

**Summary of Testimony of
Nora Mead Brownell
Commissioner, Federal Energy Regulatory Commission
Before the Subcommittee on Energy and Air Quality
of the Committee on Energy and Commerce
United States House of Representatives
March 5, 2003**

Thank you for allowing us to come before you today to discuss the future of the energy sector. The importance of healthy, vibrant energy markets is vital to our economy and to our environment. We are developing policies, whether through legislation or by regulation, that will affect the short-term and long-term economic development of our country. Clean, reliable energy markets supported by robust infrastructure will give us the competitive edge that we need and that customers demand.

The journey that began ten years ago was based on sound market principles and the belief that competitive markets encouraged efficiency and innovation in a way that monopolies and regulators could not. Technology allowed us to rethink the concept of natural monopolies.

Indeed, technology has already driven massive changes in this sector as it has in every other sector. We need to change with it. Markets are regional, not by fiat but because of new ways of managing the grid and developing generation assets. Our collective challenge is to develop tools and structures that ensure the development of a functional marketplace where participants know the rules and are held accountable.

Markets work! The same principles that drew us to initiate the restructuring ten years ago still hold true. But we've learned some hard lessons. Markets don't just happen, they need guidance, transparency, and structural changes. Markets are vulnerable in transition, we need to complete the task. Markets must have oversight with swift and certain justice. Above all, customers must be confident their needs will be met. The discussion must be informed by experience.

The debate is about our future and the future of our economy and environment. When we define it in its simplicity, reasonable and certain solutions seem imperative. I look forward to working with you in developing those solutions.

**Testimony of
Nora Mead Brownell
Commissioner, Federal Energy Regulatory Commission
Before the Subcommittee on Energy and Air Quality
of the Committee on Energy and Commerce
United States House of Representatives**

March 5, 2003

I. Introduction

Thank you for the opportunity to share my thoughts. Chairman Wood's testimony summarizes the full range of initiatives we are undertaking at the Federal Energy Regulatory Commission (FERC), and I fully support his comments on those efforts. I would like to offer observations about the state of the energy sector in general and about some of the initiatives outlined in Chairman Wood's testimony. My comments on these initiatives will address how I believe they support the transformation of wholesale energy markets for long-term customer benefit and how the FERC is making internal reforms to adjust to changes in the market place. Finally, with your indulgence, I would like to provide comment on particular portions of the discussion draft provided on February 28, 2003. Of course, I am happy to answer any questions the Subcommittee might have.

II. State of the Energy Sector

The state of the energy sector in this country is, at best, precarious:

- Power quality disturbances grow - disrupting production lines and calling into question the ability of the energy sector to serve a growing digital economy, adding to customers' costs for goods and services and driving jobs and business from our cities and towns;

- Customers have a profound lack of confidence in corporate America, public policy makers, and regulators;
- Lack of meaningful and transparent prices has led to inefficient generator siting decisions, creating access and transmission problems;
- Increasingly illiquid markets affect forward prices; and
- Questionable trading and reporting practices continue to surface.

Moreover, we are experiencing a capital crisis in the energy sector. Over \$200 billion of market capitalization has been lost. Uncertainty in the energy sector generated by the lack of clear, understandable, enforceable rules, the California energy crisis, the collapse of Enron, allegations of false reporting, criminal indictments, the closing of trading operations, and federal investigations have all undermined investor confidence. Credit ratings have been downgraded, access to capital at reasonable rates has been limited or cut-off. The result has been a lack of capital available for greatly needed investment in infrastructure to reliably deliver energy that this country so desperately needs. The near-term impact of this lack of investment is cost to customers in terms of congestion, security, and missed opportunity. Longer-term, the lack of investment threatens the very future of our economy.

While the electric and natural gas sectors are intertwined, the natural gas sector has fared better. For example, stock prices for electric utilities declined over 40 percent in 2002 compared to 25 percent in natural gas pipelines; electric generators' prices declined 80 percent compared to a 5 percent increase for oil and gas producers. I attribute this to a

more mature natural gas market with clear, standardized rules. The natural gas marketplace has shown itself to be remarkably robust and I believe that the issues facing the natural gas market are manageable over time.

I applaud the efforts of this Committee to address these very important and difficult issues and bring together a coherent and consistent energy policy for this nation's future. We at FERC are doing what we can to address the problems facing us in the energy sector. I would like to focus now on three particular initiatives: 1) restructuring wholesale electricity markets; 2) improving efficiency in processing applications for pipeline and hydroelectric projects; and 3) increasing market monitoring.

III. Restructuring Wholesale Electricity Markets

The FERC has been working actively to restructure the wholesale electricity sector into the vibrant, competitive marketplace that customers deserve. As we do so, I have been guided by five core principles:

First, customers must benefit. Restructuring markets toward a competitive outcome should be a value-added proposition. We are not abandoning what works, we are making it better. That has been the competitive advantage of the U.S. economy.

Second, the FERC must ensure independent operation of the nation's transmission highway. Such independence is essential to meeting Congress' directive in the Federal Power Act of nondiscriminatory access to the interstate grid.

Third, the FERC must promote the development of a robust and reliable infrastructure that supports the dispatch of generation on a least-cost basis. Until all

wholesale generators can compete fairly on an economic basis, customers will continue to be deprived of potential savings.

Fourth, the FERC must ensure transparency in the electricity markets. A market cannot run efficiently unless the rules are clear and there is adequate opportunity for price discovery. We can't assume this without an independent system operator and full access to information

Fifth, the FERC must ensure adequate customer protection against unjust and unreasonable rates. This begins with a well-functioning wholesale electricity market and also requires vigilant market monitoring at all times and mitigation whenever appropriate.

My decisions to support consideration of modifications to our affiliate rule, creation of the new Office of Market Oversight and Investigations, issuance of Order No. 2001 requiring detailed reporting on transactions, development of standardized procedures for generator interconnections, and aggressive investigation of the causes of the Western energy crisis were all in furtherance of these five principles. However, I continue to believe that creation of Regional Transmission Organizations (RTOs) is the single most effective way of achieving these five goals simultaneously.

RTOs that are fully independent of market participants can ensure non-discriminatory operation of the transmission facilities under their control. RTOs have FERC-approved market monitors, implement FERC-approved market mitigation plans, and conduct long-range planning all for the protection of customers. RTOs can perform economic dispatch over large geographic areas that will ensure the selection of least-cost

generators. Finally, RTOs can offer organized markets and one-stop shopping that reduce transaction costs, provide transparent market rules and allow the opportunity for price discovery.

I am pleased to announce that the majority of public utilities now seem to recognize the value of RTOs—almost every transmission-owning public utility has announced its intention to join a specific RTO. The FERC recently granted RTO status to the Midwest ISO and PJM Interconnection, and has several other RTO filings pending.

The standard market design rulemaking has been an invaluable source of information as the FERC works through the RTO filings. The wealth of comments we have received on the proposed standard market design rule has given us a much greater understanding of how to create a commercial platform within RTOs that will ensure the maximum benefits for customers. Regional differences should and are being accommodated in RTOs. Nevertheless, market platforms must be consistent in order to ensure equity, eliminate barriers to entry, reduce transaction costs, and create an environment where gaming is limited, if not eliminated. The platform must also ensure that the most appropriate solution, whether transmission, generation or demand-side, is implemented. As I continue my work at the FERC on wholesale electricity matters, I commit to you that I will retain a focus on the five principles I have articulated here.

IV. Improving Efficiency in Processing Energy Project Applications

The FERC has responsibility for authorizing the construction and operation of interstate natural gas pipelines and hydroelectric projects. We have been improving our

processes for handling project applications so that our processes do not impede market development, and may in fact advance infrastructure.

Revisions to the pipeline certification processes have resulted in reduced processing time from an average of 273 days in 1995 to 195 days today. In 2001, the FERC certificated 16 Bcf per day of new capacity.

More recently, the FERC, after hearing complaints for years about the inefficiency of the licensing process for hydroelectric projects, has proposed changes to the hydroelectric licensing regulations. Hydroelectric projects are a critical component of this nation's energy infrastructure, and inefficiencies in FERC's relicensing process add unnecessary costs and uncertainties to the detriment of consumers. The proposed rule would create a new process in which the current duplicative, sequential environmental analyses conducted separately by the license applicant, the FERC, and the other agencies is replaced with a single "integrated" environmental analysis.

This proposal was the result of work not only by FERC staff but by all stakeholders: individual licensees, small and large from all over the country; non-governmental organizations (NGOs), including the National Hydropower Association, the Hydropower Reform Coalition, and individual environmental and recreation groups; the U.S. Departments of the Interior, Agriculture, and Commerce; State agencies; and Indian tribes. In fact, the proposed rule draws heavily from proposals developed by two very different groups—the National Review Group, a coalition of licensees and NGOs, and the Interagency Hydropower Committee, a federal interagency working group—and reflects a

remarkable degree of consensus. We estimate that the proposed rule would reduce the average time it takes to complete the licensing process by 30 months—cutting down 47 months of preparation and processing time to 17 months. Further, we estimate that the proposed process would reduce the cost of licensing for a project under 5 megawatts by \$150,000 and for a project greater than 5 megawatts by \$690,000.

V. Market Monitoring

The FERC's other relatively recent initiative has been on market monitoring and investigations. Much has been said over the historic failure of market monitoring and without revisiting history, I believe we now recognize that market monitoring must:

- Be the responsibility of everyone;
- Be a continuous proactive process anticipating trends, understanding market dynamics and inter-dependencies;
- Have dedicated resources;
- Develop effective ongoing communications with regional market monitors and state commissioners;
- Clearly understand financial markets and customer needs;
- Co-ordinate effectively with sister agencies; and
- Analyze, inquire and investigate.

I am pleased to report that we have made substantive changes in FERC's market monitoring with the reformation of the Office of Market Oversight and Investigation (OMOI). OMOI is charged with the above objectives and with nearly a full staff

complement is well on its way toward meeting them. Are we where we would like to be? No, but for large portions of the country we are confident we are close. Significantly and importantly, these areas include where we have had independent system operators, transparency, organized markets, and regional monitors. In other areas of the country that lack independent grid operators, developed market rules, and independent market monitors with access to information, I am less confident of our ability to monitor markets for the exercise of transmission or generation market power, discriminatory practices or manipulation.

OMOI is not only gaining experience with monitoring, but also in responding to market conditions in a responsible manner. We have recently analyzed gas price indices and continue to monitor the situation. We will work with industry as they respond to problems with gas indices. Not every inquiry calls for an investigation; I believe that OMOI should have a panoply of tools in its tool-box to deal with different stages and degrees of development.

VI. Comments on Discussion Draft

I appreciate the opportunity to offer the following thoughts on specific provisions on the discussion draft.

Section 7101–Repeal of Section 203

Section 7101 would repeal Section 203 of the Federal Power Act and, thus, leave review of mergers and other dispositions of public utility facilities to the Department of Justice and the Federal Trade Commission. While I support coordination of federal

agency review of proposed utility mergers to ensure that such reviews are not duplicative or overly time-consuming, I do not believe it is appropriate to eliminate FERC review. The FERC has knowledge of the electric utility industry that the federal antitrust agencies do not, and FERC review is necessary to ensure that mergers and other dispositions are consistent with the public interest. The FERC has years of expertise with Section 203 matters and such matters may affect the ability of the FERC to ensure just and reasonable rates and terms and conditions of service as required under the Federal Power Act. I believe merger reviews must be disciplined and focused. They are not shopping opportunities to extract concessions on issues that add cost not value.

Title II--Alaska Natural Gas Pipeline

This title streamlines the FERC's issuance of a certificate of public convenience and necessity authorizing the construction of an Alaska natural gas transportation by recognizing the need for such a project, setting aggressive time lines for the completion of environmental reviews, and designating the FERC as lead agency for compliance with the National Environmental Policy Act and for coordination with and among federal agencies. Ensuring adequate pipeline infrastructure to deliver natural gas supplies is critical to the security, health and prosperity of this nation. For several years now there has been interest in the development of the transportation infrastructure needed to bring Alaskan natural gas to markets in the lower 48 states, and yet, for many reasons, there have been no requests for certification filed with the FERC. I fully support inter-agency cooperation and the streamlining of processes where possible and can assure you that any

applications ultimately filed with the FERC for an Alaska natural gas transportation project will be reviewed thoroughly, promptly, and fairly with recognition of the importance of Alaska natural gas to our nation's long-term energy security.

Title III–Hydroelectric Relicensing

The discussion draft would provide applicants for hydroelectric licenses the opportunity to propose alternatives to the mandatory conditions and fishway prescriptions developed by federal resource management agencies. The Secretary of such an agency would then be required to adopt the alternative if he concluded, based on substantial evidence and giving equal consideration to a wide range of factors, that the alternative provided adequate protection of natural resources and was either less costly or would result in improved electricity generation. I believe this provision is one reasonable approach to recognizing the expertise of the resource management agencies while still ensuring that such agencies perform an appropriate balancing of interests when developing mandatory conditions and fishway prescriptions, just as the FERC is required to do when developing its license conditions.

Section 7011–Transmission Infrastructure Improvement Rulemaking

This section would require the FERC to develop regulations on incentive- and performance-based rates to encourage transmission investment. An improved transmission infrastructure is critical to the success of this nation's electricity markets. I support incentive- and performance-based rates for transmission investment and note that the FERC has recently issued a proposal on incentive pricing for transmission expansion.

This section would also require that the regulations provide for participant funding of transmission upgrades upon the request of an RTO or other FERC-approved transmission organization. I support the concept of participant funding of transmission upgrades provided that an independent transmission organization, which can ensure nondiscriminatory access and rate treatment, is operating and planning expansions of the grid, and this provision appears to meet that standard.

Section 7012–Siting of Interstate Electrical Transmission Facilities

I support granting the FERC backstop authority to site interstate transmission lines. As I have stated previously to this Subcommittee, state-by-state siting of such transmission superhighways is an anachronism that impedes transmission investment and slows transmission construction. This section, which grants the FERC such authority to site transmission in Department of Energy-designated "interstate congestion areas" where states have been unable or unwilling to do so, is one potential approach to this problem. I also believe new models may respond to siting issues in a way that recognizes state concerns while accepting the reality that electricity planning and operations are regional in nature.

Section 7021–Open Access Transmission by Certain Utilities

This section would grant the FERC the authority to require all transmitting utilities (not just those that constitute "public utilities" under the Federal Power Act) to offer open access transmission service, unless they sell no more than 4 million megawatts of electricity per year. I support the intent of this provision to ensure a properly functioning

and transparent transmission grid, and understand the concerns of parties not now subject to open access. We must work to ensure that their rights are protected.

Section 7041--Public Utility Holding Company Act (PUHCA)

I support the repeal of PUHCA. 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. Nevertheless, I appreciate the concerns of those, like the rural electric cooperatives, who have opposed elimination of certain safeguards that PUHCA provides against market power. The FERC is aware of the concerns of the cooperatives and of the problems with market power in general, and we are engaged in an overhaul of our efforts at market monitoring and market power protection. I believe that the discussion draft strikes an appropriate balance by replacing PUHCA with increased access by the FERC and state regulators to certain books and records.

Section 7062--Public Utility Regulatory Policies Act (PURPA)

I support the draft's prospective elimination of the forced sale provision of PURPA. In my view, the discussion draft appropriately recognizes the vital role of organized markets in facilitating sales while providing appropriate transitions rules to

recognize the rights and obligations of parties. PURPA was enacted out of concern over dependence on oil for electric generation. Now, a quarter of a century later, when a gas-fired generator can be on-line in less than two years, and many advances are being made in distributed generation, PURPA's subsidies for certain types of generation are no longer appropriate.

Section 7084–Enforcement

The FERC must have an expanded role in monitoring for, and mitigating, market power abuse. 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 FERC with similar authority would send a powerful message to electricity market participants that we take violations of the Federal Power Act just as seriously. Therefore, I support the draft's increase in the level of penalties available under the Federal Power Act.

Section 7091–Refund Effective Date

I support allowing refunds from the date a complaint is filed, as opposed to 60 days after the filing. This proposed change will better protect customers.

VII. Conclusion

I appreciate the enormous commitment of time, energy, and leadership that the Chairman and the other members of this Subcommittee have made to address the issues facing our energy markets. I thank you for the opportunity to share my thoughts with you, and look forward to continuing to work with you on these matters.