

FERC's New Era

AGENCY IMPLEMENTS LANDMARK LAW

By Martin Rosenberg

THE STARS WERE aligned when Joseph T. Kelliher last July slipped into the chairman's seat at the Federal Energy Regulatory Commission in the shadow of Union Station.

In a matter of a few weeks, President Bush signed a new energy act that cleared the energy landscape of laws that had been gathering dust for seven decades. Katrina then devastated the energy infrastructure of the Gulf Coast.

Kelliher now is in a position to shape a federal agency and the economically huge, fast-changing energy industry it regulates for years to come. Recently, *EnergyBiz* met with the chairman in his Washington office to discuss the most pressing issues now before FERC.

energybiz: How has the Energy Act changed the dimensions of what FERC tackles as an agency?

KELLIHER: It doesn't really change the commission's policy goals, but it gives us different tools. The commission has had a responsibility since 1935 to regulate wholesale power markets, and it's always done that by relying on two different tools: competition and regulation. The mix between those tools has evolved as the markets changed. Wholesale power markets have changed so much since 1935 that we needed some new authorities. Now we have not just an interstate, we also have an international transmission grid. We're fully interconnected with Canada and parts of Mexico. By far, the majority of generation additions going back 20 years have been built by non-utilities. The natural monopoly in generation disappeared a quarter of a century ago. Congress has given us the authority to review generation transfers.

energybiz: What is FERC's position on competition in energy markets?

KELLIHER: FERC still supports competition in wholesale power markets. I think the Energy Policy Act of last year represents an endorsement of competition in the wholesale power markets. It's the third law that Congress has written in the past quarter of a century that basically says competition is the national policy in wholesale power markets.

energybiz: What about retail competition?

KELLIHER: That's something Congress defers to the states. Our policies say wholesale policies have to work in both open and closed state retail regimes.

energybiz: How do you assess the health of the independent power generation sector?

KELLIHER: Independent power has been an essential element in competitive markets going back a quarter of a century. In 1978, non-utilities generated 3 percent of our power. Yet going back 20 years, non-utilities have made a clear majority of our generation additions. Independent power is an essential part of the business. There may be changes in their ranks, and there may be consolidation, but we still need independent power.

energybiz: What about the transmission situation? How would you assess the grid today?

KELLIHER: The Department of Energy is doing a study, and we're working with them on that study. We've found pretty significant congestion in different regional transmission grids and systematic underinvestment in transmission going back 20 years or more. Now, there have been a lot of announcements of a significant increase in planned investments.

energybiz: To what extent does FERC have responsibility of making those investments more attractive?

KELLIHER: We have some responsibility to do that. When we set just and reasonable rates, we are supposed to set them at a level that attracts investment.

energybiz: Would you like to see the whole country under regional transmission organizations?

KELLIHER: The key to expansion of RTOs into regions that currently don't seem very enthusiastic about RTOs is the success of the existing RTOs. An RTO market brings significant potential benefits. Are those benefits being realized and are they being realized at costs that are acceptable to the membership?

energybiz: Is the jury still out on that?

KELLIHER: Some of the depictions of the RTOs are a little unfair. There's sometimes a depiction that their costs are out of control. I don't think that's true. Some of the RTOs have done an excellent job of controlling costs.





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energybiz: How would you assess the reliability of the grid right now?

KELLIHER: Soon we will issue rules to provide for certification of a new electric reliability organization (ERO). Grid reliability will be enhanced by enforceable reliability standards. We have proposed the reform of some of our transmission pricing policies with the goal of attracting investment in the grid. Those two things together will certainly result in a stronger, more reliable transmission grid.

energybiz: Could we again have a massive regional power failure similar to the one in August 2003?

KELLIHER: It's less likely.

energybiz: Why?

KELLIHER: Utilities realize that systematic underinvestment in transmission can result in significant problems. First Energy was hurt by the 2003 blackout. Its stock was pummeled, and there was a loss of confidence by regulators. Companies would like to avoid that experience. That's one reason we've seen an uptick in the announced plans to invest in the transmission grid. That's one difficulty in the vertically integrated model. Investments in the transmission grid must compete against other types of investments. For a long time, transmission was always losing out on that internal competition. The proponents of transmission investment inside a vertically integrated company have a stronger voice than they did on August 14, 2003.

energybiz: FERC has new authority to site transmission.

KELLIHER: It hasn't been obvious until fairly recently that the transmission grid was an interstate network. The new Energy Act established a federal process at the back-end of the state transmission approval process. It certainly is not exclusive or preemptive. Congress also split federal decision-making between two agencies—the Department of Energy and FERC. DOE determines if a certain transmission project is needed in a region or between two areas, and then we would actually site it. The applicant also would seek state approval. If a period of time has lapsed and the state hasn't acted or they have been rejected at the state level, then they could come to FERC again if they received a need finding from DOE.

energybiz: Is FERC ready for the job?

KELLIHER: FERC has been an infrastructure agency since it was first established in 1920, and one of the things we do very efficiently is site infrastructure. We've cited about 9,000 miles of gas pipelines in the past five years without great controversy. I'm sure we can cite transmission facilities efficiently as well.

energybiz: In February, the 70-year-old Public Utility Holding Company Act was repealed. What will be the impact of that?

KELLIHER: PUHCA didn't prevent large utility mergers. It discouraged entry by people who are outside the utility business. It probably discouraged some financial sector entry into the electricity business. It also probably discouraged the consolidation or merger of remote utilities. It arguably protected some very high-cost distribution companies from being acquired. I don't think PUHCA repeal is a bad thing.

energybiz: So now we may see some non-utility money coming into the industry?

KELLIHER: Yes. There's been a pretty significant entry by the financial sector in the past few years. The clear majority of generation capacity sold over the past three years has been sold to the financial sector.

energybiz: Recently in Oregon and elsewhere, state regulators have blocked moves by the financial sector to acquire utilities.

KELLIHER: It seems state regulators and federal regulators have a different view of the financial sector when it comes to the electricity business. When we see the financial sector, we see Warren Buffett. (Buffett runs Berkshire Hathaways, whose MidAmerican Energy Holdings is acquiring PacifiCorp in a \$5 billion cash deal.) We see a sector that wants to make investments that are very much needed in a highly capitalized industry. We see them as new entrants. We think financial sector entry is a good thing, but state regulators are more suspicious.

energybiz: What new energy initiatives should Congress now pass?

KELLIHER: We have all of the authority we need from Congress. The energy bill they just enacted

NATURAL GAS

AMERICA'S UNTAPPED RESOURCE



By Sen. Jim Talent

The key to America's energy security is to become more energy independent. We are leaders in industrial and economic growth, but to sustain this growth we must develop technologies to reduce our dependence on foreign sources of energy. Low-cost, reliable energy is the key to economic prosperity and national security.

Natural gas prices set record highs this winter, exceeding \$15 per thousand cubic feet. Natural gas still costs two to three times traditional levels, due in part to increasing world demands for energy.

High utility bills are hurting family budgets as well as jobs. Missouri farmers and manufacturers are big users of natural gas as feedstock for fertilizer and chemical products. The Industrial Energy Consumers of America reported that "since 2001, natural gas prices have significantly contributed to the loss of 3 million manufacturing jobs and the shifting of future investment overseas."

Rising energy costs impede our ability to compete in the global economy. We are at a disadvantage when America's natural gas sells for \$15 per thousand cubic feet and in Europe it's \$7 and in China it's less than \$5.

The Renewable Fuels Standard, which I added to last year's Energy bill, was an important first step towards reducing our energy dependence. Ethanol and biodiesel are one of the solutions. We also need to responsibly produce more of our own clean burning natural gas.

Natural gas prices are excessive because our rapidly growing demand is outstripping our production. Demand is expected to grow by over 30 percent; however, the Energy Information Administration reports that the U.S. natural gas exploration has doubled since 1998, but production has declined by 1.5 percent. This shows how we're getting all we can out of the resources we can access.

The problem isn't the availability of domestic natural gas resources, it's the barriers that have prevented us from accessing them. The Minerals Management Service estimates that we have 621.1 trillion cubic feet of remaining undiscovered, technically recoverable

gas, 406.1 trillion cubic feet of which is in federal offshore waters. That's enough natural gas to heat 60 million homes for 121 years. Unfortunately, much of this is located in offshore areas which Congress or the president has banned access.

The ban was imposed in part due to safety concerns that experts have said are no longer valid. Interior Secretary Gail Norton recently testified that, "Hurricanes Katrina and Rita confirmed that our offshore oil and gas industry produces environmentally-safe energy for America. Even in the face of two back-to-back major hurricanes, all subsurface safety valves held on the Outer Continental Shelf and there was no significant spill from production."

With energy prices at record levels, the best use of our nation's resources is to carefully and responsibly produce the abundant energy which lies within our borders. One solution may be to open the untapped portion of just one small, unexplored area 100 miles offshore in the Gulf of Mexico. Lease Sale Area 181, as it is known, has enough natural gas to heat 6 million homes for 15 years, according to the American Gas Association.

I've introduced bipartisan legislation with Senators Pete Domenici (R-N.M.), Jeff Bingaman (D-N.M.) and Byron Dorgan (D-N.D.) instructing the secretary of the interior to develop an oil and gas leasing program for this area. Our bill excludes for development any part of Lease Area 181 within 100 miles of the Florida coastline. The Senate Energy Committee will soon hold a hearing on our legislation. This is a pro-growth, pro-jobs solution to help energy consumers and increase our domestic supply of natural gas.

Passing the Energy bill last summer was a good first step and I am confident the Senate will do even more this year to make America more energy independent.



Sen. Jim Talent

Sen. Jim Talent, R-Mo., serves on the Energy & Natural Resources Committee and is co-chairman of the Biofuels Caucus.

into law has roots that go back 10 years. They spent a long time on this law. We're not asking them to dust it off and make changes to it at this time.

energybiz: What do you think is the greatest misconception in the industry about FERC and its role?

KELLIHER: One mistaken belief is that FERC relied solely on competition in the past—and now somehow we've done a 180-degree turn, and we're relying

solely on regulation. It's always been much more nuanced than that. Congress for years has supported open access to the transmission grid, because it recognizes the link between open access and competition. The Energy Policy Act of 2005 reaffirmed that policy direction and gave us better tools to make sure the policy direction is successful.

» Coming in the May/June issue: Kelliher discusses the natural gas industry.

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