding to buy out and build out Path 15. It is my understanding that the Department of Energy has put that out for proposal and there have been a number of bids put forward by private companies to build the Path 15 connection in northern and southern California. Could you elaborate on that briefly.

Mr. BLAKE. Mr. Chairman, I am actually recused from that because one of the companies that has responded to it was General Electric. But I know prior to recusing myself that there were, in fact, private entities that expressed interest in responding to that.

Mr. BARTON. Is there somebody in DOE that has not recused that could give us an answer on the record so that could be part of the hearing record?

Mr. BLAKE. We will do that.

Mr. BARTON. We thank you for your time and when you go back to the Department of Energy, there is a high degree of probability that you and others are going to be asked at a minimum to brief this subcommittee and full committee on some of these issues that Mr. Ganske and Mr. Norwood raised next week. So we need to get

a list of the availability of your ability to come brief this subcommittee.

Mr. BLAKE. Look forward to doing that. Thank you very much.

Mr. BARTON. I would like now to bring forward our second panel. We have the distinguished FERC commissioner starting with their distinguished chairman, Honorable Pat Wood, Texas Aggie, from my home State; Commissioner Linda Breathitt; Commissioner Bill Massey; and our new commissioner from Pennsylvania, Commissioner Brownell. Ladies and gentlemen welcome to the subcommittee.

We will put everyone's testimony in the record in its entirety and start with the Chairman, Mr. Wood. And we will give you 7 minutes and then we will go right down the row and give Commissioner Breathitt and Commissioner Brownell and Commissioner Massey the opportunity to also speak for 7 minutes, if they so wish. Welcome to the subcommittee, Chairman Wood.

STATEMENTS OF HON. PAT WOOD III, CHAIRMAN; HON. LINDA K. BREATHITT, COMMISSIONER; HON. NORA MEAD BROWNELL, COMMISSIONER; AND HON. WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. WOOD. Thank you, Chairman Barton. I guess in light of the events of last week, we all think first and foremost about security and reliability issues. And as a former State regulator, we have all had to deal with things like hurricanes, wildfires, encroachments on utilities, the Y2K issues, shortfalls in hydroelectricity. That is a continuing issue; certainly earthquakes. But this one is different. This one is a longer term issue that doesn't have a date-certain ending, and I think requires a very different mindset than one we had 10 days ago.

I should say, as Deputy Secretary Blake did, that the utilities have performed very well as a supporting cast in this tragedy. The measures that have been implemented across the industry certainly in hydroelectric dams, in oil, natural gas and refined product pipelines in the production area for both power and natural gas, including, certainly, the all important nuclear power stations, transmission substations, transmission transformers, transmission lines in general.

In fact the Commission weighed in last week—all four of us pretty soon after the event wanted to make clear to the industry that our policy statement that expenditures spent to enhance and increase the security of the facilities that we have regulatory authority over would be able to be treated expeditiously for rate recovery.

Bottom line is don't let cost and don't let the worry about how you are going to get your money back be a reason why you cut back on any needed and prudent security measures. So we weighed in on that as well.

But the bottom line, we have got a very open and a very dispersed system for energy in this country. That is both a blessing and a curse; a curse in that it is so open and so visible. Every map for aviators or for geology or whatever shows you where our transmission lines are and where fuel pipelines cross and where railways go by and carry coal to your power plant, where power plants

are. They are extremely visible. Again, that is also a plus because it is so dispersed, it is so everywhere, that there is a lot of give in our very reliable power delivery system.

I think total prevention against attack is a promise I cannot make. But insulation of the public and industry from its negative effects is something that we can actually do better. Redundancy of pipelines, of transmission lines, of power production facilities and others is our best bet. Redundancy used to be a big picture, a big fixture on the scene here in the country. Then what we knew would be a multi-year transition in the electric power industry began in 1992 with the Energy Policy Act. To me, as I believe Mr. Wynn asked, the authority that the Commission has to move forward on the initiatives that it has had since 1992 was clear in that Act. Retail issues are left to the States. Wholesale issues are the job of the Fed. and it is our job collectively to make markets work.

I think, Mr. Boucher, you put it pretty well in your opening statement that I made note of that. We are, next week, hearing Supreme Court review of a decision that I believe, Bill, you were the only one on the Commission at the time that it was made 5 years ago about the balance between States and Fed.

So my discussions, and certainly probably every answer in response I will give particularly on the RTO issues is yes, there is clear authority in the statute to remedy unjust and unreasonable and discriminatory actions for the use of the grid. And we will move forward on that as I think you all or your predecessors in 1992 wanted us to do.

But bottom line, it would help the Commission. It would help the people of this country significantly if there is any doubt raised by anybody that comes before the committee about this that the committee clarify it, that the Congress and President clarify that this happens so we don't spend 5 years making lawyers rich, but keeping money out of the pockets of people who could benefit from competition.

I say that with all due respect as a lawyer. But I do view that we have been treading water for 9 years. The swimmer is tired. We need to get on the other shore. People on the dock are waiting for us to come on across. FERC is committed today to providing the necessary leadership to set forth the clear path to end this overly long transition. It is important for us to work with our brother and sister regulators at the State level. They are the front line. And we know that people that might oppose competition might try to drive a wedge between us and our brother and sister regulators, but they won't succeed.

It is our job, as you expect us to do, to provide clear rules for business investment in this industry. It is important to make those rules clear as to how money gets repaid to the investor. Cost recovery is very important. So for us it is important to get investment dollars back in this bedrock industry. That is how we get the redundancy. That is how we get the security.

That is potentially going to be an issue for a very long time, as this threat continues to be dealt with. I should add, in light of the home State of the Chair, under then-Governor Bush's strong leadership, we did provide this certainty in Texas in the past 6 years. And there was investment. There has been tremendous investment

both in the power delivery system and the power production system. And I think that is certainly the ground upon which you can build a successful deregulated system. Without it, I think you are building a house on sinking sand. And in doing so, I want to make sure that you all know we will ensure the reliable, safe and competitive marketplace that Congress said it wanted in 1992.

And I conclude by saying the Nation's customers deserve no less.

[The prepared statement of Hon. Pat Wood III follows:]

PREPARED STATEMENT OF PAT WOOD, III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION AND SUMMARY

Mr. Chairman and Members of the Subcommittee: Good afternoon. Thank you for the opportunity to speak today on the role of competitive wholesale power markets in providing affordable, reliable electricity for customers, and the role of the Federal government in ensuring the continuing development of the industry. As an initial matter, I would like to talk about the issue that has been on my mind since the tragic events of September 11, 2001. Then, I will discuss the important near-term steps necessary for achieving a seamless nationwide power market that will provide customers the reasonably-priced and reliable service they deserve.

Our Nation has been unalterably shaken by the terrorist attacks of September 11, 2001. Fortunately, our electric system remained secure during and after the attacks. The attacks did not disrupt service in a broad regional area. Utilities quickly implemented their heightened security procedures. Many of these procedures are still in effect. And our existing independent transmission system operators (ISOs) in the Northeast were vitally involved in monitoring and maintaining transmission grid reliability in the stricken region.

A key question I have pondered is, can the electric power system sustain a terrorist attack? To be frank, in the face of an organized, well-financed, wide-spread effort to do harm, such a dispersed, highly visible and open system could suffer damage. The industry and its regulators are on alert and are taking many precautions, and the industry is working hard to anticipate and forestall such damage. Last week, the Commission issued a policy statement to its regulated industries stressing the importance of security measures and our willingness to consider exceptional cost recovery for unprecedented security-related expenses and investments.

While we must continue to take all appropriate security measures for existing infrastructure, our best insurance policy is redundancy. The electric power industry has had a long history of building sufficient additional infrastructure to handle unplanned contingencies. Over-design of the grid for double or triple failure contingencies and construction of excess generation capacity (reserve margin) have been historically effective ways to assure reliable performance through redundancy.

The extended and uncertain path of industry restructuring since the passage of the 1992 Energy Policy Act, though, has taken its toll on investment in infrastructure. Investors have not been eager to invest capital where rules are unclear and cost recovery is uncertain. This under-investment in critical energy infrastructure undermines the potential for competitive markets to yield significant customer benefits (as we have seen in California) and diminishes our reliability safety margin as well.

This will not change until we who work on behalf of the public declare an end to inaction, clarify the rules for the future and get through this transition.

Some have argued for federalization of all of these issues; others have advocated leaving it at the state level. I believe, however, that the solution lies in recognizing that electric power markets are regional in their nature. For that reason, the Commission has been promoting the formation and development of a small number of regional transmission organizations (RTOs). These institutions, once formed, will assure reliable minute-by-minute grid operations, optimize fair use of the "electric highway" by all users, plan for the future transmission needs of the region and ensure that long-term supply stays ahead of long-term demand.

What was a good idea for promoting competitive markets ten days ago is imperative for a reliable national power grid today. Handling the basic RTO duties is challenging and expensive, but it's even more costly to society if these duties are on a utility-by-utility basis (if at all), as they are today. The costs of planning and executing the level of security and infrastructure protection that will be needed in the days and years ahead will be significant and will require expertise and sophistica-

tion that most individual utilities or even small, sub-regional groups of utilities cannot possess. This level of security and its cost demand a size and scope that only a large, region-wide organization with intentional redundancy and access to resources can provide.

Although the Commission decided in past years to move forward with RTO formation on a voluntary basis, the Commission can go further and require them. This may be a moot point if the industry moves assertively forward to form RTOs that cover the nation's regional power markets. To the extent, however, that any party challenges this forward progress in courts, then Congress should make clear its intent that these organizations are its preference. This will save the industry four years in the courts, will ensure customers get the billions of dollars of savings that a competitive power market can deliver during that time, and most importantly, will rebuild to secure and reliable levels a bedrock industry that has suffered inadequate investment in the past decade.

II. BACKGROUND

A. The Industry's Past

In the early decades of the industry, the transmission grid was much less developed than it is now, interconnections between utilities were fewer, and power supply was a local business. Government, customers and even utilities recognized that, based on the technology at the time, regulated monopolies were less costly than the turmoil of door-to-door competition. So, for many years after its inception, the electric utility industry was regulated comprehensively on a cost-of-service basis.

By the 1970s, however, the industry began to change. The energy crises of that decade led Congress to enact the Public Utility Regulatory Policies Act (PURPA). PURPA encouraged the development of non-utility generators using cogeneration, renewable fuels or small power technologies. Regulated utilities were required to buy power from these non-utility generators so long as the latter met PURPA's ownership and efficiency criteria. The rates for sales by the non-utility generators were based, not on their costs, but on the costs avoided by their utility buyers. Many regulated utilities began, for the first time, to face strong competition for the opportunity to generate the power needed by their retail customers. This also stimulated dramatic efficiency improvements in generation technology.

In the 1980s, the Commission further encouraged the development of competition. If a generator demonstrated that it and its affiliates lacked market power, the Commission allowed it to sell at market-based rates instead of cost-based rates. If the generator or its affiliates owned or controlled transmission facilities (a source of market power), the Commission authorized market-based rates only if other sellers were allowed to use the transmission facilities to compete for sales to wholesale customers.

In 1992, Congress enacted the Energy Policy Act, strongly endorsing competition in wholesale markets. Congress authorized an exemption from the requirements of the Public Utility Holding Company Act (the 1935 companion to the Federal Power Act) for companies selling power exclusively at wholesale. Congress also authorized the Commission to order utilities, on a case-by-case basis, to provide transmission service.

In 1996, the Commission adopted its Order No. 888, requiring all public utilities to offer nondiscriminatory, open access service over transmission facilities they own, control or operate. As a result of this service, most wholesale buyers and sellers now have more trading options than they had in the past.

These efforts by Congress and the Commission laid the groundwork for more competition in wholesale power markets. However, events in California and the West over the last eighteen months, and the notable lack of progress in other areas of the country outside the Northeast are strong proof that more needs to be done. Every day I hear from someone in the industry about the uncertain investment climate created by vague rules or incomplete policies, and that uncertainty does not help us achieve our societal goals.

B. The Industry's Future

Our goal is a seamless national power marketplace, and the Commission has chosen to realize this goal through the creation of regional transmission organizations. An RTO is an entity that is independent from market participants and operates (and also may own) the transmission grid for a large region of the country. A well-functioning RTO will serve a multi-faceted role, including transmission planning, assuring reliability of service and adequacy of supply, facilitating transparent power markets and monitoring behavior of market participants.

In late 1999, the Commission adopted its Order No. 2000, encouraging the formation of RTOs. If properly constituted and truly independent, RTOs can promote wholesale competition and, where states choose to pursue it, retail competition. RTOs can broaden the size of markets by eliminating "pancaking" of transmission rates. RTOs can offer "one-stop shopping" for transmission service across a large region, better manage transmission congestion and reliability, and facilitate transmission planning across a multi-state region. By doing so, RTOs will allow buyers and sellers to have more trading choices than they now have and deliver lower energy costs and greater short- and long-term reliability on the electric grid.

The Commission has endorsed the ultimate formation of four RTOs in its jurisdictional markets, three in the eastern United States (one in the Northeast, Southeast and Midwest) and one in the western United States. (The fifth RTO, the Electric Reliability Council of Texas Interconnection, is not in interstate commerce and is not under direct Commission jurisdiction.) However, we recognize that many obstacles must be overcome to reach this goal. In this regard, market participants in the Northeast and Southeast recently completed mediation on RTO formation, and the progress made during those discussions is encouraging. In the Midwest, two proposed RTOs have agreed on a framework for coordinating their services.

The issue now is whether, and how, more can be accomplished in the short-term. Perhaps the most difficult issues are in the western United States, because of the past eighteen months of problems in that region's markets. However, utilities and elected officials in the western United States have a strong tradition of region-wide cooperation and, in my view, this tradition will eventually support the formation of a region-wide RTO.

For Congress at this time, the guiding principle should be to reaffirm the development of a reliable and competitive wholesale market, thereby assuring customers of a supply sufficient to meet their energy needs at the lowest reasonable cost. This principle requires different approaches in the transmission and generation segments of the industry.

Transmission will have to remain regulated for the foreseeable future. Lawmakers and regulators should help ensure that transmission owners and operators have economic incentives to design, build, operate, and expand the transmission grid to meet the needs of all customers and other market participants.

In contrast, in the wholesale power sector, we need to rely on competition instead of traditional regulation wherever possible. Existing laws that hinder competition need to be modified or repealed. While the Commission stands ready to intervene in power markets when market rules or other factors lead to unjust and unreasonable prices, legislation reducing the existing barriers to entry and providing regulatory clarity will minimize the need for such efforts in the future.

Before addressing these issues in detail, however, I will discuss the events of last week as they relate to the Commission's responsibilities and, in particular, how they relate to RTOs.

III. EFFECTS OF THE TERRORIST ACTIONS ON ENERGY SUPPLY

Our Nation's electric system remained secure during and after the September 11 terrorist attacks. Two substations in New York were crushed in the destruction of the World Trade Center towers. An additional substation was damaged. The local utility and its suppliers are working to replace the substations quickly.

Following the terrorist attacks, all electric utilities and generators have been in a heightened security condition. Understandably, utilities do not publicize their specific activities and precautions. However, many rely upon procedures developed over the past several decades, including the Y2K preparedness plans. Generating stations implement higher security levels, normally unmanned substations and facilities are manned, and security centers go into "lock down" with regard to access. In some areas, there may be greater reliance on local generation over imports. Some utilities also check "black start" units (combustion turbines and hydro facilities used to restore power quickly) to make sure they are readily available, and test backup communications systems. Additionally, NERC put the nation's twenty-one grid security coordinators on full alert for several days.

The three ISOs operating the regional grids in the Northeast serve as security coordinators in their regions and were vitally involved in monitoring and maintaining grid reliability. Since late last week, security coordinators have participated in a daily secure telephone conference call with representatives of the U.S. Department of Energy and the North American Electric Reliability Council (NERC) regarding security threats to the electrical system. These calls will continue for some time.

Last week the Commission assured the companies we regulate (transmission-owning public utilities as well as gas and oil pipelines) that we will welcome applica-

tions to recover prudently incurred costs necessary to further safeguard the reliability and security of our energy supply infrastructure. The Commission's aim was to prevent uncertainty about companies' ability to recover these costs, especially for those operating under frozen or indexed rates. The Commission stated that companies may propose a separate rate recovery mechanism, such as a surcharge to current rates or some other cost recovery method.

In the aftermath of last week's events, the media reported sharp price increases for gasoline in some regions. We have not seen comparable increases for natural gas or wholesale power, and prices for these commodities remain in the same range they have been in recent weeks. The increasingly-important power and natural gas trading operations across the country maintained their activities, even though the important NYMEX commodity operation in New York City was directly affected by the attacks there.

Last week's attacks prompted some to question whether we should continue to require transparency of transmission information to all potential transmission users. We require transmission providers to make available to traders an electronic bulletin board type service showing how much power can be moved from one grid location to another so they can reserve transmission capacity for trades. However, this requirement does not reveal the grid design, the locations of secure facilities, or important operational procedures. Thus, I do not believe our current transparency rules increase the vulnerability of the transmission grid to potential terrorist attacks.

Some also have asked whether having RTOs would help or hurt in the case of a terrorist attack. As I noted earlier, the three existing ISOs in the Northeast, which are precursor organizations to the RTOs we are trying to encourage, were critical to maintaining transmission grid reliability during and after the September 11 attacks. I therefore believe that last week's events demonstrate the effectiveness of RTOs and strengthen the need for RTOs. An RTO can develop a comprehensive security plan for a large area, drawing on a broader array of electrical and human resources. Joint security plans for fuel supply controls, grid operation, and telecommunications can be coordinated with multi-state emergency authorities. Further, only one or two major control centers must be hardened for protection. Such modifications are less costly than similar modifications for many smaller control centers. Centralized authority and communications involve fewer parties, facilitating quick decisionmaking and dissemination of vital instructions. In a large RTO, one standard communications protocol can be used instead of having numerous protocols for many utilities.

IV. OTHER RELIABILITY RISKS

In addition to the national security issues outlined above, there are other reliability risks that need attention. The recent changes in the electric power industry have increased the incentives for, and frequency of, violations of reliability rules. As a result, the issue confronting the industry is whether federal action on reliability is necessary.

A number of credible parties have argued that the Commission cannot enforce reliability standards for users of the grid. Congress should remove any doubt in this crucial area and provide explicit authority. Cooperation among utilities ensured a reliable electric supply in the past, but with many new players now using the grid, mandatory reliability rules administered by the RTO and enforceable under government authority are called for. I have seen drafts from several parties in this regard and believe the simplest solution may be the best. In 1999, Texas Governor Bush signed into law the following provision: "The commission may delegate authority to the [ERCOT ISO] to enforce operating standards within [ERCOT]." PURA sect. 39.151(i)

Absent clear federal authority to address reliability issues directly, the shortcomings of the traditional voluntary approach to reliability issues has driven some in the industry to seek other approaches. One option is to enforce reliability standards through contracts. Public utilities may voluntarily include reliability-related provisions in contracts or tariffs filed with the Commission because they affect or relate to the rates, terms and conditions of jurisdictional service. If reliability provisions in Commission-jurisdictional contracts are accepted and on file with the Commission, the Commission can enforce the reliability-related provisions against public utility parties to the contracts.

A system of such contractual arrangements has been established by utilities in the Western Systems Coordinating Council (WSCC), the regional reliability council for the Western United States. The effectiveness of the WSCC arrangement and the Commission's ability to enforce it have not been fully tested. But a voluntary con-

tractual regime is not the simplest, fastest or most effective way to establish and adequately enforce reliability standards. It depends solely on the willingness of public utilities to make voluntary filings and, even then, it may not capture the electric facilities of non-public utilities. Reliability is at risk to the extent that not all market participants are covered by the same requirements.

Federal legislation is a better option. On May 17, 2001, the Administration released its National Energy Policy Report. The Report recommends that the President direct the Secretary of Energy to work with the Commission to improve the reliability of the interstate transmission system and to develop legislation providing for enforcement by a self-regulating organization subject to the Commission's oversight.

I believe a legislative approach is preferable to the contractual approach discussed above. I support streamlined legislation that gives the Commission authority to adopt and enforce reliability rules, and to give deference as appropriate to organizations that develop such rules. I believe that RTOs should play the central role not only in transmission access and planning but also in reliability, and that the Commission can and should defer to these organizations once they are up and running. But the Commission should retain oversight and enforcement responsibilities to assure that the nation's reliability needs and rules are effective and honored by industry participants.

Congress should understand that mandatory reliability rules alone are not enough to ensure the reliability of the grid. In its Order No. 2000 on RTOs, the Commission set out at length the need for an RTO to ensure reliability in each region. In particular, RTOs must have the authority to ensure the short-term reliability of the regional grid and must be responsible for planning, and for directing or arranging, necessary transmission expansion and upgrades that will enable it to provide efficient and reliable transmission service.

V. TRANSMISSION JURISDICTION

There are several other transmission-related steps Congress can take to promote competition in wholesale markets. First, Congress should strengthen the Commission's ability to create truly open, competitive wholesale electricity markets by recognizing that "separate but equal" transmission is inherently unequal. Transmission of electric power is interstate commerce and should be fairly recognized as such. And all users of transmission service should be treated equally, provided they pay for it. Further, there will remain barriers of cost, time and uncertainty that slow investment in generation and increase the cost of electricity. One need look no further than Chairman Barton's home state to observe the positive impact that having clear rules from a single regulator has had on needed investment and expansion of the grid.

Second, as stated in the introduction, it would significantly speed the advent of competitive markets if Congress clarified the Commission's authority to promote large RTOs. The Commission is moving aggressively to promote the formation of RTOs but a clearer statement of Congressional intent could help avoid years of lengthy litigation.

Third, it is important that federal tax laws not be used as excuses by certain market players to resist or hinder development of competitive power markets. In that regard, Congress should address the private use restrictions affecting public power and cooperatives and the tax disincentives for investor-owned utilities to transfer transmission assets to RTOs. The provisions passed by the House earlier this year in this regard are very important to ensure that expected customer benefits from competition are not offset by tax payments.

Fourth, explicit Congressional support for standardization of rules and procedures for interconnecting all new generation, including but not limited to small-scale distributed generation, would avoid years of costly litigation. This is a high priority goal of the Commission currently. Standardization will help minimize the costs and barriers for new generation, and clarification of the Commission's authority in this area will forestall the uncertainty of litigation about jurisdiction. The timely expansion of generation capacity achievable in this way will facilitate new entry into the markets and reduce prices for customers.

VI. OTHER ISSUES

A. Market Monitoring and Enforcement

Competitive markets do not just happen; they require ongoing oversight. In the context of wholesale power markets, the foremost component of effective oversight is regular monitoring of prices. When price changes are inconsistent with the oper-

ation of competitive markets, market monitors must inquire further and ensure that market participants are not engaging in anticompetitive behavior.

The Commission has required or authorized the existing ISOs to perform certain market oversight functions, such as data collection and initial analysis. In the future, this role should be performed by RTOs.

The Commission itself must make a stronger commitment to market monitoring. As Chairman, one of my goals is to work with my colleagues to strengthen the Commission's market monitoring efforts. We must be vigilant and timely if we are to be effective. We intend to make that happen by changing our priorities and reallocating our resources. I will provide more detail to the Committee in the near future on our efforts in this regard.

Congress also can help. While the Commission can require refunds and impose civil penalties in certain circumstances under the FPA, both authorities are limited.

Currently, on refunds, section 206 of the Federal Power Act allows the Commission to require refunds for a 15 month period beginning 60 days after the filing of a complaint or publication of the Commission's initiation of an investigation. Section 5 of the Natural Gas Act does not contain a similar refund provision but permits rate changes on;y prospectively. Section 206 of the FPA also allows the Commission to change rates prospectively upon completion of the complaint or investigation proceeding.

Electric utility customers would benefit if the Commission had additional authority to order refunds. Congress should authorize refunds from the date of filing of the complaint or publication of the Commission's initiation of an investigation. Either of these events provides notice to market participants that their transactions may be modified after-the-fact, and allows market participants to modify their trading activity or knowingly accept the risk of rate uncertainty.

Congress also should expand the Commission's authority to impose civil penalties. Existing section 316A of the FPA allows the Commission to assess civil penalties of up to $10,000 per day for the violation of limited provisions of the FPA (sections 211, 212, 213 or 214) or of any rule or order issued under those provisions. This section could be extended to cover any violation of Part II of the FPA or any rules or orders issued thereunder.

B. Price-Responsive Demand

Effective markets balance supply with customer response, allowing for lower usage as prices rise. But in regulated retail electric markets, with their uniform rates, utilities have no choice but to buy or produce power, whatever the cost, and customers do not receive price signals about the true value of the energy they are using. The Commission will be working with the Department of Energy, RTOs and others to establish price-responsive demand mechanisms that reach a variety of customer groups and allow them to reduce their energy demand when prices are too high. This will reduce overall peak load levels, peak energy prices and supplier market power. I believe the Commission's present authority in this area is sufficient; but, to the extent this is questioned, statutory clarification would speed the implementation of this important demand-side mechanism.

C. PUHCA

The Public Utility Holding Company Act (PUHCA) requires registered holding companies to submit to extensive regulation by the Securities and Exchange Commission. PUHCA also generally requires holding companies to operate an "integrated" and contiguous system. As a result, PUHCA encourages concentrations of generation ownership and control in local markets that are inconsistent with competition, and discourages asset combinations that could be pro-competitive. PUHCA may also provide a significant disincentive for investment in independent transmission companies that would qualify as RTOs. Under PUHCA, any entity that owns or controls facilities used for the transmission of electric energy—such as an RTO—falls within the definition of a public utility company, and any owner of ten percent or more of such a company would be a holding company and potentially could be required to become a registered holding company. This discourages investments in independent transmission companies that qualify as RTOs.

PUHCA was enacted primarily to undo harms caused by byzantine holding company structures that no longer exist. In the decades since PUHCA was enacted, utility regulation has increased substantially under the Federal Power Act, federal securities laws and state laws. PUHCA has outlived its usefulness, and now does more harm than good. PUHCA should be repealed.

D. PURPA

As noted earlier, PURPA was enacted in the late-1970s in the aftermath of that decade's energy crises. The legislation's goal was to remove impediments to the use

of cogeneration and renewable-based generation, and promote their use by requiring utilities to buy this power at the utilities' avoided costs.

Today in many parts of the country, the impediments addressed in PURPA are gone (although other impediments may exist, such as the need for grid expansion). Also, PURPA's "forced sale" requirements are no longer necessary to promote the development of competition, in light of the availability of open access transmission, and more often serve to distort competitive outcomes. Congress should repeal PURPA but "grandfather" existing PURPA contracts. To provide a smoother transition for parties which made investments under the expectations created by PURPA, it may be appropriate to limit its repeal to those states where all generation entities have the ability to sell their output to the widest possible range of customers.

E. Transmission Siting

Since the Commission adopted its open access requirements in 1996, the use of the interstate transmission grid has grown dramatically. Also, wholesale markets have become much more regional than local, encompassing large multi-state areas. Unfortunately, the grid has not been expanded commensurately. Thus, the grid increasingly is pushed to its operational limits. The risk of possible terrorist attacks against our energy infrastructure makes even more urgent the need for additional transmission capacity to protect against contingencies. Moreover, transmission constraints frequently prevent the most efficient use of generation facilities. The institutional structures for authorizing construction or expansion of transmission lines do not meet our needs.

Congress should provide a mechanism for ensuring timely action on transmission siting applications. It would add certainty to the siting process if a time limit were placed upon state-specific approvals, and a multi-state Section 209 Joint Board (drawn from states within the relevant RTO region) were set up as a backstop if the regulatory time limit (e.g., one year) is not met. To recognize the fact that the overwhelming number of transmission siting issues are dealt with expeditiously by states, it would be appropriate to limit this provision only to those projects deemed critical by the Secretary or by the RTO (unless the states find regional transmission siting so efficient and effective that they choose to send more projects up to the regional board for handling) .

VII. CONCLUSION

Well-functioning power markets depend on three key elements: adequate infrastructure, clear and balanced rules that allow efficient trading among market participants, and effective market oversight. Our goal is to use the authority and resources of the Commission to pursue this three-pronged strategy to facilitate robust wholesale electric competition that benefits customers across the country.

The Commission will continue to regulate transmission for the foreseeable future, while encouraging transmission to become more responsive to the needs of the market. The Commission also intends to monitor wholesale markets more proactively to anticipate many problems, and take aggressive actions where unforeseen problems occur, instead of waiting in the expectation that markets will always self-correct.

It has been a slow nine years since the President's father signed the 1992 Energy Policy Act into law. Its promises of a competitive electric power marketplace are still largely unfulfilled, and the slow transition is beginning to take its toll in unacceptable ways. I pledge to you my complete dedication to the task of making up for lost time and welcome your support.

Mr. BARTON. Thank you, Chairman.

I would now like to hear from Commissioner Breathitt for 7 minutes.

STATEMENT OF HON. LINDA K. BREATHITT

Ms. BREATHITT. Good afternoon, Chairman Barton and members of the subcommittee, Mr. Boucher. Thank you for the opportunity to appear today to discuss the role of the Federal Government, and in particular, the Federal Energy Regulatory Commission in the continuing development of our Nation's electric and natural gas industries. In my written testimony, I have outlined major issues confronting the Commission today, and I also have made some recommendations for legislation that I believe will assist the Commis-

sion in its paramount objective to promote fully competitive wholesale electricity markets. In this regard, FERC's emphasis in the near future will be to complete the development of regional transmission organizations with clear responsibilities, independence and sufficient scope.

Since the Commission began promoting RTOs as a means to remove barriers and impediments present in wholesale markets, I have been fully committed to the goal of RTO implementation. Order 2000 remains the guiding document for achieving these goals. Although some are impatient with the pace, the voluntary approach is working. State commissions and other stakeholders throughout the country have devoted considerable time and resources to see that RTOs get up and running.

Another area where the Commission will be concentrating its attention is the consideration of a generic rulemaking proceeding on transmission interconnections. I believe interconnection rules should be clarified and standardized to ensure that new sources of generation are able to interconnect to the transmission system, and I also believe that we must carefully consider the associated cost responsibilities.

Also most important in the development of competitive markets is reliability. As the Deputy Secretary also said, I believe the current voluntary system, which has been in place for over 3 decades, should be replaced with one in which a self-regulated organization with oversight by the Commission enforces mandatory reliability standards, and I would welcome legislation in that regard.

On another legislative matter, I support the repeal of PUHCA conditioned upon the grant of enhanced authority by the Commission to address market power problems and assurance that both FERC and the States would have greater access to books and records of holding companies. I also support the repeal of the mandatory purchase requirements in Section 210 of PURPA, subject to new provisions that would remove disincentives for renewable generation sources.

Transmission siting is another area I think where Congress could assist us. You have heard my thoughts on transmission siting. I will briefly tell you that I recommend still that FERC be granted Federal eminent domain authority over interstate lines in order to centralize planning expansion and siting, but not power plants and not distribution. In addition, I think FERC could improve its oversight capabilities with clear authority to collect and publish transactional data while protecting proprietary information. And I also recommend expansion of our authority to remedy violations of law.

Finally, in light of the tragic events of September 11, I would like to recognize that the heightened security concerns of the Nation's energy industry may bring before the Commission new issues, some of which we may not be able to anticipate. Should matters within our jurisdiction arise out of last week's events, I assure the subcommittee that I stand ready as I know my colleagues do, to do whatever is necessary to resolve them consistent with the public interest. Thank you.

[The prepared statement of Hon. Linda K. Breathitt follows:]

PREPARED STATEMENT OF HON. LINDA BREATHITT, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee: I appreciate this opportunity to appear before you today to discuss the Federal Energy Regulatory Commission's (FERC) role in developing competitive wholesale power markets and its role in ensuring the continuing development of our Nation's electric power industry. As requested by the Subcommittee, my testimony addresses the following issues: (1) significant changes in the electric power industry; (2) the Public Utility Holding Company Act of 1935 (PUHCA) and the Public Utility Regulatory Policies Act of 1978 (PURPA); (3) the status of Regional Transmission Organization (RTO) formation; (4) FERC's role in the siting of electric transmission facilities; (5) FERC's role in overseeing wholesale electricity markets; (6) FERC's refund authority; and (7) measures undertaken to protect the integrity of the Nation's electric power infrastructure. Where appropriate, my testimony includes comments on legislation that I believe is needed to assist FERC in continuing the development of competitive wholesale markets.

In 1996, with the issuance of Order Nos. 888 and 889, FERC established the foundation for competitive wholesale power markets in the United States. With these rules, FERC ordered all transmission-owning public utilities to file nondiscriminatory open-access tariffs, thereby opening up interstate transmission. FERC's goal was to ensure that customers have the benefits of competitively priced generation.

With the issuance of Order No. 2000 in December 1999, FERC continued its effort to create open and fair competitive markets. Order No. 2000 focused on the formation of Regional Transmission Organizations (RTOs). The Commission found that RTOs may eliminate undue discrimination in transmission services that can occur when the operation of the transmission system remains in the control of vertically-integrated utilities. The Commission also found that RTOs can improve grid reliability, improve market performance, and facilitate lighter-handed regulation. Much of FERC's emphasis in the near future will be to complete the development of RTOs with clear responsibilities, independence, and sufficient scope.

Since the Commission began promoting RTOs as a means to remove barriers and impediments present in wholesale electricity markets, I have been fully committed to the goal of RTO implementation. When the Commission deliberated over how to attain the objective of RTO formation, we decided to adopt an open collaborative process that relied on voluntary regional participation. In a series of orders issued on July 12, 2001, the Commission dramatically departed from the voluntary approach we pursued in Order No. 2000 by directing the formation of four specific RTOs for the United States, excluding Texas.

I dissented on this aspect of the July 12 orders. My concern was that this decision on RTO formation departed from the basic philosophies embodied in Order No. 2000, and that any such action should be preceded by a formal notice-and-comment rulemaking. This path would allow the Commission to make a reasoned decision informed by the views of all interested parties—most importantly, state commissions.

Apart from the departure from the voluntary nature of Order No. 2000, I have further concerns with July 12 orders' determinations regarding RTO scope and timing. I certainly favor the development of large RTOs reflecting natural markets. I am not, however, convinced that four RTOs would meet the noble goals of Order No. 2000 any better than six or seven—or even eight—RTOs of sufficient size. In addition, I believe that the Commission's July 12 decisions demonstrate little regard for the status and timing of RTO formation efforts in various regions of the country. The process of merging markets as RTOs are formed is revealing itself to be a highly technical and complex endeavor. It is my view that the Commission should recognize this in developing realistic expectations.

I also felt it necessary at the time to comment on the majority's assertion that forming larger RTOs will result in lower wholesale prices, and do so now. This is a laudable goal, and as such, I embrace it. However, the promise of lower wholesale electricity prices is one that I, as a federal official, am not willing to make to consumers at this time. Competitive markets should produce lower prices; but we have not yet reached that level of market development. Consequently, I have urged my colleagues to be more circumspect in promising lower prices. Consumers and ratepayers of electricity are going through a trying time at present. We need to be honest and up front as to the benefits and, yes, sometimes the struggles, of moving toward competition.

Of utmost importance in the development of competitive energy markets is reliability. I believe that the voluntary reliability system, which has been in place for over three decades, should be replaced with one in which a self-regulated independent reliability organization, with oversight by the Commission, establishes and

enforces mandatory reliability standards. I would support legislation which authorizes a system for assuring the reliability of the electric grid that: (1) is mandatory, (2) requires sanctions and penalties for failure to comply with reliability rules, and (3) is subject to federal oversight. In my view, such a change in the manner in which the reliability of the interconnected grid is overseen and managed is required in order to ensure a competitive bulk power market. I would wholeheartedly support the establishment of a self-regulated independent reliability organization, with oversight by the Commission.

I believe that interconnection rules should be clarified in order to ensure that new sources of generation are able to interconnect to the transmission system. FERC has stated its intent to evaluate in the near future the importance of standardizing interconnection policies and procedures in a generic proceeding. I fully support such standardization. A related issue is who should bear the costs of new interconnections and upgrades. These pricing decisions need to be made carefully and with consideration of the multiple factors at issue. Any changes in cost responsibility for interconnections should be accomplished through a formal rulemaking, where all affected parties have an opportunity to express their views.

There has been significant discussion among industry participants concerning the conditional repeal of both PUHCA and the mandatory purchase requirements of PURPA. If PUHCA is repealed, I urge that such repeal be conditioned upon the grant of enhanced authority to the Commission to address market power problems, and assurance that both the Commission and the states would have greater access to the books and records of holding companies. I also support repeal of the mandatory purchase requirement in Section 210 of PURPA, subject to new provisions that would remove disincentives for renewable generation sources.

Another issue that arises in the context of FERC's goal to encourage competition in wholesale electric markets is the Commission's role in the siting of transmission facilities. I fear that the goal of a national grid may be unattainable absent a new approach to transmission planning, expansion, and siting. Currently, under the Federal Power Act, the Commission has no role in the permitting and siting of new transmission facilities. I believe that shortages of transmission are no longer just single state issues; instead, these shortages have become interstate commerce issues that must be addressed by the federal government.

There have been proposals to use federal eminent domain as a backstop to a cooperative, regionally-based approach to transmission and siting issues. In essence, FERC would be granted eminent domain authority, which we, in turn, would be allowed to cede to regional regulatory compacts. My primary concern with this approach is that it could result in costly and inefficient duplication of processes, records, and efforts by the various decisional authorities involved in transmission siting. As we have seen with the Commission's hydropower licensing program, for example, it is very difficult to build speed into a process over which several entities exercise jurisdiction. While the Commission has made great progress in streamlining cumbersome processes in this regard, I would caution the Subcommittee about initiating a new regime for transmission siting that could easily be mired in bureaucratic wrangling.

My recommendation would be for FERC to be granted federal eminent domain authority similar to the authority the Commission exercises with respect to the siting of interstate natural gas pipelines under the Natural Gas Act. The Commission could build into its implementation of such legislation procedures to ensure cooperation by the states and regional input. I believe this more centralized approach is necessary from an efficiency standpoint, and will result in less bureaucracy and more timely decisions for transmission providers and consumers. Furthermore, I am not advocating that the Commission should have siting authority for electric distribution lines or power plants. I believe state governments are best positioned to make those determinations.

I also have a concern that there is not sufficient investment in transmission facilities. In my opinion, the transmission system is not keeping pace with the growing demand in the bulk power market. The difficulty associated with siting is one reason for this. Others are that the industry is increasingly unwilling to make transmission-related investments given the uncertainties that exist in an industry still in the midst of restructuring, as well as the risk of earning inadequate returns on new transmission investments. The Commission must do its part to ensure that its transmission pricing policies incorporate an allowance for reasonable returns on investments. Independent transmission companies as well as merchant transmission companies need certainty to develop their plans.

In order to provide effective oversight of wholesale electricity markets, FERC is preparing itself to operate in today's fast-paced commercial environment. A critical element of market oversight is the availability of market information is a usable for-

mat. There is clearly a relationship between strong market transparency rules and effective regulation. I strongly believe that transparency acts as an effective deterrent to market power by allowing regulators and the public to monitor the marketplace for abuses. The lack of accurate, timely, and easily accessed pricing information can impede competition and liquidity; and for that reason, I have supported many FERC initiatives aimed at expanding the range of publicly available transactional information. With a view toward legislative action, I recommend that FERC and the Energy Information Administration be granted clear authority to collect and publish appropriate transactional data, while protecting proprietary information. These goals are not inconsistent with one another.

The Subcommittee has asked for comment on the authority of the Commission to remedy violations of law. I believe that it would be helpful for the Commission to have some additional authority to prevent the exercise of market power. In my comments to H.R. 1941, "The Electric Refund Fairness Act of 2001," I indicated my support for legislation that would expand the refund authority set forth in section 206(b) of the Federal Power Act. I did, however, emphasize that, in addition to the objective of protecting consumers, I believe it is important for regulators to seek to minimize uncertainty of energy transactions. For example, I would not advocate granting the Commission authority to reopen and order refunds on past transactions. That said, I would welcome legislation amending the FPA to allow the Commission to order refunds as of the date formal notice of a complaint is issued. All interested persons would be on notice that transactions are the subject of complaint or investigation, and that rates may change and refunds may be ordered as a result. Customers would have the added protection of an earlier refund effective date. I would also advocate lengthening the refund effective period beyond the current fifteen months; I have suggested twenty months after the refund effective date would be appropriate. Both goals of protection and certainty would be met under this framework.

In addition, I believe an amendment to the FPA to give the Commission authority to assess penalties, in addition to refunds and interest, could act as a powerful deterrent against the abuse of market power. However, I believe that, in the interest of certainty, a statutory upper limit to any such penalties should be included. Further, I would suggest that any limits on new penalty authority should be high enough to be effective and withstand the passage of time.

Finally, in light of the tragic events of September 11, 2001, the Subcommittee has asked for comment on the security of the Nation's energy infrastructures. FERC's role in the security of the energy transportation and supply infrastructure is very limited. However, the Commission's dam safety program extends to every jurisdictional hydroelectric facility, and each has in place an emergency action plan. In the event of emergency, these plans trigger procedures designed to minimize the impact of a breach on downstream property and homeowners. While jurisdictional pipelines and transmission owners are subject to certain reporting requirements, FERC does not have the authority to prescribe or monitor pipeline and electric transmission security. However, our staff is in contact with pipeline and transmission companies, many of which are operating under heightened security procedures.

The Commission's regulatory purview is largely economic; and in this regard, we recognize that the entities under FERC's jurisdiction may incur extraordinary expenses as a result of the terrorist attacks that have taken place. In particular, electric, gas, and oil companies have begun to adopt new procedures and install new facilities to further safeguard the electric power transmission grid and gas and oil pipeline systems. The costs of such additional security measures remain unclear. In order to reduce the uncertainty about company's ability to recover expenses, the Commission issued a Statement of Policy on September 14, 2001, to assure the industry that our policy favors recovery of such costs.

In closing, I emphasize that comprehensive federal electric legislation is needed to address important and unresolved issues in the restructuring of the electric industry. The Commission must have sufficient authority to advance its goals of achieving fair, open and competitive bulk power markets. Current impediments to the development of such markets must be removed as quickly as possible so that the intended benefits of restructuring for the American consumer ultimately may be realized.

Mr. BARTON. Thank you, Commissioner. We now want to welcome our new commissioner, Commissioner Brownell from the great State of Pennsylvania, former PUC Commissioner there. Welcome to the subcommittee and ask you to summarize your remarks in 7 minutes.

STATEMENT OF HON. NORA MEAD BROWNELL

Ms. BROWNELL. Thank you very much, Mr. Chairman, and members of the subcommittee. I am pleased to be here today. The events of the past week have, of course, caused all of us to rethink our priorities, both professionally and personally. But I am encouraged by your continued focus on energy markets and infrastructure. While it would be easy to be diverted, I believe this is a major economic issue that is costing consumers hundreds of millions of dollars. It is limiting the growth potential of our business community in our country. The economic development of this country rests on the efficient and innovative energy markets and a fully developed infrastructure.

Each day of delay raises the cost in ways I do not think we are effectively measuring. Today I would like to focus on the economic issues. I will talk about the importance of RTOs for future investment as well as for security. A couple of facts: Generation reserve capacity has declined from 22 percent in 1990 to less than 15 percent in the year 2000. New generation is clearly needed. New investment in transmission capacity is less than one half of 1 percent per year over the next 10 years; not keeping up with the pace of growth. Transmission constraints are growing. In the year 2000, there were an estimated $73 million in additional costs in central California; $580 million for the first 9 months in PJM New York and New England; $19 million in central east interface in New York in August alone.

It is clear that the costs are growing, but it is also clear that unless and until we create regulatory and legislative certainty, the investment will not flow. I would like to quote just a few members of the investment community, "An Electric Fall Outlet" by Christine Upenski and Deborah Coy from Schwab Markets. I quote, "When the FERC on July 11 launched an effort to jumpstart the RTO process, RTOs are expected to be the basis of regional markets for power and an improvement over single State or small regional systems. FERC's leadership on this issue could help build regulatory certainty needed to free up investment and transmission assets and market institutions that many companies see as necessary to reach full growth potential."

In a letter from J.P. Morgan, speaking of the importance and interests of the private equity sector of that company, they speak of this as an attractive business opportunity and the importance of private equity in constructing new assets to relieve transmission constraints and enhanced power flows and aggregating assets to create the critical mass necessary to provide the level of public service envisioned by FERC in its RTO policies.

But they go on to say that unless we can create some certainty and fairness in the structure and the organization of the markets that private equity will not flow. That is an example of everything we see from the analyst community, from the lending community and for the private and public capital market.

So it seems clear to me that at a time in this country when our economy needs the infusion of capital in ways that we never thought about before it is important that we fulfill our responsibilities and address the concerns of the investment community and

save the consumers the hundreds of millions dollars that are being wasted.

Just a moment on security issues. Every crisis management expert that I have ever consulted identify a number of essential ingredients for successful response in a crisis: accurate, timely communication, standardized and predictable protocols and response mechanisms, contingency planning, backup and redundancy features and the ability to identify and isolate vulnerabilities that serve as core features of crisis management.

I was in probably the largest commercial fire at our banking institution in Philadelphia, and we were up and running in 24 days because the crisis management plan that I had had all those elements.

I worked for Governor Dick Thornburg in the aftermath of TMI, and one of the clear messages to us was that when those things were lacking it was difficult to respond to the crisis. I think RTOs respond to those in ways that the existing market structure may or may not. It is easier to communicate and organize among 4, 6, 8 or 10 large, well-planned organizations than it is with scattered organizations who do not have central planning functions and who do not have contingency plans and redundancies.

There are many things that we need to do. We need to address market monitoring interconnection standards. We need the ability to impose civil penalties. We need changes in the tax laws. We need to address the issue of transmission siting. There is much for you to do, and there is much for us to do. But we feel, with my colleagues, a sense of urgency and a renewed dedication to resolve the issues, to work with the States and the other stakeholders to bring an energy market and the efficiency that competition can bring to this country.

Thank you.

[The prepared statement of Hon. Nora Mead Brownell follows:]

PREPARED STATEMENT OF HON. NORA MEAD BROWNELL, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to share my thoughts on the direction that our nation's electric restructuring policy should take. Over the past 10 days, I, like most Americans, have reassessed what is important in life, as an individual, an American, and a public servant. One thing that is obviously important is that we carefully consider the security of the nation's electric grid. I am eager to work with you and my colleagues to take every appropriate step to ensure that our energy infrastructure remains free from hideous acts of sabotage like those we witnessed last week.

Our energy production and delivery systems are among the best in the world and their safety and security are vital to our continued economic growth and development. We are proud of our energy industry's planning, communication and response in this crisis. Three days after the attacks on the World Trade Towers and the Pentagon, the Commission issued a Statement of Policy that provides the energy industry with regulatory assurance on energy infrastructure reliability and security matters. Specifically, the Commission has assured cost recovery for prudently incurred expenditures that electric, gas and oil companies incur to adopt new procedures, update existing procedures and install facilities to upgrade the safety of their electric power transmission grid and gas and oil systems. I believe that our action is a good, responsive measure. It reassures the industry to undertake what is necessary and prudent. The Commission will continue to encourage jurisdictional entities to be proactive when it comes to securing the nation's electric grid.

I also believe that the time is ripe for participants in the energy industry (including government) to review their response plans. The energy industry has evolved and is much more complex. As part of a continuous process of review and evaluation

of crisis management and response, I think some consideration should be given to the need for periodic operational audits of our energy providers and the organizational structures which manage them to assess, among other things, reliability, safety, security and communication protocols.

While we must take steps to protect the security of our nation's energy infrastructure, we must also get on with the other business of planning for the future, so that the forces of terror are not allowed a greater toll than they have already taken from this country. This nation's energy policy is at a critical juncture. Fear of change must not deter us from finishing the job of transforming an outdated, inefficient electricity industry into the economically competitive, technologically vibrant marketplace that American consumers deserve.

One necessary step in transforming electricity markets is the development of Regional Transmission Organizations (RTOs). Large, independent RTOs can improve grid reliability by facilitating transmission planning across a multi-state region, create better pricing mechanisms such as eliminating "pancaking", improve efficiency through better congestion management, and attract investment in infrastructure by facilitating regional consensus on the need for construction. Moreover, the development of large RTOs can enhance the security of the electrical grid.

Every crisis management expert that I have ever consulted identifies a number of essential ingredients for a successful response to a crisis:

- Accurate, timely communication
- standardized and predictable protocols and response mechanisms
- contingency planning
- back-up and redundancy features and
- the ability to identify and isolate vulnerabilities all serve as core features of crisis management.

Critical to the execution of any management plan is that all affected players know the plan, forward and back. It should be second nature; often there is no time to consult the play book. I believe that a large, fully functioning RTO is positioned to be a critical link in crisis management and ensuring reliability.

With large RTOs there will be a centralized chain of command and standardized processes. We also expect that RTOs would tend to have modern, forward looking control systems that generally exceed the capabilities of smaller systems. As a result, inefficiencies of non-standardized protocols and operation of the grid are reduced. There are no surprises. Emergency situations are better addressed from this efficiency of response. An RTO has the ability to ascertain and communicate system status and response plans more quickly than 20 or so control area operators. This is, I believe, what every crisis manager looks for. To this end, I believe that large RTOs are in a position to be flexible to accommodate security needs (a single control area operator may not be required).

In addition, the RTO may serve as a central point for information. Accurate, timely information is critical to the assessment of the situation. Concerns that the Commission's goals of transparent market information and our OASIS system reveal too much information are misplaced. Information posted on OASIS does not include operating data, status of generation, or operational characteristics of transmission lines. Much of the information we seek to make publicly available is information necessary for the growth of markets; and is not sensitive information regarding energy management systems.

In sum, RTOs play an important role in assuring reliability. Congress should affirm FERC's authority to require the formation of RTOs and it should do so now.

In addition to the formation of RTOs, we must take other steps if we are to transform the electricity industry. The Public Utility Holding Company Act (PUHCA) was necessary to address abuses that existed a half-century ago. However, that statute has not only outlived its usefulness, it is actually thwarting needed development of our electricity resources by subjecting registered utility holding companies to heavy-handed regulation of ordinary business activities and to outdated requirements that they operate "integrated"' and contiguous systems. One of PUHCA's perverse effects is that it causes foreign companies to buy here and U.S. companies to invest overseas. For a myriad of reasons, PUHCA should be repealed.

The Public Utility Regulatory Policies Act (PURPA) also needs repeal. PURPA was enacted out of concern over dependence on oil for electric generation. Now, 22 years later, a gas-fired generator can be on-line in less than two years, and many advances are being made in distributed generation. Therefore, PURPA's subsidies for certain types of generation are no longer appropriate and more importantly stifle the nation's economy.

I also believe that changes in tax laws must be considered to allow companies to effectively restructure and transform themselves and to attract new investment.

We also need to develop uniform business rules. Where rules are standardized, there is less room for manipulation. I believe that all interstate transmission facilities should be under one set of open access rules, including the facilities owned and/or operated by municipals, cooperatives, the Tennessee Valley Authority, and the federal power market administrations and regardless of whether they are used for unbundled wholesale, unbundled retail, or bundled retail transactions. I also believe that we should develop standardized generation interconnection policies. Having all transmission under one set of rules will ensure a properly functioning and transparent transmission grid. It will reduce transaction costs, improve efficiency, and allow for competition. GISB successfully accomplished this goal in the gas industry and is poised to do so in the electric industry.

Furthermore, we must revise the way in which transmission facilities are sited. State-by-state siting of such transmission superhighways is an anachronism that impedes transmission investment and slows transmission construction. An RTO, or regional structure, with significant input of the states, should be the first stop for siting approval. However, at some point, it may be necessary for the Commission to make the final determination. Therefore, I suggest that the Commission act as a backstop and be given siting authority over interstate transmission comparable to the interstate natural gas pipeline siting authority in Section 7 of the Natural Gas Act.

Finally, the Commission must have an expanded role in monitoring for, and mitigating, market power abuse. The Commission must hire, train, and re-train personnel skilled in market monitoring and market power mitigation or buy expertise on a short-term basis, as needed. We must seek out experts to assist us in our new role. We must also act swiftly and with certainty to respond to market abuses. Markets are fragile and prolonged problems will destroy the market and the confidence of consumers. Therefore, I believe strengthening the Commission's market monitoring and enforcement capabilities must be a top priority. As markets change, market monitoring and enforcement capabilities become an even more critical piece of the regulatory puzzle. Effective market monitoring also includes modeling for the future, so we can more effectively anticipate where investment in infrastructure is needed.

Let me offer a few suggestions that may help the Commission develop an effective market monitoring and enforcement program. There are many different players in the energy markets, many that have not traditionally been subject to our jurisdiction. A significant amount of relevant information about the operation of markets is in the possession of these entities. At times, there has been a reluctance to cooperate and provide the necessary information. It may be appropriate to clarify that the Commission has the authority to seek the information necessary to perform its statutory responsibilities from either jurisdictional or non-jurisdictional sources. With regard to the Commission's enforcement capability, the enabling statutes of the Securities and Exchange Commission and the Federal Communications Commission provide for a range of enforcement measures, such as civil penalties. I believe that providing the Commission with similar authority would send a powerful message to electricity market participants that we take violations of the Federal Power Act just as seriously.

The list of tasks for you in Congress and for us at the Commission is long but it is critical that we move forward. The cost to our country grows each day. Lack of investment in infrastructure (new transmission investment represents an average growth rate of less than one-half of one percent per year over the next decade), delays in the development and introduction of new technologies, uncertainty in and lack of confidence from capital markets impacts companies' values and thwarts transition. We need clarity and resolution. At the Commission we are working on a business plan—a blue print for the future. Our plan sets forth an aggressive set of actions to resolve the uncertainties of the marketplace. We are committed to delivering to America's consumers the promise of an efficient, reliable, innovative energy future.

I hope that this information is useful to you. If I can be of further assistance, please do not hesitate to contact me.

Mr. BARTON. Thank you, Commissioner.

We now want to hear from Commissioner Massey. Your statement is in the record in its entirety. We would ask that you elaborate in 7 minutes.

STATEMENT OF HON. WILLIAM L. MASSEY

Mr. MASSEY. Thank you Mr. Chairman.

Mr. Chair, Mr. Boucher, members of the subcommittee, my colleagues have laid out a number of the issues quite well, so I will be brief.

Developing competitive, efficient wholesale markets based on a reliable transmission platform is a highly desirable goal. There are, however, a number of barriers to creating robust markets, including grid operation influenced by merchant interests, fractured grid operation, and a jurisdictional patchwork of rules governing the grid.

Necessary grid expansion is simply not keeping pace with the requirements of robust wholesale markets. The lack of uniformity in generation interconnection standards among regions and utilities poses unnecessary barriers to entry by new, efficient, reliable generators. There has been inadequate monitoring and policing of evolving markets. Demand responsiveness that could act as a break on price run-ups is generally absent from electricity markets. Vibrant markets require a reliable trading platform, yet there are no legally enforceable reliability rules.

The Commission does not have all of the tools it needs both to promote large regional markets and to protect the public interest. A number of legislative changes are critical to achieving the goal of well-functioning wholesale markets that yield substantial consumer benefits, and that is what I think we all want.

All interstate transmission should be placed under one set of jurisdictional rules. The FERC should have authority to order the formation of RTOs and to site electric transmission facilities necessary for interstate commerce to flourish. Insuring that necessary transmission facilities are sited and built would be a huge step toward meeting our reliability goals.

Congress should promote the formation, the adoption of uniform nationwide generation interconnection standards. This would be another critical step toward reliability. The barrier to entry posed by confusing interconnection standards should be eliminated. Refunds should be authorized if rates are determined to be unjust and unreasonable, at least back to the date of the initiation of a complaint.

The Commission should have authority to assess civil penalties against prohibitive market behavior. Its authority over utility mergers should be strengthened in a number of ways, and direct authority to remedy market power should be provided.

The Commission and State commissions should be strongly encouraged to insure that electricity markets include demand responsiveness. And, finally, the promulgation of mandatory reliability standards for bulk power markets must be authorized by Congress.

I believe that confidence in market structure, confidence that the market is based upon a solid RTO platform that has clear authority for reliability planning, for an entire region, that is following mandatory reliability rules, will spur investment in the generation and transmission infrastructure necessary for a reliable system. And Congress can take steps to increase industry confidence that the necessary infrastructure can get sited in a timely fashion.

Mr. Chairman, I think it is obvious that I believe that there is a strong Federal role that is required to solve these problems. I have been engaged in this activity at the Commission now for 8

years, moving toward a market structure that benefits consumers; and I must say I have a sense of impatience about it. I would like for us to move forward aggressively with Congress's help to solve these problems.

Thank you.

[The prepared statement of Hon. William L. Massey follows:]

PREPARED STATEMENT OF HON. WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee on Energy and Air Quality: Thank you for the opportunity to testify on the role of competitive wholesale power markets in providing affordable reliable electricity to American consumers and the role of the Federal government in ensuring the development of the power industry.

HISTORICAL AND STATUTORY BACKGROUND

The electric power industry has undergone significant economic and technological changes that have rendered inadequate the current statutory scheme for regulatory oversight. In order to shorten my testimony, I am attaching a White Paper recently made available to the Senate Committee on Energy and Natural Resources by Chairman Bingaman. The White Paper provides excellent description of the historical development of the electric power industry and the role various statutes have played in that development.

The development of competitive efficient wholesale markets is a highly desirable goal. This is primarily a federal responsibility, and achieving this goal will benefit our nation's consumers and economy. There are, however, a number of barriers to the creation of robust markets, including grid operation influenced by merchant interests, fractured grid operation, and a jurisdictional patchwork of rules governing the grid. Almost a third of the grid is not subject directly to the FERC's open access and nondiscrimination requirements. Necessary grid expansion in not keeping pace with the requirements of robust wholesale markets. This means that cheaper power cannot always reach the customers who want it. The lack of uniformity in generation interconnection standards among regions and utilities poses unnecessary barriers to entry by generators that could provide cheaper power for consumers. There has been inadequate monitoring and policing of evolving markets. Demand responsiveness could act as a brake on price run ups, yet is generally absent from electricity markets. Vibrant markets require a reliable trading platform, yet there are no legally enforceable reliability standards.

With notable exceptions such as PURPA and EPACT, the legal framework that governs the electricity industry is now more than sixty five years old and assumed an old fashioned cost of service regime. Simply stated, the Commission does not have all of the tools it needs both to promote large regional markets and to protect the public interest. I would like to underscore a number of legislative changes that are critical to achieving the goal of well functioning competitive markets that yield substantial consumer benefits.

Transmission Jurisdiction

A. One Set of Rules

Congress should place all interstate transmission under one set of open access rules. That means subjecting the transmission facilities of municipal electric agencies, rural cooperatives, the Tennessee Valley Authority, and the Power Marketing Administrations to the Commission's open access rules. These entities control 30% of the nation's electricity transmission grid. Their current non-jurisdictional status has resulted in a patchwork of rules that hinder seamless electricity markets. Markets require an open non-discriminatory transmission network in order to flourish.

In addition, all transmission, whether it underlies an unbundled wholesale, unbundled retail, or bundled retail transaction, should be subject to one set of fair and non-discriminatory interstate rules administered by the Commission. This will give market participants confidence in the integrity and fairness of the delivery system, and will facilitate robust trade by eliminating the current balkanized state-by-state rules on essential interstate facilities.

B. Regional Transmission Organizations

While the Commission has made substantial progress in forming the Regional Transmission Organizations that are critical to the competitive market place, our hand would be strengthened by a clear declaration by the Congress that these insti-

tutions are in the public interest and should be formed. One appropriate action would be to give the Commission clear authority to order the formation of such institutions in compliance with Commission standards. I firmly believe that large RTOs consistent with FERC's vision in Order No. 2000 are absolutely essential for the smooth functioning of electricity markets. RTOs will eliminate the conflicting incentives vertically integrated firms still have in providing access. RTOs will streamline interconnection standards and help get new generation into the market. RTOs will improve transmission pricing, regional planning, congestion management, and produce consistent market rules. We know for a fact that resources will trade into the market that is most favorable to them. Trade should be based on true economics, not the idiosyncracies of differing market rules across the region. A clear message from Congress would certainly speed the formation of these critical institutions.

C. Transmission Siting

I would recommend that Congress transfer to the Commission the authority to site new interstate electric transmission facilities. The transmission grid is the critical superhighway for electricity commerce, but it is becoming congested due to the increased demands of a strong economy and to new uses for which it was not designed. Transmission expansion has not kept pace with these changes in the interstate electricity marketplace.

Although the Commission is responsible for well functioning electricity markets, it has no authority to site the electric transmission facilities that are necessary for such markets to thrive and product consumer benefits. Existing law leaves siting to state authorities. This contrasts sharply with section 7 of the Natural Gas Act, which authorizes the Commission to site and grant eminent domain for the construction of interstate gas pipeline facilities. Exercising that authority, the Commission balances local concerns with the need for new pipeline capacity to support evolving markets. We have certificated well over 12,000 miles of new pipeline capacity during the last six years. No comparable expansion of the electric grid has occurred.

I recommend legislation that would transfer siting authority to the Commission. Such authority would make it more likely that transmission facilities necessary to reliably support emerging regional interstate markets would be sited and constructed. A strong argument can be made that the certification of facilities necessary for interstate commerce to thrive should be carried out by a federal agency.

Adequate grid facilities are essential to robust wholesale power markets. I am confident that transmission will be built in sufficient quantities if siting authority is rationalized, rate jurisdiction is clarified, and adequate cost recovery mechanisms and risk-based rates of return are allowed.

D. Generation Interconnection

I would recommend that Congress direct the Commission to adopt uniform nationwide standards that streamline the process of interconnecting generators to the grid. The Commission has taken some steps in this direction by encouraging utilities to file their interconnection rules, but more must be done. Generation siting decisions should not depend on how easy it is to hook up in a particular region or with a certain transmission provider. Standardized and uniform rules promulgated by the Commission are necessary.

Rates and Market Power

Ensuring just and reasonable prices must be addressed far differently as we move to competitive markets than under the monopoly structure. It is more complex now. The basis nature of our regulatory tasks is moving from reviewing cost-based prices charged by individual sellers to ensuring good performance by markets. I believe that the Commission's current regulatory tools are inadequate to the new task.

A. Refunds

I believe the Commission needs additional authority to properly address the issue of refunds for unjust and unreasonable wholesale electricity prices. The Commission has concluded that section 206 of the Federal Power Act does not allow the Commission to require refunds of unjust and unreasonable rates charged prior to a date 60 days after a complaint is filed or the Commission initiates an investigation. I recommend that section 206 be amended to allow the Commission to order refunds for past periods if the rates charged are determined to be unjust and unreasonable. Limitations on how far back in time the Commission can order refunds may be appropriate.

B. Civil Penalties

I recommend that the Commission be given authority to assess civil penalties against participants that engage in prohibited behavior in electricity markets, such as anticompetitive acts and violations of tariff terms and conditions. If the Commission is to be the "cop on the beat" of competitive markets, we must have the tools needed to ensure good behavior. Refunds alone are not a sufficient deterrent against bad behavior. Simply giving the money back if you are caught is not enough. The consequences of engaging in prohibited behavior must be severe enough to act as a deterrent.

C. Mergers and Consolidations

To ensure that mergers do not undercut our competitive goals, the Commission's authority over mergers involving participants in electricity markets must be strengthened in a number of ways. Consolidations of market participants can have adverse consequences to the functioning of electricity markets. The Commission's detailed experience with electricity markets and its unique technical expertise can provide critical insights into a merger's competitive effects. The Commission's authority to review mergers should be strengthened to ensure that all significant mergers involving electricity market participants are reviewed.

I recommend that the Commission be given direct authority to review mergers that involve generation facilities. The Commission has interpreted the FPA as excluding generation facilities *per se* from our direct authority, although that interpretation is currently before the courts. It is important that all significant consolidations in electricity markets be subject to Commission review. For the same reason, the Commission should be given direct authority to review consolidations involving holding companies.

I am also concerned that significant vertical mergers can be outside of our merger review authority. Under the current section 203 of the FPA, our merger jurisdiction is triggered if there is a change in control of jurisdictional assets, such as transmission facilities. Consequently, consolidations can lie outside of the Commission's jurisdiction depending on the way they are structured. For example, a merger of a large fuel supplier and a public utility would not be subject to Commission review if the utility acquires the fuel supplier because there would be no change in control of the jurisdictional assets of the utility. If the merger transaction were structured the other way, i.e., the fuel supplier acquiring the utility, it would be subject to Commission review. Such vertical consolidations can have significant anticompetitive effects on electricity markets. Those potential adverse effects do not depend on how merger transactions are structured, and thus our jurisdiction over those transactions should not depend on how they are structured. Therefore, I recommend that the Commission be given authority to review all consolidations involving electricity market participants.

D. Market Power Mitigation

Market power still exists in the electricity industry. The FERC, with its broad interstate view, must have adequate authority to ensure that market power does not squelch the very competition we are attempting to facilitate. However, the Commission now has only indirect conditioning authority to remedy market power. This is clearly inadequate. Therefore, I recommend legislation that would give the Commission the direct authority to remedy market power in wholesale markets, and also in retail markets if asked by a state commission that lacks adequate authority. For example, such authority would allow the Commission to order structural remedies directly, such as divestiture, needed to mitigate market power.

E. Demand Responsiveness

Markets need demand responsiveness to price. This is a standard means of moderating prices in well-functioning markets, but it is generally absent from electricity markets. When prices for other commodities get high, consumers can usually respond by buying less, thereby acting as a brake on price run-ups. If the price, say, for a head of cabbage spikes to $50, consumers simply do not purchase it. Without the ability of end use consumers to respond to price, there is virtually no limit on the price suppliers can fetch in shortage conditions. Consumers see the exorbitant bill only after the fact. This does not make for a well functioning market.

Instilling demand responsiveness into electricity markets requires two conditions: first, significant numbers of customers must be able to see prices *before* they consume, and second, they must have reasonable means to adjust consumption in response to those prices. Accomplishing both of these on a widespread scale will require technical innovation. A modest demand response, however, can make a significant difference in moderating price where the supply curve is steep.

Once there is a significant degree of demand responsiveness in a market, demand should be allowed to bid demand reductions, or so called "negawatts," into organized markets along with the megawatts of the traditional suppliers. This direct bidding would be the most efficient way to include the demand side in the market. But however it is accomplished, the important point is that market design simply cannot ignore the demand half of the market without suffering painful consequences, especially during shortage periods. There was virtually no demand responsiveness in the California market. Customers had no effective means to reduce demand when prices soared.

It would be helpful for Congress to send a message that instilling a significant measure of demand responsiveness into electricity markets is in the public interest. I would recommend that legislation strongly encourage FERC and state commissions to cooperate in designing markets that include demand responsiveness. This would help to ensure just and reasonable wholesale prices and would be an effective market power mitigation measure.

Reliability

The industry needs mandatory reliability standards. Vibrant markets must be based upon a reliable trading platform. Yet, under existing law there are no legally enforceable reliability standards. The North American Electric Reliability Council (NERC) does an excellent job preserving reliability, but compliance with its rules is voluntary. A voluntary system is likely to break down in a competitive electricity industry.

I strongly recommend federal legislation that would lead to the promulgation of mandatory reliability standards. A private standards organization (perhaps a restructured NERC) with an independent board of directors could promulgate mandatory reliability standards applicable to all market participants. These rules would be reviewed by the Commission to ensure that they are fair and not unduly discriminatory. The mandatory rules would then be applied by RTOs, the entities that will be responsible for maintaining short-term reliability in the marketplace. Mandatory reliability rules are critical to evolving competitive markets, and I urge Congress to enact legislation to accomplish this objective.

PURPA and PUHCA Repeal

PURPA and PUHCA are statutes that may have outlived their usefulness and I would support their repeal in the context of broad restructuring legislation that ensures robust competitive power markets. I would support repeal of PURPA if there is a mechanism enacted to promote the development of renewable resources, such as a reasonable portfolio standard. I would support PUHCA repeal if state and federal regulators are given explicit authority to review the books, records and accounts of utilities when necessary to ensure just and reasonable rates.

Security of the electric power infrastructure

The recent acts of terrorism against our Nation underscore the absolute importance of ensuring that our infrastructure is a secure as possible. The Commission's primary jurisdiction is over the rates charged by jurisdictional companies. To that end, I would note that last week the Commission issued a statement of policy assuring the industries we regulate that they may recover all prudently incurred costs to safeguard the infrastructure.

Conclusion

I stand ready to answer questions and to assist the Subcommittee in any way. Thank you for this opportunity to testify.

Mr. BARTON. Thank you, Commissioners.

The Chair would recognize himself for 5 minutes for questions only.

Chairman Wood, on July 12, the debate about RTOs at the FERC, I have received quite a bit of negative feedback, quite frankly, from the incumbent investor-owned utilities about some of the things that the Commission was attempting to do. And one of the questions that I was asked was why the FERC felt compelled to try to force everybody into 1 of 4 RTOs. What is so magical about four RTOs nationwide instead of a larger number if it seemed to work better geographically?

Mr. WOOD. Chairman Barton, I think one of the—I think the best way to kind of come at that is compare what it would be like with 10 or 12 to the Tower of Babel, or to Europe prior to its confederation. You don't really get to a national power grid with five. I mean, I am counting ERCOT, of course, as a fifth. So I really think of five when people say four.

Mr. BARTON. I kind of count that way, too.

Mr. WOOD. Okay. So we have got a problem we share, too. And five may be too many. It was interesting in talking to the President after our vote because it was right after Vice President Cheney talked about the seamless Nation grid that it looked like five was a little too balkanized. Of course, then after that you get the call that maybe we should have stuck with 12 or 15.

At the end of the day, setting up the infrastructure to do reliability, competitive, open access transmission, planning, and supply/demand balance, which is what these organizations do, is not cheap. Right now, it is over in some regard 2,000 separate entities, the utilities in the country that do these things individually, the 160 some odd controllers that aggregate this a little bit more, the 10 NERC regions which aggregate just the reliability part of that. But, you know, that is better than nothing. But they are expensive. And I think as one who has been in front of, with ERCOT, this problem in the past, you don't want to see these replicated or duplicated where one will do well.

I think certainly in light of the reliability issues in the last week, to have hardened bunkers to maintain the reliability of the grid, to have duplicate or triplicate facilities to make sure that they are all secure so that you can really run and manage a grid through an event like last week or anything that may come our way, 4 or 5 of these is a balance, a good economic balance for what the customers have to pay. Ten or 15 or 20 start to look like wasting the customers money. And so——

Mr. BARTON. But, I mean, there is some number—well, I mean larger than four but smaller than 20 that—sure, you know, the draft that we are going to release sooner or later on electricity, you know, it is going to have a requirement, a time period for people to join an RTO and give the industry an opportunity to put its RTO where its mouth has been, so to speak, that they will join if we give them enough time. And if that turns out to be 7 or 8, if they actually make sense geographically and have the correct interconnects and at the seam, I mean, that would—would that not satisfy some of your concerns if it is done properly and they appear to work and all that, as opposed to cutting it up into four quadrants?

Mr. WOOD. Fair enough. And I would say, just so it is clear, the core issue here is to get to a seamless national market——

Mr. BARTON. Exactly.

Mr. WOOD. [continuing] and we could go about that a couple of ways. One is to make large groups that solve their own problems within themselves. Another is to do a generic market standard design, which we may do. We are going to talk about this at our meeting next week. We are going to talk about the different ways to get to yes on RTO.

But the large regional RTOs I think are, for the reasons I stated before, a pragmatic way to go forward. But, quite frankly, you

could be like McDonalds; and a hamburger in Boston is the same as a hamburger in Arlington, if the standards for producing that hamburger are the same across the country.

Mr. BARTON. There ain't no Whataburgers in Boston.

Mr. WOOD. They do have a few Mickey D's. They usually don't understand me when I try to go order up there, but that is their problem not mine.

But, in any event, if you have 50 different outlets for electricity on the wholesale level, or 12 or 8 or 4 or 1, they are all working off the same rules. I guess as a practical matter it doesn't really matter if we have got four or——

Mr. BARTON. I have got one more question for Mr. Massey, and then I am going to go to Mr. Boucher, and we will do a second round if there is enough interest to do it.

You mentioned in your testimony, Commissioner, the need for civil penalties to enforce FERC decisions. The draft that we are going to release has a provision for that. As we have talked about it, there are a lot of people that would be potentially subject to such civil penalties. To say that is redundant because the FERC has to approve everything and you have the power to enforce your decisions without civil penalties. So how do you answer that comment about giving you civil penalties to enforce your actions?

Mr. MASSEY. Well, I agree with comments that Chairman Wood has made on a number of occasions supporting civil penalties. Just paying the money back—if you engage in bad market behavior, simply paying the money back is not a sufficient deterrent. I think we need a big stick to deter bad market behavior, and that is my view on it. We would use it judiciously, but we ought to be able to use it when we need it.

Mr. BARTON. Do any other commissioners have a comment on that one?

Ms. BREATHITT. I supported civil penalties. I said that we ought to have an upper limit so there is some certainty as to how far we go monetarily, that it is just not open-ended.

Mr. BARTON. Okay.

Ms. BREATHITT. But that it should be sufficient enough to be a deterrent.

Mr. BARTON. Okay. Mr. Boucher is recognized for 5 minutes for questions.

Mr. BOUCHER. Thank you, Mr. Chairman.

Mr. Wood and other members of the Commission, you probably heard Mr. Blake earlier testify that, in the opinion of the administration, you already have sufficient authorities to do what you should properly be doing with regard to regional transmission organizations. And when asked the direct question, should we legislate additional authorities for you, his answer was no. Now, I think you may have a different view, and I would like to give you this opportunity, if you choose to do so, to differ with Mr. Blake and explain what additional authorities you would like to have conferred upon you by statute to legislate or to act with regard to RTOs, either from the standpoint of addressing the structure of RTOs or from the standpoint of requiring that investor-owned utilities become members of RTOs. So here is your opportunity to make your case for why you should have additional authorities.

Mr. Wood, would you like to begin?

Mr. WOOD. Thank you, Mr. Boucher.

My core answer is I think it is clear, but some other folks may have some smudges on their eyeglasses, so why don't you get some Kleenex and let's wipe it off of theirs as well. Because that is going to take us 5 years to have a court do that. And, for me, that—Mr. Blake didn't come at it from that and the—but as one who has got the Supreme Court looking at an order passed 5 years ago by our Commission just now, this week, that tens of billions of dollars that are going to be out of customers' pockets if we let the legal process work its way through what some claim is dubious authority or questionable authority—and so I would, on that basis, do it.

I think we should and will move forward regardless, because I think you all or your predecessors gave us that authority in 1992. It actually has been in the act since 1935 with section 206. But, in any event, I think you would be doing a good job for the folks of the United States to expedite this transition.

Mr. BOUCHER. Would you like to have the clear statutory authority to be able to order that IOUs join RTOs?

Mr. WOOD. Yes, sir. And perhaps even more than that.

Mr. BOUCHER. What more than that?

Mr. WOOD. Well, if you want to go beyond the public utility in the act and say we are not going to regulate everything else about public power but we are going to want you guys to put, if you have transmission—and not too many of them do, but the ones that do, including the Federal agencies that are regulated directly by Congress—that their transmission be part and parcel of these broad organizations so that it is a seamless national highway for electricity.

Mr. BOUCHER. Okay. I have some other questions. Let me just ask if there are members who disagree with anything that Commissioner Wood said. Everyone is in agreement.

Let me turn to the question of order 888 and the set of issues relating to your authority over transmission that are addressed in order 888. These are the matters that are now pending before the Supreme Court with arguments, I think, next week and a decision in the not-too-distant future to be anticipated.

When we asked Mr. Blake if he thought that we should legislate—what authorities we believe you should have over transmission, his answer was that we should go forward and not wait for the Supreme Court. My first question to you is, do you agree with that opinion? And if we have a particular point of view with regard to what your authority should be, should we announce that in statutory form?

The second question that I have for you is, what should we do in this area, assuming that we legislate? Order 888 basically says that FERC has authority over the transmission component of unbundled transactions in States where the State is open to retail competition. You got sued upon that order from some parties saying that you went too far, from other parties saying that you should have done more and that you should have extended your order and in fact were required in their opinion to extend it not just to that set of circumstances but also to those instances where in closed States you have bundled transactions.

My question to you is this: No. 1, as I indicated, should we legislate on this now, or should we wait and see what the court resolves? And assuming that you think we should legislate now, what should we do?

The draft that was reported from this subcommittee last year essentially confirmed your authority as announced in order 888, and it drew the line at that. It didn't go any further. Do you think we should go further? Should we give you the authority to assert jurisdiction in closed States with respect to unbundled transactions?

Mr. WOOD. Yes, sir. Order 2000, really, which is the RTO order, really, even though it is voluntary for people to participate, it really is broader and subsumed; and 888 is subsumed in that as a practical matter. The RTO has elevated transmission to a regional multistate—i.e., interstate—commerce commodity now. All transmission, it is not separate but equal, but it is one type of transmission, so it is kind of an either/or. I mean, clearly ratifying 888 or going further and saying 888 should apply more broadly and not create two classes of transmission customer but treat everybody the same as a transmission customer, then order 2000, the prior question you asked, were the committee to move on the direction of 2000 as we discussed just in the last question, I think it would subsume the questions you raise in 888.

Mr. BOUCHER. Let me ask you a direct question. Would you like to have the statutory authority to assert jurisdiction over transmission in States that are at the present time not open to retail competition and, with respect to those transactions, where transmission is bundled with the sale of the electricity itself?

Mr. WOOD. The transmission is an interstate product. It should be handled at one forum. Otherwise, investment won't happen. I think we have all heard that. Even Mr. Blake talked a little bit about that. So, yes, to answer your question.

Mr. BOUCHER. Mr. Massey, would you like to comment?

Mr. MASSEY. Mr. Boucher, I was on the Commission when we voted for order 888; and, frankly, that was a political compromise. There were very strong arguments that we had not only the authority but the obligation to go further and assert jurisdiction over all transmission, whether bundled or unbundled. That doesn't mean we are determining whether a particular State moves to retail choice. That is a separate issue that would stay with the State. But the question is whether the transmission that underlies all transactions ought to be subject to the same terms and conditions, and I think it should.

The interstate highway system analogy is not perfect. But let's assume you are traveling on the Beltway from Virginia into Maryland, and all of a sudden there is a sign over the Beltway that says, "all cars not licensed in the State of Maryland exit immediately. Congestion ahead. Beltway reserved for Marylanders." We would not stand for that. And yet that is possible now on the transmission grid.

Some States believe that they can reserve the transmission grid for bundled transactions and give them a higher priority. And I believe that all transmission ought to be subject to the same set of rules. So I would encourage Congress to act. If I knew which way the Supreme Court would come out, I might state a different an-

swer, but I would encourage Congress to act and to provide that we must exercise jurisdiction over all transmission.

Mr. BOUCHER. Yes. Ms. Breathitt, please. Thank you, Mr. Massey. Ms. Breathitt.

Ms. BREATHITT. I think the Supreme Court is going to rule, as you said, fairly quickly. And you also mention that you may only be in session a few more weeks, if you adjourn in the October timeframe.

Mr. BOUCHER. I wouldn't count on that.

Ms. BREATHITT. Well, I would see no harm in—you know, I think it is going to be difficult getting energy legislation through in a short timeframe. I don't see any harm in waiting for the Court.

On the issue of bundled sales over interstate transmission, I think I have testified as long as a year ago that I am in favor of full authority over interstate transmission. I think there is a way to make sure that native load is handled through firm transmission contracts and, quite frankly, utilities making sure that they have access to the right amount of generation, whether they own it still in vertically integrated utilities, or whether they contract for it. So I think there is a way to take care of native load.

Mr. BOUCHER. Okay. Ms. Brownell.

Ms. BROWNELL. I would certainly like to add I certainly agree with my colleagues. And I think that if you address this issue—and I would not wait for the Supreme Court—respectfully to the Supreme Court. I think we have to move forward. But I think that clarity on this issue might resolve some of the jurisdictional warfare that seems to be, I think, confusing the debate and might move us forward on some other issues.

I don't think you can have multiple masters. I think that authority has to be clear. There are other issues that require new regional compacts and regional structures that we do need to work out with the States, but I think it would help out everyone if you moved swiftly and clearly.

Mr. BOUCHER. Thank you very much.

I want to thank each of you for those cogent answers, and we will certainly consider your advice.

Thank you, Mr. Chairman.

Mr. BARTON. Before we yield to Mr. Shimkus, I just—editorially, you know, the Constitution gives the Congress, I think, supremacy over the Supreme Court when we choose to do that. And I am often un persuaded by the sagacity of the Supreme Court's arguments, so I am willing to tread on that ground if we have time to tread.

The gentleman from Illinois is recognized for 5 minutes.

Mr. SHIMKUS. Thank you, Mr. Chairman.

I do appreciate the commissioners' presence, and I think we have had a good discussion. It has helped focus back on some of the work that we have to do.

Mr. Massey, Commissioner Massey, you mentioned in your testimony—and I am going to use this to lead into some other questions. I am from Illinois, so I have a lot of commodity products. I have corn, soybeans and the like. And in your testimony you mentioned that, you know, electricity is one of the few commodity products that you use the product and then you find out how much you are charged. Can we ever change that? Is there a way to know

what we are purchasing and have four contracts like we do in corn and soybeans? I know the big consumers may get an opportunity to do that. But will we as individual consumers have an opportunity to do that?

Mr. MASSEY. Someday, yes. I think the technology is emerging to do that. Clearly, the large consumers can do that now. I think the key is for a significant number of consumers, perhaps the larger ones, to be able to see the price in real time and respond accordingly.

Frankly, I think that if we get markets designed appropriately, there will be wholesale aggregators of demand reduction that will aggregate demand reduction offers and bid megawatts into the market. I believe a megawatt of energy not produced is just as valuable as a megawatt.

Mr. SHIMKUS. Yes, we had some of those megawatt debates a few short months ago.

I want to go back again, Commissioner Massey, on your analogy of the interstate highway system. But isn't the debate that the chairman had mentioned earlier, isn't it more like the PJM pool where it is just like across State lines—highly charged transmission grid out there and it is already across the State lines? And we are drawing out of that. We are—the consumers are drawing out of that pool of electrons that are floating around in the transmission grid. How do we deal with the debate if my friends in the co-ops and munis that they are not part of that interstate grid of highly charged particles that are across State lines?

We can go to everyone. We will give you a chance to answer that.

Mr. MASSEY. Well, I think they are part of it—at least, in terms of physical flows. They aren't legally, because they are not subject directly to the same set of open-access rules as the investor-owned utilities are. Roughly a third of the grid is not subject to those rules. So there is a patchwork that makes it much more difficult to get the market rules right.

I would encourage Congress to resolve that problem, because certainly they are a part of the physical flows right now. We just don't have direct authority to require their transmission assets to comply with the same set of rules that the assets of the investor-owned comply with.

Mr. SHIMKUS. Anyone else want to add? I know it hasn't been addressed. We have all kind of dodged that issue. But it is not an issue that we as individual members will be dodging once we talk to our friends from these—our communities.

Ms. BROWNELL. Well, I don't think any of us want to dodge it. I have spent a lot of time in Pennsylvania and since I have been here talking to the co-ops, and they have very specific concerns. But I think if some of those concerns could be addressed vis-a-vis protections for them that I think they would be willing to work with us because I think they do understand that we can't have this patchwork and they are part of the whole.

In Pennsylvania in our experience we did not regulate the co-ops; and we certainly did not order them, for example, to retail competition. But we worked so closely with them that in the end they wanted to follow the rules that we set up for the market and did and joined us, and we worked with them to make sure that it

worked and to make sure that their consumers were afforded the same protections that others were.

So I think this is something that we can, by listening and being very specific about what their needs are, I think we can address them in other ways. Because it is important that everyone be part of the whole in order for this national grid to work.

Mr. SHIMKUS. Let me jump in and we can continue with this same answer, but I want to—two things just popped into my mind. Also with the exclusion of co-ops and munis is the inability to incentivize or to penalize. And incentivize the aspect of, if we are going to have an expansion of the grid, how do we develop a system by which there is a return on investment to the IOUs or the RTO to expand the grid? Where is the capital to do that to begin with?

So I mean I think that is part of the other debate on this national network, penalize and incentivize, and if we can continue down or whoever wants to jump in—my time has expired so after this, Mr. Chairman, I will just yield back my time after the answers.

Mr. BARTON. We let both the chairman and the ranking member take a little extra time, so if you want a little extra time you can, and we will give Mr. Wynn extra time, too.

Mr. SHIMKUS. Then I will just finish up by seeing if anybody wants to respond to those questions.

Mr. WOOD. I think that the current state of play for RTOs is pretty attractive to parties that are smaller, even smaller IOUs that are required to do it. Co-ops and munis are advantaged by a large and vibrant wholesale market. A lot of them don't generate 100 percent of the power that their customers need, so they have to go out on the market and buy it. So if there is a robust electric highway out there to drive on to go get power and bring it back home, that is good for the customers of the co-op and the muni.

So my experience not only in Texas but to date here in the Commission has been that the transmission-dependent utilities, again, a large number of which are public power entities, like RTOs and support them and see the advantages of wholesale markets working right for their own customers. So I think the incentives are there. When you have got good juicy carrots, you don't need so many sticks; and I think the carrots are really juicy for this particular segment of the industry.

The ones that it is not so juicy for are large, that are self-reliant on their own generation, so they don't need power from the outside. They don't need to use the grid of everybody else to get power. So they are a harder group to work with. But there are other virtues that they see to RTOs that bring them to the party.

So it might be better to ask them directly, but I personally have not seen that that segment and that hole in-the-grid regulation authority of the FERC is that big a deal. So while it might make good legal sense as a practical matter, getting these things set up to deliver the benefits that we know in fact are in the business of trying to quantify so people really do understand that RTOs are good. But that is a job we have to do.

We have to make it evident to you and all and to the public that these are better than the world we are leaving behind, not just for the competition issues but for the reliability and security issues we

were talking about today. They deliver good benefits to customers. I think that case is what we will be making over the months to come at the FERC to you and to the public, because the public needs to be confident about this. You all need to be confident about this. But the co-ops are one part of the public that I hope and believe will see the advantages if they haven't already.

Ms. BREATHITT. Congressman, one quick comment. As municipals and cooperatives compete for transmission rights with everybody else, if their former provider is no longer able to do that, they are telling me that they need to be able to get firm transmission rights in order to serve their load and in that—they see that as a problem.

Mr. SHIMKUS. Thank you, Mr. Chairman. I yield back my time.

Mr. BARTON. We will put the new chairman down as a big juicy carrot guy, as opposed to a big stick guy.

Mr. WOOD. Oh, I know a few sticks as well.

Mr. BARTON. Oh, okay.

The gentleman from Maryland, Mr. Wynn, is recognized for 5 minutes.

Mr. WYNN. Thank you, Mr. Chairman.

Mr. Wood, let me—excuse me, Commissioner Wood, I would like to apologize if I missed your testimony earlier on this subject. But could you explain to me exactly what is the basis for your contention that FERC has authority to mandate RTOs? It is stated in your testimony somewhat as a conclusion, but I would like a reference as to exactly what the authority is.

Mr. WOOD. Yes, sir. It would be section 206 of the Federal Power Act.

Mr. WYNN. 1935?

Mr. WOOD. Yes, sir.

Mr. WYNN. And would you kind of——

Mr. WOOD. Summarize? The Commission, on its own motion, if it observes that any rule, regulation or practice of a public utility is unjust, unreasonable, unduly discriminatory, it is really the discriminatory or preferential, we shall establish that after the hearing and order and do so——

Mr. WYNN. Okay. So you had——

Mr. WOOD. [continuing] which we have not proposed to do at this time.

Mr. WYNN. Okay. Well, that was my next question. If the contention is it is somehow discriminatory conduct in the northeastern region, was there ever a hearing on this?

Mr. WOOD. We have not—as I mentioned, we have not had a hearing, and we have not mandated that all the utilities up there form an RTO. They have come before, they have joined with strong encouragement from the Commission in an RTO voluntarily, and were asked to mediate, joining their own organizations together so that we can have a more regional approach to that. But, so far, we have not done a section 206 hearing.

Mr. WYNN. But, actually, you ordered mediation, literally forcing them into this, or the litigation which I believe is pursued.

Mr. WOOD. Well, I would just say procedurally ordering someone into mediation does not come into the conclusion that we are going to 206 hearing. We have got a report back from the mediator just

about 2 days ago which I have not reviewed at this point. So we will see at that point if we need to go forward in a different manner. But——

Mr. WYNN. In the absence of a full-blown hearing, evidentiary hearing, what is the basis for concluding that or justifying this mediation order?

Mr. WOOD. As you pointed out in your question I believe earlier, sir, or opening statement and as I responded to Mr. Barton a moment ago, the seams issues, which was the word for the Tower of Babel. We have got PJM, for example, of which I believe Maryland is a part——

Mr. WYNN. Yes, that is correct.

Mr. WOOD. [continuing] is right next door to the New York independent system operator, which is one the three power grids that we were saying talk to each other and see what you can do to get to one.

On a given day in the summer, because the rules are different between the two power grids, some are more—the New York grid is a little more positive for generators on one side and negative for generators, depending on the state of play, people would take their power out of the PJM grid to sell into New York, rather than just treat it as a seamless grid because the rules are different there, being arbitraged. And that is clearly not in the public interest. So what do we do about it?

Mr. WYNN. Now you said—I understand you are kind of speaking broadly. But where are those examples or anecdotes cited?

Mr. WOOD. We have had orders before the Commission just in my short term here, sir. We have had several instances where—just dealing with the border between New York and PJM. In fact, there is one I was reading as recently as last night. There are tons of what I call border issues there, and those are what we call seams.

Mr. WYNN. Could you forward those?

Mr. WOOD. Yes, sir, I would be glad to.

Mr. WYNN. The other issue is, you suggest that—you imply that probably you don't have the authority, because you ask Congress to clarify the authority. That is on page 4 of your testimony, acknowledging that there is literally 4 years worth of litigation pending and in order to avert this Congress ought to make clear, which implies that it is not clear that you have this authority.

Mr. WOOD. It is clear to me. It is not clear to some parties. And all it takes is one person to sue us to tie this up in court. And, yes, sir, in that regard I probably should have been clearer in my testimony. But at the bottom of page 3 I do say that although we have decided to go forward voluntarily on a volunteer basis we can go further and require them. And then at this point I point out that some parties may not agree with that.

Mr. WYNN. Okay. So you think there may be room for clarification.

Just one quick question. It is my understanding that PJM has significant reserves, about 19 percent, and in New York it is substantially lower. Is that correct?

Mr. WOOD. I believe that is—I am not sure about the numbers, but I know that PJM is in better shape than is New York. New

England I think is in better shape than New York. So the two bookends are in better shape than the book.

Mr. WYNN. So the bookends would be disadvantaged, theoretically at least, through the merger merging with a less successful or a less well-managed center section. Isn't that true?

Mr. WOOD. Well, disadvantaged, I guess.

Mr. WYNN. Our reserves would be less if we merge with an independent that is operated——

Mr. WOOD. One that is lower, that is true. But I think——

Mr. WYNN. That would jeopardize the citizens of Maryland who really have done no wrong in this case.

Mr. WOOD. Well, I don't agree. I mean, I think that economic sale there that is now available to somebody that is a tax-paying citizen of Maryland can now sell power more easily to New York and bring revenue back to the State. So I think the reserve margin may go down but then that may also result in more investment in power plants in the region generally.

Mr. WYNN. Well, a lower reserve margin doesn't seem to me to be a good thing. It certainly has not been a good thing in California and has led to forcing people to spot markets and other things, generally resulting in higher price to the consumer, which is why I am kind of pursuing this because I don't see this as advantageous to Maryland. It may be advantageous to New York. Obviously, there is a difference of opinion here.

I think my time is up, and I won't belabor the point. Thank you, sir. I relinquish what little time I have.

Mr. BARTON. Everybody else has taken another time. If you want to ask another question or two, you have got that opportunity.

Mr. WYNN. Well, thank you, Mr. Chairman. I appreciate that. I think I have really covered this ground. Thank you, Commissioner.

Mr. BARTON. The Chair would recognize himself for the second 5-minute round.

I want to in a similar vein kind of piggyback on Congressman Wynn. In our bill that passed the subcommittee in the last Congress, we took the NERC reliability proposal and put it in the statutory language in the bill. The bill never became law. We are going to release a draft in the very near future, and at the request of the administration, or at least some people working with the administration, we are not being quite as prescriptive. We are basically giving the FERC the authority to come up with some reliability standards subject to certain terms and conditions, but we are not taking verbatim the NERC proposal that we had in the bill last time.

Without having that opportunity to see the draft, does the Commission think that we should continue to be prescriptive like in 2944? Or do you think it might be more appropriate in light of what has happened in the last 2 years to give the FERC a little more flexibility on reliability issues? And that is a pretty hypothetical question.

Mr. WOOD. Well, it is pretty easy to answer.

On the top of page 12 of my testimony I mention that a corresponding issue was dealt with by then Governor Bush and the Texas legislation with one sentence. So I think it is substantially shorter than the draft that I have seen or the bill that was passed

before. You can make it pretty clear that Congress wants the Commission or its designee to enforce reliability standards and have the authority, as I believe the bill talked about, have the authority over a lot of other things other than the ones we have now, have authority to either penalize or yank certificates of people who aren't playing by the rules.

And this is a governmental function. I think that there is no way around that, that the enforcement or police side of what we do probably should not be delegated to a private or quasi public organization.

Mr. BARTON. Any of the other commissioners wish to comment on that?

Ms. BROWNELL. I absolutely agree with Pat. I would also point out, and I think you were getting there, is that we are in a different place now than we were 2 years ago. I think the vision of perhaps responsibilities of the RTOs has changed. We have learned a great deal about market structure and what kinds of responsibilities are required to make it work. And I think that, while it might have been appropriate 2 years ago, it is no longer appropriate. In fact, I am advised that a number of the members of the coalition that endorsed that have, in light of changes, actually changed their mind.

I also think it is very important to remember the distinction between what a governmental authority and what we do delegate to what I sometimes call the fourth branch of government, which is in my mind is not a great public policy.

Mr. MASSEY. Mr. Chairman, my view is the answer is probably somewhere in between one sentence and 56 pages or whatever it is. I know that there is some concern that Congress needs to grant through legislation a measure of antitrust protection if a bunch of utility representatives are going to get together and come up with reliability standards that are mandatory because they will have a commercial impact. So I know that concern exists; and a one-sentence provision might not solve that problem. There may be other nits and gnats that need to be worked out. So my answer is somewhat different than my colleagues.

Mr. BARTON. Okay. We spent most of the spring trying to put together a bill to help California help itself, which was an almost impossible task as it turned out. But we did move a bill through subcommittee. We didn't move it through full committee. As it turned out, God helped California because the weather was pretty mild. But apparently the FERC commission also helped California, so I am going to give you all an opportunity to pat yourselves on the back, if you wish to.

What did y'all do at the Commission—and, of course, part of the time Commissioner Hébert was chairman and we didn't have Mr. Wood and Mrs. Brownell. That calmed things down out there. Because apparently they are not out of the woods yet, but they are at least moving in the right direction. So give y'all a chance to comment on what has happened in California that you feel like the FERC can take credit for doing a good job.

Ms. BREATHITT. I think a major factor was eliminating the tariff that forced 100 percent of the entire load of California to be bought and sold in the spot market. I think that has not gotten as much

notice as it deserves, but eliminating, just eliminating the tariff that allowed that, which forced sales to be bought and sold with a more fixed price was a huge factor. And of course, later, price mitigation plans I think were a huge factor. The ability to monitor outages, the mandatory sell arrangement for any megawatts that weren't already committed into long-term contracts was very important. So there were a number of things that the Commission did that have not gotten the recognition and notice that they deserved.

Mr. BARTON. Well, you do a good job. You are seldom recognized.

Ms. BREATHITT. Over 60 orders.

Mr. BARTON. When you do a bad job you are always recognized. That is just one of the rules in Washington. The fact that we haven't seen you folks in the headlines means you are doing a pretty good job.

Ms. BREATHITT. And I agree it was a factor of weather and conservation. But certainly those 60 orders which fed on each other over a number of—7 months certainly had an impact.

Mr. BARTON. Okay. Mr. Massey, you were a big player in that. Do you want to comment?

Mr. MASSEY. I think Commissioner Breathitt has summarized it very well, Mr. Chairman.

Mr. BARTON. Okay. The gentleman from Virginia is recognized for 5 minutes.

Mr. BOUCHER. Thank you, Mr. Chairman.

One of the more far-reaching recommendations that the administration made in its energy strategy submitted to us earlier this year is that your Commission be given the same kind of authority to site electricity transmission lines that you currently have with regard to the siting of natural gas transmission lines. That at the end of the process, if there are delays in the States of exercising their authority to site the transmission lines, that you would be able to implement an eminent domain authority and make the final decision and be sure that the line be sited.

I will confess to a certain amount of reservation about this recommendation. I would like for those of you who support this recommendation to tell me why you do and why it is necessary. And if there are those among you who oppose the recommendation or have some equivocal view with regard to it I would like to hear from you, also.

To the extent that you support this recommendation, I would very much like to have some real examples of problems that have arisen and the siting of transmission lines under existing State authorities that would merit this rather dramatic shift of authority in this sensitive matter to your Commission. These recommendations are proposed at the State level. The environmental community is very concerned about this. There is a quantitative difference between siting electricity transmission lines and natural gas transmission lines when it comes to the effect that these lines have on the environment. So it is truly a major proposal, one I think we have to consider carefully; and I would like to have your views and particularly examples of why this may be necessary.

Mr. Wood.

Mr. WOOD. Mr. Boucher, I would acknowledge that this proposal certainly makes the transmission, 888, States rights and Federal

rights issues kind of minor by comparison. The human side of me said that is why I left the last job, was to get away from that. It was the worst part of being a State regulator, and I am amazed that States continue to fight for it.

But as far as, you know, the bigger picture, it is a turf issue. That is understandable. The citizens generally want to be heard by somebody that is closest to them, so that involves local and State people.

So I think certainly from the discussions that I have either been part of or heard about within the administration and then the Commission that this is something to approach pretty delicately and actually probably pretty restrictedly for a small universe of lines that really are a national significant impediment to competition type of lines. There are a number of different ways to go from a "we site everything from the transmission like a hundred feet through your backyard" to "we do absolutely nothing whatsoever." In between there a lot of places to rest, and I could spend all day giving you different places to do that.

I would be more than happy, if the committee is interested, to gin up some examples of proper ways to land on that issue to try to balance the national needs and the local needs.

As to examples, I have asked the same question myself because I have walked in the shoes of the people that are being complained about, not being able to make decisions, and the list is relatively short. The list that I have seen, actually all ended up getting resolved, one of them after 13 years, I should say, and I believe involves your own home State.

Mr. BOUCHER. That one is not quite resolved yet. It is on its way to being resolved. And it hasn't been quite 13 years. Maybe 11.

Mr. WOOD. All right. I knew it was a double digit.

Mr. BOUCHER. It has been a while.

Mr. WOOD. It has. That is 1 of 7, Mr. Boucher, that I have seen on the list from the industry when I have asked for it.

Mr. BOUCHER. Is that the worst example, by the way?

Mr. WOOD. It depends what your definition of worst is. Length of time, that is probably it.

Again, the question sometimes is what never got filed in the first place because they knew there would be no way. To which my response is, well, if you knew there would be no way, then there is probably a reason why it shouldn't be built.

But the world has changed just in the last 10 years. The need for a national highway, if you had told somebody in the mid-1940's about the interstate highway system, they would have said, well, we don't need that so why on the earth does the Federal Government get involved? But we have moved now to an interstate highway system, whether we know it or not; and I think that and that alone is really what is invoking the need to talk about this issue.

Mr. BOUCHER. If you have a list——

Mr. WOOD. I will get that for you.

Mr. BOUCHER. [continuing] that cites these examples, I really would like to see that.

Mr. WOOD. It was instructive. But in the litany of things that are, you know, must have today, I would not put that on the list.

I would—you are asking me as Uncle Santa Claus what do I want or what do we need for the good of the public——

Mr. BOUCHER. Well, I have had two reassuring answers here coming in both ears, and I thank you.

Mr. WOOD. With the same twang.

Mr. BOUCHER. Let me offer other commissioners an opportunity to comment on this.

Ms. BROWNELL. I agree with Pat. It is a tough issue. I have done stranded costs, and I don't necessarily want to do siting. But I do think it is an issue that we need to understand.

It was interesting to be with the Western Governors Association this summer and watch them grapple with this issue, and it was pretty clear to me that they recognized that it is not just a State issue, that it is a regional issue. Ideally, I think we need to look at some new regional structures, perhaps to make these decisions and make recommendations, and perhaps it is regional Governors who have an overriding look at economic development issues.

But I think you have to consider very strongly that the reason you don't have lots of examples is because many State commissions have sent very clear messages just not to come calling. In Pennsylvania, the last time we had a transmission siting application, and I wasn't there, but I am told that we had 900,000 comments in a State of 12 million people. That is a lot of attention and very difficult to deal with the political pressures and really look at the larger picture.

So somehow we have to get into the next generation of this answer, and we have to be able to answer the question of the environmental impact.

But, once again, with real markets, there are also the introduction of new technologies that might address some of these issues, but we will never see them unless we get moving on the larger picture.

Mr. BOUCHER. What kind of new technologies? I am curious.

Ms. BROWNELL. I think that there are some potential out there to enhance existing transmission that may address some of the constraint issues.

And, by the way, I forgot to mention that DOE is doing a study. We are taking a look at transmission constraints where they are and getting a better handle of what the cost is, and we might be doing a cost-benefit analysis longer term to say the price of building this transmission is X and the mitigation is Y, but the cost of not doing anything is thus. The Governor of Nevada feels quite strongly about that kind of look, and he is feeling that impact.

So I think we are making progress. I wouldn't necessarily act tomorrow, but we should not take this off the table and wait for a long period of time to address the issue.

Mr. BOUCHER. Okay. Mr. Massey.

Mr. MASSEY. Mr. Boucher, if I could just put the issue in context. If there is congestion on the system that needs to be resolved in some way, there are three ways to do it.

Way No. 1 is a demand reduction, which we all need to be working on. You can free up transmission facilities by reducing demand, which is the environmentalists' favored approach, of course, and it is a good approach.

No. 2 is to site a generator which can change the flows and eliminate the congestion. So transmission investment is not always the answer, but sometimes it is. And when it is, it is not always laying a wire. There is a new technology, the F.A.C.T.S. technology, called a thyrister which is, as I understand, a computer chip that allows the lines to be loaded with much more confidence. So a line now that is loaded in a way that doesn't use all of its capacity could be loaded much more up to capacity because of confidence that this computer chip can control the flows.

But when a wire is necessary, the problem is FERC can determine that certain facilities are necessary for interstate markets to work well, but we cannot ensure that those facilities are built. Now there is something about that that doesn't make sense. You can have facilities that had to be built in a certain State, and yet the argument that the facilities would benefit that State may be a weak argument. But everyone knows the facility would benefit the broad regional market as a whole and benefit other States. So it is very, very hard for that particular State to site those facilities. This is a problem that has to be solved if markets are going to work. Perhaps Federal backstop authority would work. We don't have to do all the environmental work. Perhaps working with the States to solve this problem. But I am convinced that it is a very serious problem that has to be solved.

Mr. BOUCHER. Well, those are helpful answers.

Ms. BREATHITT. Very quickly. When we came before you 2 or 3 times in the last 6 months, we all learned that California had not built power plants for 10 years. I think the evidence that you are asking for is pretty clear to me. Transmission infrastructure is not being built. I don't want to see the same wake-up call that we all faced with respect to California with getting more and more of what we call transmission loading relief calls throughout the country. So it is not being built. That is pretty good evidence.

Mr. BOUCHER. But in all fairness now, aren't there a number of reasons that we are not having an adequate investment in transmission infrastructure, which are rate of return issues to the utility itself? Has nothing to do with siting concerns?

Ms. BREATHITT. It is applications that just aren't being put forth to siting boards, but the return issue and the uncertainty of whether or not there is going to be adequate return on this investment.

Mr. BOUCHER. Well, thank you. Those are helpful answers and let me just take the opportunity to express our appreciation for your spending as much time as you have with us today.

Mr. BARTON. This will be a final question and I will let you all go, I promise. We are probably going to be asked by the administration in the next week to really work to get the energy package that is already out of the House, if something similar gets out of the Senate, to go to conference and move that before we adjourn, if we adjourn, in mid October.

I thought we would be in session until mid November or maybe even early December, so I could go through the normal process on the electricity and then put out a draft and then change it then maybe put out a second draft and then change it and then go to markup, subcommittee, full committee and have it ready to go to the floor. That may not be possible if—so, you all deal with these

electricity issues everyday. If the President wanted to push the Congress on an energy package on his desk by mid October and if the President decides that electricity should be a component of that, do you feel like that the issues that are still not a consensus are close enough to consensus that if we work together, administration and legislatively and bipartisanly, that we can forge a consensus in the next 3 weeks? Is that possible? That is a real question. That is not rhetorical. I want to hear what you all think about it.

Mr. WOOD. Well, we haven't met as a body since I have taken over as Chair, but I hope we would provide some incentives in the near future so that the settlement would happen down here. So the ground is fertile for people to come together with at least knowledge of what the alternative would be. So we will do our best on the fronts that are in our pocket to provide some clarity as soon as we can. Now 3 weeks is pretty tight. I think to be straight up, the bill you all passed before the last break, the tax provisions in that for both public power and IOUs participating in RTOs, if enacted, will make anything we need to do on RTOs a moot point. I think we will have instant migration to RTOs and a very fast forwarding of that agenda.

Mr. BARTON. You are saying that we are closer to consensus than some of the parties are telling us now?

Mr. WOOD. Carrots, even if they are sticks painted orange, they tend to work a whole lot better than just thou shalts.

Mr. BARTON. I like them to be maroon, but that is a personal preference.

Mr. WOOD. Maroon is good. The steps you took that facilitated that decision certainly came out of the House on a pretty strong vote. I would say that is an important provision. And I know that the fiscal tag on that was not in the scope we are talking about around this town the last couple of weeks. So I—that is just one observation of what may be one of the most prickly issues from our earlier discussions, Chairman Barton, is the RTO issue. The siting issue has a life of its own, and certainly maybe if the tax provisions handle the RTO issue, then we do talk about siting.

Mr. BARTON. The other commissioners?

Mr. WOOD. PURPA and PUHCA, and that requires a statutory change.

Mr. BARTON. We can do statutory changes. That is what we are all about.

Ms. BREATHITT. Public power being scrambling for generation resources and transmission resources is huge. There needs to be, I think, more discussion of how to get over those hurdles and also State commissions need to be, I think, very much involved in how we move forward with RTOs and the eminent domain question on transmission siting.

Mr. BARTON. Ms. Brownell.

Ms. BROWNELL. I think if we can get done in the next couple of weeks, what we intend to do at the FERC, and you and the administration send a strong message that you are determined to get this done, and that it is critically important to get this done, I think we will achieve some kind of consensus. But understanding that you are dealing with as you know better than I, very big competing

agendas. So perfect consensus? It is not a perfect world. I don't think we will ever get it. But I think we can get enough there and provide the carrots—I am more of a stick person myself—to make it happen. So would it be tough? Yes. Can we do it? Absolutely.

Mr. MASSEY. Mr. Chairman, I wouldn't minimize the task that you have before you, but I would note that Mr. Blake seemed to endorse the bulk of the Bingaman legislation. So if you use that as a starting place, I think a lot of the disagreement goes away. And if there is a common agreement that the goal is large vibrant, robust, wholesale power markets based upon the RTO platform, I think a lot of the disagreement melts away.

Mr. BARTON. Well, I want to thank the Commission for taking out of a very trying time to come over and testify before the subcommittee. It is my intention to work out some final details of the proposed draft and let the minority look at that as quickly as possible tomorrow. And if that is done in a satisfactory way, it is a possibility we could release the draft for public review late tomorrow, and if not, sometime early next week. So we are adjourned and we do, again, thank the Commission for their attendance.

[Whereupon, at 5:15 p.m., the subcommittee was adjourned.]

[Additional materal submitted for the record follows:]

July 20, 2001

To: Members, Committee on Energy and Natural Resources
From: Jeff Bingaman, Chairman
Subject: White Paper on Electricity Legislation

SUMMARY

There are many lessons that can be drawn from the recent and continuing electricity crisis in California and the West. The clearest one is that the market institutions that have developed are not adequate to the task. If we are to relieve the current problems in that region and prevent their appearance in other regions it is essential that the structural defects in the market be cured.

The Federal Energy Regulatory Commission (FERC) and state regulators currently have some tools to relieve these problems. Many of the structural defects in the market, however, are either beyond the jurisdiction of either FERC or state regulators, or are intractable for other reasons, both political and economic.

Congress has a clear duty to address this situation as part of comprehensive energy legislation. Our task must be to look at the economic foundations upon which this industry is based, to review the market institutions that are developing, and to assess the adequacy of the legal and regulatory institutions that are in place to ensure that these markets function properly. Such an assessment must lead to a legislative solution that will match the regulatory structure to the market institutions that they are intended to govern and give adequate authority to resolve market defects, without interfering unduly in those markets. This Committee has laid the foundation for much of this work in previous Congresses. We must now move forward with a legislative solution. To leave electricity legislation for another day would be to ensure that the problems faced now in the West will be replicated across the country.

The business of supplying electricity has changed. So must the regulatory and legal framework within which it operates now change. Those changes must reflect the realities of the market. In order to understand how laws regulating electricity should be changed, it is necessary to understand why the system worked the way that it did, and what has changed to make it necessary to change the laws governing that system.

This paper contains a short summary of the history of the industry and its legal structure, a discussion of the developments that necessitate the change of that legal structure, and an outline of the elements that I believe are essential to a legislative solution for electricity that is in the broad national interest.

I plan to use this outline as a framework for my questions in our electricity hearings next week. I encourage you to provide me with your thoughts and suggestions

on this outline and any other elements of electricity legislation that you believe should be treated in the comprehensive energy legislation we are about to mark up.

A BRIEF HISTORY

Electricity has been supplied in the U.S. by regulated monopolies for nearly a century. Vertically integrated utilities, with state-granted monopoly franchises, have sold electricity that they generated, over wires that they own, to customers to whom they have the exclusive right to sell. The legal structure for regulation of this industry has been based on this framework, both at the federal and the state levels.

The reason that the normal pattern of business—customer choice in a competitive market—has not been followed in the electric industry is because with the technologies that have been available, a monopoly could sell power more cheaply and efficiently than a multiplicity of competitors.

Samuel Insull, Thomas Edison's personal secretary and founder of Commonwealth Edison in Chicago, developed some basic understandings at the beginning of the last century that set the mold for the sale of electricity. The multiplicity of suppliers in Chicago meant duplication of facilities that raised costs. Many suppliers, with separate sets of distribution wires, and separate small generators could not take advantage of the economies of scale that would result from allowing a single seller to serve the city. Insull convinced the city's leaders to grant him a monopoly to sell power. In return he would serve all customers and allow the city to set his rates, as long as they assured him of a reasonable return on his investment.

Thus was born the regulatory compact that became the pattern for electric companies throughout the United States. States and cities granted monopoly franchises. Utilities developed their own generation resources, built distribution systems and sold electricity to their customers under these exclusive franchise rights. States developed public utility commissions to regulate rates.

In the 1920s, this system began to get out of control. Large holding companies that owned many utilities developed. The regulatory systems developed to control the electric monopolies were soon unable to function adequately. Since corporate structures were so complicated, and holding companies operayed in many states, local or state public utility commissions were unable to keep track of revenues, which could be shifted from one company to another, or to a parent holding company in another state.

To further complicate matters, it became clear that states did not have jurisdiction to control wholesale electricity transactions across state lines. The Supreme Court, in a case involving the sales from a Rhode Island utility to Attleboro Steam and Electric Company in Massachusetts, ruled that states could not regulate interstate sales of electricity.

Abuses in the electric industry were rampant. Assets were shifted from state to state. Sales were unregulated. Stocks were peddled from door to door. A complex and mostly unseen structure of financing was funding the whole tottering structure. Retail customers, since they were captive customers of the franchise monopolies, had no protection from these abuses.

When the Roosevelt administration came to power in 1933, among its first initiatives were responses to the abuses that had created the electricity debacle. In 1935, legislation was signed into law that was aimed at these problems. The Public Utilities Act of 1935 had two titles, the Public Utility Holding Company Act (PUHCA) and the Federal Power Act. The former was intended to deal with corporate structure abuses and the latter to regulate transactions in interstate commerce.

PUHCA broke up the industry into manageable chunks and focused it on its core business—the provision of monopoly electricity service—by requiring utilities either to operate primarily in a single state or to be regulated stringently at the federal level by the Securities and Exchange Commission (SEC). Utilities were also forbidden to engage in businesses that were not directly related to their monopoly electric service without explicit approval by the SEC. The sprawling empires of interconnected corporations owning electric utilities were broken up. Companies were required to choose between their other businesses and the electric industry.

The Federal Power Act gave the Federal Power Commission authority to regulate transmission of electricity in interstate commerce, wholesale rates for electricity, dispositions of utility assets—primarily mergers—and certification of hydro-electric facilities. Government owned facilities were not subject to regulation. The Commission was explicitly denied jurisdiction over generation facilities and over distribution in intrastate commerce.

With the passage of the Public Utilities Act, the framework for the sale of electricity was set. Regulated monopolies sold electricity to captive customers and were protected from monopoly abuse by an overlapping framework of regulation at the

state and federal levels. Rates for electricity, both at the state level for retail sales and at the federal level for wholesale sales, were set by regulators and based on the costs to the utilities to build, maintain and operate generation, distribution and transmission facilities plus a reasonable return on investment. As technological developments furthered the economies of scale and scope on which this industry's efficiency depended, electric rates fell. In fact, electric rates, in real dollar terms, declined from the turn of the century until the late 1960s.

In the late 1960s and early 1970s, however, things began to change. Utilities, which had seen steady rapid growth of demand throughout the first half of the century, built for a continuation of that level of demand growth. Plants grew larger and larger. It is certain that the oil crisis of the early seventies forced fuel prices up, causing reductions in demand. Reduced demand left utilities with excess capacity. Customers had to pay for that excess. For the first time in history, electricity prices began to rise. Many public utility commissions would not allow utilities to recover the cost of building excess capacity from their consumers.

At about this time, technological developments began to change the underlying economics of the utility monopoly structure. The economies of scale and scope that had lead to the creation of utility monopolies began to change. Before this time large central station coal plants were the most efficient way to produce electricity. Natural gas generators had been expensive and inefficient. Development of new combustion turbines that burned natural gas far more efficiently and at the same time were far less expensive to build meant that small gas plants could compete with large coal plants. Technologies of transmission meant that electricity could be shipped for far greater distances than in the past. New switching technologies and computerization of the control systems meant that regional transmission grids were possible.

The first legislative response to these technological and economic changes was the Public Utility Regulatory Policies Act of 1978 (PURPA). That law created the first non-utility generators. In order to encourage alternative generation resources, such as wind, solar, biomass and cogeneration, PURPA freed these types of generators from the restrictions of PUHCA and required utilities to buy electricity from them at rates equal to the cost avoided for the construction of new facilities, as determined by state regulators.

The result was a fairly gradual change in the way new resources were acquired. From the middle of the 1980s through the middle of the 1990s, over half of the new generation that came on line in the U.S. was from these non-utility generators. The wholesale electricity business was no longer the exclusive province of utility monopolies.

In 1992, Congress, seeing the success of the non-monopoly generation sector, changed the law to further allow development of a competitive wholesale electricity industry. The Energy Policy Act of 1992 (EPACT) exempted generators who sold exclusively at wholesale from PUHCA. It also gave FERC (the successor organization to the Federal Power Commission) the authority to require utilities to allow their competitors to use their transmission lines to sell electricity. For the first time ever, wholesale buyers of electricity could shop freely.

RECENT DEVELOPMENTS

Changes since the passage of EPACT have been rapid and dramatic. Today utilities no longer build generation for their sales to their retail customers, but buy those supplies from the wholesale market. Some states have removed the restrictions that require retail monopolies, and allow their customers to pick their own generation suppliers. Other states have begun the process that will lead to dependence on competitive retail markets. Supplies of electricity depend to a greater degree than ever before on regional market institutions. Virtually all wholesale electric rates are based on the market, and not on cost of service.

The FERC has implemented the changes in the law primarily through two major rules, Order No. 888 and Order No. 2000. Both orders deal with the transmission system and its uses for competitive sales of electricity. Order No. 888, issued in 1996, requires all jurisdictional owners of transmission to file tariffs stating the rates, terms and conditions for use of their transmission systems by others buyers and sellers. Those rates, terms and conditions must be comparable to those that the utility gives to itself and its affiliates. This order also encourages the development of independent system operators of the transmission system. Order No. 2000 extended this encouragement. This order required all jurisdictional utilities to file proposals to turn control of their transmission facilities over to independent regional transmission organizations (RTOs) or to explain why they were not doing so by January of 2001.

All utilities have complied, but not all proposals have been found to be acceptable to the Commission. FERC has issued orders in many of the filings, either giving conditional approval, or rejecting the filings as not meeting the characteristic and functions of the Order.

The thrust of these orders comes from the Commission's understanding that a competitive market that will produce just and reasonable rates for electricity cannot exist until the essential facilities for trade in electricity, i.e., the transmission system, is operated and controlled on a regional basis, and by entities who have no vested interest in outcomes in the generation market and so have no incentive to manipulate the use of the transmission system for the benefit of their generation affiliates.

The transition to a competitive industry is well under way. However, not all has been smooth. The last few years have seen severe price spikes in the Midwest and South. There is a clear and pressing crisis in prices and supply in the West and particularly in California. The North American Electric Reliability Council reports that there may be problems with prices and supply in New York, New England and the Central South. They also report that there are serious transmission constraints that may threaten reliability and supply in the West and the Central South. The institutions on which the country now relies for delivery of affordable, dependable electricity service are showing the strain of adapting to the new market circumstances.

A LEGISLATIVE PROPOSAL FOR THE COMMITTEE ON ENERGY AND NATURAL RESOURCES

To meet the challenges of the new realities of electricity markets, Congress must make some important legislative changes. A balanced and comprehensive, rather than a piecemeal, solution is imperative. These changes that I believe are needed can be grouped under five primary headings: 1. Transmission Jurisdiction; 2. Reliability; 3. Rates and Market Power; 4. Regional Planning and Siting; 5. Market Transparency Rules. These provisions should be complemented by appropriate changes to the tax code to allow a transition to a modern transmission grid.

1. Transmission Jurisdiction

Congress should clarify that FERC has jurisdiction over all transmission, whether bundled or unbundled. Once jurisdiction has been clarified, the Commission can use its existing legal authority determine which facilities are transmission in interstate commerce and which are distribution facilities and thus state jurisdictional.

FERC jurisdiction should be extended to public, cooperative and federal utilities. Such jurisdiction should not extend to setting transmission rates for these entities, but should require that rates set by these transmitting utilities should be comparable to those that the public power utilities charge to themselves.

Legislation should affirm FERC's authority to order utilities to join regional transmission organizations.

Interconnection rules should be clarified in order to ensure that new sources of generation are able to interconnect to the transmission system.

2. Reliability

Legislation should authorize a system for assuring the reliability of the grid that is mandatory, that requires sanctions and penalties for failure to comply with the rules that institutions for that purpose develop, and that is subject to federal oversight.

3. Rates and Market Power

Legislation should require the FERC to promote competitive markets.

Legislation could require FERC to, where markets are depended on to set rates, ensure that those markets are workably competitive. A slightly more prescriptive formulation could authorize the Commission to allow market-based rates for transactions that are entered into freely by participants in a workably competitive market, or rates that result from market institutions such as power exchanges or other bid mechanisms. Where such workably competitive markets do not exist, the Commission should take such actions as are otherwise consistent with its authority that it deems necessary to foster competition.

All sellers into such markets should be clearly subject to market rules and market mitigation measures ordered by the Commission. It should be made clear that normal transactions, not into market-based-rate setting institutions, by public power entities should continue to be non-jurisdictional.

Legislation should also clarify that the Commission may take into account in assuring just and reasonable market-based rates the effect of demand response mechanisms on those rates.

4. Regional Planning and Siting

A national transmission grid is a necessity, but cannot occur without a new approach to transmission planning, expansion, and siting. Federal eminent domain, by itself, is not likely to lead to an effective approach to meeting this need. What is needed is to use federal eminent domain as a backstop to a more cooperative, regionally based approach to transmission and siting issues.

Legislation should authorize regional regulatory compacts that are charged with exercising jurisdiction over transmission planning, expansion and siting. In this context, it would be necessary to grant FERC siting authority, but allow it to cede such authority to appropriately constituted regional entities.

A more extensive authority for regional entities would be to allow such bodies to exercise all or some jurisdiction previously exercised by states, but that, by reason of the regionality of markets, would be in danger of being preempted by the FERC. Such other authorities might include jurisdiction over regional reserve requirements, maintenance requirements and market monitoring functions.

PUHCA protections should be replaced by giving FERC jurisdiction over mergers of holding companies that own utilities and over acquisitions of generation assets.

5. Market Transparency Rules

Legislation must ensure transparent information on market transactions and should grant clear authority to the Energy Information Administration and the FERC to collect and publish appropriate data, while protecting proprietary information.

OTHER PROVISIONS

A balanced and comprehensive legislative solution should also:

- Repeal PUHCA, but only if FERC is given enhanced authority to address market power problems, and both FERC and the states are given greater access to the books and records of holding companies to prevent affiliate abuses.
- Repeal PURPA's mandatory purchase requirements, but only if it is replaced with provisions that remove disincentives for renewables or make their place in the market less sure. Such provisions should include clarification of energy imbalance rules for intermittent generation; interconnection rules for distributed generation; interconnection rules for combined heat and power facilities; and standards to accommodate net metering of renewable resources. Legislation must also develop a market incentive structure to encourage the development of renewable resources.
- Require that sellers of electricity provide adequate information to customers to allow them to make reasonable choices, including information about prices, alternatives, and environmental characteristics of the generation being sold, to the extent practicable. The Federal Trade Commission should also be directed to develop rules to prevent such unfair trade practices as slamming and cramming, and inappropriate disclosure of consumer information.
- Provide for the continuation of programs that traditionally have been borne by utilities through a Public Benefits Fund. The fund should provide support for such programs as low income assistance, research and development, efficiency and conservation investment, renewable resource investment, universal service, and other public good programs that are being left behind by the transition to a competitive industry.

TAX PROVISIONS

Certain provisions of the tax code create a disincentive for participants in the market to engage in certain of the structural changes that are necessary. These provisions should be repealed. The tax code should be amended to allow utilities to spin transmission assets off into separate corporations and to remove tax restrictions on participation by public power utilities and cooperative utilities. While such provisions are not jurisdictional to this Committee, they represent an essential component of a functional electricity policy and should be pursued through the committees of jurisdiction.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

October 29, 2001

Honorable Joe Barton
Chairman, Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515-6115

Dear Chairman Barton:

Thank you for your letter dated October 2, 2001 asking for my response to additional questions pertaining to my testimony of September 20, 2001 in regard to National Energy Policy: Federal Government Perspectives. Here are my thoughts on the questions you asked.

Question 1: Please describe some of the criteria you have used in determining what type of RTO structure might work best? You have enumerated the need for four and have characterized the need for large RTOs. What is the basis for this determination with respect to both number and size? Is it feasible? How will this impact consumers? Will this result in lower costs to the consumer?

The Commission has considered a number of factors in deciding to promote a limited number of large RTOs. Among these are our statutory obligations, industry financial considerations, and regulatory practicalities.

Formation of a few large RTOs is the best way to ensure non-discriminatory transmission services among localities within a wide region and to eliminate undue advantages, as directed by Section 205(b) of the Federal Power Act. Similarly, the extensive market monitoring conducted by large RTOs will buttress our ability to meet our Federal Power Act responsibility to ensure that public utilities selling in competitive bulk power markets do not engage in market power abuse across regions and ensure that markets within the Commission's jurisdiction are free of design flaws.

In addition, the widespread availability of truly non-discriminatory transmission service that larger RTOs can offer will instill confidence in the financial markets to help support the billions of dollars of capital investment in generation, transmission and demand-side projects that are necessary to maintain a reliable and competitive electricity marketplace.

Sufficiently large RTOs also mitigate generation market power of large generation companies by opening the market available to any given customer much more widely. This avoids the need to require power plant divestiture or to place price caps or other non-market based restrictions on a given company in order to reduce market concentration.

A large RTO will be in a better position to comprehensively plan new transmission facilities needed by the region it serves and fund their construction, than a smaller RTO. Currently, one utility can schedule the delivery of energy and be the sole recipient of transmission revenues for that service that nonetheless may also utilize the transmission facilities of neighboring and more distant interconnected utilities. From the perspective of the "other utilities," the difference between their actual and scheduled power flows is often referred to as parallel path flow or loop flow. The other utilities are not compensated for these unscheduled flows and the resulting loss of transmission revenue can be an impediment to investing in new transmission facilities. Because of its size, a larger RTO will be better able to comprehensively schedule all energy flows within its region and adopt a more equitable transmission rate design that applies to all energy transactions including the loop flows that currently go unbilled.

From the practical standpoint, combining the transmission owners within each market to form a single larger RTO would be preferable to formation of multiple smaller RTOs serving the same market. A collection of smaller RTOs would need to be coordinated through an umbrella organization or through seams agreements and, so far, our experience indicates that this may present certain challenges. As demonstrated by RTO developments around the nation, numerous smaller RTOs within a regional market often develop different business models, governance structures, market models, and transmission facility policies. Each RTO incurs the costs of designing its structures, implementing its individual plan, and starting up. While size and geography will certainly influence the cost of each RTO, clearly many of the costs will be independent of size. And the more RTOs that are developed, the more startup costs will be placed on energy customers. It seems to me that the startup costs of fewer RTOs spread over the national wholesale market will result in lower per kWh startup costs.

In sum, over the longer term, large RTOs will foster market development, will provide increased reliability, and will result in lower wholesale electricity prices. While I think that a low number is preferable, the Commission is not fixed on having four. In fact, we have already indicated that Florida may stay outside the Southeast region due to its unique peninsular character. ERCOT is additional. And, in the West, getting to one RTO in the near-term will not be feasible. That gets to eight.

A particular note about the West which led me to focus my thoughts on this issue: under the Western Governors' urging, the stakeholders in the West recently filed (and the Commission promptly approved) the creation of the Western Electricity Coordinating Council, which will combine the duties of transmission planning with the historic West-wide reliability function. Placing these two most critical electric functions together over the broad, natural market region makes a lot of sense, and clearly allows us all to go a little more slowly with integration of the economic marketplaces in the West. Obviously, this could be a model for the Eastern half of the country as well – lifting key infrastructure functions to a broader, multi-lateral regional body right away, while allowing the economic marketplace aspects within each region to come together on perhaps a slower track, guided by the ongoing efforts in the industry to standardize as many "seams" issues and other market issues as much as possible. My colleagues and I have not discussed this approach yet, but from discussions with colleagues at the state level, this bifurcated approach may give them more time to get comfortable with regional electric markets, while still providing the needed investment signal to the market (by means of region-wide planning).

Question 2: There has been a lot of talk about transmission pricing reform. What is the FERC's view on this subject? Is legislation needed to do this?

FERC has been pursuing transmission pricing reform in order to promote more competitive and efficient electricity markets. The Commission currently has adequate statutory authority to consider and adopt transmission pricing reforms; new legislation in this area is not needed at this time.

Historically, transmission prices have been designed to recover the fixed costs of the transmission owner. Typically, a transmission price would remain constant over a period of time, and would not change with market conditions. The Commission has recently adopted reforms to this approach. For example, recently, the Commission has approved changes in transmission pricing for markets operated by Independent System Operators in the New York, PJM, and California that establish transmission prices that vary over time with the level of "congestion" on the transmission paths. These prices allow market forces to allocate existing scarce transmission capacity to their most efficient uses. They also provide market signals to investors about where new transmission investments are most needed.

The Commission expects to expand the use of market mechanisms to allocate use of scarce transmission capacity. The Commission's Regional Transmission Organization (RTO) Rule, Order No. 2000, has required RTOs to develop market mechanisms to manage transmission congestion. The RTO rule also would allow transmission owners that join RTOs to charge transmission prices that depart from strict cost recovery, by including incentive mechanisms that encourage efficient construction and operation of

transmission.

In addition, the Commission has recently accepted proposals by non-utility owned "merchant" transmission companies to charge market-based transmission prices where they can show that there are not entry barriers, and where they turn over operation of their facilities to an RTO. These latter conditions ensure that the merchant transmission company will not exercise market power. Allowing market-based transmission prices for merchant transmission companies under these conditions may encourage greater transmission investment. Given the positive response to the Commission's interest in transmission pricing reform, I feel that, at this juncture, further federal legislation, while welcome, is not needed in this area.

Question 3: With respect to bulk power transmission, was the Northeastern section of the electric grid affected by the attacks in New York City? In the event of a terrorist act, what are the advantages of having a large RTO system versus individual utilities?

With respect to the September 11, 2001 terrorist attacks on New York City, Consolidated Edison Company has publicly reported that it suffered a significant impact on its energy infrastructure in lower Manhattan. The distribution system was heavily damaged, and two substations as well as major electric transmission cables sustained permanent damage. However, it appears that there was limited damage to the transmission network serving the wider area.

The three existing ISOs in the Northeast, which are precursor organizations to the larger regional organization we have encouraged, helped to maintain transmission grid reliability during and after the terrorist attacks in New York. Most individual utilities or even small, sub-regional groups of utilities, however, have limited resources to devote to security protection and infrastructure investment that our nation needs to deal with a wide-spread system emergency. In the event of a future severe emergency, a large RTO will be able to implement a coordinated wide-area response which should minimize disruption more efficiently and effectively than the possible uncoordinated response of a number of utilities operating independently.

Question 4: You state that having four RTOs will be more secure against terrorism than having the multiple control centers that we have today. What is the basis for this? Has the commission conducted a study on this issue?

Bulk power systems have two unique characteristics. First, there is a need for continuous and near instantaneous balancing of generation and load, consistent with transmission constraints. Second, the transmission network is mostly a passive system with minimal practical ability to regulate electrical flows. Control actions are limited primarily to

adjusting generation output and to opening and closing switches to add or remove transmission lines from service. Problems initially limited to one geographic area, if not quickly corrected, can cascade into bigger problems that affect a whole region. For this reason, we believe that a larger RTO in charge of an area-wide interconnected grid can better contend with a terrorist attack than can a larger number of small, independent entities and control centers, each of which operates only a small part of the area-wide grid.

The Commission has not conducted its own study of the security of the nation's interstate grid. However, the Secretary of Energy's Advisory Board Task Force on Electric System Reliability has; it issued a report titled, *Maintaining Reliability in a Competitive U.S. Electricity Industry*, on September 29, 1998. There the DOE found, in general, that, since bulk-power systems are regional in nature, they can be operated more reliably and efficiently when coordinated over large geographic areas. Moreover, DOE found that the challenge of maintaining transmission reliability is to better control disturbances that may originate in an isolated, local event but whose effects may almost instantaneously propagate throughout the system as a whole. In our view, these findings suggest that a large number of smaller RTOs serving sub-regions of the nation will not enhance grid security.

If I can be of further assistance in this or anything else, please call me.

Best regards,

Pat Wood, III
Chairman

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

OFFICE OF THE COMMISSIONER

November 1, 2001

The Honorable Joe Barton
Chairman
Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515-6115

Dear Congressman Barton:

Thank you for your letter of October 2, 2001, concerning my testimony before the Subcommittee on September 20, 2001. I appreciated the opportunity to share my views on national electricity policy. I also appreciate the chance to reply to the following additional questions submitted by Members of the Subcommittee and enclosed in your letter.

Question # 1: Please describe some of the criteria you have used in determining what type of RTO structure might work best. You have enumerated the need for four and have characterized the need for large RTOs. What is the basis for this determination with respect to both number and size? Is it feasible? How will this impact consumers? Will this result in lower costs to the consumer?

The orders the Commission issued this summer concerning RTO formation are on rehearing, and I and my fellow Commissioners are carefully considering whether the positions set forth in those orders should be modified. Therefore, I am limited in my ability to discuss this issue at this time.

I will say, though, that the size and number of RTOs should ideally be set so that the economies of scale are maximized to the point of diminishing marginal returns. In other words, we want to get the biggest bang (in terms of increased efficiency, elimination of pancaking, improved coordination and communication, enhanced regional planning, and streamlining of duplicative organization structures) for the buck (and, thus, bring greater savings for the customer). The factors to be considered while we attempt to

reach this goal include trading patterns, the balance of supply and demand, administrative and technical feasibility, as well as, the laws of physics.

Given the complexity of our regional electricity markets, we may not be able to put a static exact number on how many RTOs there should be or specify in terms of megawatts or geography the precise size. However, I believe that there are natural markets and our focus should be on them. To assist us in defining RTOs, the Commission has hired an outside consultant to perform an updated study of the costs and benefits of RTO formation.

I also note that to the extent that market design and business practices can be standardized to develop a seamless national grid, the size and number of RTOs may become less important.

Question # 2: There has been a lot of talk about transmission pricing reform. What is the FERC's view on this subject? Is legislation needed to do this?

The primary problem with transmission pricing in today's electricity markets is pancaking, by which a market participant is charged cumulative transmission access fees to send power across a system regardless of the actual cost to provide service. I believe that there is more work to be done on transmission pricing. Depending on the type of service, the most appropriate rate design may be incremental, mileage-based, or postage stamp. It is critical to get this right in order to encourage investment as well as minimize cost shifting. What is clear is that pricing, like siting, is a regional issue, if not a national one. As such, we need to develop solutions which reflect the borderless nature of the energy industry.

During the week of October 15, 2001, we held a conference to discuss various issues associated with ensuring a seamless national wholesale electricity market, including the problem of pancaked transmission rates. We will be addressing this issue in an upcoming rulemaking on RTO market design standards as well as in our review of the formation of individual RTOs. I do not believe at this time that legislation is needed to address this issue.

I hope this information is helpful. Again, thank you for the opportunity to speak to the Subcommittee on September 20, 2001, and if I can be of further assistance, do not hesitate to contact me. I am still hopeful that we can act to implement legislation that sets national energy policy and addresses electricity markets. I believe the certainty would act as an economic stimulus and bring much needed investment.

Sincerely,

Nora Mead Brownell

Nora Mead Brownell
Commissioner

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D. C. 20426

OFFICE OF THE COMMISSIONER

November 1, 2001

Honorable Joe Barton
Chairman, Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515-6115

Dear Mr. Chairman:

Thank you for your letter dated October 2, 2001 asking for my response to additional questions pertaining to my testimony of September 20, 2001 before the Subcommittee on Energy and Air Quality. Enclosed please find my responses.

If I can be of further assistance, please contact me.

Sincerely,

William L. Massey/ace

William L. Massey
Commissioner

Enclosure

RESPONSES OF COMMISSIONER WILLIAM L. MASSEY TO ADDITIONAL QUESTIONS FROM MEMBERS OF THE SUBCOMMITTEE ON ENERGY AND AIR QUALITY

1. **Please describe some of the criteria you have used in determining what type of RTO structure might work best. You have enumerated the need for four and have characterized the need for large RTOs. What is the basis for this determination with respect to both number and size? Is it feasible? How will this impact consumers? Will this result in lower cost to the consumer?**

I have reviewed Chairman Wood's response to this question, and I am in general agreement with his description of the benefits of large RTOs.

I would like to make the following additional points. The Commission has measured the adequacy of RTO proposals against the characteristics and functions set out in Order No. 2000. Application of those criteria will result in robust RTOs that accomplish the Commission's goal of efficient and reliable wholesale electricity markets.

The purpose of grid regionalization is to ensure that the grid is planned and operated in a way that recognizes the physical realities of the transmission network. As electric generators are dispatched to meet load, the energy flows over broad regions that do not respect corporate boundaries. In addition, the growing commerce in electricity occurs within and between broad regional markets. Seamless trading requires seamless grid planning and operation. Thus, RTOs need to cover broad regions. I am not aware of any physical or other limitations on the size of potential RTOs that have been discussed so far.

Large RTOs will improve reliability and lower costs by permitting more efficient operation and seamless trading. Fewer RTOs means lower start up and administration costs too. Improved reliability and lower costs benefit the nation's electricity customers.

2. There has been a lot of talk about transmission pricing reform. What is the FERC's view on this subject? Is legislation needed to do this?

The Commission's transmission pricing policy should result in transmission rates that perform three functions. One is to efficiently allocate scarce transmission capacity and signal the need for new generation or transmission facilities or reduced demand. Locational marginal cost pricing accomplishes these objectives. The Commission has approved the use of locational marginal cost pricing by several ISOs. Second, there should be incentives for good operating performance. I expect the RTOs that form to propose performance based rates that provide for rewards for good performance and penalties for poor performance. Order No. 2000 provides for performance based transmission rates. And third, there should be adequate compensation sufficient to attract new transmission investment. I believe that a risk based rate of return will accomplish this objective.

The Commission has approved rates for a few stand alone merchant transmission projects. Such projects show promise of providing an additional source of new transmission investment. Our pricing policy should accommodate those proposals.

Legislation is not needed for the Commission to accomplish its transmission pricing reform goals. We have adequate statutory authority to consider and adopt pricing reforms.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

OFFICE OF THE COMMISSIONER

February 7, 2002

The Honorable Joe Barton, Chairman
Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
United States House of Representatives
Washington, DC 20515

Re: Questions pertaining to September 20, 2001 hearing on National Electricity Policy: Federal Government Perspectives

Dear Chairman Barton:

Please accept my sincere apology for failing to submit a timely reply to your letter dated October 2, 2001, in which you asked me to respond to two questions as a follow-up to my September 20, 2002 testimony before the Subcommittee on Energy and Air Quality. As my staff has explained to Peter Kielty, your letter arrived at a time when I was without an electric advisor; and unfortunately, it was misplaced.

Attached please find my responses to your questions. I will be happy to provide any additional material you require. Again, I am very sorry for the delay in sending these responses to you.

Sincerely,

Linda K. Breathitt
Commissioner

Attachment

Question No. 1:

Please describe some of the criteria you have used in determining what type of RTO structure might work best? You have enumerated the need for four and have characterized the need for large RTOs. What is the basis for this determination with respect to both number and size? Is it feasible? How will this impact consumers? Will this result to lower costs to consumers?

Response:

This question arises from several Commission orders, issued on July 12, 2001, pertaining to RTO formation. On that day, I issued a dissent, in which I expressed my objection to the language in those order supporting the creation of four RTOs. I believe my dissent is responsive to the question you have posed, and I am attaching it as my response. My views have not changed since that time.

Question No. 2:

There has been a lot of talk about transmission reform. What is FERC's view on this subject? Is legislation needed to do this?

Response:

Transmission pricing is on the verge of some very new thinking. There are new studies being proffered and innovative ideas being discussed at the Commission and throughout the industry. Transmission pricing reform must incorporate a feature that all stakeholders insist upon: rates that eliminate or greatly minimize pancaking. Beyond that, I believe transmission pricing reform needs to fairly address existing contracts (an issue important to transmission-dependent utilities and public power entities); incent new transmission and transmission upgrades; minimize congestion/constraints; and facilitate creative solutions in the planning process that involve least-cost alternatives -- whether it be a gas pipeline, a transmission line, a new power plant, or a decision to do nothing about congestion because it is more economic than the alternatives.

At this time, I do not believe legislation is necessary for the Commission to implement transmission pricing reform.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Bangor Hydro-Electric Company
Central Maine Power Company
National Grid USA
Northeast Utilities Service Company
The United Illuminating Company
Vermont Electric Power Company
ISO New England Inc.

Docket No. RT01-86-000

NSTAR Services Company

Docket No. RT01-94-000

(Issued July 12, 2001)

Breathitt, Commissioner, dissenting, in part:

Since the Commission began promoting RTOs as a means to remove barriers and impediments to wholesale electricity markets, I have been fully committed to the goal of implementing RTOs. However, I am dissenting, in part, to express my objections to specific language in this order and other RTO orders on today's agenda supporting the creation of four RTOs in the country. I agree with the majority's claim that the Commission has been attempting to facilitate the development of large RTOs reflecting natural markets since we issued Order No. 2000. That was our stated goal and one that I have actively pursued. However, today's orders go further by stating that the Commission "favors the development of one RTO for the Northeast, one RTO for the Midwest, one RTO for the Southeast, and one RTO for the West." I do not necessarily favor such development.

When the Commission deliberated over how to attain our mutual objective of RTO formation, we decided to adopt an open collaborative process that relied on voluntary regional participation. The intent was to design RTOs so that they could be tailored to the specific needs of each region. We specifically declined to propose fixed or specific regional boundaries under section 202(a) of the FPA. Instead, we concluded, as a matter of policy, that we would not attempt to draw boundaries, based upon our conviction that transmission owners, market participants, and regulators in a particular region have a better understanding of the dynamics of the transmission system in that region, and that they should propose the appropriate scope and regional configuration of an RTO. We did not specifically endorse one particular scheme of RTO configuration, but opted instead to establish appropriate guidelines to aid in RTO development. In fact, our regulation requires only that an appropriate region is one of sufficient scope and configuration to

permit an RTO to maintain reliability, effectively perform its required functions, and support efficient and non-discriminatory power markets.

Today's order represents a dramatic departure from the approach we pursued in Order No. 2000 to the extent that it directs the formation of four specific RTOs. Just as some commenters to our RTO rulemaking feared, the Magic Markers have come out, and the boundaries are being drawn with little regard to the status and timing of RTO formation efforts in various regions of the country. This was not my intent at the time we issued Order No. 2000; and the events since we issued Order No. 2000 do not compel me to embrace this policy shift. Parties have spent many hours and countless resources in negotiations, collaborations, and complicated business strategy sessions to develop reasonable RTO approaches. The impact of the majority's directive that these four RTOs be formed could be to render these efforts useless and force parties to begin the difficult and time-consuming process anew. For example, the Midwest ISO -Alliance settlement, which the Commission approved and which represented a tremendous effort by many parties, could unravel.

If the majority believes that the Commission should depart from the basic philosophies embodied in Order No. 2000, then I believe it would be only appropriate to initiate a formal notice-and-comment rulemaking proceeding so that we could make a reasoned decision informed by the views of the stakeholders in this process – state commissions, chief among others.

Finally, I do not adopt the majority's assertion that forming larger RTOs will result in lower wholesale electricity prices. This is a laudable goal, and as such, I embrace it. As a general proposition, Order No. 2000 encouraged the development of large RTOs. However, the promise of lower wholesale electricity prices is one that I, as a federal official, am not willing to make to consumers at this time.

For these reasons, I respectfully dissent.

Linda K. Breathitt
Commissioner