

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

February 4, 2005

The Honorable John D. Dingell
Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515-6115

RE: Federal Energy Legislation

Dear Congressman Dingell:

Thank you for your letter dated January 24, 2005, which seeks an update on various issues as the Committee members prepare to consider energy legislation in the 109th Congress.

I have enclosed my responses. If you need additional information, please do not hesitate to let me know.

Best regards,

A handwritten signature in black ink, appearing to read 'Pat Wood, III', written in a cursive style.

Pat Wood, III
Chairman

cc: The Honorable Joe Barton, Chairman
House Committee on Energy and Commerce

Enclosure

**CHAIRMAN WOOD'S RESPONSES TO
REPRESENTATIVE JOHN DINGELL'S QUESTIONS**

Question

1. At your appearance before the Subcommittee on Energy and Air Quality on March 5, 2003, you testified as follows:

In my view, the three most important steps that Congress can take are these: first, clarify FERC's authority to obtain market information necessary for price discovery and effective monitoring of natural gas and electric markets; second, increase civil and criminal penalties for violations of the Federal Power Act (FPA) and Natural Gas Act (NGA) or our rules and regulations thereunder; and, third, take the steps required to make the Alaska Natural Gas Pipeline project a reality in this decade.

- a. To what extent have these issues been addressed in the time since you presented this testimony, and how?
- b. Does the FERC have adequate authority to address these matters under current law? If not, please describe what new authority you believe is needed and provide legislative language.
- c. Are these topics still the Commission's top legislative priorities? If not, please explain and describe your new priorities, including legislative language.

Response

Price Transparency: Significant progress has been made concerning price discovery and effective monitoring of natural gas and electric markets since my March 5, 2003 testimony before the Committee on Energy and Commerce, U.S. House of Representatives. Technical conferences and workshops in the spring of 2003 led the Commission to issue a Policy Statement on natural gas and electric price indices on July 24, 2003.¹ The Commission then conducted two broad surveys of industry price reporting practices in September 2003 and March 2004; held a public workshop on liquidity issues in November 2003; issued market behavior rules in November 2003;²

¹ *Policy Statement on Natural Gas and Electric Price Indices*, 104 FERC ¶ 61,121 (2003).

² *Order Amending Market-Based Rate Tariffs and Authorizations*, 105 FERC ¶ 61,218 (2003) and Order No. 644, *Amendment to Blanket Sales Certificates*, 105 FERC ¶

issued a comprehensive staff report on price formation issues in May 2004;³ held a further technical conference on progress to date and the use of price indices in jurisdictional tariffs in June 2004; and, most recently, issued an order on November 19, 2004, outlining plans for further monitoring and adopting requirements for price indices used in jurisdictional tariffs.⁴

The Commission's engagement with industry has, as we found in our November 19 order, resulted in significant progress in the amount and quality of both price reporting and the information provided to market participants by price indices. Price discovery and effective monitoring of markets remains an important issue for the Commission. It would be helpful if the Congress clarified the Commission's authority to require the development of an electronic price reporting system if the Commission determined it was appropriate to do so, and if the Congress gave the Commission the ability to require all electric market participants to participate in such a reporting system. If the quality of price discovery continues to improve, continued monitoring may be sufficient, and continued reliance on commercial vendors would be appropriate. If not, the Commission should be able to step in and require market participants to provide price information. The electric transparency language in section 1281 of H.R. 6, if modified to be permissive, would adequately address this issue. The Congress also should consider allowing the Commission to rely on a non-governmental entity to compile this information and make it publicly available. Testimony that we file in response to Chairman Barton's letter of invitation to the February 10, 2005 hearing on H.R. 6 will further address this issue.

Penalties: Since my March 5, 2003 testimony, the conference report on H.R. 6 proposed providing the Commission with greater penalty authority under the Federal Power Act (FPA) and the Natural Gas Act (NGA). Specifically, the conference report proposed increasing criminal penalties for violations of the NGA and the FPA and expanding civil penalty authority for violations of the FPA. However, the conference report did not provide any civil penalty authority for violations of the NGA.

61,217 (2003). The market behavior rules require holders of market-based rate authority (electricity) and sellers using blanket certificate sales authority (natural gas), if they choose to report transaction data, to report such data in accordance with the Policy Statement standards.

³ *Report on Natural Gas and Electricity Price Indices*, Docket Nos. PL03-3-004 and AD03-7-004, issued May 5, 2004.

⁴ *Order Regarding Future Monitoring of Voluntary Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets*, 109 FERC ¶ 61, 184 (2004).

Expanded civil and criminal penalty authority remains a high priority of the Commission. The Commission's current civil penalty authority is extremely limited – for example, penalties are available only in very limited circumstances under Part II of the FPA and civil penalties are not available at all for violations of the NGA. Notably, where civil penalties are authorized, for example under the Natural Gas Policy Act (NGPA), the Commission has effectively used that authority to obtain significant penalties from market participants who violate the NGPA. Most recently, on January 26, 2005, the Commission approved a settlement with American Electric Power Corporation for a record \$21 million in civil penalties. Unfortunately, there are many instances where violations occur under the NGA or FPA in which the Commission can order only refunds or the disgorgement of unjust profits, because the Commission has no civil penalty authority under the NGA, and only limited civil penalty authority under Part II of the FPA. While such refunds and disgorgements are significant, they do not serve the same deterrent function that civil penalties could. Section 1283 of H.R. 6 addresses the major gaps in civil penalty authority by increasing civil penalty amounts and applying civil penalties to violations of Part II of the FPA. I recommend that the H.R. 6 provision also apply to any violations of Part III of the FPA and that a similar provision be enacted for civil penalties for violations of the NGA.

Alaska Natural Gas Pipeline: Since my appearance before the Subcommittee, Congress has enacted the Alaska Natural Gas Pipeline Act,⁵ which clarified issues regarding proposed Alaska transportation projects, and established a framework for Commission consideration of applications for such projects. Between that Act and the pre-existing NGA and Alaska Natural Gas Transportation Act, I believe that the Commission has sufficient authority to address this matter. Given this background, additional legislation on Alaska natural gas pipelines is not a priority for the Commission. Alaska natural gas pipelines are, however, one of the Commission's highest regulatory priorities. As required by the Alaska Natural Gas Pipeline Act, the Commission is in the process of drafting regulations governing open seasons for the allocation of capacity on Alaska pipeline projects, and will issue those regulations by February 10, 2005. We stand ready to work with potential pipeline proponents, shippers, the State of Alaska, other government agencies, and the public to do everything we can to ensure prompt consideration of proposals to move Alaska natural gas to markets in the lower 48 states.

⁵ Emergency Supplemental Appropriations for Hurricane Disasters Assistance Act, 2005, Pub. L. No. 108-324, ch. 12, sec. 1201, §101-116, 118 Stat. 1220, 1255-67 (2005).

Question

2. Your testimony of September 3, 2003, focused on issues surrounding the August 2003 blackout, and stressed the need for mandatory and enforceable reliability rules.

Your testimony also addressed the need for legislation on a number of other electricity issues, including encouragement of membership in regional transmission organizations (RTOS), transmission rate incentives, and transmission siting authority.

- a. In the absence of new federal authority, how has the Commission dealt with these issues? Please summarize significant rulemakings, policy statements, orders, or other Commission initiatives, as well as any court rulings that may affect these issues.
- b. Does current law provide the Commission with adequate authority to address these matters?
- c. If you believe new authority is needed, please provide legislative language.

Response

Reliability: A system of mandatory reliability rules, with penalties for violations of these rules, is needed to maintain the reliability of our Nation's transmission system. The provisions in H.R. 6 on this issue are adequate.

On April 19, 2004, the Commission issued its *Policy Statement on Matters Related to Bulk Power System Reliability* in Docket No. PL04-5-000.⁶ As stated in the *Policy Statement*, the Commission strongly supports legislative reform to provide a clear federal framework for developing and enforcing mandatory reliability rules. In addition, the Commission has taken other steps within its existing authority to promote greater reliability of the United States' bulk power system and its operation and to support industry efforts to improve the current voluntary, industry-based approach. For instance, the Commission clarified that it interprets the term "Good Utility Practice" to include compliance with North American Electric Reliability Council (NERC) reliability standards or more stringent regional reliability council standards.⁷ Accordingly, public

⁶ 107 FERC ¶ 61,052, *order on clarification*, 108 FERC ¶ 61,288 (2004) (*Policy Statement*).

⁷ *Policy Statement* at ¶ 23.

utilities that own, control or operate Commission-jurisdictional transmission systems are required to operate their systems in accordance with Good Utility Practice as set forth in the Commission's pro forma open access transmission tariff, including complying with NERC reliability standards.⁸

In addition, concurrent with the issuance of the *Policy Statement*, the Commission issued an order directing transmission providers to report on their vegetation management practices related to certain overhead interstate transmission lines.⁹ The Commission later submitted a report to Congress summarizing the responses it received from transmission owners. The report made certain recommendations, including the adoption of legislation on establishing an Electric Reliability Organization (ERO) and making its standards mandatory and enforceable, under federal oversight.

RTO Membership: Two-thirds of the country is now served by Regional Transmission Organizations (RTOs) or Independent System Operators (ISOs). The areas covered are the Northeast (ISO New England and the New York Independent System Operator), the mid-Atlantic (PJM Interconnection), the Midwest (Midwest Independent Transmission System Operator (MISO) and Southwest Power Pool (SPP)), California (California Independent System Operator) and most of the state of Texas (ERCOT). This means that electricity customers over most of the nation now enjoy the benefits of coordinated regional planning, operation and reliability oversight as well as independent grid decision-making that RTOs and ISOs deliver.

Since the time of my last testimony, the Commission has not issued any rulemakings or policy statements regarding membership in regional transmission organizations. During that time, the Commission has pursued a region-by-region approach to encouraging the voluntary formation of additional regional grid organizations. In April 2003, the Commission issued a White Paper on Wholesale Power Market Platform, in response to comments received on our July 2002 notice of proposed rulemaking on wholesale power markets. The White Paper set out goals for wholesale electricity markets and regional grid organizations, whether RTOs or ISOs, and provided for regional flexibility in such areas as geographic scope, planning, congestion management, market monitoring, resource adequacy and retail demand response. Following issuance of the White Paper, Commissioners and staff held regional conferences with market participants and state regulators to discuss grid issues in the regions and how those issues might be addressed. Conferences were held in San

⁸ *Policy Statement* at ¶ 25.

⁹ *Order Requiring Reporting on Vegetation Management Practices Related to Designated Transmission Facilities*, 107 FERC ¶ 61,053 (2004).

Francisco, Phoenix, Omaha, Boston, Tallahassee, Wilmington, New York City, Atlanta, and Dallas.

Of particular note are new RTO developments in the Southwest and Midwest. As a result of efforts in the SPP region, the Commission was able to issue a series of orders resulting in SPP becoming one of four RTOs in the nation. Many of the state commissions in the SPP region (Arkansas, Kansas, Missouri, Oklahoma, and Texas) formed a regional state committee that will help address such key issues as transmission cost responsibility and transmission pricing. The Commission has also approved a joint operating agreement between SPP and MISO that will facilitate trade and reliability oversight between these regions and we have staffed a regional office in Little Rock, Arkansas to support the SPP and the regional state committee in RTO development and operations.

The Commission has also worked to improve the design and operations of the existing regional organizations. We have devoted extensive resources to working with the MISO staff, participants, and the Organization of Midwest ISO States (the state regulators in the region) toward designing and establishing a single regional dispatch and organized electricity market that will stretch from Ohio to Montana and from Manitoba to Missouri. This effort has required extensive discussions and Commission orders addressing regional approaches to a host of market design and operational factors, including protection of existing transmission rights and market monitoring and mitigation. Through these efforts, the MISO market is now scheduled to begin operation on April 1, 2005. The Commission has also approved a joint operating agreement between MISO and PJM that will facilitate trade and reliability oversight between these regions.

As noted above, the Commission's policy is to encourage membership in RTOs, since RTOs enhance the reliability and economic efficiencies of a region's transmission grid and power supply. H.R. 6 endorses this effort in a "Sense of the Congress" provision. The Commission has adequate authority to address membership by public utilities in RTOs. Increased membership by non-public utilities would also provide benefits to electric customers, and H.R. 6 would facilitate this result for federal power marketing agencies and the Tennessee Valley Authority.

Transmission Rate Incentives: The Commission has evaluated several incentive proposals on a case-by-case basis since the issuance of its *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid* in January 15, 2003, in Docket No. PL03-1-000.¹⁰ The policy statement proposed to provide rate incentives to transmission owners for their participation in RTOs and independent transmission companies (ITCs), because the independence of such organizations from market participants makes competitive wholesale markets more efficient, fair, credible and cost-effective. The Commission has not yet issued a final policy statement.

Since I testified in September 2003, the Commission has authorized transmission rate incentives for a number of entities that have proposed to expand transmission infrastructure or taken steps to make their transmission facilities independent from activities of other market participants, such as becoming members of RTOs or forming ITCs.¹¹

I believe the Commission currently has adequate authority to provide transmission incentives. However, as I indicated in my testimony of September 3, 2003, action by Congress on transmission incentives could provide greater certainty to investors and thus encourage quicker, appropriate investments in grid improvements. The provisions in H.R. 6 would lay to rest any potential legal arguments that the Commission does not have authority to provide transmission incentives.

Transmission Siting Authority: The Commission currently has no authority to site transmission. H.R. 6 would provide the Commission with backstop transmission siting authority for certain backbone transmission lines, in the event a state or local entity does not have authority to act or does not act in a timely manner. I support these provisions.

¹⁰ 102 FERC ¶ 61,032 (2003).

¹¹ See *Michigan Electric Transmission Co., LLC*, 105 FERC ¶ 61,214 at P 9, P 20 (2003) (basis point adder for formation of an ITC and RTO membership); *ITC Holdings, Inc.*, 102 FERC ¶ 61,182, *reh'g denied*, 104 FERC ¶ 61,033 (2003) (higher return on equity for an ITC); *Midwest Independent Transmission System Operator*, 100 FERC ¶ 61,292 at P 31 (2002), *reh'g denied*, *Midwest Independent Transmission System Operator*, 102 FERC ¶ 61,143 at P 14 (2003) (basis point adder for joining an RTO); *PJM Interconnection, L.L.C., et al.*, 104 FERC ¶ 61,124 at P 74-75 (2003) (basis point adder for joining an RTO); *ISO New England, Inc., et al.*, 106 FERC ¶ 61,280 at P 232-236 and P 245-249 (2004), *order on reh'g*, 109 FERC ¶ 61,147 at P 206-207 (2004) (basis point adder for regional network service); and *American Transmission Co., LLC and Midwest Independent Transmission System Operator, Inc.*, 107 FERC ¶ 61,117 (2004) (alternative incentives for building of transmission infrastructure).

Question

3. The conference report for H.R. 6 included a number of other provisions related to electricity matters pending before the Commission, including standard market design (section 1235), native load obligation (section 1236), voluntary transmission pricing plans (section 1242), and sanctity of contract (section 1286).

- a. Does the Commission need new legislative authority with respect to these four areas? If so, please explain why you believe FERC's existing statutory authority is inadequate.
- b. If the answer to (a) is yes, does the Commission favor enactment of the specific language in conference report? If the answer is no, please explain why and provide alternate language.
- c. How would enactment of these four provisions affect current Commission policy. Please be specific.

Response

a. The Commission has adequate authority in all of these areas. However, I believe that the sanctity of contracts provision in section 1286 could be useful in clarifying the standard of review for proposed changes to FERC-jurisdictional contracts and ensure greater preservation of the terms of contracts.

b. I support enactment of section 1286 in H.R. 6 because it would help resolve disputes about the standard of review to be applied to contracts that do not clearly provide the standard of review.

c. Section 1235 would remand the Commission's proposed rulemaking on standard market design, issued over two years ago in July 2002, and delay the implementation of a final rule until 2007. As described above, many regions of the country are achieving its goals already, by forming RTOs or ISOs and developing regional markets that meet local needs and concerns. Thus, section 1235 is unnecessary.

Section 1236 addresses native load service obligations. The Commission's policy is consistent with the goal of this provision, that customers who paid for transmission facilities should retain the physical or financial rights to use those facilities even if a new market design is adopted. The Commission has adequate authority to implement this policy without legislation.

Section 1242 addresses transmission pricing plans proposed voluntarily by transmission providers, and requires FERC to approve the plans if they meet certain

criteria. The Commission has adequate authority to approve such plans under existing law and FERC's pricing policies are consistent with the core policy of section 1242, i.e., that customers who benefit from new transmission facilities should pay for those facilities.

Section 1286 addresses the sanctity of contracts and requires a "public interest" standard of review for new contracts unless a contract expressly provides otherwise. This section would clarify an unclear body of judicial and administrative precedent in a way that ensures greater preservation of the terms of contracts. I support enactment of this section.

Question

4. Please describe any other issues you would like to bring to Congress's attention as members prepare to take up energy legislation in the 109th Congress.

Response

H.R. 6 adequately addresses the urgent need for energy legislation and responds to each of the major issues I have raised previously. There are four additional areas the Congress might want to consider addressing in H.R. 6, described below.

First, with regard to liquefied natural gas (LNG), in order to effectively and efficiently site infrastructure that is in the public interest, the Congress should consider clarifying the Commission's jurisdiction to site LNG facilities, and provide for a single federal record and for direct appeal of LNG-related decisions to a United States court of appeals.

Second, the Congress should consider modifying the reliability legislation to give the ERO authority to require the expansion of transmission facilities for reliability purposes. Any expansion required by the ERO should be subject to siting authorization by governmental entities with jurisdiction. If such governmental entities do not act timely on a request for siting, I believe the matter should be subject to the backstop siting procedures contained in section 1221 of H.R. 6, excluding the process for the Secretary of Energy to designate national interest electric transmission corridors.

Third, the Congress also should consider expanding the H.R. 6 provision (section 1237) on "economic dispatch." The Congress should consider allowing the Commission to require a public utility to use economic dispatch if it will reduce the costs incurred in supplying power to the utility's customers.

Fourth, it would be helpful if Congress gave the Commission emergency authority to approve temporary changes to, or temporarily suspend, tariff provisions on file with the Commission, if necessary to ensure reliability or prevent market power abuse.

These matters will be addressed in more detail in testimony we will provide in response to Chairman Barton's letter of invitation to the February 10, 2005 hearing on H.R. 6.