Testimony of
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Federal Energy Regulatory Commission
before the
Subcommittee on Energy and Power
Committee on Commerce
United States House of Representatives

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San Diego, California

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to appear before you this morning in San Diego to discuss the price spikes and volatile electricity markets confronted by California consumers this summer and the continuing need for Federal electric utility restructuring legislation. Let me begin by commending you, Mr. Chairman, Congressman Boucher, and other Members of the Subcommittee for sensing the urgency of the situation in southern California and convening this important congressional hearing in San Diego. This is a matter deserving careful attention by Congress, the Administration, the Federal Energy Regulatory Commission, and California regulators, legislators, and market institutions. I can assure you that my colleagues and I share your concerns and are just as anxious to understand fully this difficult situation. I have no doubt that today's hearing, as well as recent actions taken by FERC, which I discuss below, will result in significant findings that will lead us to real and long-lasting solutions to the problems affecting the energy markets in this region.

The electricity market abnormalities experienced by California consumers this summer are complex and multi-faceted. Although many in the energy industry and media have speculated as to the causes of these problems, the exact origin is not known. What is known, however, is that the result of these market flaws has been alarming for consumers and policy makers alike. For instance, we have learned that prices for electricity in the San Diego area have more than doubled this summer, with the average monthly residential bill rising from around $50 to more than $100. Some accounts even estimate that, during the second week of June, purchasers of California power paid 300 percent more than they paid during the same period in 1999. These are troubling estimates that have caught the attention of the entire Nation.

Several causes of this price volatility have been proffered by various industry analysts. These include: (1) a lack of new generation resources being sited and constructed in California, leading to tight regional demand/supply conditions; (2) a lack of new transmission facilities leading to reduced availability of imports into California; (3) higher-than-expected loads (i.e., a 15 percent increase in average daily peak since 1999); (4) a lack of demand-side programs that allow consumers and businesses to receive and respond to price signals; (5) impediments for utilities to hedge in forward markets, resulting in an over-reliance on the spot market; (6) flawed market structures, such as congestion management and ancillary services markets; (7) underscheduling of loads and generation in the Day Ahead market; (8) possible exercise of market power by both in-state and import suppliers; and (9) unusually high temperatures in southern

California. When combined, these and other conditions would likely lead to higher market prices and ultimately, to higher electric bills for consumers. However, since we cannot identify the exact underlying causes, it is crucial that we delve deeply into this situation in order to ascertain whether these or other factors are to blame for the price volatility. Once we have this information, we will be better able to decide on the appropriate steps that will be necessary to correct the problems. This important fact-finding process has already begun.

Earlier this summer, FERC undertook definitive actions to address market abnormalities in California. First, and most recently, on September 1, 2000, we announced that we will convene a public meeting here in San Diego to allow interested persons to give us their views on recent events in California's wholesale markets. This public meeting will be held tomorrow, September 12, 2000, beginning at 9:00 a.m. at the San Diego Concourse. This public meeting will be an important forum for FERC to obtain first-hand information regarding the concerns of consumers that were affected by these price spikes and to hear from policy makers on recommendations they may have to address this situation.

Second, on July 26, 2000, we directed our Staff to initiate a thorough fact-finding investigation of factors affecting competition and market price fluctuations in electric bulk power markets in various regions of the country, including California and the Western region. We directed Staff to determine any technical or operational factors, regulatory prohibitions or rules (Federal or State), market or behavioral rules, or other

factors affecting the competitive pricing of electric energy or the reliability of service. Staff is to report its findings to us by November 1, 2000. Since the issuance of that order, Staff has been directed to concentrate its initial efforts on the California market and to report to us on that portion of the investigation as soon as possible.

Third, on August 23, 2000, in response to a complaint filed by San Diego Gas & Electric Company (SDG&E), FERC instituted hearing proceedings pursuant to Section 206 of the Federal Power Act. As part of these proceedings, we will investigate the justness and reasonableness of the rates charged by public utilities that sell energy and ancillary services to or through the California Independent System Operator (ISO) and Power Exchange (PX). We will also investigate whether the tariffs and institutional structures and bylaws of the California ISO and PX are adversely affecting the efficient operation of competitive wholesale electric power markets in California and need to be modified. As our order explains, a Section 206 investigation initiates a formal evidentiary process where all interested parties are assured an opportunity to present evidence and arguments on the record before the Commission. In addition, it provides a mechanism for the Commission to exercise its remedial powers to change the rates, terms and conditions of jurisdictional services that are found to be unjust, unreasonable, unduly discriminatory or preferential and, if appropriate, to order refunds.

Our overarching goal in these investigations and hearings is to detect and, to the extent within our jurisdiction, to resolve as expeditiously as possible, any defects in the operation of competitive bulk power markets in California and elsewhere. It is

important to understand that, while FERC has jurisdiction over certain aspects of the California market, such as wholesale electric prices and the market design and rules of the ISO and PX, certain other factors fall within the jurisdiction of state regulatory authorities in California. In particular, these include the siting of new generation and transmission facilities, the removal of constraints on hedging in forward markets, and the implementation of consumer demand-side programs. These are important functions that must receive serious consideration by the California regulators.

Because regulation of the California electric market is shared between FERC and various State regulators, it will be imperative that we work closely together in order to arrive at a reasonable and timely resolution of these problems. I am committed to such a partnership with my State colleagues.

Although FERC has undertaken important activities over the past few months to address the current situation in southern California, our involvement in the California energy markets has not been limited to this summer. Since the enactment of A.B. 1890 by the California Legislature in 1996, which dramatically restructured the California electric utility industry and implemented retail access, FERC has devoted significant resources to analyzing and processing the myriad tariffs and agreements proposed by the ISO and PX. In fulfilling our jurisdictional responsibilities and duties with regard to these market institutions, I believe FERC has been especially diligent over the past four years in addressing the interests and concerns of California regulators, legislators and industry stakeholders. We have had to make some tough decisions regarding the

formation of competitive bulk power markets in California, but I believe we've been mindful of the ambitious goals of the California PUC and Legislature to create competitive markets in that State.

However, there are flaws in the existing market structure that must be repaired and the repairs must result in a lasting solution. That is why I supported our decision on August 23, 2000, to deny SDG&E's request for an immediate cap of $250 per MWh on seller's prices in California. In my opinion, approving the seller's price cap at this time would have been an inappropriate and rash action that would have sent the wrong signal to the market. I am concerned that such a cap would only exacerbate the current scarcity of supply by discouraging generators from serving California markets. We must find ways to encourage supply into the market and to ensure a sufficient generation and transmission infrastructure.

I continue to believe that robust competitive wholesale bulk power markets are attainable. Moving forward, not retreating, is the right thing to do. In order to accomplish this challenging work we will need the assistance and commitment of Congress. As I testified before this Committee last October and before the Senate Committee on Energy and Natural Resources in April, I continue to believe that Federal electricity restructuring legislation is needed. I urge Congress to pass comprehensive restructuring legislation as soon as possible. Such legislation, I believe, is necessary to address important and unresolved issues in the Nation's electric industry, such as reliability, jurisdiction, and transmission access. Legislation is needed to enable FERC to

achieve its goals of creating fair, open, and competitive bulk power markets. The opportunity to benefit consumers through the creation of truly competitive and efficient wholesale bulk power markets is too important to squander. Therefore, I ask Congress to become a partner with FERC and California officials in our attempt to ensure that competitive markets are achieved and that consumers enjoy the intended benefits.

In conclusion, let me reiterate that FERC is on a fast track to understand the causes of the abnormalities that currently exist in the California electricity market and to decide on the appropriate remedies. Our Staff will complete its preliminary investigation of bulk power markets by November 1, 2000. The California and Western regional portion of that investigation should be completed in advance of that date. Our investigation will identify those areas of the market that are in need of repair. FERC is committed to doing all that it can to make those repairs that are within our jurisdiction in a timely and resolute manner.