

July 12, 2006

**Testimony of the Honorable Joseph T. Kelliher
Chairman, Federal Energy Regulatory Commission
Before the Committee on Government Reform
Subcommittee on Energy and Resources
United States House of Representatives
July 12, 2006**

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to appear before you to discuss the Commission's Summer Energy Market Assessment and the measures we have taken to facilitate resource adequacy and to enhance the interstate electric transmission grid. The Energy Policy Act of 2005 (EPAct) gave us important new tools to address both market and reliability issues in each region. I welcome this chance to review current market issues and to report to you on how we are using the new authorities you gave us.

I. The Summer Assessment

I will begin with the Commission's Summer Assessment. The Commission's staff prepares an assessment of energy market conditions before each summer's electric cooling season and winter natural gas heating season. These reports highlight major changes from the year before and areas of potential concern for the upcoming season.

The staff presented the Summer 2006 Assessment at our Commission Meeting held on May 18. The Assessment was generally reassuring.

A. Hydroelectric and Fuel Supply

Hydroelectric conditions in the West are far better this year than last, providing a margin of safety throughout the region, at least for the beginning of the summer.

Natural gas prices have fallen compared to oil. In Florida and New York, regions where fuel-switching is important, we have seen significant levels of switching from oil to natural gas. As a result, more gas is being used for generation nationally, but at prices 15 percent lower on average around the country than they were a year ago before the hurricanes.

Coal stockpiles early in the year, on the other hand, were at relatively low levels compared with most recent years. Low stockpiles were especially prevalent in regions served by Western Powder River Basin coal. I am pleased to report to you that on June 15, the Commission held a public discussion on rail deliveries of Western coal and possible effects on reliability. Representative of both the electric utility industry and the railroad industry provided their perspectives on the issues. Good, timely statistics about coal deliveries are hard to come by, but our staff has tracked what appears to be some improvement recently.

The Assessment noted four geographic areas in North America that could face problems this summer: Southern California, Long Island, Southwest Connecticut, and Ontario with implications for adjoining markets in Michigan and New York. In all four areas, supplies appear to be adequate to meet normal demands on the system. But all four regions could be at some risk if loads are high or key parts of the generation and transmission system have unplanned outages. Under these conditions, prices could be

high and some load might need to be shed.

Before I turn to the four regions individually, I want to note that each has already been tested by some periods of early summer heat. So far, there have been no major problems in any of the four regions. Still, this is not the time for complacency. In most regions, July and August are the times of greatest vulnerability to sustained high heat. Moreover, looking beyond this summer, all four regions remain at greater risk if fuel supplies tighten in future years.

B. Southern California

Turning to the four regions identified in the Assessment, Southern California faces another summer of a tight supply in an area of fast growing demand. The region depends heavily on imports from northern California, the Pacific Northwest and the Southwest, particularly at peak. Under high load scenarios, Southern California needs to import 10,000 megawatts (MW), fully a third of its load. Since last year, transmission upgrades may have helped import capability somewhat, but net generation growth barely covered load growth.

If loads or unplanned outages are high, the California Independent System Operator (ISO) will call on interruptible demand and demand response to maintain adequate operating reserve margins. Under extreme – and fairly unlikely – conditions, the ISO might again need to shed load through rolling blackouts in Southern California.

Southern California faced its first test for this summer when hot weather covered the whole West for several days two weeks ago. No major problems emerged during this period. That is good news. But it is important to remember that August and September

are likely to bring greater challenges, as hydropower reserves are drawn down and temperatures rise further.

C. Southwest Connecticut

In the Northeast, Southwest Connecticut again faces a very tight balance between supply and demand. Combined local generation and import capacity are not sufficient to meet both expected demand and reliability requirements. Transmission capacity for imports now operates at or near its limit while transmission capacity within the region cannot fully support local generation. The region has not added significant generation or transmission capacity since 2004. Under current plans, there will be some improvement in transmission inside the region later this year. Transmission upgrades for imports will not be completed until late 2009.

As in Southern California, the most important threats to electricity markets in Southwest Connecticut come from extended periods of summer heat and from unplanned outages. Widespread heat in the northeastern United States could limit imports into Southwest Connecticut also. Overall, the fragility of the infrastructure into and within the region makes summer problems possible and maybe even likely.

D. New York City and Long Island

New York City and Long Island pose long-standing challenges for the electric system. The Assessment noted key improvements in New York City, as recent generation investments began to relieve some reliability concerns.

On Long Island, however, the balance of supply and demand remains tight. Imports from upstate New York and New England are still crucial for Long Island and

the area remained exposed to the risks of heat and of unplanned generation and transmission outages.

During the last two weeks, two of four major transmission lines into New York City from upstate New York have failed. They will be for some time. Our Division of Reliability is consulting closely with the affected transmission owner to ensure that the outages have no reliability effects. Nonetheless, the loss of these two lines means that New York City as well as Long Island will be tested during any periods of sustained hot weather.

E. Ontario

Finally, the Assessment touched upon the Canadian Province of Ontario, which imports power from adjacent U.S. electric markets in New York and Michigan, as well as the Province of Quebec. The Assessment noted the North American Electric Reliability Council's view that Ontario has lost some of its already-tight capacity margin since last summer.

Our concern is the effects that Ontario demand may have on U.S. markets. Demands for emergency energy could make balancing supply and demand in New York and in the Midwest more difficult and more costly. Ripple effects could be felt in PJM and New England as well.

II. Commission Actions

All four of the areas identified as concerns in the Seasonal Assessment involve two key problems: how to ensure that there is enough transmission investment to deliver power to the areas that need it and how to ensure that there is enough generation available

to keep the lights on, especially in highly populated load pockets. With EPart, Congress gave the Commission new tools to help address these concerns among others, including reliability. I am pleased to report to you the progress the Commission has made in using those new tools.

A. Transmission Investment

Let me start with transmission. Our nation's transmission system has suffered from underinvestment for years. In 2004, the interstate transmission system expanded by a total of 0.6 percent in circuit miles. Transmission congestion has risen steadily since 1998.

One of EPart's major goals is to strengthen our energy infrastructure, especially the transmission grid. Transmission underinvestment is a national problem. We need a national solution. Using important provisions of EPart, the Commission is addressing two key impediments to transmission investment: the failure of transmission rates to give a strong enough incentive for investment and the difficulty in siting new lines.

Transmission investment will not return unless the rates companies are allowed to charge for transmission give them a strong enough incentive to invest in new transmission. Accordingly, we issued proposed rules on November 17, 2005, to implement incentive pricing for transmission under EPart. The goal of the proposed rules is clear: secure greater investment in the transmission grid. A stronger transmission grid will increase electric system reliability and promote greater wholesale competition.

Our proposed rules encourage investment in transmission in all regions, by both vertically integrated utilities and transmission companies. Transmission companies are a

proven vehicle for transmission investment. Internal analysis at the Commission shows that transmission companies are investing five times as much as prior owners. We want to reinforce that success. The Commission has been working on transmission pricing reform for nearly three years. We are hoping to issue a final rule very soon.

B. Transmission Siting

Siting is the second major barrier to transmission investment. In enacting EPCRA, Congress recognized that a robust transmission grid is important to both assure reliability and support competitive markets and that some federal transmission siting authority was needed to lower barriers to major transmission projects.

EPCRA, therefore, authorizes siting of interstate electric transmission facilities in “national interest electric transmission corridors” designated by the Department of Energy. The Department is working on its congestion study, which is expected to be issued in early August. At some point after August, the Department may begin designating these corridors.

I want to congratulate the Department of Energy for its work on the congestion study and to express my confidence in its ability to designate transmission corridors in a timely manner, consistent with the statute. The Commission and the Department of Energy have been working closely and productively. In particular, I want to commend it for the recent delegation order, which delegated to the Commission lead agency status once a permit application is filed.

We will be ready to act on construction permits. Last month, even as the Department of Energy completes its congestion study, the Commission issued proposed

rules to implement the transmission siting provisions of EPCRA. These rules will govern the issuance of construction permits by the Commission for projects that meet the statutory criteria. My intent is to have the Commission's final transmission siting rules in place by the time the Department of Energy may begin designating transmission corridors.

In talking about transmission siting, I want to emphasize two points. First, EPCRA gives the Commission a carefully limited role that supplements state authorities rather than supplanting them. Second, the Commission is well qualified to do the work of siting new transmission facilities when the law calls upon it to do so.

The federal transmission siting provisions differ profoundly from those that govern natural gas in that they do not preempt the states and do not provide for exclusive federal siting. In fact, I expect that states will continue to site most transmission projects under state law.

We are also well-equipped to handle those projects that we do site. In those cases, the role we are assigned is familiar to us from our work in siting gas pipelines, something we have been doing for decades. In the past five years alone, we have sited more than 8,000 miles of pipelines. For natural gas pipelines, it now takes us an average of only 11 months to go from a filing through the full comprehensive review needed to approve construction. I have no doubt we will be able to site transmission projects as efficiently and fairly as we site natural gas pipelines, when we are called upon to do so.

C. Electric Generation Adequacy

Transmission reform addresses half of the issues raised for load pockets in the

Summer Assessment. Ensuring generation adequacy is the other half. The Commission and regional transmission operators around the country have recognized the issue and have worked hard to create mechanisms, such as capacity markets, to address them. I would like to focus on a settlement we recently approved in New England to address the issue for a region with a particularly pressing version of the problem. The process shows both how necessary and how difficult it is to address regional resource adequacy issues.

As the Summer Assessment noted, parts of New England face the prospect of an electricity supply problem, if not this summer, then very soon. Demand for electricity in the region is growing. Supply is not increasing to meet demand. Last year New England added 11 MW of new generation while its peak demand rose by 2,700 MW. The region faces the prospect of real supply shortages and very high prices.

We have seen a consensus in New England for some time around these basic facts, though there are disagreements about how soon supply shortages and high prices might be realized.

ISO New England proposed a location installed capacity proposal (LICAP) to address the problem. This proposal generated considerable controversy, largely because resource adequacy is not cheap. Many in the region felt they had not had the opportunity to develop a workable alternative. In response, we urged the parties to engage in settlement discussions around an alternative to the LICAP proposal. We authorized settlement discussions and appointed a settlement judge.

These discussions were productive, and resulted in a settlement that we approved this spring that establishes a new Forward Capacity Market for New England.

The great majority of the parties settled. They realized that it was better for the region to propose a regional solution to this serious problem facing New England. They negotiated in good faith on a series of difficult issues. They acted responsibly. They also trusted that the Commission would give the views of the region appropriate deference. I want to commend the settling parties for working collaboratively to reach this settlement.

Despite the lack of unanimity, we found that the settlement was just and reasonable, and that the newly established Forward Capacity Market will serve to assure adequate electricity supply and just and reasonable wholesale power prices in New England.

Our decision remains controversial – some in the region have criticized it. Resource adequacy decisions are never easy. But this decision was necessary. In the end, I would prefer to be criticized for acting to prevent a crisis, a crisis New England knows is coming, than for failing to be proactive.

D. Electric Reliability

I will end by noting that the matters I have spoken of today are only a part of the Commission's response to Congress's intent in enacting EAct. Most importantly, we have acted swiftly to implement the reliability provisions of the statute.

EAct requires the Commission to issue rules to certify an Electric Reliability Organization (ERO), establish North American and regional reliability standards, authorize delegation of enforcement responsibility from the ERO to regional entities, and oversee the enforcement of mandatory reliability standards.

We issued proposed rules only three weeks after EPOA was signed into law. Parties filed roughly 1,700 pages of comments on the proposed rule. We reviewed the comments thoroughly, and they helped shape the final rule, which we issued early last winter.

The final rule is faithful to the law. EPOA gave the Commission the duty of assuring the reliability of the bulk power system. We will exercise that duty by certifying an ERO, carefully reviewing proposed reliability standards, approving standards that provide for reliable operation of the bulk power system, remanding those that do not, and working to improve reliability standards over time. We will review proposed reliability standards to assure that they not only have technical support but also are written to be enforceable against “all users, owners, and operators of the bulk power system,” as required by law.

I am committed to faithfully executing the EPOA as Congress intended, including appropriate regional differences in reliability standards. The law does not provide for absolute uniformity in reliability standards. Under EPOA, regional entities will propose regional standards or variances to the ERO, which can then propose to the Commission those regional standards that it has approved. I take this provision seriously. Congress would not have provided for consideration of regional standards or variances if it had intended a “one size fits all” approach.

With the Final Rule in place, we are now moving forward expeditiously with certifying the ERO. I expect final action on this very soon.

Meanwhile, we have improved our ability to discharge our duties once an ERO is

certified and reliability standards established. Last fall, I directed Commission staff to hold a series of technical conferences with industry and stakeholders to review current North American and regional reliability standards, including procedures for establishing, approving, and enforcing electric reliability standards. As part of this effort, Commission staff released a report entitled “Staff Preliminary Assessment of the North American Electric Reliability Council’s Proposed Mandatory Reliability Standards” on May 11th of this year.

Last week, the Commission itself held a technical conference to hear reaction to the Staff’s report, *Assessment of Reliability Standards*. Not surprisingly, given the importance of the issue, all of the Commissioners attended and played an active role in the discussion. These proceedings will help establish a record that will assist the Commission to issue a Notice of Proposed Rulemaking this fall to act on each of the reliability standards that have been submitted.

In conclusion, the Commission is working hard to ensure reliable, affordable electric power for Americans, both in the areas of immediate concern identified in our summer assessment and more generally around the country. Thank you again for giving me this opportunity to speak, and I will be happy to answer any questions you may have.