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S. HRG. 108–57

ELECTRICITY PROPOSALS AND ELECTRIC TRANSMISSION AND RELIABILITY ENHANCEMENT ACT OF 2003

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

TO RECEIVE TESTIMONY ON VARIOUS ELECTRICITY PROPOSALS INCLUDING, BUT NOT LIMITED TO, S. 475, THE ELECTRIC TRANSMISSION AND RELIABILITY ENHANCEMENT ACT OF 2003

MARCH 27, 2003

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE

87–936 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
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ELECTRICITY PROPOSALS AND THE ELECTRIC TRANSMISSION AND RELIABILITY ENHANCEMENT ACT OF 2003

THURSDAY, MARCH 27, 2003

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 9:34 a.m., in room SD–366, Dirksen Senate Office Building, Hon. Pete V. Domenici, chairman, presiding.

OPENING STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATOR FROM NEW MEXICO

The CHAIRMAN. Good morning, everyone. It is obvious that we have a very difficult subject and one of great importance here today, and a number of Senators who will participate will also have to come in and out because of a hearing on Armed Services appropriations and an important Judiciary Committee. But I will try my best to maintain the schedule, and Senator Bingaman, from your side, you will have somebody here, more or less, for the witnesses during the day?

Senator BINGAMAN. Probably, right.

The CHAIRMAN. Good morning again.

Next week the committee is going to begin, if I can possibly get it done, 2 weeks of markup on a comprehensive energy bill. I think that is possible because a great deal of the work was done last year, and much of it will be carried forward. While there will be changes proposed in the chairman's mark, a substantial portion of the work has been done. It is my intention that on April 9—that is the end of those markup days—we will consider the electricity title.

Today's hearing will consider four legislative proposals and obviously anything constructive that witnesses care to share with us.

S. 475, introduced by Senator Thomas on February 27. I compliment Senator Thomas. A lot of work went into this. I am sure he spent a great deal of time with varying views, and the bill is before us showing a great deal of effort, work, and obvious compromise.

The second one is title VII from the House Energy and Power Subcommittee chaired by Congressman Barton.

The third is a Senate October 16 offer from last year's energy bill conference, which Senator Bingaman participated in and he and his staff had a great deal to do with.

And the fourth is the staff draft circulated from last week, which I have participated in, but is principally a work of the majority staff. I thank them for their effort. It obviously shows a great deal of ingenuity, innovation, and hard work.

After reading most of the prepared testimony submitted for today's hearing, it is clear that the witnesses are essentially divided into two camps, those who support open access to transmission and generally support SMD and want the committee to approve Senator Thomas' proposal that would expand FERC's authority to ensure market access. On the other hand, those with serious concerns about SMD, in particular public power, prefer that the committee do nothing out of fear that including anything creates an unacceptable risk that we will include, either now or at some point down the legislative path, provisions that expand FERC's authority.

Both sides make good cases, and from talking to individuals from the industry and from institutions, it is obvious that positions have been very well thought out.

On the one hand, even though both sides make good cases, competition in the market is generally a good notion and the underpinning of our economy.

On the other hand, I do believe that FERC's SMD proposal failed to sufficiently consider the fact that this country does not have a single market for the generation and transmission of electricity. In fact, it has a series of regional markets that, particularly in the West and South, are structured and operate differently than the markets in the Northeast and Mid-Atlantic regions.

It is in this insensitivity to regional disparities and the fact that the current FERC has an expansive view of its authority that exceeds that vision by Congress, at least in my opinion, when we last amended the Federal Power Act in 1992 that has caused many of my colleagues who understandably suggest that Congress should curtail FERC's SMD.

While I share those concerns, SMD is a single rulemaking. If Congress were to simply curtail that rulemaking, it seems to me that the current FERC would remain free to implement the same policies through other rulemaking or proceedings.

On the other hand, if we attempt a wholesale rewrite the Federal Power Act to remove the discretion of FERC to make permanent limitations on FERC's authority and to truly block SMD-like regulation, I believe that Congress would be deeply divided, as our witnesses are today, as their interests are represented.

Finally, I do not see fundamental problems with the Federal Power act, at least as I have reviewed it. I believe the regulatory entities need discretion to address matters unforeseen to Congress.

On the other hand, I believe that this FERC in particular sought to so expand its authorities so far beyond those that Congress anticipated, that those concerned about SMD have some very legitimate reasons to be skeptical about assurances made by the commission and its chairman.

It was my view that the Federal Power Act itself is not fundamentally flawed, but that the current FERC has ignored real regional issues that must be considered in the regulation of generation of electricity and its transmission that has caused the committee staff to develop this regional energy services proposal, RESC.

This proposal would authorize States to come together to implement part of the Federal Power Act themselves. The RESC's would permit regions to develop their own policies for market design and transmission, including rulemaking authority, reliability, efficiency, and infrastructure investment matters without FERC preemption.

I know, from reading the prepared testimony that many of the witnesses have concerns about parts of this proposal. Clearly those who support FERC's SMD proposals object to the notion of regional markets, and they raise all sorts of concerns about adding another layer of regulation.

But I do not believe that RESC has to be an additional layer, and I say that to my good friend, Senator Thomas, who has great concerns about that. I believe that RESC can assume as much power and authority under part II of the Federal Power Act as it desires and make its own determination as to whether there would be an appeals process from within the RESC to FERC. Ideally, I believe FERC's role would be limited to States that prefer not to enter a RESC and to issues among RESC's, much like Congress originally envisioned FERC's authority to be limited to interstate matters originally.

After reading the proposals, some have approached me and recommended that instead of creating regional authorities, Congress should, instead, force FERC to give differences to regional matters in the form of regional transmission organizations, RTOs. I can imagine a system by which we give RTOs much greater authority than they currently possess would go a long way in addressing regional issues, but those would have to be real authorities over key issues or the RTOs would remain beholden to FERC where the matter starts in its sense of consternation today.

Finally, the staff draft includes a provision for transportation development certificates to facilitate the construction of new transmission lines. I believe lack of transmission is one of the principal reasons for the mess we have today. I know that providing even limited authority to obtain right-of-way is strongly opposed by some of my colleagues on this committee. However, Congress has already provided authority for pipelines, and I think we just cannot ignore the fact that it is now virtually impossible to build a new transmission line.

So with that, from somebody who used to read statements on budgets, I find it almost difficult to read this kind of statement.

[Laughter.]

The CHAIRMAN. But I am trying.

I yield now to Senator Bingaman.

[The prepared statements of Senators Craig, Kyl, Landrieu, and Murkowski follow:]

PREPARED STATEMENT OF HON. LARRY E. CRAIG, U.S. SENATOR FROM IDAHO

Over a decade ago, Congress passed legislation that cautiously moved the electric industry away from its historically regulated framework toward a new competitive market approach for the sale and resale of wholesale electricity.

Some believe it is time for Congress to take bolder action. Most of these advocates represent a class in the industry known as merchant traders and merchant generators that I understand is suffering financial distress.

It is instructive to me that most public power, coops, and investor owned utilities are not clamoring for bold change.

It is also instructive that the pressure for bold action is coming primarily from electric system geographical corridors located in the Northeast and parts of the Midwest.

Apparently, Middle Atlantic, Southeast, and Western electric system entities are content with the pace of the electric industry's evolution.

They obviously don't rely on merchant traders and merchant generators the way the Northeast region did. And it appears that those regions did not fall prey to the over-regulation experienced in the Northeast.

It certainly explains the outrage expressed by the South and West regions about the Commission's proposed Standard Market Design (SMD) rule.

Chairman Domenici has aptly characterized the Commission's action on SMD as a serious overreaching of its authority. I and many others on this Committee agree.

But what is equally troubling to me is the confusion created by Commission action since 2001. For example, the Commission's Order 2000 set-out a voluntary incentive-based approach to restructuring that is clearly in conflict with the prescriptive approach set-out in its proposed SMD. The industry spent about $100 million to form Regional Transmission Organizations (RTOs) under Order 2000 that now appears to be money not well spent in light of SMD.

Moreover, the Commission placed utility companies in settlement proceedings to form RTOs, only to disavow the results when the new Commission took over in 2001.

This happened most dramatically in the Midwest, where parties negotiated and the Commission approved two RTOs, one for-profit and one not-for-profit in May 2001.

In December, the Commission ignored its previous final action. In fact, the Commission questioned whether for-profit companies could become RTOs.

In the Northeast and the Southeast, the Commission opened marathon mediation efforts, only to ignore the results.

In the Northeast, the Commission originally required three RTOs to merge, then reduced the number to two and acquiesced when the parties to the merger that would have established the two RTOs canceled their plans.

It seems to me that the Commission's policy lacks direction. Since 2001, there has been too much lurching forward in provocative ways and then retraction once it becomes clear that the Commission went too far.

It would be far better for the industry and consumers alike if the Commission would propose reasonable rules in the first place, rather than announce ambitious programs that require later modifications.

I believe it far more prudent for this Committee to exercise much closer oversight of the Commission's administration of its current authority rather than contemplate the value of giving the Commission more authority, which in my opinion would only give the Commission more opportunity to create uncertainty in the marketplace.

I have made no secret of my preference for Congress to go slow in determining whether electricity legislation is needed.

During the last six years, Congress has struggled to find consensus on what to do on this issue. That consensus, to put it bluntly, has been illusive.

We once again find ourselves on the eve of another effort to find consensus. The Chairman is working hard to make it happen. I want to express my appreciation to the Chairman for his efforts to accommodate the many Western concerns that have been expressed by me and other colleagues on this Committee. I am grateful for his willingness to think "outside-the-box" to ensure that the traditional role of the States in this area is not compromised.

However, the draft legislation distributed by the Chairman introduces a rather novel idea for regional control of electricity regulation.

Although it raises many attractive concepts for regional and local control, it demands more thought and careful analysis. Put simply—it needs more time to mature.

Electricity regulation is, by nature, complex. In the short time I have had to review the proposal I have developed many questions about the concepts in the Chairman's proposal.

I would be much more comfortable about proceeding with the analysis if I was not confronted with the very short time line that has been set to complete the energy bill.

I continue to be confounded by the enormous pressure to include an electricity title in this bill. Such pressure contributed greatly to the demise of a similar energy bill in the last Congress. I hope our efforts in this Congress to pass such important legislation is not met with a similar fate.

PREPARED STATEMENT OF HON. JON KYL, U.S. SENATOR FROM ARIZONA

Mr. Chairman, as the Senior Senator from New Mexico, you understand the issues that are unique to the Western power markets and have endeavored to bring new perspective and new ideas to the table in order to promote workable competitive markets. I appreciate the leadership you have shown on this issue and look forward to working with you on these provisions in the bill. Obviously, we want to develop a bill that will do no harm to the electric utility industry and that will restore the faith of consumers and investors in our energy markets.

The proposals on the table for an electricity title present a number of interesting concepts, with Regional Energy Services Commission the most recent. We must shift power from FERC to the States, so I appreciate this regional idea. A number of questions have been raised about details of the proposal, and I do think it needs further consideration and development before we mark-up the bill.

But my principal concern is that we seem to be ignoring the elephant in the middle of the room—FERC's Standard Market Design proposal. FERC's SMD proposal represents a dramatic overreaching by FERC for jurisdiction and control over electricity issues traditionally dealt with by the States. Yet, much of the legislation on the table, including the Regional Energy Services Commission proposal, appears to accept, through silence, that the Standard Market Design proposal will move forward. This, despite the fact that the Northwestern, Southwestern, and Southeastern regulators, governors, and utilities are overwhelmingly against the proposal.

It is beyond dispute that there is a lack of consensus across the Nation that SMD is the way to go. And, as I said, there is outright hostility to the idea by many. So, I think we should deal with SMD directly, and not just try to find a way to work with or around it.

In the meantime, to maintain the confidence of retail consumers and investors, Congress should protect the retail service obligations of jurisdictional and non-jurisdictional utilities to provide needed regulatory certainty. I would have preferred to see this issue nailed down in the Chairman's draft. You have indicated, however, Mr. Chairman that you will work with me and other Senators who are interested in this to address this concern as the committee moves to markup.

As a final matter, I must address federal siting. Nothing in these bills strikes more at the heart of federalism, nor seems to be more of a solution looking for a problem than the consistent attempts to preempt state authority over the siting of transmission lines. This Committee has heard from witnesses who testified unequivocally that States are denying permits for interstate transmission lines. However, these accusations have been devoid of factual evidence to back up the claims. It is clear that there are areas where transmission congestion is a problem, however I have not heard any evidence to suggest that State inaction on siting is the cause. The case has not been made, therefore, to justify centralizing these land-use decisions in Washington, D.C. And, we certainly do not want to speed up the process of siting transmission lines on private lands to the point that it provides an incentive to site an private rather than federal lands.

Indeed, in the West, federal agencies control a large percentage of the land. In my home State of Arizona federal and tribal lands comprise 74 percent of the total land base. If a siting problem in Arizona can be identified it is on federal lands because of the large number of environmental restrictions. Therefore, I support efforts in these proposals to streamline the federal process, but do not support efforts to preempt state authority.

In sum, while I support the development of competitive markets to allocate resources efficiently, I believe that before we federally legislate any new market model (or allow FERC to force western utilities into a new market model) we should move with appropriate caution and deliberation. Only in this way can we ensure that we do not create another California-type scenario that provides an opportunity for unscrupulous market participants to game the system at the expense of consumers. We can, at this time, however, quell concerns about SMD by clarifying state jurisdiction and making sure that our local utilities are able to provide for their local customers first.

I thank the Chairman for convening this hearing and look forward to hearing from our witnesses.

PREPARED STATEMENT OF HON. MARY L. LANDRIEU, U.S. SENATOR FROM LOUISIANA

Mr. Chairman, today our country is at a critical juncture with respect to the need for affordable and reliable electricity. It is for these reasons that I have introduced the "Federal Power Act Amendments of 2003." This bill is intended to ensure afford-

able and reliable electricity to all electricity customers in a fair and equitable manner.

Electricity users, my constituents and your constituents, Mr. Chairman, wake up in the morning, flip a switch and expect their lights to turn on. They also expect that each month when their electricity bill arrives in the mail that they'll pay a reasonable price for that service. Customers don't care where the electrons come from or what new scheme the Federal Energy Regulatory Commission (FERC) has in mind for the electricity industry or really much of anything else. And frankly, as a representative of nearly four and a half million people in my home State of Louisiana, affordable and reliable electricity are my primary concerns when it comes to electricity policy, and that is the purpose for which I offered my legislation.

Electricity prices in Louisiana, and throughout the Southeast for that matter, are some of the lowest in the nation. According to the North American Electric Reliability Council's most recent reliability assessment report, the Southeast region is expected to enjoy, at least for the near term, "adequate delivery capacity to support forecast demand and energy requirements under normal and contingency conditions." In other words, electricity customers in the Southeast should expect to continue to enjoy reliable electric service over the short run. My concern, however, is about the future of retail electricity service in my State.

There are several specific areas of concern that I have and that I attempt to address in my legislation being offered.

First, the current balance between State and federal jurisdiction, which has worked exceedingly well in my home State to provide low-cost and reliable electric service, is in jeopardy. Retail transactions, regulated by State public utility commissions, have historically comprised 90 percent of most utilities' transactions and continue to do so in a majority of States that have not restructured their electricity markets. In fact, there is not a single State in the Southeast with the exception of Virginia that has authorized retail competition. Yet, customers in our region of the country enjoy some of the lowest priced electricity service.

The FERC, however, has issued a proposed rule that would strip States of much of their current jurisdiction over retail electric service, including the transmission component of bundled retail sales. In so doing, FERC would dramatically impair the ability of States to use retail ratemaking to attain local policy goals and to continue to ensure low costs for retail customers. It would also prohibit States from ensuring that retail customers are given a priority for electricity service. As a result, in the event that supplies are tight, retail customers could lose the right to priority service.

FERC's proposed plan is a one-size-fits-all scheme on the entire country based on a model that closely resembles the one in place in New Jersey, much of Pennsylvania and Maryland. This model may work well in the Northeast, but it has never been tested or proven viable in any other part of the country. In fact, in a study performed by the consulting firm, Charles River Associates, it was concluded that there is "considerable uncertainty as to whether the FERC's proposed Standard Market Design would provide greater benefits to the southeast than the implementation costs." In Louisiana, and I'm sure in many other States throughout the Southeast and across the country, customers are happy with their electric service. So I ask Mr. Chairman, what's wrong with the current jurisdictional division between the State and federal government? If a State or region wants to adopt a new approach, they should be free to do so. But we should not allow a federal agency to make fundamental policy decisions that are best left to State officials who are accountable to local interests. We know what happened out West when California regulators attempted to institute a sweeping, new plan for its electricity markets. I hope to avoid importing those problems into Louisiana.

To address this jurisdictional concern, Section 2 of my bill would clarify the federal-State arrangement under the Federal Power Act by explicitly stating that States shall have jurisdiction over the retail sale of electric energy, including all component parts of a bundled retail sale. In addition, Section 7 would enable States to continue to allow utilities to reserve transmission capacity for retail customers. This is current law and the current practice in a large number of States, including States with some of the lowest average retail rates and the best history of reliability. As contemplated by Congress when the Federal Power Act was enacted, FERC will retain jurisdiction over the wholesale sales of electric energy and States will retain jurisdiction over retail.

My second concern for retail customers is the potential for increased rates caused by the costs of accommodating the "merchant generation" that, over the past several years, have been seeking to connect to the electric grid in the Southeast. Though new generation is important to wholesale competition, it is a strain on the transmission system. To accommodate the new generation, new transmission facilities and upgrades to existing facilities are needed. However, customers in Louisiana

would be forced to pay for the facilities needed to accommodate the merchant generators, even though most of their customers are out-of-region customers. State regulatory commissioners, understandably, are reluctant to pass transmission construction and upgrade costs off to local customers who are not benefiting form the electricity. Meanwhile energy dependent regions of the country are denied cheap and reliable electricity.

A reason they choose to site in Louisiana is because we are blessed with abundant reserves of natural gas—the currently favored fuel source for electric generation. Merchant generators are siting their facilities to gain access to these resources as cheaply as possible, and then are delivering electricity to regions where they can sell electricity at a higher cost. If enough transmission is built to export just a portion of the new generation that is planned to come on-line in Louisiana—10,000 megawatts—the estimated cost would impose a retail rate increase of 5 to 11 percent.

Surely, there must be a more equitable way to allocate cost while simultaneously enhancing our transmission capacity. It is not fair to expect customers in energy generating States to keep paying for transmission expansion when this increased transmission is primarily being developed for out-of-region use. In Section 3 and 4 of this bill, I have attempted to provide a more equitable system. Section 3 would allow for "voluntary participant-funding" in which a regional transmission organization may choose to establish a system in which market participants pay for expansions to the transmission network in return for the transmission rights created by the expansion investment. This approach gives proper economic incentives for new generator location and transmission expansion decisions.

Similarly, Section 4 of my bill would require the FERC to initiate a proceeding to establish rules for interconnecting new generation to transmission facilities. As in Section 3, any costs made necessary by the interconnecting generator would be funded by the generator, or cost-causer, in return for a right to use such facilities funded by the investment.

The third problem that I see is the lack of new investment in transmission facilities. FERC noted in its Electric Transmission Constraint study that transmission congestion costs retail customers across the country millions of dollars every year. Over the past 10 years, demand for electricity has increased by 17 percent while transmission investment during the same period has continuously declined about 45 percent.

What is even more troubling is that current demand for electricity is projected to increase by 25 percent over the next 10 years with only a modest increase in transmission capacity. In the short term, this lack of transmission investment and the corresponding lack of transmission capacity, adversely affects the ability of retail customers to realize the benefits of wholesale competition. Over the long term, and if this trend continues, the reliability of the bulk power system could be compromised. In the summer of 2000, transmission constraints limited the ability to sell low-cost power from the Midwest to the South during a period of peak demand, causing higher costs for customers. In the summer of 2001 during the California electricity crisis, transmission constraints along the Path 15 transmission route were a significant cause of the blackouts experienced by customers in the northern parts of that State.

To help spur this needed investment in the transmission sector, Section 5 of the legislation would provide further guidance to FERC in establishing transmission rates in two ways. First, Section 5 would amend Section 205 of the Federal Power Act to clarify that the cost causer is responsible for paying the costs of new transmission investment and that all users of the transmission facilities are required to pay an equitable share of the costs such facilities. These provisions will help ensure that users of the transmission system have proper economic price signals and encourage investment where it is needed most. Second, Section 5 would add a new section to the Federal Power Act, Section 215, that would require the FERC to initiate a rulemaking to establish transmission pricing policies and standards to promote investment in transmission facilities. Although the Commission may have sufficient authority under current law to initiate such policies, our nation's transmission system has been neglected too long and I believe that the FERC could benefit from more specific guidance from Congress.

Finally, Mr. Chairman, customers are not realizing all of the potential benefits of wholesale electricity markets because of its balkanization. The likely result is higher electricity prices. In different parts of the country, electric utilities are in various stages of joining together to form large regional markets, or in the terms used by FERC—regional transmission organizations. In addition, public power entities, including municipal utilities, cooperatives, and federal and State power marketing associations have been willing or resisting, to varying degrees, to contribute

to the efforts to establish regional markets. Exacerbating this problem is the underlying fact that FERC does not have the same jurisdiction over public power utilities as it does over electric utilities.

Properly functioning regional markets for electricity can bring about significant benefits to customers in all parts of the country. More competitive wholesale generation, for example, will allow retail sellers greater opportunities to purchase generation from independent power producers. Improperly functioning markets, or one-size-fits all proposals that do not take into consideration regional differences, can be devastating. Current law and policy at FERC has been insufficient in achieving the proper balance between the need for robust regional markets, the reality of regional differences and the legitimate efforts of utilities.

Therefore, in Section 6 of the bill, the FERC would be required to convene regional discussions with State regulatory commissions to consider the development and progress of regional transmission organizations. It would further provide for specific topics of discussion between FERC and the States including the need for regional organizations, the planning process for facilities, the protection of retail customers, and the establishment of proper price signals to ensure the efficient expansion of the transmission grid. Section 6 would also help reduce the balkanization of the electric grid by authorizing the federal utilities such as the Tennessee Valley Authority and the Bonneville Power Administration to join regional transmission organizations. Also, in an attempt to help expand wholesale markets, Section 8 would provide for FERC to require that public power entities provide a limited form of access to their transmission facilities. This provision would give wholesale generators increased access to markets and ensure that competitors pay only the fair and reasonable price to use the transmission grid owned by public power.

In conclusion, Mr. Chairman, I ask my colleagues to support this legislation and consider its affect on retail electricity customers in the States. Affordable and reliable electricity should be our objective for customers, in all parts of the country.

PREPARED STATEMENT OF HON. LISA MURKOWSKI, U.S. SENATOR FROM ALASKA

Mr. Chairman, thank you for calling this hearing today to review a variety of legislative proposals regarding electricity. As I have stated earlier, this nation needs a comprehensive national energy policy. I commend the Chairman for taking the lead on this important issue, and setting an aggressive schedule for reporting out a comprehensive energy bill.

I understand that the Majority Leader would like to have energy legislation on the Senate floor following the April recess.

The Electricity Title will undoubtedly be a controversial part of energy bill. I hope the many interested parties will be able to reach consensus on this issue.

Many problems exist in the electricity market in the United States. These problems, for the most part, have been felt most notably in the Western Lower 48 States.

As we are all aware, Alaska is unique. My State is not adjacent to any other state. It borders only Canada. The electric grid of my state is not interconnected to the electric grid Lower 48 States. Thus, careful review of the applicability of a number of the provisions of the Electricity title to Alaska is necessary.

In this regard, I am pleased to note that the Energy Committee Staff Draft exempts the State of Alaska, as well as Hawaii, from the Regional Energy Services Commissions (RESC) and the Reliability Subtitle of the Electricity title.

As we consider these proposals, I would like to point out some of my goals. We need to seek to lower energy prices for consumers in my State and the rest of the United States.

We also need to restore confidence and stability to the energy marketplace. Without this, the investment capital needed to assure an adequate supply of reasonably priced energy and the infrastructure investment we need will not occur.

We must also keep in mind the many far reaching effects the Electricity Title will have on the demand for fossil fuels, particularly natural gas. It will be important to construct the Alaska Natural Gas Pipeline, as the demand for natural gas rises, and no doubt will continue to rise. In addition to providing well paying jobs, construction of the Alaska Natural Gas Pipeline will provide a secure, domestic source of energy for our nation.

The Staff Draft also has several provisions aimed at updating our nation's electricity policy to reflect current realities in the energy marketplace. These include the repeal of the 1935 Public Utility Holding Company Act (PUHCA) and reform of the Public Utility Regulatory Policies Act (PURPA). Careful consideration should be given to these proposals. Any repeal of the PUHCA should include appropriate con-

sumer safeguards. Reform of PURPA may also be appropriate if properly conditioned. Together, these can be important steps toward the modernization of our nation's electricity policy.

I look forward to working with Chairman, Senator Bingaman, and the other members of this committee as we push forward on this legislation.

I am also eager to hear the testimony of today's witnesses.

Thank you Mr. Chairman.

STATEMENT OF HON. JEFF BINGAMAN, U.S. SENATOR FROM NEW MEXICO

Senator BINGAMAN. Thank you very much, Mr. Chairman, for having the hearing.

I have supported, as you know, moving legislation to deal with electricity issues for several years now. Last year we came close to enacting a comprehensive energy bill with an electricity title in it. Senator Thomas worked very hard on that. I worked very hard on that. Other members of the committee did as well.

And it was not easy to get as far as we were able to get in the last Congress. I do not think it has gotten any easier. The path forward on electricity legislation is not clear to me at this point.

Some issues that were fairly settled or seemed to be settled last year, FERC-lite for example, do not seem to be enjoying the same kind of consensus now that they did then. There also seems to be more uncertainty about the wisdom of repealing the Holding Company Act than before. In general, I think that many who supported an electricity title in the bill last year have great reservations about doing so this year.

I continue to believe that PUHCA can be repealed, but only if the loss of essential consumer protections is offset by increasing FERC's merger review authority, as we did in the bill last year. I have long believed that many issues should be dealt with on a regional basis rather than at the State or Federal level. Such issues might be the siting of transmission lines, planning for both transmission and generation.

The proposal that is contained in the Republican staff draft before us today goes, in my view, far beyond that and gives essentially all Federal electricity authority to regional bodies to be appointed by the Governors. This would raise serious constitutional questions, as well as questions about the practicality of how it would work and I think, as I presently read the proposal, it might well add to the regulatory uncertainty in the market.

I look forward to hearing from the witnesses on their views on the proposal. I look forward to learning more about it.

I also believe it is important to encourage renewable generation. That is an issue that we discussed and debated extensively in the last Congress. I think it is important to diversify our resource mix to get a head start on actions that are going to be necessary to address the issue of climate change. A portfolio standard is the best way to do that in a market-friendly way, and such a provision in my view is essential in an electricity title.

I have a couple of items of testimony, one from the Utility Coalition advocating renewable energy. I would ask that that be included in the record, although they are not testifying.

The CHAIRMAN. It will be admitted in the record.

Senator BINGAMAN. Thank you.

And let me just say in closing that clearly we have very few days before the markup that you have scheduled. I hope that we can resolve differences that exist on the committee about this issue of electricity in that period. I hope the witnesses today can help us do that. But clearly there are many differences and I think we need to recognize the complexity of this issue as we move forward.

The CHAIRMAN. Senator, I am very grateful for at least the implication of your last statement. We will work together and hopefully we will try. This is, from what I can tell, as I have reviewed the entire agenda, the most difficult provision to reach consensus. Obviously, the House is having the same difficulty. That is why I said at last I was hoping that we would get some momentum and learning how to work together and get some things done.

On the other hand, I do believe that we could also delay incessantly over an issue such as this, and I do not intend to do that because we have three more episodes before we arrive at a conclusion. We have the floor and we have a conference besides this markup. So that will all be a great learning exercise from what I have experienced in the legislative process. Some who think one way today will probably think differently when we finish a conference. So we will continue with that.

I have one observation regarding renewables and then we will call the witnesses.

Senator, there are many of us who look with favor upon pursuing renewables, and I think you will find in the proposals from this Senator that I intend to offer as many and more incentives than ever before for renewables. I believe major incentives is the best way to bring renewables into the marketplace rather than forcing them. But that issue will be taken up another time, and we will discuss it at length.

Senator DORGAN. Mr. Chairman?

The CHAIRMAN. Yes, Senator.

Senator DORGAN. Because the Appropriations Committee and the Defense Approps Subcommittee is holding a hearing at 10 o'clock, I will not be able to stay for the entire hearing this morning. That is on the supplemental which is moving on a very fast track and I think will require a lot of effort.

But might I make one comment?

The CHAIRMAN. Yes, sir. Can you make it brief?

Senator DORGAN. Yes, of course.

The CHAIRMAN. Everybody will want to, and we have four Senators who want to go to that committee.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. I understand.

I think it is very important we move forward and move forward aggressively, but I am concerned, especially having chaired hearings last year about what happened in California which we now understand was in part grand theft. I am very concerned that we not only move forward with some dispatch, but we get this done and done right.

The electricity title I think is very complicated. As I listened to your statement, I was thinking about it is almost a foreign lan-

guage that we speak here with RESC, MISO, SMD, RPS, PURPA, PUHCA, RTOs. I mean, it is almost a foreign language, it is so godawful complicated. I just hope that as we set dates here for markups and so on that we have enough flexibility to be able to make sure that as we sort through all of this, we are going to get it done right. That is my only concern.

The CHAIRMAN. You can be assured of that. I have come to the conclusion, having been here a long time, that if we have good will and hard work, we will make as good a judgment in 3 or 4 weeks as we will in 3 or 4 months because 3 or 4 months—we will do all that work the last week anyway.

[Laughter.]

The CHAIRMAN. So we are going to move with some degree of dispatch with your concerns fully in mind.

Now, the other Senators who are here, I know some are going to stay, some must leave. Senator Campbell, you are going to leave for appropriations. Would you care to make a comment?

Senator CAMPBELL. Mr. Chairman, with your permission, I would like to just include something in the record, because I had hoped we would be able to listen to the testimony of at least a couple of witnesses before we had to run to the next hearing. So thank you.

[The prepared statement of Senator Campbell follows:]

PREPARED STATEMENT OF HON. BEN NIGHTHORSE CAMPBELL, U.S. SENATOR FROM COLORADO

Mr. Chairman, thank you for holding this hearing on electricity issues in moving forward on crafting a comprehensive energy bill. I would also like to applaud you for your proposed draft establishing Regional Energy Service Commissions (RESC). I'd also like to welcome Mr. Phil Tollefson from Colorado Springs Utilities and Ray Gifford, who recently head Colorado's PUC and who is now going to testify on behalf of the Progress & Freedom Foundation.

Many members of this Committee, myself included, have been highly critical of FERC's proposed Standard Market Design Rule because it fails to consider regional differences and instead applies a one-size-fits-all approach to our nation. Your proposal, on the other hand, picks up where FERC left off and is designed specifically to address regional distinctions.

I am troubled that the Regional proposal is a direct answer to FERC's SIVID. In fact, as worded, the RESC draft requires states to choose between regulated by a Regional Commission or the Federal Commission—a choice some states may find objectionable.

The strength of the RESC's novel and innovative approach is also its principle drawback. Your regional vision allows FERC and the state to retain certain levels of jurisdiction, but where do those lines of jurisdiction begin and end? Is this not just a third layer of regulatory bureaucracy that will cost states? How are the regions established, and can one state comprise a region?

Regarding that last question, my state of Colorado is in a unique circumstance. Colorado borders the eastern interconnect at Kansas. Therefore, there is no west to east transmission. Colorado's demand for electricity is localized to the front range, and we have coal-fired plants to meet that demand, and any excess is imported from Wyoming. 14,000 ft. peaks divide Colorado in half, making transmission across the state prohibitive, and people living on the west slope are principally served by public power.

Therefore, although Colorado is in the middle of the nation, it is more akin to an island like Hawaii than an eastern state like Virginia.

That said, the state of Colorado's electricity costs are in the lowest quarter of the nation. Denver is one of the five cheapest cities for ratepayers. As we proceed, we must ensure that states like Colorado retain their efficient, reliable, and inexpensive electricity while crafting national policy. We must make sure that "flexibility" does not result in price shifting that may benefit some states, while detrimentally affecting others.

I look forward to working with you, Mr. Chairman, and the other members of the Committee, on a reasonable and balanced approach.

The CHAIRMAN. Senator Craig.

Senator CRAIG. Mr. Chairman, I do have an opening statement. I will make it in my first questioning period. I am interested in hearing the witnesses. I think I am more interested in listening today than I am in questioning, unless somebody comes up with something uniquely novel, but I have sat through a good number of—well, maybe 100 hours of testimony on this issue before. My guess is nothing novel, but all of you hold strong and very important opinions. Thank you.

The CHAIRMAN. I hope you are wrong.

[Laughter.]

The CHAIRMAN. We will start with the witnesses. The witnesses are listed here. David Svanda, Ray Gifford, Gerald Norlander, and John Anderson, would you please come up?

Senator Thomas, would you like to make some opening remarks?

Senator THOMAS. Mr. Chairman, I had a very insightful comment to make, but I will withhold because I would like to hear from the witnesses. Thank you.

The CHAIRMAN. Thank you very much.

Okay. We are going to start on this slide, please.

STATEMENT OF DAVID A. SVANDA, PRESIDENT, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, AND COMMISSIONER, MICHIGAN PUBLIC SERVICE COMMISSION

Mr. SVANDA. Mr. Chairman and members of the committee, thank you so much for this opportunity to share my thinking with you on the Senate draft energy legislation. I am presenting the views of NARUC, and when I so indicate, I will also be injecting some of my own thinking. My comments will follow the suggested template and will highlight the content of my written testimony.

With respect to regional energy services commissions, NARUC supports legislation allowing States to form voluntary regional bodies to address multistate issues, including transmission siting. However, the RESC proposal in this draft legislation is significantly different than the models that NARUC and others have been working with, such as joint boards, compacts, and informal coordination. The proposal to create RESCs is a new attempt to build on the momentum I think already developing toward cooperative and voluntary regional regulatory bodies to oversee those regional markets that many of you have spoken about. It needs to be carefully considered.

A great deal of work has already been done by the affected parties to develop logical and efficient regulatory constructs that allow the electric industry to move forward in a reliable and cost effective way. The work has been public and it has been painful, but critical knowledge and shared insights have been gained. Many parties have helped move us to the important juncture at which we now collectively find ourselves.

Under the Energy Policy Act of 1992, the States, through the NGA, various regional governors associations and entities, and NARUC, have been working to develop wholesale power markets and regional mechanisms for the coordination of State efforts including siting responsibilities. Progress continues to be made in these areas driven by the NGA, its regional affiliates, NARUC,

FERC, the Department of Energy, currently approved RTOs, and numerous other industry stakeholder groups.

All parties are now preparing to hear how FERC synthesizes the ideas that have surfaced to this point when its white paper is issued later this spring. The conclusions of the white paper can inform the discussion on this RESC proposal. NARUC has taken no position on the issuance of the white paper, nor on the underlying SMD proposal.

As you know, all regions of the country are not on the same page with regard to the standard market design. The standard market design proposal has, however, acted as a catalyst to focus our attention on achieving the objectives of the National Energy Policy Act.

That is why we offer our hard-won experience to you as you consider, review, and analyze the RESC proposal in this draft legislation. The RESC proposal would be a significant step beyond current proposals and therefore does warrant additional considerable work.

There are provisions such as section 402 requirements that narrowly define the options open to States considering the RESC and also section 1222 which usurp State siting authority, and that is something that we would certainly want to work with you on.

Any proposal contemplating a multistate approach should explicitly include representation by State regulatory bodies. The requirement that States cannot be in more than one RESC does not work, as we know that some States are bisected and even trisected by RTOs, and that simply creates problems.

The provision also creates great uncertainty in States like mine where transmission is owned by third party independent providers of transmission services.

Authorizing swift release of funding to help the States with the logistics of regional coordination would certainly help the States and regions move forward.

We know that you recognize how long and hard we have worked on these issues and would love the opportunity to continue to work with you and your staff in helping to create systems that we can all live with.

Reliability standards. NARUC has staked out positions, and you know them and we will continue on those, as well as on transmission siting. We at NARUC need to respectfully oppose section 1222 based on the FERC backstop provision that is included.

With regard to incentives—and I will go quickly to the point here with the remaining time that I have—energy markets need clear rules and certainty. Right now the investment community, as you have heard in previous hearings, views the energy industry as being in constant flux, including even the implementation of existing rules. The parties can work together to create a stable environment where investment can happen. However, new institution-building, while it may be necessary in other venues, would tend to retard the supply of investment capital in this sector by pushing off horizons.

In my testimony, I have provided a number of suggestions for incenting investment, and those include focusing on customer needs, focusing on technological advancement, focusing on bal-

ancing this country's fuel portfolio and demand response mechanisms, focusing on maintaining America's competitive advantages and fostering wise North American energy utilization, and finally, focusing on enhancing homeland security. I think that those options can be accommodated in a balanced investment incentive program that this committee could craft that would give equal weight and value to all of those categories.

I have commented on a number of other areas within the draft, and would be happy to respond to any questions about those comments that you may have. Thank you very much.

[The prepared statement of Mr. Svanda follows:]

PREPARED STATEMENT OF DAVID S. SVANDA, PRESIDENT, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, COMMISSIONER, AND MICHIGAN PUBLIC SERVICE COMMISSION

Mr. Chairman and members of the Committee, thank you so much for this opportunity to share my thinking with you on the Senate Staff draft energy legislation. I am David A. Svanda, President of the National Association of Regulatory Utility Commissioners (NARUC) and a commissioner on the Michigan Public Service Commission. I am presenting the views of NARUC, and when I so indicate, my own views on the draft legislation at issue.

NARUC is a quasi-governmental, nonprofit organization founded in 1889. Its membership includes the state public utility commissions for all states and territories. NARUC's mission is to serve the public interest by improving the quality and effectiveness of public utility regulation. NARUC's members regulate the retail rates and services of electric, gas, water and telephone utilities. We have the obligation under state law to ensure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, and to ensure that such services are provided at rates and conditions that are just, reasonable and nondiscriminatory for all consumers.

I especially appreciate the fact that it is your collective concern with the energy needs of this country that is providing this opportunity. Your sensitivity to the regulatory concerns we have, your desire to help the regions of the U.S. achieve efficient wholesale energy markets, and your willingness to hear what we, the affected parties, have to say about the draft legislation, has brought us here today. My comments will follow the prescribed outline.

REGIONAL ENERGY SERVICES COMMISSIONS

NARUC supports legislation allowing states to form voluntary regional bodies to address multistate issues, including transmission siting. However, the Regional Energy Services Commissions (RESC) proposal in this draft legislation is significantly different than the models NARUC has examined in the past, such as joint boards, compacts, and informal coordination. The proposal to create RESCs is a new attempt to build on the momentum already developing toward cooperative and voluntary regional regulatory bodies to oversee regional electric markets. It needs to be carefully considered.

A great deal of work has been done in recent years by affected parties to develop a logical and efficient regulatory construct that allows the electric industry to move forward in a reliable and cost-effective way. The work has been public and painful, but critical knowledge and shared insights have been gained. Many parties have helped move us to the important juncture at which we now collectively find ourselves.

The NGA's Task Force on Electricity Infrastructure issued a report in July 2002, entitled, "Interstate Strategies for Transmission Planning and Expansion". This report recommends the creation of Multi-State Entities (MSEs) "to facilitate state coordination on transmission planning, certification, and siting at the regional level." In July of last year, both NARUC through its resolution on interstate transmission planning and expansion, and the FERC in its market design proposal, acknowledged the MSE concept as worth developing.

Under the Energy Policy Act of 1992, the states, through the NGA, various regional governors associations and entities, and NARUC, have been working to develop wholesale power markets and regional mechanisms for the coordination of state efforts, including siting responsibilities. Progress continues to be made in these

areas, driven by the NGA and its regional affiliates, NARUC, FERC, U.S. DOE, currently approved RTOs, and numerous industry stakeholder groups.

All parties are now preparing to hear how the FERC synthesizes the ideas that have surfaced to this point when its white paper is issued later this spring. The conclusions of the white paper can inform the discussion on this RESC proposal. NARUC has taken no position on the issuance of the white paper, nor has it taken a position on the underlying SMD proposal. As you know, not all regions of the country support FERC's direction to this point. The SMD proposal has, however, acted as a catalyst to focus our attention on achieving the objectives of the Energy Policy Act.

That is why we offer our hard-won experience to you as you consider, review, and analyze the RESC proposal in this draft legislation. The RESC proposal would be a significant step beyond current proposals and warrants very careful examination before the Committee commits to this concept.

Specifically, preliminary analyses suggest that the intent of the provision is to allow contiguous states in a region to come together and reclaim from the FERC much jurisdiction over the form, function and operation of regional wholesale electric markets. In cases where states set up an RESC, FERC jurisdiction would be largely limited to resolving conflicts among states in that region or addressing interregional complaints. This idea may have some appeal to some states on its surface. However, other provisions of the bill such as the Sec. 402 requirements that narrowly define the options open to states considering an RESC combined with the Sec. 1222 provisions which usurp state siting authority unless states form an RESC that meets certain criteria, are likely to yield unintended results.

Similarly, it is NARUC's position that any proposal contemplating a multi-state approach, must explicitly include representatives from each of the regions state's public utility regulatory bodies. Additionally, we do not support provisions that permit the RESC or FERC to preempt individual state commission decisions. Further, the requirement that states cannot be in more than one RESC would be logical if the electric grid and the regional transmission organization (RTO) borders conformed to state boundaries. However, several states are in the unenviable position of being bisected (or trisected) by more than one RTO. It is not reasonable to limit those states to membership in one RESC. This would force such an unlucky state to choose favorites among its jurisdictional utilities and consumers. If a state declined to favor one group of its jurisdictional constituents over another, under the proposal currently before the Committee, it would be required to sacrifice its siting jurisdiction. This provision also creates great uncertainty where transmission is owned by third-party independent providers of transmission service.

Also, a statement of support encouraging states to proceed expeditiously with regional initiatives to coordinate reviews of multi-state transmission siting proposals might be welcome. Authorizing and directing swift release of funding to assist with the logistics of regional coordination would be helpful in enabling states to move ahead quickly. Given the momentum that has been developing on this issue, any attempt to introduce a federal backstop or federal pre-emption of the state transmission siting jurisdiction could be counterproductive.

We know this Committee recognizes how long and hard the parties have been laboring on creating workable wholesale energy markets. We have consolidated and defined issues that have elevated the status of this debate. These foundations can be built upon and incorporated into this draft legislation. Please let NARUC work with you and the Committee as you debate, vet, and develop the RESC concept. We would like to give you the benefit of the lessons we have learned.

RELIABILITY STANDARDS

NARUC has consistently held that reliability should be addressed in any federal energy legislation. NARUC has been a strong and consistent supporter of legislation that establishes a more robust, mandatory model for the enforcement of compliance with mandatory technical reliability standards. This is provided that states are not preempted on resource, adequacy, and planning issues and can form voluntary regional bodies to advise FERC on implementation of the standards within their regions. Accordingly, NARUC supports the electric reliability provision in S. 475 introduced by Senator Thomas.

NARUC believes that Congress should mandate compliance with industry-developed reliability standards on the transmission system that include adequate reserve margins and preserve the authority of the states to set more rigorous standards when in the public interest. The reliability section of the staff draft is complicated by the RESC proposal, which puts standards development and enforcement responsibility with the RESC, rather than the NERC collaborative effort. There is also

some confusion as to whether the Electric Reliability Organization needs to file with both the FERC and the RESC.

TRANSMISSION SITING

We appreciate the efforts that have been made in an attempt to alleviate the concerns raised by NARUC and other state and local government organizations with regard to the siting proposals floated during the last Congress. However, NARUC must respectfully oppose Sec. 1222 based on the FERC backstop provision that is included. Although efforts have been made to produce a more moderate backstop proposal, the result is the same: the FERC will have authority to override state decision processes on transmission siting, if that state is not in an RESC.

NARUC finds this provision to be unacceptable. States should retain authority to site electric facilities. Congress should support the states' authority to negotiate and enter into cooperative agreements or compacts with federal agencies and other states to facilitate the siting and construction of electric transmission facilities as well as to consider alternative solutions to such facilities, such as distributed generation and energy efficiency. NARUC has strongly opposed any role (direct or backstop) for FERC in authorizing or siting transmission lines.

Looking to the future, this committee also needs to be aware of the growing debate concerning central station power plants versus distributed resources. At one extreme are those who believe that the U.S. needs huge new investments in transmission, to allow competitive markets to gain access to central station generation assets. At the other extreme are those, including a utility in Michigan, who believe that distributed resources may make both central generation stations and transmission redundant and obsolete.

TRANSMISSION INVESTMENT INCENTIVES

Helping to stabilize and reinvigorate interest in investing in America's infrastructure is one of the goals I have set for my term as President of NARUC.

Energy markets need clear rules and certainty. Both are needed sooner rather than later. Right now, the investment community views the energy industry as being in constant flux, including even the implementation of existing rules. Together, the FERC, the regions, and the states need to set market rules that have staying power and can be relied upon when making investments. New institution building may be necessary in other venues, but in this sector of the economy it will retard the supply of infrastructure investment capital because it creates confusion rather than clarity, and pushes out the decision horizon.

The energy industry does not operate in a vacuum. Contributing to sector uncertainty are a laundry list of issues: the general health of the American and global economy, adjustments of an industry that had been unchanged for over half a century, attempts to encourage alternative fuel sources, California's restructuring problems, serious (even criminal) lapses in corporate ethics and business practices, wash trades and market manipulation, the September 11 tragedy, homeland security and war concerns, lack of liquidity in markets, and the current regulatory debate about electricity market restructuring.

Even though there are current uncertainties, there are ways to open closed investment wallets and we must get those wallets opened again. Electric transmission systems in this country have been on a starvation diet for nearly two decades, with actual transfer capacity having peaked in the 1980's. We need to upgrade the dumb system of the last century with an internet-speed and internet-smart grid for this century. The policies pursued should entice investment that helps accomplish other major national objectives.

In my opinion, this Committee could help to bring considerable stability to the energy related investment climate by:

1. Focusing on customer needs by incenting;

   a. Investment to enhance reliability to support the information, manufacturing and lifestyle expectations of today

   b. Investment for removing bottlenecks wherever they exist in the transmission system. Investment incentives could be given for the removal of bottlenecks, while penalties could be applied for maintaining bottlenecks,

2. Focusing on technological advancement by incenting;

   Investment in new smart-grid technology

   The export of this new technology for our economic benefit and for global fuel efficiency and environmental purposes,

3. Focusing on balancing this country's fuel portfolio and demand/response mechanisms;

4. Focusing on maintaining America's competitive advantages and fostering wise North American energy utilization;
5. Focusing on enhancing Homeland Security.

Future investment options will generally fall into four categories. They are 1) traditional public and investor-owned utilities; 2) unbundled-asset utilities; 3) independent power producers; and 4) independent transmission owners. These all have their place, and are all right for particular circumstances. A balanced investment incentive program crafted by this Committee would give equal weight and value to each of these categories.

TRANSMISSION COST ALLOCATION (PARTICIPANT FUNDING)

NARUC is supportive of transmission cost allocation proposals however, the provision found in Subtitle E falls short of our policy on this issue. NARUC supports a pricing policy which allocates transmission costs in two ways. One, the cost of investments that have been demonstrated; through an even-handed assessment of transmission, generation and efficiency alternatives; to be needed to maintain the reliability of the existing transmission system, is recoverable through rates paid by all transmission customers. Two, the cost of upgrades and expansions that are necessary to support incremental new loads or demands on the transmission system is borne by those causing the upgrade or expansion to be undertaken. Additionally, any cost allocation proposal should not preclude the assignment of interconnection cost to the general body of ratepayers within a state when that state's regulatory body determines that such allocation is in the public interest.

PUHCA

Congress should reform PUHCA, but in doing so, should allow the states to protect the public through effective oversight of holding company practices and increased state access to holding company books and records. This should be independent of any similar authorities granted to federal regulatory bodies.

The draft legislation requires a state to begin a proceeding to get access to books and records. NARUC believes a written request from a state should be sufficient, and that no proceeding is required.

PURPA

NARUC supports legislation to repeal the PURPA "must purchase" requirement if a state determines that the generating markets are competitive or that the public interest in resource acquisition is protected. However, NARUC opposes the language found in the Senate draft that preempts state jurisdiction by granting FERC authority over the recovery of costs in retail rates or to otherwise limit state authority to require mitigation of PURPA contract costs. States that have already approved these contracts are better able to address this issue than FERC.

I think it is important for the federal government to remove barriers to the adoption of new and improved energy technology infrastructure. It is also appropriate to open up opportunities for cogenerators and small power producers to interconnect and gain access to competitive wholesale and/or retail markets, with the details of those policies clearly reserved for the appropriate regulatory agency.

NET METERING AND REAL-TIME PRICING

NARUC believes that net metering, real-time pricing, and distributed generation are retail in nature and subject to state, not federal legislation. The draft legislation provides that each state has the ability to determine if such services are appropriate for state implementation. NARUC's interpretation of this language is that no state would be required to implement these provisions without the state determining that they are appropriate for that state. However, we prefer the language currently found in PURPA that allows states to consider but may adopt or reject, rather than mandatory federal standards.

NARUC is supportive of these provisions, but the draft language needs to be clarified consistent with our understanding. Such revision may also help the distributed generation and distribution interconnection provisions because they are retail in nature, and therefore within the jurisdiction of the states.

MARKET TRANSPARENCY, ANTI-MANIPULATION, ENFORCEMENT

There is an increased need for oversight of the energy markets in order to protect against market abuse. Electricity price volatility has raised concerns about the integrity of wholesale markets, suggesting a much greater need for monitoring of these markets by regulatory bodies. The draft legislation does not address a critical

concern, the state regulatory role in market monitoring. States can provide a "first responders" view of energy markets.

However, in order to be an effective market monitor, the state regulators must have access to all necessary data. These data include generating plant production, fuel sources, heat rates, and both scheduled and actual transmission path flows. State regulators must have the ability to review this type of data to be able to detect market gaming as well as attempts to obtain and exercise unlawful market power.

There is a real concern that the energy markets are vulnerable to manipulation and there needs to be an improvement in the reliability of the indices used. A minimum set of standards should be established for how price reporting occurs. Regulatory oversight of price reporting and the ability to impose penalties on traders that don't comply with the rules should help ensure that energy companies follow the rules.

The energy industry must adopt a set of practices and benchmarks to increase market transparency and to help restore public confidence in the US energy markets. If the goal of legislation is to ensure that the market participants do not manipulate the market, the policies ought to provide for more transparency, not less. Claims that data reporting to state regulators will result in competitive disadvantages to those reporting are spurious. To the extent the necessary data are commercially sensitive, state regulators can provide appropriate protections. States routinely and frequently handle such information without compromising parties' interests.

CONSUMER PROTECTIONS

NARUC's members have a long-standing commitment to consumer protection. Indeed, state utility commissions were established to ensure that consumers received essential services without fear of predatory practices and pricing. However, while we favor strong consumer protection measures, NARUC does not believe that preempting the states by federally legislating retail consumer protections is the way to go.

The states are more capable in dealing with abuses that occur at the retail level, and in fact many, if not most, of the states that have moved to restructure and unbundled their retail electric markets have in place regulations or laws that address the consumer issues found in the staff draft. In short, Congress should not limit state authority to prescribe and enforce laws, regulations or procedures regarding consumer protection. We believe legislation should include a state authority section, such as that found in the Senate energy legislation from the last Congress so that states are not precluded from imposing their own consumer protection requirements.

Thank you for your attention. NARUC would welcome the opportunity to work with the committee to address the concerns raised here today. I would be happy to answer any questions you may have.

The CHAIRMAN. Mr. Svanda, thank you so much for your testimony and your observations.

All of your testimony will be made a part of the record. We will have some questions.

Ray Gifford, president of The Progress and Freedom Foundation.

STATEMENT OF RAYMOND L. GIFFORD, PRESIDENT, THE PROGRESS AND FREEDOM FOUNDATION

Mr. GIFFORD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. GIFFORD. Mr. Chairman, members of the committee, thank you for the opportunity to testify. My name is Ray Gifford. I am president of The Progress and Freedom Foundation and immediate past chairman of the Colorado Public Utilities Commission.

Each of us here today shares the same goal: to benefit consumers through a reliable, efficient, affordable system that accommodates technological change and meets consumers' needs.

But to get there, we need to confront the twin pillars of human behavior: mistakes and opportunism. Everyone knows what a mistake is. It means that we do not know everything about the electric

industry, how it works, how it will evolve, and what it will look like in the future. Even if we did, we might make the wrong policy choices. Opportunism is the reality that people will often act to elevate a narrow interest above one that is broader.

We should strive to minimize mistakes and make sure they do not become permanent. Similarly opportunism, be it the opportunism of companies, regulators, or, I even dare say, legislators must be channeled to work for consumers.

With that in mind, I turn to a few topics on the table today.

The RESC is a sound theoretical idea that, if executed properly, could help solve some problems that are larger than just State problems but smaller than a Federal problem. However, in execution, I fear that it will simply introduce a new layer of regulation that will be even less accountable than our current regulatory scheme.

As I read it in the draft, the RESC is a new regulatory body raising a few concerns.

First, its accountability is highly questionable. Flying below the Federal radar but above State accountability, the RESC will become a prime target for regulatory opportunism. Our current State-Federal jurisdiction ultimately makes the regulators accountable to some political body. The RESC, in contrast, will operate in a murky middle ground. This presents great risk for regulatory capture, the perversion of the regulatory process toward parochial ends.

Second, the RESC does not appear to displace old regulatory structures, but rather adds a new layer of regulation. This will add to the regulatory costs and burden with no clear identifiable benefit to consumers. If you are at all inclined to create this new regulatory body, the jurisdiction of both FERC and the State commissions must be pared back to make the RESC the sole preeminent regulatory body for electricity, and that body must bring within its scope all players public and private. That is the only way to have a coherent and fair regulatory scheme.

The elephant in the room that no one is talking about is FERC's proposal to alter national utility regulation through standard market design. Congress should block it or at least mandate a dramatic change of course in its regulatory direction. We should minimize the effects of a potential grand national regulatory mistake and shrink the space for opportunism that will pervert outcomes.

The major premise of SMD is to further split operation and control over the transmission system and to reside control over the system in a barely accountable entity, the independent transmission provider. This new entity I fear will have accountability problems similar to the RESC.

Next, SMD does not solve the most pressing problems of adequate transmission investment. While the pricing mechanisms of SMD solve short-term allocation issues, FERC admits that it does not give the right long-term price signal to spur efficient investment. Accordingly, the long-term investment decisions are thrown into what will become a hyper-political planning process.

Finally, SMD imposes a regulatory vision on the national grid that will lock in the current paradigm for electricity generation, transmission, and distribution for years to come. There are exciting technological developments that may change the way electricity is

generated, transmitted, and metered. I would hate to see the regulatory regime stifle that innovation. I would urge FERC and this committee to be modest in how far and how fast we want to change the regulatory paradigm for electricity.

Finally, I will add briefly I think one omission in the current markups is that section 203 and FERC merger review authority remains. I think this merger review authority is duplicative and unnecessary. The Department of Justice Antitrust Division does a most capable and efficient job of that, and you may want to look seriously at eliminating that FERC jurisdiction.

I thank you again for the opportunity to appear here today. I hope my presentation will help you in your deliberations. Thank you.

[The prepared statement of Mr. Gifford follows:]

PREPARED STATEMENT OF RAYMOND L. GIFFORD, PRESIDENT, THE PROGRESS & FREEDOM FOUNDATION

Mr. Chairman, members of the Committee, thank you for the opportunity to testify. My name is Ray Gifford. I am president of the Progress and Freedom Foundation, a think-tank devoted to studying the law and regulation of network industries, including this most fundamental network industry, electricity. Also relevant to my testimony here today is that I am the immediate past-Chairman of the Colorado Public Utilities Commission, so immediate, in fact, that I only left less than two months ago. I hope therefore my comments offer you some insight of a dispassionate, academic observer, tempered with the experience of having been an actual state regulator.

Debates over regulation of the electric industry too often play according to the following script: proponents of markets and restructuring describe the abstract, theoretical benefits of competition, therefore claiming to illustrate the superiority of markets over close regulation. In rebuttal, defenders of a more regulatory approach, describe the theoretical benefits of properly focused, all-knowing administrative regulation, which when done right mimics the outcomes of a market. You thus get an impasse over which abstract, theoretical way of ordering an industry will produce the most abstract, theoretical benefits. This is perhaps interesting in a classroom, but sterile and fruitless to you as policymakers.

Any debate over the right policy for electricity must start by setting a goal. I think that we can all agree that the goal is to benefit consumers through a reliable, efficient, affordable system that accommodates technological change and meets individual consumers' needs.

However, getting back to that false debate over competition versus regulation, we must forge our views over which regulatory system most benefits consumers by acknowledging the twin pillars of human behavior: mistakes and opportunism. The theoretical superiority of markets or regulation is swamped by these practical concerns of how people actually behave. Now, mistakes are something we all know well my wife is particularly good at pointing mine out to me but they simply reflect that we cannot know all there is possible to know about electric industry and, even if we did, we might make the wrong policy choices. Opportunism, meanwhile, is the reality that people will often act to elevate their own, narrow interest above that of some broader interest.

Our goal therefore in making policy must be to minimize the possibility of mistakes and make sure that our system does not make those mistakes a permanent, irreversible feature of the landscape. Similarly, opportunism be it the opportunism of companies, regulators, legislators, whom have you must be channeled to work for consumers, not against them. Focusing, then, on minimizing mistake and opportunism, I turn to a few topics on the table for today: Regional Energy Services Commissions

The Regional Energy Service Commission (RESC) notion strikes me as a perfectly sound theoretical idea that, if executed properly, could have some merit in solving some of the problems that we confront that are larger than just state problems, but smaller than a federal problem. However, in execution I fear that the RESC will simply become engrafted on the current system of federal and state electricity jurisdiction. As such, the RESC will introduce a new layer of regulation and be even less accountable if that's possible than our current dual-layered regulatory scheme.

As I read it in the draft, the RESC is a new regulatory body to be authorized, I presume, under the commerce and interstate compact clauses of the Constitution. The RESC will not affect traditional state jurisdiction, but will be shunted in below FERC's current national jurisdiction. Again, in the abstract this idea has some merit, but I fear it will go wrong rather quickly.

First, the RESC's accountability is highly questionable. Flying below the federal radar, but above state accountability, the RESC will become a prime target for regulatory opportunism. Our current state-federal dual jurisdiction while highly imperfect, to be sure ultimately makes the regulators' accountable to some political body. In the states, that is the voters, the governor or the legislature. With FERC, the Commission is ultimately accountable to both the executive branch and you here in Congress.

The RESC, in contrast, will operate in the murky middle ground between state and federal regulation, beyond state accountability and below federal scrutiny. To me, this presents great risk for regulatory capture; that is, perversion of the regulatory process toward parochial ends. I am not sure who will be able to capture the RESC it could be a company, it could be a regulatory staff with a particular agenda, indeed, I daresay, it could even be a powerful senator in the given region whose interests may reflect an agenda to benefit his state or his preferred vision of the electric industry. None of this potential for opportunism will be good for consumers.

Second, the RESC does not appear to displace old regulatory structures but rather adds a new layer of regulation. While in the draft the FERC's role recedes somewhat, FERC is still there, the state commissions are still there and the RESC is added to the mix. This addition of a regulatory body threatens to be a mistake, I think, because it will inevitably add to the regulatory cost and burden, with no clear, identifiable benefit to consumers. One thing we know about regulation is that it is nearly impossible to get rid of once established. Therefore, before creating a new regulatory body, you need to be sure, based on clear and convincing evidence, that a real benefit will come from it. Right now, the RESC has a "this might be a good idea" brainstorming quality to it, but the case has not been made that it will actually be beneficial to consumers.

I would therefore be very cautious before you legislate the creation of a new entity hovering in the frontier between state and federal jurisdiction. If you are at all inclined to create this new regulatory body, you must, I submit, categorically, unambiguously, clearly, definitively I am out of adverbs pare back the jurisdiction of both FERC and the state commissions to make the RESC the sole, preeminent regulatory body for electricity, and that body must bring within its scope all players, public and private. That is the only way to have a coherent and fair regulatory scheme.

STANDARD MARKET DESIGN

The elephant in the room that no one is talking about in this electricity title is FERC's bold proposal to alter national utility regulation through Standard Market Design, or SMD. I submit that you in Congress must go on record about your desire to authorize this dramatic experiment with our national electric system, or to block it. I would urge you to block it, or at least mandate a dramatic change of course to its regulatory direction.

On SMD, the sides quickly retreat into the sterile debate between theoretical competition and theoretical regulation. These are not the questions you should ask. The questions should again be motivated from a desire to minimize the effects of a potential grand, national regulatory mistake, and shrink the space for opportunism to pervert outcomes.

One thing we know in an economy is that the last thing you want to ever do, unless you absolutely have to, is split ownership and control of a firm or asset. This is because when you divide ownership from control, your risk of mistake and opportunism skyrocket. Mistakes are easier to make and more enduring because the effects of errors are not internalized when ownership and control are split. Meanwhile, the potential for opportunism runs rampant because entities managers, regulators, and politicians have the incentive to run the firm in their own interests.

Now we tolerate separating ownership from control with traditional public utility regulation, to an extent, by giving partial control over the utility to political bodies the FERC and state commissions. We do this because of the natural monopoly character of the electric system, but recognize the imperfections and trade-offs inherent in such a regulatory solution.

The major premise of SMD is to further split operation and control over the transmission system, and to reside control over the system in a barely accountable entity, the Independent Transmission Provider (ITP). Now this new entity, I fear, will have

accountability problems similar to the RESC. Which master does it serve? Toward what ends is it managed? The possibilities for mistake and opportunism are replete.

Next, SMD does not even solve the most pressing problem of adequate transmission investment. While the pricing mechanisms of SMD solve short-term allocation of transmission issues, FERC admits that it does not give the right long-term price signal to spur efficient investment. Accordingly, the long-term investment decisions the keystone to the robust wholesale markets we all presumably support are thrown into what will become a hyper-political, planning process. And when that happens, economic rationality is the first thing that will be thrown out.

Finally, SMD imposes a regulatory vision on the national grid that will lock-in the current paradigm of electricity generation, transmission and distribution for years to come. Given the exciting innovations and cost reductions in technologies from the distributed generation side, to the superconductivity advances in the transmission area to the real-time and time-of- use metering in distribution it would be premature to cement the current industry structure in place through regulation, rather than allowing technology and know-how to transform how consumers are served.

Our understanding of how complex, network markets like electricity work is primitive, at best. Electric markets are interdependent and require some degree of public control. Requirements for open and equal access seem sensible and necessary, and after the fact policing of those requirements is certainly a legitimate regulatory goal. However, I would urge FERC and this Committee to be modest in how far and how fast we want to change the regulatory paradigm for electricity.

FERC MERGER REVIEW, SECTION 203 [1]

One omission from the draft bill, as well as a change from the original Barton bill coming over to you from the House, is the retention of FERC's merger review authority under Section 203. I would urge you to use your bill to eliminate this duplicative and costly layer of regulatory review.

As it stands now, the Department of Justice Antitrust Division reviews any merger in the electric industry for its potential to harm consumer welfare. FERC, meanwhile, now reviews those same mergers under § 203 using the vague and undefined "public interest" standard. At best, this review duplicates the antitrust review and adds costs that ultimately must be borne by consumers. I do not think that Congress wants to affect a net wealth transfer from American consumers to Washington regulatory lawyers.

At worst, the merger review authority presents the opportunity and temptation for a regulatory shakedown by FERC or interested outside parties. The breadth of the review standard is simply too open an invitation for opportunistic behavior by other players in the industry and by regulators themselves, who may seek to accomplish through mergers what they have not been otherwise authorized to do by you here in Congress.

PURPA AND PUHCA

Legislative and regulatory mistakes endure whereas market mistakes are corrected relatively quickly and often remorselessly, as the Internet bubble showed our 401(k) accounts. Nevertheless, with this electricity title, Congress has the opportunity to correct two enduring regulatory mistakes that are inhibiting investment and innovation in this sector specifically, I urge you to take the opportunity to repeal both the Public Utility Holding Company Act (PUHCA) and the Public Utility Regulatory Policy Act (PURPA).

Both PUHCA and PURPA are outmoded pieces of legislation that stifle innovation, misallocate investment and mandate regulatory solutions that harm consumers.

I have spoken today about how mistakes and opportunism, and how those considerations should influence your deliberations. I generally prefer privately-ordered markets over legislation or regulation because markets correct mistakes more quickly than regulatory mistakes can be undone. Likewise, markets real markets, not "markets" jury-rigged through regulation take opportunistic behavior and channel it for consumers benefit. I therefore urge you to approach all your legislative work with a deregulatory bent minimize regulation, allow markets organically to emerge and work where they can. In the end, that will benefit consumers most.

The CHAIRMAN. Thank you very much, Mr. Gifford. Many of the things you have said with reference to attempting to regulate na-

[1] 16 U.S.C. § 824b.

tionally I agreed with in my opening remarks. I thank you for it and for the constructive ideas and criticisms today.

Let us now proceed. Mr. Norlander, chairman of the National Association of State Consumer Advocates; executive director of Public Utility Law Project of New York, Inc. Please proceed.

STATEMENT OF GERALD NORLANDER, CHAIRMAN, ELECTRICITY COMMITTEE, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, AND EXECUTIVE DIRECTOR, PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.

Mr. NORLANDER. Thank you, Senator Domenici and committee members. First, I would like to make a minor correction. I am the chairman of the Electricity Committee of NASUCA, the National Association of State Utility Consumer Advocates.

The CHAIRMAN. All right.

Mr. NORLANDER. And I speak here today on behalf of NASUCA, except at some points where we have not had an opportunity to take a position where I will be speaking for the Public Utility Law Project and myself.

NASUCA is an organization of consumer advocate offices with members in 42 States and the District of Columbia. Some of our members are from States that restructured their utility industries. Others are from States that plan to do so but since 2000 have either slowed their plans or in some aspects reversed them. Yet, other members are from States that have no plans at this point to restructure their utility industries and they retain the traditional, vertically integrated models. Thus, on issues such as SMD and so forth, NASUCA has not taken a uniform position on it, but instead, depending on the region, we have had a regional spokesman participating over at the FERC on these issues.

But today I am speaking on behalf of all NASUCA members in opposition to changes in the Federal Power Act that we believe would weaken the statutory scheme for regulation of electricity.

I would point out from our point of view, the Federal Power Act is a consumer protection statute. The purpose of the Federal Power Act is to protect consumers. And we believe that changes to the Federal Power Act should be a value proposition for consumers.

There is great risk for consumers, as we have seen in California and from less well-publicized events in the New York City area where mistakes have been made and consumers have suffered. We all recognize when there is a flood or a fire or a hurricane or other event that creates utility outages that we have a humanitarian crisis, but there is a crisis going on every day in the homes of low income families throughout this country who cannot afford their electricity and who are shut off. So the things that are done here, that are done in the wholesale markets, that are done to affect the infrastructure of the electric industry have a great impact on people. And the original intent of the Federal Power Act was, we believe, to protect customers by requiring a comprehensive regulatory scheme at the Federal level.

Some of the provisions that have been out there, NASUCA has supported for a number of years. Among them, I would mention the reliability provisions that would provide a firmer ground for setting reliability standards that heretofore have been voluntarily done. As

there has been a transition to a more competitive industry, some of the cooperative structures for maintaining the reliability of the grid need to be shored up, and we think that those provisions have merit.

Likewise, there has been a proposal for a national consumer advocate to participate in Federal agency proceedings. Again, NASUCA thinks that that is in concept a very good idea if we could have a function at the Federal level to intervene in cases like market-based rate applications or some of the generic proceedings where individual States and State consumer advocates have difficulty participating. Of course, such a function needs to be independent, needs to be able to take positions at variance from the agencies in which it is participating, and it needs to be sufficiently funded.

Again, I would point out some of the features in several of these proposals that we are very strongly opposed to. One of those is the transmission incentive proposals. There are several of them out there. We have at NASUCA taken a position recently with the FERC opposing those as being unnecessary. The FERC proposal would reward companies for doing things they have already done such as joining an RTO and so forth.

We also think that the repeal of PUHCA and the elimination of FERC merger authority should not be done, as has been proposed, and we think there is a function for the FERC to review electricity market mergers.

Thank you.

[The prepared statement of Mr. Norlander follows:]

PREPARED STATEMENT OF GERALD NORLANDER, CHAIRMAN, ELECTRICITY COMMITTEE, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, AND EXECUTIVE DIRECTOR, PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.

SUMMARY OF TESTIMONY

The National Association of State Utility Consumer Advocates (NASUCA) represents state utility consumer advocates from 42 states and the District of Columbia. A Senate Bill (S. 475), a recent House committee draft bill, and related staff proposals all would significantly alter the existing statutory paradigm for federal and state regulation of electricity, the primary purpose of which is to protect consumers. NASUCA opposes these proposals because they eliminate existing protections and add new risks without a clear demonstration of overriding benefit to electricity consumers. While we support the reliability provisions of S. 475, NASUCA generally opposes the broader proposals.

Some proposals under consideration would authorize unnecessary and costly new federal financial incentives to encourage investment in transmission facilities, beyond the level of return on investors' equity normally sufficient to achieve reliable service and just and reasonable rates. A transmission incentives proposal now under consideration by the FERC could unnecessarily add $13 billion to consumers' bills, and should not be ratified by new legislation.

The need for consumer protection against market power and prevention of utility holding company abuses remains. Yet some recent legislative proposals would have eliminated FERC merger review authority, and some current proposals would repeal the Public Utility Holding Company Act of 1935 (PUHCA). Despite unenthusiastic enforcement, PUHCA and FERC merger review authority are prophylactic measures discouraging the exercise of market power and re-creation of interstate utility holding company empires. Accordingly, NASUCA has concluded that passage of electricity legislation along these lines would not be in the overall interests of utility consumers.

STATEMENT

Chairman Domenici, and Members of the United States Senate Committee on Energy and Natural Resources, thank you for inviting me to testify today for the National Association of State Utility Consumer Advocates (NASUCA). My name is Gerald Norlander I am the Chairman of the Electricity Committee of NASUCA, and I am the Executive Director of the Public Utility Law Project of New York, Inc. (PULP).[1] NASUCA is a national association of consumer advocate offices, with members in 42 states and the District of Columbia. NASUCA members are charged by their respective state laws with the responsibility to represent consumers in utility proceedings before state and federal regulatory commissions and courts. NASUCA members have considered many of the issues addressed in the proposed Electric Transmission and Reliability Enhancement Act of 2003 (S. 475) and related proposals including in a draft House bill to amend the Electricity Title of the Federal Power Act.

NASUCA includes members from states that in the past five or six years restructured their wholesale and retail electricity industries; others are from states that planned to restructure, but have slowed or reversed that course since 2000; and still other NASUCA members are from states with the traditional vertically integrated utility industry structure. Today, I am speaking on behalf of all NASUCA members in opposition to measures we believe would weaken the statutory scheme for regulation of electricity, and unnecessarily create new risks for consumers without sufficient consumer benefits. This unified opposition reflects a national consensus of state consumer advocates that, despite the merit of some items, such as the reliability provisions in S. 475, the broader proposals, if enacted, would be detrimental to the public interest and interests of retail electricity consumers.

NASUCA is particularly concerned about proposals to authorize unnecessary and costly transmission investment incentives, and proposals that would weaken consumer protections against market power and holding company abuses. I will now address the issues in the order suggested by the Committee.

REGIONAL ENERGY SERVICES COMMISSIONS

Draft Senate Staff amendments to the Federal Power Act would authorize states to create new interstate regional energy services commissions (RESCs) to operate under FERC jurisdiction to address regional, interstate aspects of the electricity grid.[2] The Staff Draft would give the RESC "primary jurisdiction over energy services"[3] in an interstate region, which would include the power to form and approve RTOs in the region, establish markets to set rates, and decide "rate design and revenue requirements for transmission and wholesale sales in the RESC region,"[4] without clearly requiring all rates and charges demanded or received be just and reasonable, as is now required by Section 205 of the FPA. While the draft would give the RESC jurisdiction over "market power review and market monitoring efforts in the RESC region,"[5] apparently it would lack authority to remedy market power and market manipulation problems.

NASUCA has not yet had an opportunity to develop a position on this issue, but in my view, these newly proposed entities may add further confusion to the picture in areas of the country that now have RTOs or are considering their formation. For example, in some regions, geographic and electric grid characteristics may not coincide with state lines, but under proposed Section 1211, a state apparently could be a member of only one RESC. Also, underlying issues of FERC jurisdiction and FERC-approved market rates still troubling some states and areas of the country are not resolved. Accordingly, it is not clear that the proposed RESC entities would meaningfully add to consumer benefits available under existing law.

RELIABILITY STANDARDS

S. 475 addresses the issue of system reliability by allowing the FERC to recognize a standards-setting Electric Reliability Organization. At the present time, reliability standards for the bulk electric grid system are set by a voluntary organization, the North American Electric Reliability Council (NERC). In 1998, in recognition that the cooperative and voluntary underpinnings of NERC standards need strengthen-

[1] PULP, a non profit organization representing the interests of low income utility consumers, is an Associate Member of NASUCA, with offices at 90 State Street, Suite 601, Albany, New York 12207.

[2] Staff Draft, Section 1211.

[3] Staff Draft, Section 403(a).

[4] Staff Draft, Section 403(b)(3).

[5] Staff Draft, Section 403(b)(4).

ing, particularly in areas of the country where competitive concerns may weaken traditional cooperation among utilities, and thus threaten reliability, NASUCA adopted the following resolution:

> NASUCA supports efforts to develop a national reliability organization that will continue the vital functions now performed by NERC, and will do so in a manner that is competitively neutral and recognizes the paramount concerns of consumers in a reliable electric system;
>
> NASUCA supports efforts to establish an independent Board of Directors that will govern NERC (or any successor national organization) in a competitively neutral manner that will benefit all consumers and that will not be dominated or controlled by any particular industry participant or segment;
>
> NASUCA supports federal legislation that would clarify FERC authority to review the reliability requirements imposed by NERC (or any successor national organization) and to ensure that such requirements are adopted and implemented in a manner that benefits all consumers. . . .[6]

Consequently, placing the development and review of electric system reliability on firmer statutory ground has been supported by NASUCA as an independent legislative reform in recent years. The enactment of reliability legislation, such as contained in S. 475 is supported by NASUCA.

OPEN ACCESS (FERC-LITE)

It has been proposed that public power entities not now under FERC jurisdiction under the Federal Power Act (FPA) would be required to open their transmission systems and come under limited FERC jurisdiction (FERC-Lite). In numerous areas of the country, residential consumers receive the benefits of low cost power from federal dams and hydro power projects, often transmitted over the lines of public power entities currently exempt from FERC regulation. I have no objection to extra capacity of those public power transmission facilities being open to carry energy for other entities and other customers, so long as it does not interfere with longstanding statutory, regulatory and contractual commitments of public power to retail consumers at the lowest possible cost. There is a concern, however, that the benefits of low cost power from federal projects would be compromised if the transmission component of rates were set by the methods proposed by the FERC in its pending Standard Market Design (SMD) rulemaking.[7] This concern for the continued provision of valuable public power benefits intended to be provided for the benefit of consumers is not sufficiently addressed in the legislative "FERC Lite" proposals.

TRANSMISSION SITING

Under state laws, utilities typically have the continued obligation to provide reliable and adequate service upon demand to all retail customers. State regulators have the ability to address the need for new facilities, and to determine the appropriate mix of solutions, whether they be transmission, generation, demand side, distributed generation, or other means. The proposed Staff draft would allow the Secretary of Energy to designate transmission congestion zones and gives FERC ultimate authority to issue certificates for siting new facilities. The states and a RESC would have the right to comment but apparently there would be no full hearing on the appropriateness of a FERC-proposed transmission siting plan.[8] The House draft would give the FERC authority to grant transmission facility permits with eminent domain power.

Meanwhile, authority to make other transmission siting decisions, and decisions about the location of power generating plants, would still remain under state jurisdiction, and so it may prove to be even more difficult to evaluate the cost effectiveness of long term additions, improvements, and investments in either generation or transmission if siting responsibility is fragmented as proposed. Accordingly,

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[6] NASUCA Resolution 1998-07, *Urging the Establishment of an Independent Board to Govern Electric Reliability Matters and the Enactment of Federal Legislation of Ensure FERC Jurisdiction Over the Actions of Such a Board in the Future.*

[7] Notice of Proposed Rulemaking, *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design* 67 Fed. Reg. 55,452 (proposed August 29, 2002.

[8] Section 1221(d) of the Staff draft would give parties "a reasonable opportunity to present their views and recommendations with respect for the need for and impact of a facility coverted by the transmission development certificate." This suggests a written comment type of proceeding. Thus, there is no assurance of a hearing with an opportunity to present evidence and confront proponents before an impartial decision maker.

NASUCA does not support federal eminent domain power for siting of transmission facilities.

TRANSMISSION INVESTMENT INCENTIVES

NASUCA believes that rate incentives to promote capital investment in new transmission facilities beyond the just and reasonable standard of the FPA are unnecessary, and the added costs of such incentives are not justified.[9] A very broad proposal of the FERC, now pending, would increase interstate electricity transmission rate allowances to provide financial incentives.[10] The pending FERC proposal, made without the benefit of any enabling legislation to change the way electricity transmission rates are set under the FPA, is to allow automatic increases in the return on equity (ROE) for transmission investments, well beyond the level normally allowed in the development of just and reasonable rates. These ROE "adders" are intended to reward utilities for divesting control over their transmission assets to regional transmission organizations (RTOs), for outright divestiture of these assets to newly created "Independent Transmission Companies (ITCs)" utilities, and for construction of new transmission facilities. Control and ownership of the facilities would shift to regional transmission organizations and the new transmission service utilities which would operate new and expanded transmission service spot markets. Cooperating utilities will receive ROE bonuses, well above the normally calculated reasonable rate of return on equity invested, of 200 basis points—2%—for existing transmission facilities, and 300 basis points—3%—for new investments in transmission. Nothing in the proposed FERC rule requires any showing that these bonus-conferring actions are cost effective, and nothing in the proposed bill places any upper limit on the rate making incentives.

In response to the FERC proposals for ROE "adders," NASUCA commissioned an examination of the cost and policy implications, and recently filed comments in the pending FERC proceeding.[11] I would like to highlight several conclusions of that study:

- NASUCA calculates the cost of the current FERC initiative, if fully utilized by transmission owners, will cost consumers over $13 billion, or approximately $711 million per year for the 19 year time horizon in the FERC proposal. This is a conservative estimate of the potential cost of these investment incentives, and it virtually offsets the putative $725 million per year benefit of forming Regional Transmission Organizations, a benefit estimate that is controversial for its optimism.
- The $13 billion incentive is unnecessary and will provide no incremental benefit in many areas where transmission owners previously agreed to turn over control of their systems to regional transmission organizations (RTOs) or independent system operators (ISOs). There is no reason to provide new "incentives" to reward actions previously taken.
- If Congress seeks to encourage national adoption of the system proposed by FERC, such ROE incentives may only impede that result. States that have not approved divestiture of transmission facilities owned by state-regulated utilities may be more reluctant to do so if automatic cost increases are the result, without any clear, offsetting benefits.

There has been no showing that the existing just and reasonable standard for ratemaking needs alteration. For these reasons, NASUCA opposes extraordinary financial incentives to stimulate transmission investment.

TRANSMISSION COST ALLOCATION (PARTICIPANT FUNDING)

The cost of transmission investments and other procedures needed for reliability purposes should be allocated fairly to the persons or entities benefitting from the added reliability. Transmission investments for purposes other than reliability, for example, to facilitate energy trading or performance under long term supply con-

[9] Section 7011 of the proposed House Energy Policy Act of 2003 bill would add a new Section 215 of the Federal Power Act requiring the Federal Energy Regulatory Commission (FERC) within one year to establish new rules for "incentive-based and performance-based rate treatments to promote capital investment" by electricity transmission utilities, "to support economically efficient markets for the sale of electricity at wholesale." The Senate Staff Draft, Section 1242, would also authorize the FERC to promote transmission solutions through "proper price signals" and an "adequate return on investment."

[10] *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid,* FERC Docket No. PL03-1-000.

[11] The NASUCA comments on the FERC transmission incentives proposal are available at www.nasuca.org

tracts, should be borne by the participants. These principles are already generally recognized.[12]

TRANSMISSION ORGANIZATIONS/RTOS

In recognition that voluntary regional transmission organizations (RTOs) have been formed in many areas of the country, and without endorsing their nationwide implementation, NASUCA adopted a resolution addressing its key concerns about RTOs.[13] These concerns include reliability standards, independent governance, just and reasonable RTO costs, price transparency, prevention of the exercise of market power and anti-trust violations. The proposed legislation does not fully address these concerns and the need for added consumer protections in these areas.

PUHCA

The Public Utility Holding Company Act of 1935 (PUHCA) should not be repealed, as proposed in several of the legislative proposals. For example, Section 7043 of the draft House energy bill would repeal it. PUHCA remains as a statutory bulwark against reassembly of vast utility holding company empires. Even if not vigorously enforced, its very existence is a deterrent to abuse of captive ratepayers and inappropriate transactions between regulated utilities and unregulated affiliates. NASUCA has adopted the following resolution on this subject:

> "in considering action affecting regulation or the structure of the electric industry, including PUHCA repeal or reform, Congress should require federal regulatory agencies to: 1) prevent abusive or preferential affiliate transactions, 2) continue oversight and protection over corporate and market structure to prevent abuses to consumers and competition, 3) disallow costs which are not prudent and reasonable from wholesale rates, 4) exercise sufficient regulatory authority to prevent ratepayers from bearing any risk of utility diversification and to prohibit cross-subsidies between regulated and nonregulated subsidiaries. . . ."[14]

Recent events reveal the recurring tendency of holding companies in financial trouble to look to regulated affiliates as a source of credit, cash, or other resources, all at the expense of captive utility consumers. The bill would eliminate current PUHCA ownership restrictions on non geographically contiguous utilities, would limit state and federal regulatory agency and intervenor access to books and records of the holding company to the costs of regulated entities, would require a showing of necessity for regulators to examine holding company books, and could make information regarding holding company records and affiliate transactions, obtained in state regulatory proceedings, confidential. PUHCA remains an essential consumer protection. In light of recent utility holding company problems, it should be more vigilantly enforced, not repealed. A copy of NASUCA's resolution on PUHCA is attached.

PURPA

No comment.

NET METERING & REAL-TIME PRICING

NASUCA is not opposed to net metering or to voluntary real-time pricing options. At the wholesale level, all rates and charges made, demanded or received must be just and reasonable under the Federal Power Act and FERC regulation. At the retail level, traditionally not an area of federal concern, states are experimenting with a variety of net metering and time of use pricing methodologies for retail rates. Federal measures to require or encourage states to address these issues, such as contained in the House Draft and the Staff Draft, are unnecessary.

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[12] See *New York Independent System Operator, Inc.,* FERC Docket Nos. ER97-1523-071, OA97-470-066ER97-4234-064, Order on Compliance Filing, 102 FERC ¶61,284 (March 13, 2003). "[T]he Commission finds that the current allocation of [Con Edison's Thunder Storm Alert]—related costs is unjust and unreasonable. These procedures are mandated by a local reliability rule designed to prevent a recurrence of a major blackout in New York City, and which were, prior to the formation of the NYISO, the sole responsibility of Con Edison. The specific reliability benefits from these procedures inure solely to the benefit New York City load, so that the costs should be allocated solely to that load. . . . Neither the NYISO nor Con Edison make any convincing arguments justifying the continued statewide socialization of TSA-related costs." *Id.*

[13] NASUCA Resolution on Regional Transmission Organizations, August 1999. www.nasuca.org. Click Resolutions.

[14] NASUCA Resolution 1996-04, *Urging the Congress and Federal Agencies to Address Market Power as a Component of Any Federal Restructuring Action.*

NASUCA is opposed to federal mandates for real-time pricing of electricity for residential consumers, and opposes the incorporation of volatile wholesale real-time price determinants into retail rates in states that "unbundled" their rates for generation. NASUCA adopted a resolution favoring rate methodologies that promote price stability and predictability of the "default" rates for customers, urging each jurisdiction which introduces competitive markets for the provision of elements of electric or natural gas service to design default service rates so that:

> The Default Service Provider is equipped and able to assure that the rates, terms and conditions, reliability and quality of customer service offered to such customer are no worse with such service than they would be with traditional utility service;
>
> The rates charged by such Default Service Provider are stable and predictable over the long term and that the rates or formulas to determine such rates are approved only after appropriate notice to the public, consumers, and adequate administrative review;
>
> The Default Service Provider shall not simply pass through wholesale spot market rates for the energy or gas commodity portion of Default Service, and shall be required to take prudent measures to provide least cost service and assure long term rate stability, through various means including but not limited to competitive bid, bilateral contract, or provider-owned generation or supplies. . . .[15]

RENEWABLE ENERGY

States are already making major efforts to increase the portion of renewable energy used by consumers and to foster the development of new technologies to make renewable energy sources more economically viable. I would agree that a federal role in this area is appropriate.

MARKET TRANSPARENCY, ANTI-MANIPULATION, ENFORCEMENT

NASUCA is concerned that electricity rates at the wholesale level may at times be vulnerable to the exercise of market power, without effective remedies for consumers. There is a widespread concern that the FERC may lack certain powers needed to supervise markets effectively and to effectuate full remedies for consumers injured by the exercise of market power.[16] In 2002, NASUCA adopted a detailed resolution supporting effective monitoring of such markets where they have been approved by the FERC.[17]

The Staff Draft would authorize the FERC to implement an electronic rate filing system, in which rates demanded by sellers (except for the spot market clearing price actually received) might not be made public. This is apparently a less "transparent" substitute for existing sunshine principles long embodied in the FPA, such as those regarding public rate filing, notice of rate changes, and public inspection of all rate schedules.

The proposed House Draft and Staff Draft include provisions to outlaw the specific abuse of "round-trip" trading, but they are not comprehensive enough to reach new market manipulation strategies that may not be expressly covered in the statute. For example, the bar of "round-trip" trading seems to apply only to bilateral strategies, and might not cover a triangular trading gambit. The refund remedy would be broadened, but would be prospective from the date of a complaint, so there may be no real refund remedy in situations where rates change every hour or day.[18]

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[15] NASUCA Resolution 02-02, *Urging Jurisdiction Introducing the Competitive Provision of Electricity or Natural Gas Service to Assure the Continued Availability of Reliable Service to Customers from a Default Service Provider at Just and Reasonable Rates, at* www.nasuca.org.

[16] A recent GAO report questions whether the FERC's capabilities and enforcement powers, originally designed for the traditional rate setting paradigm, are sufficient tools for an effective market overseer. *Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight,* GAO-02-656, Table 4, 69 (June 2002), *Available at* http://www.Gao.gov/new.items/d02656.pdf.

[17] NASUCA Resolution, *Promoting Market Monitoring Functions Within Regional Transmission Organizations (Rtos) Whenever Such Regional Entities Are Created,* June 2002, available at www.nasuca.org.

[18] In just one day, June 26, 2000 "[a]ccording to the NYISO, consumers bore over $100 million in excess costs before bid mitigation could be applied. As a result, and in light of FERC's unwillingness to allow retroactive price corrections, the NYISO subsequently implemented an automated mechanism for mitigating bids prior to setting the market-clearing price" *Best Practices in Market Monitoring,* Synapse Energy Economics, et al., p. 18-19 (Nov. 9, 2001) (citing NYISO, *Exigent Circumstances Filing of the [NYISO],* p. 8 (May 17, 2001)).

CONSUMER PROTECTIONS

NASUCA does not view customer protections as a separate item within the overall statutory framework for federal oversight of the electricity industry. Rather, the fundamental purpose of the entire Federal Power Act of 1935 (FPA) is to protect customers and to assure reasonableness in the provision of a service essential to life in modern society.[19] Accordingly, any effort to amend the FPA must address whether the proposed modifications assure real benefit to consumers, or at least maintain and not jeopardize the existing level of customer protection. From this broad perspective, the pending legislative proposals do not, in NASUCA's view, increase overall customer protection, and some measures may erode existing protections.

Some of the specific consumer remedies really add nothing to existing state measures. For example, states that allow retail utility competition quickly and effectively addressed the "slamming" issue—the unauthorized switching of providers. Accordingly, there is no need for federal legislation in this area of traditional state jurisdiction, especially when many states have not adopted retail energy competition models.

On the other hand, several of the proposals would repeal PUHCA or and some would still urge repeal of existing FERC merger review authority, provisions intended to protect customers from holding company abuse and market power. For example, Section 7101 of the original House Draft bill would have repealed Section 203 of the Federal Power Act, which includes FERC review of proposed utility mergers. The rationale for the repeal is that review of a merger of electricity utilities is performed by other agencies and that any further review by FERC would be redundant. FERC review of mergers of electricity utilities under its jurisdiction, however, should be preserved. There is a growing understanding that the nature of electricity and evolving electricity markets may permit the subtle exercise of market power, even without overt collusion, by entities having market shares typically allowed by the FTC and regulators in other industries. Many of the benefits projected by the FERC in its efforts to create broader geographic markets for electricity, at significant expense, rest upon the assumption that flaws in existing markets will be mitigated if buyers can find more sellers in expanded regional trading areas. If, however, industry mergers and consolidation are allowed to occur simultaneously with costly transmission expansions to facilitate larger geographic marketing areas, the mergers could result in a shrinkage of the number of sellers, and a corresponding re-concentration and reappearance of market power. FERC should have continued authority to scrutinize and reject proposed electric industry mergers, under evolving standards for measuring market power in electricity markets, and Section 203 of the FPA should not be repealed.

CONCLUSION

In conclusion, while some individual provisions, such as the reliability measures of S. 475, have merit, the various proposals before the Committee to amend the Federal Power Act of 1935 and to repeal the Public Utility holding Company Act of 1935 do not assure demonstrable benefits or added protection that would make their enactment a value proposition for consumers. Some proposals may increase consumer rates by allowing unwarranted rate increases for owners of electricity transmission lines and facilities, beyond the level that is just and reasonable. Some proposals would eliminate longstanding protections of the Public Utility Holding Company Act (PUHCA) intended to protect consumers from utility holding company abuses. Other proposals would for the first time provide explicit statutory authorization for the use of market mechanisms, but without providing adequate enforcement powers to the FERC to oversee the markets and market participants, and without the tools to provide full remedies to consumers. In light of recent instances of energy market manipulation, holding company abuses, and the possibility of further industry consolidation in the aftermath of major losses incurred by energy generation and trading companies, it is clear the consumers need greater, not less, protection from the exercise of market power in the electricity markets under FERC jurisdiction. For these reasons, NASUCA has concluded that the proposals to modify the Electricity title of the FPA now under consideration are not in the interests of utility consumers.

I want to thank Chairman Domenici and the committee again for permitting me to share NASUCA's views on these important issues. I would be pleased to address any questions you may have at this time.

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[19] "The Federal Power Act's primary purpose [is] protecting the utility's customers." *Electrical Dist. No. 1 v. FERC,* 774 F.2d 490, 493 (D.C. Cir. 1985) (Scalia, J).

The CHAIRMAN. Thank you very much. Did you have prepared remarks that you wanted admitted in the record?

Mr. NORLANDER. Yes, we have submitted those.

The CHAIRMAN. That will be done.

John Anderson, executive director of the Electricity Consumers Resource Council. Thank you for coming.

STATEMENT OF JOHN ANDERSON, EXECUTIVE DIRECTOR, ELECTRICITY CONSUMERS RESOURCES COUNCIL

Mr. ANDERSON. Thank you, Mr. Chairman, and I appreciate the opportunity to be here.

ELCON is the national association of large industrial consumers of electricity. Our members come from virtually every segment of the manufacturing community and have operations in every State. We, along with other consumers, are the ones that pay the bills, and we care very much about these issues and we know that you do too.

ELCON members compete in free and open markets, both here in the United States and abroad. We support competition, and accordingly, for well over 10 years, ELCON and ELCON members have sought free and open electricity markets both at the wholesale and retail levels.

At present we find that progress toward competition is being made. It is slow, to be sure, but there is progress nonetheless. At the wholesale level especially, more power is being bought and sold than ever before. There are independent generators, marketers, and other participants buying and selling low cost electricity that we believe is beneficial to all consumers, industrial, commercial, and residential.

I hasten to add that regarding wholesale markets, progress must be made at the national, rather than the State or regional level. Our grid is interconnected. Electrons cross State and regional boundaries with impunity. The Federal Energy Regulatory Commission is the regulatory body necessary to deal with Federal issues.

Before I address the individual issues before this committee, I would like to state that while we as industrial customers do not oppose the eventual enactment of an electricity title, we do not encourage one either at this time.

My fear, as I have observed in several States that have adopted so-called electricity restructuring plans, is that legislative solutions, almost by necessity, involve political compromises. And all too often, these compromises create market problems without providing market solutions.

Unless we are sure of what will, in fact, make electricity markets more competitive, I urge the committee to take no action on electricity at this time.

Let me now touch on couple of the subjects that you put before us today.

The Holding Company Act, or PUHCA. ELCON members, as large industrial electricity users, have identified market power and market power abuse by utilities as the greatest issue they face in the electricity marketplace. Legislatively that issue is embodied in repeal of the Public Utility Holding Company Act. I emphasize no

bona fide consumer group supports PUHCA repeal. PUHCA is the primary Federal statute available to address the abuse of market power by utilities today. I argue that PUHCA is needed at least as much today as it was when it was enacted in 1935. In fact, in some ways, PUHCA should be strengthened. For the reasons set forth in our more detailed written testimony, we urge you not to repeal PUHCA at this time.

RTOs. The transmission grid is the linchpin to the creation of truly competitive wholesale electricity markets. We will never see truly competitive electricity markets as long as monopoly utilities continue to use the transmission grid to benefit their own generation and deny access to power generated by others.

ELCON strongly supports FERC's efforts to make the grid more open and less discriminatory. We strongly recommend that Congress does not restrict these efforts.

As far as incentives, contrary to some assertions, lots of transmission, both new and upgrades, is being constructed today. In spite of this, there certainly are some critical areas where additional transmission investment is needed. However, the incentive provisions in both the House and Senate proposals are unnecessary, unneeded, and unwarranted the way we look at them. If FERC believes that incentive rates are necessary, a decision that can and should be made on a case-by-case basis, FERC has sufficient authority to order such rates under current law.

Incentives certainly should not be offered in areas where new transmission is not needed. In areas where new transmission is needed and cost recovery is guaranteed, it should be recognized that there is very little risk. If the risk is low, the rate of return must also be low. Perhaps TEBO rates today.

I emphasize the potential cost of these so-called incentives may be very large, billions and billions of dollars that consumers will be required to pay. Consumers must be assured they will actually receive benefits if they are going to have to pay these.

Regional energy services corporations. I join with several with my other colleagues today to raise some problems with this. The proposal in the draft legislation truly amazes me. It barely has been discussed, and yet it is the central part of the legislation. I find it hard to believe that this committee is going to begin markup next week on a legislative proposal that has only been in the public domain for a couple of weeks. At a minimum, the creation of RESCs would create yet another layer of unnecessary and unwise bureaucracy. We urge the committee not to adopt this proposal, at least until it can be studied in full.

The so-called reliability language is often referred to as consensus language. We do not believe it is a true consensus. We, along with everybody else, support reliability, but we do not believe that the language will serve its purpose. It is too long and prescriptive. It balkanizes the markets and it ignores commercial implications.

And finally, last but not least, let me mention PURPA, the Public Utility Regulatory Policy Act. Although PUHCA and PURPA are different statutes, they are similar in that each gets a bad rap because of constant utility criticism, and each has been the subject of extensive lobbying by utilities to achieve its repeal. The utilities claim that they are mandated under PURPA to purchase power

from co-generators and other renewable energy resources, though they do not tell you that the rates that are out there have been approved by the appropriate State commissions. They do not state that the cost of wholesale electricity has gone down since PURPA has been affirmed, and they do not tell you that qualifying facilities which sell power under PURPA are far more energy efficient and environmentally beneficial.

Last year, the Senate approved Carper-Collins, and I hope that if you do anything with PURPA, you will do the same thing today.

As I said at the outset, we support competitive markets. However, many of the proposals put forth in the Senate draft and other legislation would not only make the market less competitive, it would stifle the buds of competition that we have seen emerging.

Thank you for the opportunity to be before you today.

[The prepared statement of Mr. Anderson follows:]

PREPARED STATEMENT OF JOHN ANDERSON, EXECUTIVE DIRECTOR, ELECTRICITY CONSUMERS RESOURCE COUNCIL

SUMMARY

ELCON is the national association representing large industrial users of electricity. ELCON members seek competitive wholesale and retail competitive markets. ELCON supports including electricity provisions in a comprehensive energy bill only if such provisions clearly will advance the cause of competitive markets.

- Regional Energy Services Commission: This proposal is untested and could hinder, not facilitate, the flow of power.
- Reliability Standards: The "consensus" legislation could balkanize the market (by granting deference, or providing a rebuttable presumption to certain groups); it also does not take into account the intrinsic inter-relationship between reliability standards and their commercial impact.
- Open Access (FERC-Lite): Optimally, at some point, the entire grid, regardless of ownership, will be open and subject to uniform rules and regulations.
- Transmission Siting: Granting FERC a "fallback" right of eminent domain, as provided in the House draft, while rarely used, would provide a motivation to ensure that state inaction does not occur.
- Transmission Investment Incentives: Investment incentives will be costly to consumers. Investment incentives can already be offered by FERC on a case-by-case basis; there is no demonstrated need to utilize investment incentives in all instances.
- Transmission Cost Allocation (Participant Funding): This should be considered as a regulatory issues, not a legislative one. Under current law, FERC can allocate the cost of new transmission in any way it deems appropriate—one approach, i.e., participant funding, should not be locked into statute.
- Transmission Organizations/RTOs: ELCON supports large RTOs with independent governance; legislation is not needed on this issue.
- PUHCA: Given recent turmoil in electricity markets, repeal of PUHCA—which protects both consumers and investors—seems unwise.
- PURPA: PURPA guarantees to cogenerators regarding purchase of electricity and the availability of back-up power should be retained until functioning competitive markets are established.
- Net Metering and Real-Time Pricing: ELCON members support the concept of net metering; if real-time pricing is required, a utility's risk is reduced and, we believe, its potential rate of return should be reduced as well.
- Market Transparency, Anti-Manipulation, Enforcement: The suggested language seems minimal considering the abuses that have been revealed in electricity markets.

STATEMENT

Good morning. My name is John Anderson. I am the executive director of the Electricity Consumers Resource Council, or ELCON. ELCON was established in 1976 and is the national association of large industrial consumers of electricity. Our members come from virtually every segment of the manufacturing community and have operations in every state.

ELCON members compete in free and open markets here in the U.S. and abroad. We support competition, and, accordingly, for over ten years, ELCON and ELCON members have sought free and open electricity markets at the wholesale and retail levels. We have testified to that purpose before this Committee on several occasions.

At present we find that progress toward competition is being made—slow progress to be sure, but progress nevertheless. At the wholesale level especially, more power is being bought and sold than ever before. There are independent generators, marketers and other participants trading electricity that we believe is beneficial to all consumers, industrial, commercial and residential.

The evolution to a truly competitive wholesale market is far from complete. That market is very much in transition. It is changing partially in response to the pro-competition directives of the Energy Policy Act of 1992 and from FERC, specifically Orders 888 and 2000, and partially in response to market developments.

I hasten to add that, regarding wholesale markets, progress must be made at the national, rather than state or regional, level. Our grid is interconnected; electrons cross state and regional boundaries with impunity. The Federal Energy Regulatory Commission (FERC) is the plenary regulatory body with the statutory authority necessary to deal with interstate electricity issues. Last year's Supreme Court case affirmed FERC's jurisdiction over interstate transmission. We urge Congress and this Committee not to tamper or try to modify the basic holdings of that decision.

Before I address the individual issues before this Committee, I would like to state that while we as industrial consumers do not oppose the eventual enactment of an electricity title, we do not encourage one either. Markets are rapidly evolving. Participants are aware of the rules and are responding to market forces. Legislation is not necessary at this point in time.

My fear, and I have observed this in several states that adopted so-called electricity restructuring plans, is that legislative solutions, almost by necessity, involve political compromises. And too often those compromises create costly market problems without providing market solutions.

So if this Committee is certain that it is crafting legislation that will make markets more competitive, that will remove the barriers that monopoly utilities have hidden behind for decades, and will provide more options and lower prices for consumers, I say go ahead and ELCON will support you.

But if instead you are drafting legislation that you hope addresses one company's problems, one region's uniqueness, or one Senator's political needs, I urge you to go slow. In fact, unless we are sure of what will, in fact, make electricity markets more competitive, I would urge the Committee to take no action on electricity at this time.

I will now elaborate on the various sub-issues that are part of the legislative proposals before the Committee today. Given the complexity of each issue, I have tried to state our objectives somewhat simply. In all cases, we are striving for more competitive markets.

Regional Energy Services Commission (RESCs)

From a personal perspective, let me say that I have worked on electricity policy issues for over twenty-five years. Although some claim that the issues rarely change, every now and then there emerges a completely new proposal. Today that proposal, as contained in the Senate staff draft, is for the creation of Regional Energy Services Commissions, an idea I never encountered before last week.

I have heard this proposal called innovative. I have heard it called radical. Regardless, it is certainly untested—in fact it has barely been discussed as to its potential impact on markets and competition. I find it hard to believe that this Committee is going to begin markup next week on a legislative proposal that has only been in the public domain for two weeks.

We oppose the concept of RESCs as outlined in the Committee draft. We do so because we believe that a primary component of achieving more competitive wholesale markets is uniform rules that make it easier for buyers and sellers of electricity to meet and do commerce. From the perspective of industrial users who have multiple electricity-consuming facilities across the country, we envision an eventual market that facilitates the purchasing of power for numerous facilities from one source. Such a market would provide lower cost power, reduce administrative costs, and make American manufacturing facilities more competitive.

We base this position on the fact that the interstate transmission grid is divided into three interconnections, one in the East, one in the West, and one comprised of most of Texas. Within each interconnection, power is synchronized and flows without regard to state or regional boundaries. We believe consumers would benefit if access to power within any one interconnection were made easier, not more dif-

ficult. We believe the creation of RESCs as described in the Senate draft would hinder, not facilitate, the flow of power.

Accordingly we support the concept of a standard market design, though we certainly do not endorse every provision of the proposal FERC put forth last year. We want to make markets more consumer friendly. Allowing each region's transmission infrastructure and tariff rate design to be governed by an RESC rather than by FERC would balkanize the market and, as we see it, benefit nobody—certainly not consumers.

The creation of RESCs would create yet another layer of bureaucracy. Consumers, even if they are the largest corporations in the country, have limited staff time and money to participate in proceedings such as envisioned by the creation of RESCs. Utilities, on the other hand, have endless human and financial resources because, unlike corporations in competitive markets, they can pass those costs on to captive customers.

I have tried, without success, to find the creator of this radical, new, and untested proposal. Although I have been unable to locate its progenitor, I can be reasonably certain that it is no one in the consumer community. We urge the Committee not to adopt this proposal, at least until it can be studied in greater detail.

Reliability Standards

All of the bills under discussion, with minimal degree of variation, contain what is commonly referred to as "consensus reliability" language. Though we recognize that many disparate stakeholders have endorsed this section in one form or another, we do not believe that it is a true consensus document and we do not believe that it will, in fact, enhance reliability.

By way of background, ELCON was part of the process that developed, and endorsed, the original "consensus reliability" language roughly seven years ago. That language was unfortunately the result of a Christmas tree effort, as every stakeholder representative (including us) tried to add language to advantage their own particular group. Since then, when we have looked at that end product and subsequent revisions, we see that they all have similar flaws.

We recognize that this is an issue in which few Members have an interest. All Members—and all industry stakeholders—support increased reliability. Certainly we do. But we do not believe that this language will serve that purpose.

First, not one of the "reliability" proposals actually increases reliability—rather each establishes a regulatory process which is designed to authorize one organization to set standards that are supposed to maintain reliability. Although promoters of this language purport to model it on the securities industry, that model fails under scrutiny. For example, violators of rules promulgated by the National Association of Securities Dealers can be denied the ability to trade. It is unclear how violations and violators would be sanctioned or punished in the electricity industry. Clearly, removal from market activities would be difficult if not impossible when dealing with owners of interstate transmission lines. And, since electricity functions in "real time," violations of reliability rules would cause real, possible irremediable, damage before any action could be taken in response.

Second, the language in the four proposals grants deference (or provides a rebuttable presumption) to regional groups founded on an interconnection-wide basis. This is in response to demands from western officials that "the West is different." This may be, and in fact reliability rules recognizing these regional differences can be developed without granting statutory deference in the standard-setting process to any regional group. If the facts support a regional standard, that regional standard should be adopted. But by granting deference to one group, this language opens the door for deference to be granted to other groups (perhaps to one organized on an RTO-wide basis; perhaps to consumers who actually pay the bills). Creating deference of any kind will encourage the development of a regional, rather than a national, standard, and generally make it more difficult for power to move from one region to another. In essence, what is supposed to be a "standard" is no longer a "standard."

And third, for those truly interested in making wholesale markets more competitive, reliability should not be considered in a vacuum. The issues of reliability and commercial impact are inextricably intertwined. One would be hard pressed to imagine a reliability issue that did not have commercial implications, and vice versa. Reliability standards should not be developed without an examination of their impact on commercial practices. To do so is to invite the development of "reliability standards" that are in fact new trade barriers or disguised mechanisms for discrimination. Ideally the preparation of reliability standards and so-called commercial practices would be done by the same organization. This would ensure compatibility between the two and maximize the benefits of both reliability and markets to consum-

ers. The current bifurcation of duties between the North American Electric Reliability Council (NERC) and the North American Energy Standards Board (NAESB) has a number of problems. For consumers and new entrants to the market, participation in NERC and NAESB standard-setting processes entails a considerable outlay of staff and other resources. Moreover, the fact that reliability and commercial practices will be made by two different organizations will lead to all sorts of complications and inefficiencies. We continue to believe that one organization, tasked with both standard-setting responsibilities, should consider both reliability and commercial practices.

In conclusion, we support a clear and short statement that FERC has the responsibility and authority to assure reliability and to consider the commercial impact as well. Everyone wants reliability. We believe it is worth the time to develop the legislative language that will truly achieve it. The legislative proposals before the Committee today will not accomplish what we are seeking.

Open Access (FERC-Lite)

FERC jurisdiction or the equivalent over currently non-jurisdictional utilities is an important issue if the transmission grid is to be operated in a truly open matter. We are pleased that over the past several years non-jurisdictional utilities have seen fit to agree to many concessions. Optimally, at some point, the entire grid, regardless of its ownership, will in fact be open and subject to uniform rules and regulations.

Transmission Siting

Generally speaking, ELCON supports giving FERC a right of eminent domain for siting of electricity transmission lines similar to that enjoyed for the siting of natural gas pipelines. That having been said, we certainly recognize the political problems with such a position and find the language in the House draft to be a reasonable approach. We understand that in fact states have not been the principal reason for delay in siting and building new transmission lines. But having a "fallback" right of eminent domain, as laid out in the House draft, while perhaps rarely used, would provide a motivation to ensure that state inaction does not occur.

Transmission Investment Incentives

The Senate staff draft, as well as the House draft and last year's October 16 draft, all address the need for new transmission. We believe that there is a need for new transmission in some regions, but not in all. The directive in these pieces of legislation that FERC implement and utilize incentive rates for the construction of all new transmission seems unnecessary and overly restrictive. If FERC believes that incentive rates are necessary—a decision that can and should be made on a case-by-case basis—they have sufficient authority to order such rates under present law. In House hearings, witnesses from both Goldman Sachs and for-profit transmission companies testified that such incentives are not needed in every case.

There certainly is no reason to provide incentives in areas where new transmission is not needed. Such efforts would merely reward monopoly transmission owners and increase costs for consumers.

In areas where new transmission is needed and cost recovery is assured, it is intuitive that the risk involved is very low. Utilities enjoy an almost ironclad guarantee that they will receive both a return "of" and a return "on" their transmission investments. If the risk is low, i.e., the new transmission will be fully utilized, presumably a just and reasonable rate of return, not an incented one, is appropriate.

A recent study undertaken at the request of the National Association of State Utility Consumer Advocates attempted to quantify what these incentive rates would mean to consumers. According to an affidavit filed at FERC, consumers would pay $711 million per year, or $13.5 billion over the next 19 years, if incentive rates were to be the norm just to build transmission that would be built anyway. Looked at another way, that would be $13.5 billion of ratepayer money that would not be invested in new transmission infrastructure. On behalf of all consumers, industrial, commercial and residential, I find that objectionable, especially since the North American Electric Reliability Council has stated that significant new transmission will be built regardless.

TRANSMISSION COST ALLOCATION (PARTICIPANT FUNDING)

The House bill's language on participant funding is less restrictive than language in the Senate draft and the language circulated last year. But participant funding ought to be a regulatory issue, not a legislative one. FERC has—and frequently uses—the authority to order such funding on a case-by-case basis. There is no rea-

son to lock into statute an inflexible plan that mandates how transmission costs are to be assigned now and forever.

As a practical matter, it is nearly impossible to determine who will benefit from transmission upgrades, and it is inevitable that such beneficiaries will change over time. In addition, since nearly all stakeholders agree that new transmission is necessary in some areas, I question why Congress would adopt a plan such as participant funding that will likely retard the growth of new transmission. All consumer groups and all non-utility generators—the groups most likely to suffer if new transmission is not built—believe that mandating participant funding will hinder, rather than help, the construction of new transmission. If there is an electricity title in legislation, we hope Congress will be silent on this issue.

Transmission Organizations/RTOs

Industrial users know from experience that the transmission grid is the lynchpin to the creation of truly competitive wholesale electricity markets. If monopoly utilities can continue to use the transmission grid to benefit their own generation and deny access to power generated by others, we will never see wholesale competition in any real way.

ELCON has supported FERC's efforts to make the grid more open for many years. We support large, independent Regional Transmission Organizations (RTOs) with the day-to-day responsibility of running the grid (under FERC oversight). In order for an RTO to operate effectively, it needs independent governance so that monopoly transmission owners cannot develop self-serving rules and regulations.

We are, in fact, a little disappointed that FERC now seems more positively disposed to smaller RTOs than those originally envisioned. The greater the number of RTOs, the more important the "seams" issues become. "Seams" is just another word for barriers. How power goes from one RTO to another—through the seams, so to speak—is an issue that can greatly effect whether consumers have access to low-cost power or not. The proposal to create RESCs could make that "seams" issue into a "walls" issue.

Ideally an RTO would have administrative responsibility over all transmission, regardless of whether it is publicly or privately owned. It would also be responsible for the economic dispatch of merchant utility-owned generation within the RTO footprint. We believe the language in the House draft provides a positive first step toward ensuring that federally owned transmission does not become the hole in the doughnut.

Although its efforts have not been perfect, we hope that Congress does not restrict FERC in its efforts to make the grid open and non-discriminatory. Legislation is not needed on this issue, other than perhaps to reaffirm FERC's authority to act.

PUHCA

Let me begin my comments on PUHCA by stating that I understand all too well why investor owned utilities have spent literally millions of dollars in lobbying and communication efforts over the last ten or so years to repeal PUHCA. It should be equally understandable why no bona fide consumer group supports PUHCA repeal. PUHCA is the primary federal statute available to address the abuse of market power by utilities that operate in more than one state.

Proponents of PUHCA repeal argue that the statute is outdated—an anachronistic law that no longer applies to today's utility markets. I argue that it is needed at least as much today as it was when it was enacted, in conjunction with the Federal Power Act, in 1935. In fact, in some ways PUHCA should be strengthened.

Indeed the current market structure, with so many regulated utilities having unregulated subsidiaries, provides a situation ripe for abuse. In fact no less a pro-business newspaper than the Wall Street Journal ran an article last December describing how utilities were taking debt from their unregulated enterprises and shifting it to their regulated entities so that ratepayers, rather than shareholders, were assessed the costs. PUHCA's language on cross-subsidization ought to be strengthened, rather than repealed, to protect consumers.

Similarly, taped conversations between energy traders of a major company dramatically depict how consumers were gouged during the Western power crisis. Congress should not repeal PUHCA but rather enact needed legislation to make it unlawful for any entity, directly or indirectly, to undertake fraudulent, manipulative, or deceptive actions in wholesale energy markets. Such language was included in HR 5614 last Congress; it is not included in any of the four bills before this Committee today.

A discussion of PUHCA is not complete without a discussion of mergers. Retaining FERC's merger review authority is essential given the number of recent utility mergers and the consolidation of the industry into a few large regional (and multi-

regional) players. States and the federal antitrust agencies cannot do this—FERC therefore must be the fallback for this essential consumer protection. FERC also adds special expertise to the examination of these mergers.

Finally I would add that maintaining PUHCA as a federal statute is necessary not just to protect consumers but to protect investors. At present roughly forty percent of all power companies are listed on Standard & Poor's CreditWatch as having a negative outlook. More than 13 percent of all energy firm's have non-investment grade securities. On behalf of all consumers, we ask that you not repeal PUHCA at this time.

PURPA

Although PUHCA and PURPA are very different statutes, they are similar in that each gets a bad rap because of constant utility criticisms. And each has been the subject of extensive lobbying by utilities to achieve its repeal.

Utilities claim that they are mandated, under PURPA, to purchase power from cogenerators and other renewable energy resources. They claim that such power is often available at a costly price. But they don't tell you that rates were approved by each state utility commission. They don't say that the cost of wholesale electricity has gone down since PURPA was affirmed by the Supreme Court in 1982. And they don't tell you that Qualifying Facilities which sell power under PURPA are far more energy efficient and environmentally beneficial than the conventional base load power plants owned by utilities.

The Administration has recognized the benefits of cogeneration and combined heat and power (CHP) and has established a national goal of doubling our CHP output by 2010. It is totally inconsistent to endorse this objective and then repeal the mandatory purchase and sale requirements of PURPA.

ELCON addresses this issue from two perspectives. First, many of our members cogenerate power on-site, sometimes for their own use, sometimes to sell, most often a combination of the two. They know that the mandatory purchase requirement of PURPA is necessary until there are truly open wholesale markets for cogenerators to sell into. Otherwise utilities—who routinely obstruct the development of customer-owned generation—will not buy cogenerated power or will use their market power to keep such electricity off the grid. Until that time, PURPA guarantees are not just desirable, they are essential.

Similarly, the PURPA requirement that monopoly utilities supply back-up power to cogenerators at just and reasonable prices is necessary until there is a competitive retail market in which to purchase that power. Without a guarantee of back-up power, cogenerators cannot operate and the manufacturing facilities connected to it become useless.

Second, all of our members are consumers—and big consumers at that. It is noteworthy that those companies that pay the largest electric bills in the nation recognize that PURPA was the first federal statute to inject any competition into the electricity marketplace. PURPA is at least partially responsible for the decrease in electricity rates over the years. Industrial consumers believe it would be both short-sighted and harmful to repeal in any way the guarantees available to cogenerators under Section 210 of PURPA.

The language that the full Senate approved last year, in the Carper-Collins amendment, demonstrated the support that cogeneration enjoys. Similarly, the House Subcommittee on Energy and Power approved by voice vote the language now in the House draft. Both Carper-Collins and the House language recognize that PURPA protections should stay in place until working, competitive markets are available. We hope this Committee adopts a similar approach should it approve legislation. Retaining present law would also be acceptable if the Committee chooses not to act on electricity issues.

Net Metering and Real-Time Pricing

As I stated earlier, many ELCON members are cogenerators utilizing a combined heat and power system, often fueled by a renewable resource. Our members strongly support the concept of net metering as long as it does not require the disclosure of proprietary information or intrude upon the internal operations of a company's generation activities.

Real-time pricing is a much more complicated issue than generally considered. Utilization of real-time pricing is a necessary but not sufficient condition to ensure that there is a functioning demand market (in contrast to demand programs as is generally the case in demand side management). All end users, and especially large end users, can assist in times of peak demand and congestion by reducing consumption. In real terms, a kilowatt hour of reduced consumption has the same effect as a kilowatt hour of increased generation. Many large industrial users are willing to

play such a role assuming that compensation is appropriate. Real time pricing would be helpful in determining those levels, but only sophisticated consumers can assume the high risk of such actions. Hence, it is extremely important that real-time pricing is voluntary and not mandated on any customer class.

Finally, it should be noted that requiring end use customers to purchase power under only real-time prices transfers all risk from the utility to the customer. If a utility requires real-time pricing, its risk is lowered and, we believe, its potential rate of return should be reduced as well.

ELCON does not recommend that legislation address the issue of real-time pricing.

Market Transparency, Anti-Manipulation, Enforcement

The language in the Senate draft on information availability, disclosure requirements and the prohibition of round-trip trading are all good as far they go. But they don't go to the heart of the problem which is each utility's ability to exercise market power, the ability of a utility to manipulate markets, and the lack of significant market enforcement by any federal agency. These issues are related to the PUHCA issues discussed above. If Congress is to address this issue, it should take large steps, not small ones, and the steps should make markets more competitive and remover barriers to entry by new participants.

Consumer Protections

The issues found in the Senate draft and other pieces of legislation regarding slamming and cramming affect residential consumers far more than industrial. They are valid concerns and should be addressed.

Other Issues

An issue that has been the subject of much recent dialogue, including discussion at the recent House Subcommittee markup, is "economic dispatch." The basic question is whether utilities should dispatch (put on the grid) the lowest cost power available, even if it is not from their own generating facilities. Many utilities refuse to do so, claiming that they are protecting their customers or "native load." However, this claim fails. As a witness representing some of the largest customers in America, I can assert that we would certainly prefer to see the lowest cost power be made available whenever possible. Although I can understand why utilities try to protect their own generation, this practice is not beneficial to consumers and also discriminates against non-utility generators.

Conclusion

As I stated at the outset, we support competitive electricity markets. However, many of the proposals put forth in the Senate draft and in other legislation would not only make the market less competitive, it would stifle the buds of competition that we have seen emerging in recent year. We support positive legislation that encourages markets to develop and removes barriers to new entrants. But quite honestly, we do not see that emerging from this Congress. That is why we believe that no electricity language may well be the preferable option, and that no electricity language may in fact be the most positive way to promote competition.

The CHAIRMAN. Thank you very much for your testimony.

First, I want to compliment all of you for helping us stay on time.

Now we will proceed to some questions. I can save mine until last. I will yield first to Senator Bingaman, then Senator Thomas, Senator Craig, Senator Alexander, in that order.

Senator BINGAMAN. We had an earlier hearing with some people from the financial community—I think, Mr. Svanda, you testified at that hearing as well—and one of the main issues that was raised was the need for us to get to a point of regulatory stability as quickly as possible so that this industry could obtain and attract the capital it needed to make the investments that were needed.

Frankly, one of the concerns that I have with the new proposal for regional energy services commissions is that, if that were adopted by the Congress, it would take a substantial period before it could be implemented, before Governors could gear up to appoint people, and it could be sorted out as to which States were grouping

with which States. There is a lot of regulatory instability that I think might result, putting aside other problems with the proposal.

I would be interested in Mr. Svanda's view as to whether that is a valid concern or one that he shares.

Mr. SVANDA. Thank you, Senator. It is a concern that I share and those very concerns are woven through my written testimony to you.

The concern is I come from an area of the country in Michigan where we generally are working as a region to implement region-wide organizations for electricity markets. We have been doing that for quite a while and we have been doing it with States that are squarely behind restructuring the industry, such as Michigan, with States that are squarely not behind restructuring the industry, such as our immediate neighbor to the south, Indiana.

But Indiana and Michigan agree completely with regard to how we structure the wholesale regional market. We have rolled up our sleeves, along with most of the rest of the States in the region, to make the MISO a living, breathing, and reliable entity both from a physical reliability and an economic reliability sense.

To move away from those concepts that we have all been working on, to introduce the new RESC type of thinking and have each of the States in that region, multiplied times 50 across the country, evaluate how we can fit into the new structure, I think moves the horizon out considerably, and it is that horizon that is so important to creating investor confidence, that they can understand what types of investments are going to make sense, mid, short, long term.

Senator BINGAMAN. Let me ask Mr. Anderson. I understand your testimony to the effect that PUHCA should not be repealed. If PUHCA were repealed by the Congress—we went to great lengths in the last Congress to try to strengthen FERC's merger authority in order to compensate for the repeal of PUHCA—do you think that is an important way to proceed if PUHCA were to be repealed, or do you have any thoughts on that?

Mr. ANDERSON. Senator, we certainly do have thoughts on that, and we appreciate the efforts that you did last year working in this area. We compliment you on it very highly.

But I think it is even more than just merger authority. I think it is also broader and the whole concept of market power. And I think there are a whole set of provisions that we support, and I will be glad to provide them for the record for you. But it is access to books and records and the idea of monitoring to make sure that the exercise of market power—let us be the first to recognize that a law that was created in 1935 is probably one that is not perfectly tuned for today's times, and we think that there could be some modifications to it. At the same time, it is a very valuable consumer protection act in the market power area, and we urge the mergers and access to books and records and market power monitoring, things along that line, go along with it.

Senator BINGAMAN. Mr. Gifford has suggested that the antitrust laws adequately meet these needs. Mr. Anderson, would you want to comment as to your view on that?

Mr. ANDERSON. Thank you, Senator. The antitrust laws are very cumbersome and time consuming and expensive to use. They are

extremely difficult to use. Besides it is a matter in the Holding Company Act, once a merger has gone together, it is very, very difficult to unscramble that egg, if you like. So it is a situation we have to be very careful up front on. The antitrust laws represent a tool that should be relied on at appropriate times. We would like to see the market power issue dealt with up front and directly and not after the fact when it is very difficult to come up with remedies.

Senator BINGAMAN. My time is up. Mr. Chairman, thank you.

The CHAIRMAN. Thank you very much, Senator.

Senator Thomas.

Senator THOMAS. Thank you, Mr. Chairman. I am going to take just a second, since I did not make an opening statement, to comment just a little bit.

Thank you, certainly all of you, for being here.

This is an issue that is very important I think to all of us. I believe any comprehensive energy bill has to have an electric title. There is nothing that touches more people in energy than electricity. It seems to me we are at a crossroads. One path is based on opening competition, being able to compete, the way things have changed, the consumer to decide. The other is more Federal regulation, more command and control. I certainly am not interested in that. I am interested in letting the marketplace work.

So it just seems to me that clearly we need to make some decisions. We can sit there and say, well, things are happening, but the fact is there are a lot of changes taking place in this country with respect to energy and with respect to electricity. It has to do with the investment. It has to do with organization. There is just no question about how it is happening.

We had some folks here a while back that talked about the plans and how much investment there has been in generation recently. It is damn little, and the same is true with transmission. As demand goes up, our ability to fill that demand has not. So we need to make some decisions, it seems to me.

Generation has changed. It used to be, of course, when you had a distribution system, why, you generated for yourself, and that was it, very easy. Now we have market generators. There is a movement of market generation around the country and you have to be prepared to handle that.

We have regional differences. I am one who is not at all interested in SMD. I do not think that is the way to resolve it because there are differences. We see them very much in the West, as a matter of fact. But nevertheless, it moves nationally and so there has to be an element of national movement so that you can move those things.

So reliability. We have had some experience with the lack of reliability. We need to be sure we strengthen that.

Transparency into the deals that are being made in this market generation. You just mentioned that being open.

I happen to think PUHCA can sufficiently be covered by SEC and Justice, and that is an out-of-date thing, and PURPA can be handled as well.

So as you can see, I have my prejudices fairly well arranged on what we need to do. Now, how we do it is quite a different thing.

It is interesting. One of our members said do it the right way. Well, if we ask everybody in this room which is the right way, I do not suppose we would come out with a consensus necessarily.

In any event, let me ask Mr. Svanda. Do you think RTOs could be organized in such a way to do the job to represent the differences in needs in various areas?

Mr. SVANDA. I do believe that they can be, but I am also a strong advocate for large recognition, large respect for regional differences as they occur.

Senator THOMAS. Is that not what RTOs are for?

Mr. SVANDA. Absolutely, and that is why the RTOs should not be a cookie-cutter, prescribed type of organization. They should develop freely and voluntarily within the regions as they are necessary. But they are an organization that will work, and that is being proven out in many parts of the country.

Senator THOMAS. Hopefully that is something that can happen.

Mr. Anderson, you suggest no action. How do you deal then with the clear problems that lie ahead in terms of adequate generation, in terms of movement of market wholesale power, and so on?

Mr. ANDERSON. Senator, first of all, as far as generation goes, the numbers that I look at say that we have plenty of generation. I do not think that is the problem for the foreseeable future.

Senator THOMAS. You look at different numbers than I do, I am afraid.

Mr. ANDERSON. Well, I would like to compare some numbers with you sometime, Senator.

But I think that there are some problems in certain areas of transmission. That is a different one.

If I could come back to the RTO issue just a minute and say that the RTOs are very useful, very important, necessary entities. But the RTOs cannot do everything. We have to have, I think, also some things that are done in an interconnection-wide basis, in a broader basis than this. All too often to us there are regional differences because there are regions, not because there are real differences. And if all we are going to do is codify the differences that are out there today, we are going to end up with balkanized markets.

We would like to see Federal legislation that encourages competition. We would like to see Federal legislation that reduces barriers to entry and makes it where customers have more options in the purchasing of power.

What my message today is is that we have not seen in legislation that looks likely to be enacted that it would achieve these kind of goals. We see legislation that, instead, would make it more difficult to have large, nondiscriminatory, seamless electricity markets. And that is why I said our recommendation is not to have legislation at this time.

Senator THOMAS. Very well. But if you cannot move power—we generate more power in the West, you do not generate much power in New England. You have got to get it there somehow if you want to have some choices. If you are going to put a throttle on the movement of power, then you are not going to have choices I believe.

Thank you, sir.

The CHAIRMAN. Thank you very much.

Senator Alexander.

Senator ALEXANDER. I do not have any questions right now, Mr. Chairman.

The CHAIRMAN. I thank you very much and thank you for coming.

Let me just take a little bit of time. First of all, I thank all of you for your testimony, and there will be a lot more before we finish here today.

I do want to suggest that it is extremely difficult. I think it is good that I am a new chairman and come in just brand new because I begin to understand the complexity of trying to put something together. There is a lot of concern about this new idea, the transition to something like RESCs, but the same kind of transition concerns plague the SMD or the RTO development. The RESCs may be a new concept, but regional solutions are not. Everybody has suggested there are. In fact, your testimony is eloquent with reference to it. Great progress is being made, even on a voluntary basis.

There are obviously many regional things that are taking place, and I hope, as we move through—people are saying to me, we do not want things done nationally. We want them done regionally. We want the protection more of States' kinds of rights. Yet, we do not want SMD because we do not think they will do that.

So from my standpoint, what I would like you to do, if you can, is to make some constructive recommendations in writing as to how you think we can facilitate the transition to more regional regimes that would be binding, not a set of voluntary joining up of organizations.

The RESCs are not intended to be voluntary, nor are they to be without authority. They have a problem of how do you get them into existence, but they are intended to have the same kind of authority ultimately as FERC. They are regional FERCs, to put it in its simplest terms, with the Federal Power Act as its underpinning of authority.

With that, let me just ask some general questions. Do all of you assume that there are regional markets, or are there single markets? Can we just go down the line?

Mr. SVANDA. There are regional markets, but there are very important interfaces between those regional markets that need particular attention too.

The CHAIRMAN. Mr. Gifford.

Mr. GIFFORD. Yes, there are most certainly regional markets. Your biggest challenges come out West where the distances are greater and the terrain is tougher. To say that there are regional markets in the West may be an ambitious overreach, but you have regional markets.

Mr. NORLANDER. With the possible exception of Texas, I think that most of the contiguous States trade energy across State lines.

The CHAIRMAN. And they were in to see me yesterday saying that they have what might be considered their own regional market.

Mr. NORLANDER. For example, New York has its own system operator, and it does import energy from Canada. It exports a bit, al-

though there are always inter-ties, but much of the energy is within the State.

The CHAIRMAN. Let us get you, John, Mr. Anderson.

Mr. ANDERSON. Mr. Chairman, yes, I think there are regional markets. But I think it is the definition of the region that we should look at, and I have quite a different definition. To me the United States is divided by the Rocky Mountains and by the sovereign Nation of Texas, which has decided to turn its electricity from AC to DC and then back into AC. The western interconnect is a market. The eastern interconnect is a market, and there are little flows across the Rockies.

What I am concerned about is if we then start talking about subregional markets within those regions, we have artificially created and therefore balkanized and made the market smaller. And that is what we need to avoid.

The CHAIRMAN. Just hypothetically, what do you think, starting on this end, the effect of FERC's proposed SMD rulemaking would have been if the RESCs had been an available option to the States?

Mr. SVANDA. I believe that many of the concerns that I have raised would have been a part of the discussion, and so some of the weaknesses that I highlighted would have been dealt with. I think that is true also of the SMD proposal by FERC. As my testimony indicated, we have all learned a great deal from the focused discussion, and I think that is beneficial. It has been painful, but nonetheless, the regional concepts that I have espoused and others have talked about in this panel have really come to the surface as an outgrowth of that standard market design discussion that FERC has fostered, and that is very beneficial for all of us.

We do understand that the West is the hydro West and it is the fossil West. We understand that there are other components within Michigan and the Midwest that look very different from those aspects of the western region. So those can be accommodated and only on a regional basis and only by interacting regionally and understanding each other can we get to a solution that respects and yet moves us forward.

The CHAIRMAN. Let us go quickly.

Mr. GIFFORD. Yes. I think if it was an either/or, an RESC or the SMD, you would probably still have a lot of States and a lot of regions saying neither. As the Senator is very well aware, out West you have a big hole in the jurisdictional donut with large public power presence that is not FERC jurisdictional. And that problem would have to be solved to have anything resembling a coherent and fair regional market.

The CHAIRMAN. Right.

Mr. NORLANDER. I think the fundamental rift, if there is one, is between those who would adhere to the filed rate, cost-based system of setting wholesale rates, as the original Power Act provided, and those who would go to a market system. Those of our members who are participating in regional activities probably would be working on the same kinds of concerns of market design, market power, and market concentration.

Thank you.

The CHAIRMAN. Mr. Anderson.

Mr. ANDERSON. I think the big difference between the RESC and the SMD is the "S" and that is called standardization. If you have a series of RESCs that are different, then you have balkanized the market. You have created seams around it. You have made smaller markets. If you standardize the market, if you had a series of RESCs that were all identical, they all had precisely the same rules and regulations and that sort of stuff, then we have the larger markets again, and that is what we think is very good. We need the large markets to be able to have real competition in electricity.

Mr. SVANDA. May I react to that?

The CHAIRMAN. Yes, sure.

Mr. SVANDA. I agree in an ideal world with Mr. Anderson's comments, but we do not live in an ideal world. We also are not creating this system from scratch. We in fact have to recognize where we are coming from and move from there as opposed to an idealized type of beginning.

I agree completely. Standardization not just across this country, but across this continent would be beneficial, but we need to move forward, and the reasonable way to move forward is working with the regions as they exist today.

The CHAIRMAN. I have one last question, but I will make an observation. I would assume that all of the concerns that have been expressed will be harmonized when we hear from the Chairman of the FERC. I assume he will say everything you have said is so, and I will take care of them all. Just let me do it. That is what I assume SMD is all about. I think he is going to start by saying he thinks regionalization has great merit. In fact, I know he will. And then he will proceed to suggest that he will take care of it. And I know he has such authority, but I have so many Senators saying we do not want to let him do it. So everybody is looking for another way.

One last rather technical thing. There are some who advocate legislating a jurisdictional delineation between bundled and unbundled transmission. Who feels expert enough to tell us the advantages and disadvantages to those kinds of proposals?

Mr. Gifford.

Mr. GIFFORD. I will take a shot, Mr. Chairman. I would think defining a regulatory category when we are not really quite sure if that is an actual product that a consumer or an end user would be interested in, be that end user an industrial or a retail customer, would be one of those instances of a potential regulatory mistake where we create an artificial legal category that creates a whole bunch of distortions throughout the market and inhibits kind of the organic organization of a really competitive market as opposed to kind of a fake, bounded competitive market.

The CHAIRMAN. Would you want to answer that, Mr. Svanda?

Mr. SVANDA. I would be happy to. Thank you. There are great legal minds working on either side of the jurisdictional issue, and so I will not go there.

I guess my answer is more from the practical aspect of this, and that is a recognition of the laws of physics that apply to electricity, that in fact much of transmission operates in interstate commerce, which squares with our principles in that regard. And the institutions that we create need to respect those and work with them.

The CHAIRMAN. Yes, Mr. Anderson.

Mr. ANDERSON. I would like to pick up on what my good friend Commissioner Svanda just said, which I agree with completely, but I would like to also say that all too often the difference between bundled and unbundled comes down to an idea that one entity, usually an investor-owned utility or its regulator, wants to protect its native load customers and say we have a duty and a responsibility to protect our native load customers. Therefore, we should control bundled service.

A very wise FERC Commissioner roughly 10 years ago made the statement once that everybody is somebody's native load, and that is very, very true. So just because a customer is not the native load of that utility, that customer is the native load of somebody else's utility. So it is extremely important that transmission be treated in a nondiscriminatory way for every customer. That to me requires a single transmission tariff for all customers, whether they are bundled or unbundled.

Thank you.

The CHAIRMAN. All right. Yes, sir. You are last.

Mr. NORLANDER. Well, I think the issue that kind of cropped up with the FERC-lite I think illustrates a bit of this problem. Much of public power is required by statutes or long-term contract to be provided for the benefit of customers. I know in New York residential customers get an allocation, as do industrial customers. And those allocations generally involve extremely low cost hydropower and, generally speaking, there is a transmission component of that price that is a cost-based component and the transmission is carried by the public power entity.

The moment that the FERC jurisdiction comes in and says now we are going to perhaps auction off the transmission line to those who value it the most on a hot day, it destabilizes that price and makes it volatile, unpredictable. I think it is that nervousness that likewise affect State regulators in other areas of the country that still have bundled rates. I think from what I have heard at least, their objection is not so much to open access but as to the pricing and loss of control and lost of stability and predictability of the transmission component of rates.

The CHAIRMAN. Senator Bingaman, do you have any further questions?

Senator BINGAMAN. No. You have several others panels. I appreciate these witnesses.

The CHAIRMAN. Let us move on. We thank you all very much. We are glad we stayed on time and you helped contribute to that.

The next group of panelists, please. Mr. Phillip Harris, president and CEO of PJM Interconnection; James P. Torgerson, president and CEO of Midwest Independent Transmission System; and P.G. "Bud" Para, director of legislative affairs, Jacksonville Electric Authority.

Mr. Harris, would you like to start please? Thank you very much for coming.

Mr. GLAZER. Mr. Chairman and members of the committee, the bad news is I am not Phil Harris. He is on his way here.

The CHAIRMAN. You are not. Okay.

Mr. GLAZER. But if you wish, I will be happy to start out.

The CHAIRMAN. What is your name?

Mr. GLAZER. My name is Craig, C-r-a-i-g, Glazer, G-l-a-z-e-r.

The CHAIRMAN. G-l-a-z-e-r?

Mr. GLAZER. Yes.

The CHAIRMAN. And why do you feel like you can take his place? Who are you?

[Laughter.]

Mr. GLAZER. I do not feel like I can take his place. I am very humbled by this whole thing. I am the vice president of government policy for PJM Interconnection.

The CHAIRMAN. We will tell him that you were all they had.

[Laughter.]

The CHAIRMAN. Go ahead.

STATEMENT OF CRAIG GLAZER, VICE PRESIDENT OF GOVERNMENT POLICY, PJM INTERCONNECTION, L.L.C.

Mr. GLAZER. Thank you, Mr. Chairman and members of the committee. I am Craig Glazer, vice president of government policy for PJM. Prior to serving in that role, I was for 10 years a member, along with Dave Svanda, of the regulatory commission. I was chairman of the Ohio Public Utilities Commission and appeared before this committee in that role as well. So I have been around these issues for some time, including Federal-State issues.

My basic message today is, as you deal with these complex issues, I have some good news for you and that is that the present system is working. It is working well in our region, and I think our region in many ways could potentially set a model for other regions. I am not saying, therefore, our region is the answer to all the rest of the Nation. I am not saying that at all. But I am saying that before we create new institutions, I would ask you to take a look at some of the lessons of experience, and the facts actually speak for themselves. Let me give you just some examples.

In our region, we are the independent system operator, basically the air traffic controller, the grid operator, for a five-State region that includes Pennsylvania, New Jersey, Maryland, Delaware, Virginia, and the District of Columbia. It actually serves this building, among other things. We have had other companies join us and we are soon to be serving a seven-State region that will go out to Chicago, Illinois and encompass even more of the State of Virginia, as well as Indiana and parts of Tennessee.

The good news story is that the market has really worked, and the lesson from that is these things can work I think with appropriate Federal-State partnerships and a lot of hard work. It is not to say that it is easy, but I think the facts speak for themselves.

In the Mid-Atlantic region, we have seen improvements in generator performance, actually the efficiency being driven by competitive forces, with an increase of 35 percent in generator performance over the last 5 years. Prices in our marketplace have remained both stable and competitive. Although 2002 was 25 percent warmer than 2001, the average load weighted price in PJM actually dropped by 13.8 percent. So the weather got hotter, but the prices got lower. And that is an example of more generators wanting to come in providing service in the region.

Infrastructure investment. We have got more than 6,000 megawatts of new generation that has gone on line, another 24,000 megawatts in the queue, and over $725 million in transmission infrastructure investment since the year 2000.

How has this worked? It has not been easy. The lessons that we have learned are this.

One is—and Phil Harris would say this better than I—but little steps for little feet. Take an incremental approach. We worked with our State commissions. We introduced markets one at a time. We did not do the big bang theory like California did, and we made sure we cemented those relationships with the State commissions up front. We entered into a memorandum of understanding with our State commissions and worked with them on planning issues, as well as capacity and related issues. So lesson one was sort of take an incremental approach.

Lesson two was that the system really can work, and it can work if in fact we do not get wrapped around the axle on Federal-State jurisdictional issues but we try to work through it. And let me take the siting issue as a good example.

We have not run into the siting problems. We understand the issues in the West are far different with regard to siting. But we get the States involved in our regional transmission planning process up front. It ferrets out what are the siting issues, what are the siting problems, what is the best solution, be it transmission, generation, or demand side, up front. As a result of that, everyone has a seat at the table. It is an open and transparent process, and that has been very, very helpful to our processes.

Just a couple of comments on the legislation itself. We do not think that the committee ought to divest FERC of jurisdiction over RTOs and RTO formation. We are concerned with some language in the staff draft that seems to say that an RTO can be basically any form or any shape that a particular entity proposes. These things have to make sense. They have to fit with regard to natural markets. So that is one of our concerns.

The additional concern with the language is that, again, we have been able to work through these issues with our States. We are afraid we are going to get another entity that the industry has to deal with, and I am not sure this is the time to create new bureaucracies.

The same with regard to transmission siting and the reliability issues that I had mentioned previously.

Finally, let me touch on participant funding. We actually support participant funding. We have been doing participant funding in PJM from the beginning, basically that the person who causes the cost of the upgrades should pay for it. That being said, some of the language I think may take away flexibility. We have a system where if an upgrade is needed here in the Washington, D.C. area, the customers in that area pay for it. We do not want to have that cost transferred to Erie, Pennsylvania or customers in California paying for costs in Oregon, et cetera. So we think some more flexibility with regard to that might be helpful.

On transmission incentives, we think the committee is going in the right direction. We think we need incentives to build trans-

mission, and the kind of flexible language with policy direction from Congress has been very helpful.

Let me close by saying the bottom line is the systems can work. Federal-State relationships in our region have been good. Our State commissions will attest to a good working relationship with FERC and with us. It does not mean we do not have issues and problems. We do. But there is an element of trust there. I think as we build that trust in other parts of the country, I think that rather than new institutions may be the way to move forward with these markets.

Thank you very much.

[The prepared statement of Mr. Harris follows:]

PREPARED STATEMENT OF PHILLIP G. HARRIS, PRESIDENT & CEO, PJM INTERCONNECTION, LLC

SUMMARY

". . . (M)arkets don't always operate efficiently because buyers and sellers don't always have access to the information they need to make optimal choices."

Akerlof, Spence & Stiglitz, Nobel prize winners for economics

Mr. Harris urges that Congress both do no harm to markets and regions that have been successful and look to actual facts from regions that have been successful as it considers legislative solutions. In his testimony, Phillip Harris notes that with five years of operating experience, the successes in the Mid-Atlantic region underscore the fact that competitive wholesale markets can work and do provide real value to consumers both in bundled and unbundled states. He points out critical facts that have proven the success of the Mid-Atlantic competitive model:

Performance: In the Mid-Atlantic region, generator performance has improved by nearly 35% over the last five years;

Prices: Prices in PJM remain both stable and competitive. Although 2002 was 25% warmer than 2001, the average load weighted price in the PJM market dropped by 13.8%;

Infrastructure Investment: More than 6000 MW of new generation have gone on line in the region with another 24,500 MW in the interconnection queue. Over $725 million in transmission infrastructure has been committed since 2000;

New Markets: PJM operates nine separate voluntary wholesale markets and recently successfully instituted new markets for regulation and spinning reserves.

In commenting on the Staff March 20, 2003 draft, Mr. Harris details that there are existing institutions and processes presently in place in the Mid-Atlantic region which obviate the need for creation of a Regional Energy Services Commission. He argues against depriving FERC of authority to review the size and functions of RTOs. In addition he said that transmission planning and siting to relieve congestion should remain a collaborative effort between FERC, the states and the RTO rather than being assigned to the Secretary of Energy or exclusively to FERC or an RESC. He raises concerns with the lack of flexibility in the proposed Participant Funding language and the lack of a specific call for RTOs to administer competitive wholesale markets. Mr. Harris embraces the legislative language regarding transmission rate incentives both for its flexibility and its strong policy direction.

He promises PJM's pledge to work with the Committee to ensure balanced legislation that identifies the real need to restore trust in the marketplace.

STATEMENT

This observation from these Nobel laureates highlights exactly the conundrum we face today. We are faced with a crisis of confidence in this industry. Our collective task must be to restore the trust and confidence which is so critical to fund and manage this essential product. By working together, providing real time information that makes markets work and by building institutions that can earn the trust of the public, we can restore the awe and respect for this industry that was first earned almost 100 years ago by Thomas Edison and his colleagues. We have begun

down that road in the Mid-Atlantic region. With five years of operating history, we have proven that markets can work and do provide real value to consumers both in bundled and unbundled states.

My name is Phillip Harris and I am the CEO and President of PJM Interconnection, L.L.C. PJM operates the world's largest competitive wholesale electricity market. We serve seven states, including the District of Columbia (including this building) and will soon be expanding our market to a 14-state region. Large systems such as those of American Electric Power and Commonwealth Edison have expressed their intent to voluntarily join our markets. We are working closely with our sister entity, the Midwest ISO, to develop a joint and common market that will provide the benefits of a transparent voluntary wholesale energy market to a region covering 27 state and a Canadian province and reaches 33 million customers. This market has been independently estimated to provide savings to customers of over $7 billion over the next ten years.[1]

As you struggle with these difficult issues, I urge you to look closely at the lessons of history. In the Mid-Atlantic region, we faced many of the same issues that other regions are facing today—federal/state jurisdictional disputes, the role of municipals and cooperatives in the marketplace, siting concerns etc. Although I am not here to indicate I have all the answers to these issues, I am here to urge that in drafting legislation you do no harm to markets and regions that have been successful. Moreover, I urge you not to reach snap judgments based on fiery speeches from various industry segments without looking at the actual facts from regions that have gone through many of the transformations you are considering today.

The Mid-Atlantic Story: The critical test is the test of use. Our five years of history as a fully functioning Regional Transmission Organization (RTO) can provide critical lessons for what can work.

Back in 1992, this Congress enacted the Energy Policy Act which made wholesale competition in electricity the law of the land. This was a natural consequence of other Congressional action including passage of the Natural Gas Policy Act of 1978 and orders from the Federal Energy Regulatory Commission (FERC) in both the gas and electric arenas.

In the Mid-Atlantic, we made this Congressional mandate work. And although many say that the PJM model is different because we arose from a tight power pool, in April of last year we extended the concept once again to a service area that was never part of the original power pool and showed that one can develop a successful market over multiple states, including bundled states and over multiple reliability councils and regions. The expansion of PJM to encompass the Allegheny Power system alone has lead to a $100 million annual savings to entities serving customers in the overall region. And for this reason, new entrants such as American Electric Power, Commonwealth Edison, Dayton Power & Light, and Dominion Virginia Power which together comprise over 64,000 MWs, have sought to join these markets.

The facts speak for themselves:

The market model has worked both in the original power pool area and in the broader region. Just a few real life statistics prove the point:

- *Size:* Size does matter. The eastern interconnection is one large 650,000 MW synchronous motor. With our expansion we will total over 130,000 MWs representing 20% of the entire eastern interconnection. We have over 215 members actively trading every day in our marketplace. In 2002 we cleared over 178,000 transactions which have totaled over $15 billion in energy trades since the opening of the markets in 1997. Market participants come from every state including the southeastern part of the United States and the Canadian provinces;
- *Performance:* The performance record of generators has improved by nearly 35% since 1997. This improved performance translates into $1.2 million in savings on a hot summer day;
- *Prices:* Prices are both stable and competitive. Although 2002 was 25% warmer than 2001, the average load-weighted wholesale price in PJM dropped by 13.8%;
- *Generation Infrastructure:* More than 6000 MW of new generation have come on line in the region, another 6500 MW are under construction with another 24,500 MW in our interconnection queue;
- *Reduced Congestion:* The total hours of transmission congestion actually decreased in 2002 from 2001 despite greater imports.
- *New Markets Instituted:* PJM currently operates over nine different markets that ensure both the delivery of energy, capacity and ancillary services to cus-

[1] "Impact of the Creation of a Single MISO-PJM-SPP Power Market", July 2002 by Energy Security Analysis, Inc.

tomers. We have most recently implemented successful markets for regulation and spinning, two ancillary services that traditionally were supplied through command and control processes. These new markets have performed extremely well. We continue to look for additional market-based solutions to the provision of key services associated with the delivery of electricity.

This is not to say that our market is perfect—it isn't. We need to do a better job in areas such as achieving true demand response and finding market-based solutions to ensure reliability. Nevertheless, with the right mix of transparency, independence and trust, wholesale competition in our region has spurred the very sought of efficiency that has made Congress' 1992 vision a reality.

With this backdrop, let me address each of the issues you raised through the Staff draft of March 20, 2003. I appreciate that this is a Staff draft intended to drive discussion on these critical issues. The staff should be applauded for framing the issues for debate and discussion.

I. FORMATION OF A REGIONAL ENERGY SERVICES COMMISSION

You will undoubtedly hear much testimony, pro and con, on the minutiae of this proposal—who sits on the Commission, what is its relation to state PUCs, is it a creature of federal or state statute, what constitutes a region etc. Rather than becoming embroiled in the minutiae, I would like to go through each of the goals outlined for the Regional Energy Services Commission (RESC) in the Staff draft. I would suggest to you that there are institutions and processes presently in place that are already addressing these issues and that can meet these goals and the needs of the states without requiring the creation of yet another regulatory institution.

The Staff draft allows the RESC to perform the following tasks:

- undertaking transmission infrastructure planning, certification and siting;
- identifying resource needs;
- setting rate design and revenue requirements;
- monitoring markets for the abuse of market power;
- promoting demand response, distributed generation and advanced technologies;
- cooperating with federal land agencies;
- promoting reliability standards; and
- undertaking enforcement.

Within our region, each of these tasks is being accomplished collaboratively through close cooperation among ourselves as the RTO, the state and federal regulators. In short, the system is working, not because we have created new institutions but rather because we have worked hard to build trust among the existing institutions. As a result, although not without controversy on any given day, we believe the Mid-Atlantic/Midwest PJM region is a model of the appropriate balance between state and federal authority. And you should not take our word for it—rather look at the statements made by our own state commissions in numerous public filings.

From its very inception, the PJM Board collaboratively developed a Memorandum of Understanding with the state commissions in our region. The MOU commits the RTO to work with the state commissions on these and other critical issues. We have subsequently built on the MOU to provide a key state role in each of the areas listed above. Specifically:

Transmission Planning and Siting: We have the first approved regional transmission planning process. The states participate actively in that process to ensure that state needs are identified and addressed. Moreover, should there be difficulties in siting a particular upgrade, these issues are identified early on in the regional transmission planning process rather than at the end of the line after critical time has been lost or resources expended. Under this regional process, over $725 million of transmission investment has been undertaken since 2000 alone.

Most recently, PJM has submitted to FERC a revised planning process that takes regional planning to the next level by addressing the need to plan to relieve congestion. Our proposal calls for a critical balancing between the role of the marketplace and the role of the regulator in economic planning and provides an active role for the states in addressing the particular needs of customers in load pockets where traditional market forces may not always provide adequate market-based solutions. These processes are either in place or proposed and all work under the existing structure of federal and state regulation;

Identification of Resource Needs—The RTO independent Board presently sets the reserve margin for the region as part of its fiduciary duty to maintain the reliability of the system. We have begun discussion with our states on the concepts proposed

by FERC for a Regional State Advisory Commission which would, among other things, provide critical input or even set the reserve margin for the region. At the end of the day, someone needs to be able to set this margin and meet the resource needs promptly and clearly without questions as to accountability or endless litigation. Nevertheless, the state role in this area is extremely important and one that we embrace. We are working to accommodate the state role under our existing model. No additional bureaucracies are needed to address this issue—simply hard work and trust between the RTO, the state commissions and the market participants;

Rate Design and Revenue Requirements—This issue is one which involves the resolution of difficult equity and cost shifting issues. We embrace the elimination of pancaking of rates. But as we have seen, somewhere there is a border and a revenue stream which will be affected through rate pancaking elimination. In short, it is difficult to solve this issue merely by focusing on the needs of one region. Rather than creating a new institution, we need clear regulatory guidance on how these lost revenue and cost shifting issues should be addressed.

Market Power Review—This too is an issue that is already being addressed both at the state and federal level in our region. Although more work is clearly needed, the answer here too is not to create another institution which will require its own staff and technical expertise that could duplicate the resources already available at FERC, the state level and within the RTOs.

At the end of the day, someone needs to weigh the facts and determine whether market power has been abused. It does no good for a regional entity to find no market power in its region when an entity in an adjoining region finds that very same action has caused market power abuses in its own marketplace. Even within a region, the industry is entitled to some parameters to determine what constitutes acceptable and unacceptable practices as marketers make split second decisions.

The PJM Market Monitoring Plan calls for the PJM Market Monitor to respond to state requests and perform analyses at the request of states. We have done this on a number of occasions. The lessons from our region demonstrate that we need proactive and prompt leadership from the Market Monitor, quick action from the regulator and state attention to the issue. What we do not need is to create yet another entity to address the critical dual role of FERC and the states in this area;

Demand Side Response, Distributed Generation, Fuel Diversity and New Technology—In our region, the states rather than the FERC already dominate in these areas. The states worked with and supported before FERC adoption of our demand side response program. We have appointed individuals specifically assigned to these tasks to ensure that these programs are receiving the attention they deserve.

More demand side response is needed. The key role here is for the states not for a Congressional mandate and new institutions that may interfere with appropriate state prerogatives.

RTO Formation—Depriving FERC of authority in this area may be a solution in search of a problem. The states have played an extremely active role in addressing the appropriate borders of RTOs,[2] whether RTO mergers should occur[3] and RTO governance issues. In short, the states have held our feet and FERC's feet to the fire by appropriately demanding cost/benefit analyses and independent governance before lending their support. And history shows that the FERC has responded to state demands in each of the regions in the country. The track record of FERC/state collaboration in this area is a good one both in the Midwest and Northeast regions. Congress should avoid inadvertently setting this progress back by assigning the difficult task of drawing RTO borders to a new institution.

In short, we urge the Committee to look at models that have worked. They have worked well with minimal Congressional intrusion because the parties worked to build trust and confidence rather than resorting to political battles. We think that you should look at models such as ours, which are accomplishing the goals the Staff envisions for the Regional Energy Services Commission, before you enshrine yet another institution for this industry and for consumers to have to interface with.

II. RELIABILITY STANDARDS

We had raised considerable concerns with prior drafts of this legislation which, among other problems, lacked a definition of reliability. Prior drafts also did not reflect recent changes in the marketplace such as the development of RTOs. We worked with Committee Staff and stakeholders to improve the language and are pleased that it is much shorter and better drafted. Furthermore, it now contains a

[2] *Alliance Cos.* 97 FERC 61,327 (2001).
[3] *PJM Interconnection,* 101 FERC ¶61345 (2003).

recognized definition of reliable operation, a conflict resolution provision, a requirement for FERC guidance on implementation and better consumer protection. We still remain concerned that we are creating yet another institution which, at least for the eastern interconnection, could move us towards a command and control approach to enforcement and away from using the market to extract far more appropriate penalties for non-compliance. The language is better than it was and for that we thank the Committee staff, both in the House and Senate for their work at improving this proposed legislation;

III. TRANSMISSION SITING

The staff draft removes siting authority from the states and places it in the hands of the Secretary of Energy and FERC (or, if applicable, a RESC) in those cases where the Secretary finds there to be congestion "at a level that affects reliability or economic security."

Quite simply, the decision as to whether a particular area is congested is an extremely complex task—in PJM, we have found that the slightest changes in power flows can cause an area that is congested one day to not be congested the next. Moreover, not all congestion is bad—one need weigh, through an appropriate cost/benefit analysis, whether the cost to clear congestion that is causing increased costs but does not threaten reliability is outweighed by the cost to remedy that congestion. To automatically require that all congestion that "affects economic security" be relieved runs the risk of "gold plating" the network and not allowing new technologies in the areas of demand response and generation to compete with transmission solutions. In short, the decision as to whether or not an area is congested and needs relief should be determined by the marketplace relying on technical information provided by the regional transmission organization or the system operator. This highly complex issue should not be concentrated in a Washington agency far removed from the technical, minute-by-minute performance of the grid. By implementing regional planning as a first step combined with incentives for new construction and regional cooperation on siting issues, we can solve this issue without creating a new bureaucratic hurdle for the industry.

IV. TRANSMISSION INVESTMENT INCENTIVES

The incentive language in the Staff Working Draft provides an appropriate level of flexibility while setting forth a broad Congressional principle. PJM is committed through its model to ensuring that proper information is provided in the marketplace so that generation, transmission and demand response solutions can all compete against one another.

This language, although already reflecting actions that FERC has underway, appropriately reinforces the sense of Congress on these critical issues.

V. TRANSMISSION COST ALLOCATION (PARTICIPANT FUNDING)

PJM has long employed the principle of participant funding. We have turned it from an abstract concept to a working tool for the proper assignment of cost responsibility associated with network upgrades. PJM employs a "but for" analysis—but for the action of a particular generator, would the upgrade have been needed? If the action were otherwise needed in the future but the addition of a generator has accelerated the need for the upgrade, then the generator bears that cost but is entitled to a credit for the fact that the upgrade would otherwise have been needed. That being said, even if it is determined that the cost should be borne by the general class of ratepayers, those costs are borne by that particular zone—namely the service territory of the transmission provider. It would be no more fair for customers in Erie, PA. to pay for an upgrade needed in Northern New Jersey than it would be for customers in Oregon to pay for reliability upgrades needed in Los Angeles. In short, the language, although seemingly embracing participant funding, would rather have the effect of straitjacketing the FERC or RTOs from applying more tailored remedies to be funded by the local zone rather than throughout the system. By so doing, the language would decide by Congressional fiat critical judgments that need to be made on a regional level based on specific facts and circumstances.

VI. MARKET TRANSPARENCY/ANTI-MANIPULATION ENFORCEMENT

This language would require that FERC establish "electronic information systems" to provide necessary price transparency. Although the language is well-intentioned, it focuses on the tool rather than the key ingredient that will make the tool work. In our market, we operate a transparent voluntary spot market for electricity. Making that market work requires the kind of information this proposed legislation

calls for. However, since under the staff draft RTOs are not required to operate spot markets, there is no assurance that the tool will provide the kind of day ahead and real time open trading platform that an RTO can offer. In short, without a market-based system that works hand in hand between the financial market and the physical market, there will be little meaningful information to report. This would be the equivalent of disbanding the New York Stock Exchange but still requiring brokers to report individual bilateral transactions. One would still not have the organized marketplace that provides open, transparent prices that are verifiable. One need only look at the problems found recently in bilateral trader reporting of natural gas prices in trade publications to see why an approach without an actual exchange is problematic. We believe that RTOs should operate day ahead and real time spot markets which are voluntary. Through the operation of such markets, the kind of reporting called for in this language would be automatic and not require separate Congressional action.

We feel the Staff draft is asking the right questions. We think the answer is in strengthening our existing institutions and learning from the incremental approach we have embraced in the mid-Atlantic in order to restore needed trust and confidence in the industry. We stand ready to work with the Committee on this pressing task.

The CHAIRMAN. Thank you very much, Mr. Glazer.

Now we are going to have Bud Para. If you will testify, please. Thank you for coming.

STATEMENT OF P.G. "BUD" PARA, DIRECTOR, LEGISLATIVE AFFAIRS, JACKSONVILLE ELECTRIC AUTHORITY, ON BEHALF OF THE SETRANS RTO SPONSORS

Mr. PARA. Thank you, Mr. Chairman and members of the committee. I want to thank you for this opportunity to be involved in this process.

I am with JEA. JEA is the largest municipal electric utility in Florida. We provide electric, water, and sewer services to more than 1 million people in the city of Jacksonville, Florida.

I am here today testifying on behalf of the SeTrans Sponsors. That is nine utilities in the Southeast that are currently developing the SeTrans RTO for the Southeastern United States. The SeTrans Sponsors include a diverse group of transmission owners. We have three investor-owned utilities: Cleco Power, Southern Company, and Entergy. We have three municipal utilities representing the city of Tallahassee, Florida, the city of Dalton, Georgia, and JEA. We have two electric cooperatives: the Georgia Transmission Company and the Sam Rayburn G&T Cooperative. And we have one municipal joint action agency, MEAG Power in Georgia.

The SeTrans RTO would be one of the largest RTOs with electric systems in seven States: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi and Texas.

The SeTrans Sponsors support open access to the transmission system. We do not believe it is necessary, and we think that it may be inadvisable to make sweeping legislative or regulatory changes to the electric industry at this time. The electric system in the Southeast works today.

The SeTrans Sponsors are working with other stakeholders, customers, generators, and State commissions, to develop an RTO that will work in the Southeast and that meets the FERCs requirements, but also one that will not cause tremendous harm to the electric industry, which is crucial to the Southeast.

We do not now understand what happened to cause the energy crisis in California and the Northwest, and we feel that we must

understand what went wrong there before we change the electric industry in the Southeast. We do not want to make that same mistake twice.

The SeTrans Sponsors believe that to be successful in the Southeast, an RTO must be voluntary. It must be designed to recognize regional flexibility and that there must be no standard market design, no SMD. Non-FERC jurisdictional utilities like JEA must be able to join the RTO without becoming FERC jurisdictional. Non-jurisdictional utilities would, of course, comply with their contractual obligations to the RTO, when and if they voluntarily join the RTO.

And that is why JEA is involved in developing the SeTrans RTO. We want an RTO in the Southeast that will work for us and that will benefit our customers. If we join the SeTrans RTO, JEA will live up to its contractual obligations and we will participate in the market according to the RTO rules.

Joining the SeTrans RTO, however, should not make JEA subject to FERC jurisdiction, particularly not such that FERC can come in and change the rules, effectively change our contract unilaterally without our agreement. If FERC changes the rules, then JEA should be able to leave the RTO and get out of this changed contract.

There are at least three impediments to completion of the proposed SeTrans RTO and to the continued participation of the current SeTrans Sponsors.

First, there is the lack of regional flexibility. We must have regional flexibility in order to get our State and local approvals, without which there will be no RTO. Without the flexibility to structure the SeTrans RTO in a manner that meets our needs and the needs of the Southeast and that benefits the Southeast, we will not get the approvals from our State and local regulators that we must have for SeTrans to be successful.

I ask you to read the letter from SEARUC to FERC which was attached to my testimony. It explains the views of the Southeastern Regulatory Commissioners quite well.

The second impediment is the standard market design. The FERC SMD rulemaking is a distraction. It undermines regional flexibility and it cannot be right for every region no matter what is in the SMD because the regions are not standard. Congress, if it does anything, should direct FERC to abandon its SMD efforts.

The third impediment to development of the SeTrans RTO is the recent FERC attempts to expand its jurisdiction. FERC has recently issued decisions in which it attempts to expand its jurisdiction over retail activities historically subject to State and local authority. FERC is also attempting to expand its jurisdiction over non-jurisdictional utilities that voluntarily join RTOs. These actions by the FERC discourage JEA from participating in RTOs.

In conclusion, Mr. Chairman, members of the committee, the SeTrans Sponsors do not believe we need electricity legislation today. The time is not right. We do not yet understand what happened in the West, and there is no crisis to be fixed in Southeast.

I thank you for your attention and welcome any questions.

[The prepared statement of Mr. Para follows:]

PREPARED STATEMENT OF P.G. PARA, DIRECTOR, LEGISLATIVE AFFAIRS, JACKSONVILLE ELECTRIC AUTHORITY, ON BEHALF OF THE SETRANS RTO SPONSORS

Mr. Chairman, Members of the Committee, my name is P.G. (Bud) Para, and I am the Director, Legislative Affairs for JEA, the largest municipal electricity utility in Florida. I am testifying today on behalf of the transmission owners that are developing a Regional Transmission Organization (RTO) in the Southeast, the SeTrans RTO. I will refer to this group of transmission owners throughout my testimony as the SeTrans Sponsors. The SeTrans Sponsors include the following: Cleco Power LLC; Dalton Utilities (acting as agent for the City of Dalton, Georgia); Entergy Services, Inc. (acting as agent for Entergy Arkansas, Inc., Entergy Gulf States, Inc., Entergy Louisiana, Inc., Entergy Mississippi, Inc., and Entergy New Orleans, Inc.); Georgia Transmission Corporation; JEA (formerly Jacksonville Electric Authority); MEAG Power; Sam Rayburn G&T Electric Cooperative, Inc.; Southern Company Services, Inc. (acting as agent for Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, and Savannah Electric and Power Company); and the City of Tallahassee, Florida.

We appreciate the opportunity to share with you our views on the proposed electricity legislation.

The SeTrans Sponsors represent a diverse group of transmission owners in the Southeastern region of the United States. The SeTrans Sponsors' cumulative transmission investment is approximately $9.0 billion, and our systems include approximately 48,000 miles of transmission lines rated 40 kV or higher. The SeTrans RTO would include electric systems in seven states: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi and Texas. The proposed SeTrans RTO would be one of the largest RTOs in the nation.

Mr. Chairman and Members of the Committee, the SeTrans Sponsors appreciate your efforts and the attention that you are giving to our industry. As a group, we join you in supporting a competitive, reliable wholesale power market to benefit consumers. Nonetheless, we believe it is not necessary at this time to make sweeping legislative or regulatory changes in the regulatory structure of the electric industry across the United States.

Importantly for the SeTrans Sponsors, the existing regulatory structure performs well in the Southeast and there is no need for broad changes to the electric regulatory structure in the Southeast. We do not believe the electric industry in the Southeastern United States is broken, and we therefore see no need to fix it. The SeTrans Sponsors include a broad cross-section of transmission owners—electric cooperatives, municipalities, municipal joint-action agencies and investor-owned utilities. Three of the sponsors are public utilities subject to the general jurisdiction of the Federal Energy Regulatory Commission, but six are not. These utilities have coexisted in the Southeast for a long time and we believe our region enjoys a vibrant wholesale electricity market. Moreover, the SeTrans Sponsors are working together today to develop an RTO model that serves the needs of the wholesale market in the Southeast, as well as those of the investor-owned, publicly-owned, and cooperatively-owned utilities in the Southeast.

In addition, we have serious reservations with regard to efforts to significantly restructure the electric industry across the nation. There is not yet a clear understanding of what went wrong in California, nor how or why those problems then spread across electricity markets in the Northwest. Until we know more and better understand the reasons that underlie the problems experienced in the electric industry in California and the Northwest, we should not promote comprehensive national restructuring of the electric industry. Although there may be a need for legislation to address discreet issues faced by certain segments of the electric industry or unique circumstances in certain regions of the United States, the SeTrans Sponsors as a group do not support legislation that would mandate any particular industry structure or that would change the way electric service is provided in our region. We appreciate, however, the opportunity to be involved in the legislative debate and are willing to assist in crafting targeted legislation. There are some areas for which clarification by Congress would be useful and I will describe those further.

I would now like to comment more specifically on the issues that are the focus of the Committee's attention today. We are providing comments here on only those issues with which we have agreement as a group, and more specifically, in order to support and advance a process that would allow further, expeditious development of the proposed SeTrans RTO. In that vein, I will begin my comments with a discussion of "Transmission Organizations/RTOs".

TRANSMISSION ORGANIZATIONS/RTOS

The SeTrans Sponsors support the voluntary formation of regional transmission organizations, or RTOs, as is evidenced by our active participation, and the consequent time and resources we are spending on the development of the proposed SeTrans RTO. It is important to note that if RTOs are to go forward and succeed, they must be proven to provide benefits to all the stakeholders involved. At JEA, we have an efficient and cost-effective electric system of which we are very proud. We are working hard on the development of the proposed SeTrans RTO in order to make sure it will meet our customers' needs and provide benefits for our system, as well as work for and secure benefits for the entire Southeastern region. Every one of the SeTrans Sponsors is doing the same thing.

The proposed SeTrans RTO is organized around the key governance concept of an independent, incentive-driven, third party operator, the SeTrans Independent System Administrator (ISA), that will manage, but not own, the transmission facilities dedicated to the RTO. The SeTrans Sponsors are currently negotiating with the preferred ISA candidate, a team made up of ESB International, Ltd. and Accenture, LLP. The ISA model provides a platform for the formation of, and a role for, independent transmission companies (ITCs), as well as individual participating transmission owners. The proposed SeTrans RTO offers a common market design for the Southeast that includes in "Day 2" a broad, seamless market for energy and ancillary services, a congestion management model based on Locational Marginal Pricing (LMP), tradable Financial Transmission Rights (FTRs) to hedge against the impact of congestion costs, and Participant Funding of certain new transmission facilities. The SeTrans Sponsors believe our proposed market design would minimize seams issues, support a robust competitive wholesale market, and encourage market-driven planning and expansion, while protecting native load customers.

As I stated before, the SeTrans Sponsors are trying to develop an RTO that will meet the needs of the competitive wholesale market, as well as those of the investor-owned, publicly-owned, and cooperatively-owned utilities in the Southeast. This is a difficult task given the disparate types of utilities in the Southeast and the fact that substantial portions of the region's transmission facilities are owned by state and federal authorities, municipalities and electric cooperatives. In developing the proposed SeTrans RTO, the SeTrans Sponsors have identified a number of concepts that are critical to demonstrate that the RTO will provide benefits to everyone and ensure the voluntary participation of the Sponsors. Those concepts include:

- the ability of non-jurisdictional entities to withdraw from participation due to tax concerns;
- the Participant Funding concept;
- the ability to avoid cost shifting by utilizing a zonal rate structure through at least 2012;
- the ability to charge for power being exported from the SeTrans region, as a way of recovering revenues lost through the elimination of multiple transmission rates across the RTO footprint;
- the ability to honor grandfathered agreements;
- the ability to ensure that native load continues to get priority in use of the transmission system;
- the concept of installed capacity requirements; and
- the ability for state regulators, local authorities (in the case of municipals), or governing boards (in the case of cooperatives) to set rates for retail electric service, including retail transmission rates.

The SeTrans Sponsors believe the proposed SeTrans RTO, which includes these concepts and contemplates voluntary participation by transmission owners, can and will support a robust competitive wholesale market.

I must point out, however, that there are impediments to completion of the proposed SeTrans RTO, and to the continued participation of all current SeTrans Sponsors. First, although it is not clear the Commission will approve a proposed RTO that includes certain of the critical concepts outlined above, the Southeast Association of Regulatory Utility Commissioners (SEARUC) has made clear that FERC must accept regional flexibility in its efforts to develop electricity markets in the Southeast. I draw your attention to an attachment to my testimony, a February 21, 2003, letter from SEARUC to Pat Wood, the Chairman of the Federal Energy Regulatory Commission.* In its February 21 letter, SEARUC listed the following commit-

*The letter has been retained in committee files.

ments that were necessary "as a foundation for cooperatively developing appropriate modifications to the structure of the electric industry in the Southeast":

- retention of state jurisdiction over the transmission component of bundled retail rates and service;
- protection of native load customers from increased costs;
- avoidance of cost shifting between regions or between consumers within the region;
- voluntary RTOs and recognition of joint jurisdiction over RTO formation; and
- a SMD in the form of broad guidelines with substantial regional flexibility.

The SeTrans Sponsors believe it would be helpful for the Congress to clarify for the Federal Energy Regulatory Commission the need to recognize regional flexibility in order to ensure that the RTO proposals currently underway are completed, and that the proposed SeTrans RTO will have a chance to be granted necessary state approvals.

A second potential impediment to RTO formation is the Federal Energy Regulatory Commission's recent rulemaking on Standard Market Design (SMD). In the proposed rule on SMD, the Commission proposes to order FERC-jurisdictional utilities to either become Independent Transmission Providers (ITPs), or to join an approved RTO. This mandate to become an ITP or join an RTO is extremely counterproductive at this time. Indeed, the SeTrans Sponsors have made great progress on a voluntary basis toward developing the proposed SeTrans RTO, and in the middle of their efforts, along comes a rulemaking that eliminates the voluntary nature of RTO participation for jurisdictional utilities. I would point again to the February 21 SEARUC letter that is attached to my testimony and note that state public service commissions are more likely to approve participation in a voluntary organization. The SeTrans Sponsors believe that if the Congress were to direct the Federal Energy Regulatory Commission to abandon its SMD efforts, or make significant modifications to the SMD rule to accommodate regional differences and allow voluntary participation, it would greatly enhance the chances for the proposed SeTrans RTO to become a reality and succeed in meeting FERC and the Congress' objectives for a competitive wholesale electricity market.

REGIONAL ENERGY SERVICES COMMISSIONS

The SeTrans Sponsors have not studied this new concept in detail and cannot offer comments on its substantive provisions. It is encouraging to see a proposal that allows for regional differences. However, there are many important components left undefined, including the relationships between RESCs and with FERC and overlapping RTOs. The SeTrans Sponsors believe that this concept deserves full consideration by stakeholders and this cannot be resolved before the Committee's markup that is scheduled for next week. We therefore encourage the Committee to focus on what needs to be done to ensure efficient and reliable wholesale markets under the existing regulatory scheme.

RELIABILITY STANDARDS

The SeTrans Sponsors believe that participation by transmission owners in RTOs, like the proposed SeTrans RTO, may provide additional administration and more uniform enforcement of reliability standards. We do not support the reliability provisions contained in the staff discussion draft dated March 25, 2003. Assigning reliability enforcement authority to regional energy service commissions (RESCs), as does the March 25 draft, substitutes a brand new governmental entity, with no technical competence or experience whatever, for the industry-led enforcement, subject to government oversight, that is the essence of the S. 475 reliability provisions. Introduction of the concept of regional energy service commissions into the reliability context also raises a host of unanswered questions concerning the intended relationship between the existing electric reliability organization and RESCs.

OPEN ACCESS (FERC-LITE)

The FERC-lite language in Section 2071 of Congressman Barton's bill, as marked by the subcommittee, gives FERC sufficient authority to ensure that non-jurisdictional utilities provide open access, non-discriminatory transmission service.

The individual SeTrans Sponsors have supported various moves toward open, non-discriminatory transmission systems as have been developing in the electricity industry over the past few years. As a group, the SeTrans Sponsors agree that development of RTOs must provide for participation of utilities that are not subject to the general jurisdiction of the Federal Energy Regulatory Commission without those utilities becoming, in effect, jurisdictional.

In the proposed SeTrans RTO, the SeTrans ISA will be a FERC-jurisdictional electric utility. Each participating transmission owner will enter into a contractual relationship (the Transmission Operating Agreement (TOA)) with the SeTrans ISA, providing the SeTrans ISA the right to use its transmission facilities to provide service under the SeTrans open access transmission tariff (OATT). We intend that a TOA between the SeTrans ISA and a non-FERC-jurisdictional transmission owner will not be a jurisdictional contract. Therefore, a non-jurisdictional utility that joins the SeTrans RTO will not subject itself to the jurisdiction of the Federal Energy Regulatory Commission simply by virtue of joining the RTO.

The SeTrans Sponsors believe this proposal strikes a reasonable balance between the goals of the FERC and the Congress to establish efficient, reliable and competitive wholesale markets and the goal of non-jurisdictional utilities to retain their current status. The SeTrans Sponsors ask the Congress to direct FERC to accept that non-jurisdictional utilities that voluntarily join an RTO do not subject themselves to FERC jurisdiction and to approve RTO proposals that include provisions to achieve such a result.

TRANSMISSION SITING

The SeTrans Sponsors do not believe that transmission siting is a major problem in the Southeastern region of the United States. Unless specific problems are demonstrated, we believe Federal pre-emption for purposes of transmission siting is not required.

SERVICE OBLIGATION

The SeTrans Sponsors support legislation to ensure that a utility which reserves transmission service to meet its service obligations will not be considered as engaging in undue discrimination or preference.

PARTICIPANT FUNDING

In developing the proposed SeTrans RTO, the SeTrans Sponsors have included Participant Funding of certain new transmission investment. For purposes of the proposed SeTrans RTO, Participant Funding refers to a mechanism whereby a party or parties seeking the economic expansion of the transmission network, as compared to an upgrade that is required to maintain existing reliability levels, will be responsible for funding the cost of the expansion. In return for funding the expansion, the funding parties will receive the net incremental financial transmission rights, FTRs, created by the expansion for a 30-year term.

Participant Funding is important in the Southeast. Over the past few years, a lot more new generation capacity has been announced than is needed to serve the load in the region. Since this excess planned growth in generation appears to be caused by the abundant natural resources in the Southeast, including proximity to natural gas, water and available land, the region may continue to attract more generation than is needed to serve the load. This issue did not emerge when utilities planned both generation and transmission in an integrated manner. Today, however, much of the new generation is to be built by independent power producers. If all transmission upgrades needed to add these generators to the grid are "rolled-in," generators will not see a transparent and accurate signal as to the cost their locational decisions are imposing. The SeTrans Sponsors proposed the Participant Funding concept to provide a transparent and accurate price signal, and to act as a market surrogate for the integrated planning traditionally employed by utilities.

Participant Funding in the proposed SeTrans RTO is part of the Day 2 market and is consistent with the broad principles outlined in the Infrastructure Cost Allocation Principles in Subtitle E, Section 33 of the Discussion Draft. However, the SeTrans Sponsors are concerned that the proposed language may require the Federal Energy Regulatory Commission to socialize costs even in cases where the transmission improvements are made that would not have been required absent a specific request for transmission service. Any transmission investment may have system-wide reliability benefits. However, if the transmission investment would not have been made in the region absent a specific request, then it should be paid for by the party that benefits from the investment. Otherwise, existing customers are paying for system improvements that they did not need.

I would note that forms of participant funding have been adopted in PJM and the New York Independent System Operator. In addition, Participant Funding is a critical component of the market in the proposed SeTrans RTO. Therefore, the SeTrans Sponsors request that if this Committee addresses transmission pricing in energy or electricity legislation, it ensures that Participant Funding is not precluded.

CONCLUSION

I appreciate the opportunity to testify before this Committee and to provide the views of the SeTrans Sponsors on these important issues. Our first obligation is to our native load customers. We believe that we must be able to continue to fulfill our obligation to serve those customers and provide them with reasonably priced, reliable electric service. As a group, we believe that one way we can continue to meet this obligation under the existing electricity statutory scheme is by further developing, and then participating on a voluntarily basis in, the proposed SeTrans RTO. We do not believe that the Congress or FERC should mandate wide ranging changes to the electricity market before we understand what caused the western energy crisis.

At the same time, we believe it would be extremely helpful as we continue our RTO development efforts if the Congress would direct the Federal Energy Regulatory Commission to:

- recognize the need for regional flexibility in the development of RTOs;
- abandon its SMD efforts or modify the rule to accommodate regional differences;
- allow voluntary RTO participation; and
- approve RTO proposals that allow non-jurisdictional entities to join an RTO without becoming subject to FERC jurisdiction.

In addition, we ask the Congress to support Participant Funding if FERC itself does not adequately address transmission pricing.

I will be happy to answer any questions you have.

The CHAIRMAN. Thank you very much.

We will proceed now with Mr. Torgerson. Thank you for coming.

STATEMENT OF JAMES P. TORGERSON, PRESIDENT AND CEO, MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.

Mr. TORGERSON. Good morning, Mr. Chairman and members of the committee. I am Jim Torgerson, president and CEO of the Midwest Independent Transmission System Operator, the Midwest ISO, the Nation's first FERC-approved RTO. I want to thank you for this opportunity to discuss energy legislation before the Congress.

Headquartered in Carmel, Indiana, the Midwest ISO serves over 16 million customers in 15 States and controls more than $13 billion in installed assets. This hearing comes at an important time for us, our customers, and the Nation as a whole. The task before us is significant.

The Midwest ISO believes that it is correct to analyze transmission and energy markets regionally. Electrons cross borders. Power lines cross State lines. Actions in one State can significantly affect customers in another.

A properly organized region energy market offers benefits to all users of the grid.

Nonetheless, competitive markets continue to face challenges.

Mr. Chairman, let me first state that none of the bills which are the subject of the hearing this morning would unduly interfere with the voluntary arrangements that the Midwest ISO has reached among its members and Federal and State regulators under existing Federal and State statutes and regulations. However, the staff draft presents us with the most significant questions. Obviously, the members of the Midwest ISO would like to retain the benefits that we have achieved to date. We are anxious to work with this committee to ensure that, where appropriate, legislation permits Midwest ISO to maintain current arrangements.

As a general proposition, we believe that consistent Federal and State policies that encourage participation in stable, rationally sized and transparent transmission and electric energy markets will go a long way in attracting much-needed capital to our electric utilities, which in turn can strengthen our infrastructure. Midwest ISO would like to continue to be able to assist in the attraction of much-needed capital for critical infrastructure improvements.

I will now turn to two of the specific issues on which the committee has requested comment.

Section 1211 of the staff draft would create RESCs as a means of resolving jurisdictional disputes between State and Federal authorities. I am pleased to note that the States within which the Midwest ISO operates have set forth a proposal that will advance development of wholesale markets and promote efficient Federal and State interaction. Specifically, these States have proposed to form a Midwest multistate committee which would coordinate State expertise and inputs on matters related to RTO implementation, systems operation, planning, and transmission siting. I have every reason to believe that the MMSC will be successful and highly effective.

At this time for our region, the Midwest ISO would support further encouragement of voluntary associations between Federal and State authorities and RTOs. Appropriate regional differences should be respected and States have critical interests in the protection of retail customers. The MMSC approach offers a promising vehicle by which basic national consistency and flexibility to meet regional needs may both be addressed.

I should also point out that under the definition section of the bill, a transmission organization is defined as being approved by either the FERC or an RESC. It might be helpful to clarify that for consistency the approval should be based on the same standards and criteria to be applied by either body. It is also critically important for the Midwest that those transmission organizations, already unconditionally approved by the FERC, do not need further approvals.

The Midwest ISO is in agreement with the legislative requirements for a viable and workable RTO.

In addition, while we certainly agree with the policies set out that RTOs should provide for the elimination of pancaked transmission rates within the RTO's region, we would suggest that the committee might use this legislation to also eliminate pancaked rates between RTOs.

We are also in full agreement with the sense of the Congress provisions contained in the Senate counteroffer and the House Energy and Air Quality Subcommittee bill indicating that all transmitting utilities should voluntarily become members of RTOs and that the FERC should provide any transmitting utility that becomes a member of an RTO a return on equity sufficient to attract new investment capital for expansion of transmission capacity.

We believe it is particularly helpful that RTOs be provided with tools to identify and manage congestion on the wholesale grid.

In conclusion, Mr. Chairman, the Midwest ISO believes that the legislation being considered by Congress can bring significant benefits to energy consumers. The Midwest ISO has been on the fore-

front of RTO development, regional oversight of transmission and electricity markets between States and the Federal Government, regional planning, attracting crucial investment to our electricity infrastructure, planning for grid enhancements necessary to utilize wind resources, and vigilant monitoring of our energy markets.

The Midwest ISO looks forward to continuing to build on its activities to date in these and other areas and to working with you, Mr. Chairman, and this committee on these important matters.

Thank you.

[The prepared statement of Mr. Torgerson follows:]

PREPARED STATEMENT OF JAMES P. TORGERSON, PRESIDENT & CEO, MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.

Good morning, Mr. Chairman and members of the Committee. I am James P. Torgerson, president and CEO of the Midwest Independent Transmission System Operator—or Midwest ISO.

I want to thank Chairman Domenici, Senator Bingaman and the entire Committee for this opportunity to discuss energy legislation before the Congress. Headquartered in Carmel, Indiana the Midwest ISO serves over 16 million customers in fifteen states and controls more than $13 billion dollars in installed assets. This hearing comes at an important time for us, for our customers, and the nation as a whole. The task before us is significant.

After the Federal Energy Regulatory Commission (FERC) issued its Order Nos. 888 and 2000 creating Regional Transmission Organizations (RTOs), the transmission owners of the Midwest were the first to step to the plate, voluntarily creating Midwest ISO and becoming the nation's first FERC-approved RTO.

The Midwest ISO believes that it is correct to analyze transmission and energy markets regionally. Electrons cross borders. Power lines cross state lines. Actions in one state can significantly affect customers in another.

A properly organized regional energy market offers benefits to all users of the grid. It offers transparent pricing. It offers improved peak resource management. It offers more options and more flexibility for market participants to meet their needs. It offers the increased efficiency of an interconnected transmission system. Finally, markets offer enhanced reliability.

Nonetheless, competitive markets continue to face challenges. I would like to address some of those issues now and would then be pleased to answer your questions.

Mr. Chairman, let me first state that none of the bills which are the subject of the hearing this morning would unduly interfere with the voluntary arrangements the Midwest ISO has reached among its members and federal and state regulators under existing federal and state statutes and regulations. However, the Staff Draft presents us with the most significant questions. Obviously, the members of the Midwest ISO would like to retain the benefits that we have achieved to date. We are anxious to work with this Committee to ensure that, where appropriate, legislation permits Midwest ISO to maintain current arrangements.

As a general proposition, we believe that consistent federal and state policies that encourage participation in stable, rationally sized and transparent transmission and electric energy markets will go a long way in attracting much needed capital to our electric utilities, which in turn can strengthen our infrastructure. At this Committee's recent hearing on March 4th on the financial condition of the electricity market, the President of the National Association of Regulatory Utility Commissioners, Mr. David Svanda, pointed to two recent transactions in his home state of Michigan that resulted in a substantial infusion of new investment dollars in the transmission sector. Mr. Svanda said:

> "It is interesting to note that both of these transmission sales, almost one billion dollars of new investment, were made possible in part because of consistent state and federal policies that encourage participation in the new regional Midwest Independent Transmission System Operator (MISO). The stability of regional open access rules and the promise of transparent and vibrant midwest transmission markets no doubt encourage investors to commit substantial capital to an otherwise stagnant utilities sector."

I not only share in these observations but would also add that stable markets with transparent rules continue to be actively sought out for investments of the type described above. Midwest ISO would like to continue to be able to assist in the attraction of much needed capital for critical infrastructure improvements.

Given this general background, I would now like to turn to the specific issues on which the Committee has requested comment.

REGIONAL ENERGY SERVICES COMMISSION

Section 1211 of the Staff Draft would create Regional Energy Service Commissions (RESCs) as a means of resolving jurisdictional disputes between state and federal authorities. The Midwest ISO believes that addressing this issue is very important. Both federal and state authorities have serious issues at stake in how the electric service industry is restructured to bring the benefits of competitive wholesale markets to consumers. In some areas of the country, the debate over the jurisdictional divide has slowed progress toward robust wholesale markets.

I am pleased to note, however, that the states within which the Midwest ISO operates have set forth a proposal that will advance development of wholesale markets and promote efficient federal and state interaction. Specifically, these states have proposed to form a Midwest Multi-State Committee (MMSC), which would be a regional organization designed to achieve a flexible approach to energy market design and transmission infrastructure enhancement. Membership in the MMSC would be open to all state regulatory authorities that have jurisdiction over the retail electric or distribution rates of transmission-owning members of the Midwest ISO and regulatory authorities in states in which transmission-owning members of the Midwest ISO or independent transmission companies associated with the Midwest ISO own transmission facilities. The MMSC will coordinate state expertise and input on matters related to RTO implementation, systems operation, planning and transmission siting.

I have every reason to believe that the MMSC will be successful and highly effective. The Midwest ISO has been fortunate to work with state authorities that have strongly supported its creation and who have contributed significantly to its development. Representatives of state utility commissions serve on the Advisory Committee of the Midwest ISO and have provided invaluable insights concerning the integrated provision of transmission service over a large geographic area.

Guidance from states will continue to be of paramount importance to the Midwest ISO. The MMSC structure should facilitate the development of comprehensive, state-supported approaches to the challenges facing the Midwest ISO and should allow it to more effectively provide the wholesale service that benefits the retail activities that the state commissions regulate. Even more importantly, the Midwest ISO recognizes that, in many instances, the guidance it seeks from the states will be provided based on a regional perspective. The bulk power grid is regional and the market for electricity, just like the physical flow of electricity, does not always respect state or utility boundaries. At certain points the states will consider regional solutions to secure maximum benefits in their individual states. The MMSC, where appropriate, should facilitate regional solutions to regional challenges. Regional solutions for transmission upgrades and siting issues are particularly important. Cooperation among the interested parties rather than coercion, is key to the success of this effort.

Nevertheless, there should be a consistent framework within which regional state authorities act. The staff suggests that a regional approach based upon the Colorado River Compact, which I understand to be a blend of regional state control and residual federal supervision, may be useful here. While the apportionment of water rights and uses, such as the management of the Colorado River, may lend itself to a governance structure in which regional and federal authorities are separated, it is the Midwest ISO's view that the wholesale electric energy market, in order to succeed, requires basic national consistency. As we have seen, and continue to see, in many areas of the United States, electric energy conformity among regions is desirable to relieve congestion, diminish opportunities for market manipulation and maintain reliability efficiently.

At this time, for our region, the Midwest ISO would support further encouragement of voluntary associations between federal and state authorities and RTOs. Our experience shows that the concept can work and that it is not necessary that there be recurrent jurisdictional disputes. At the federal level, it is important that there be a comprehensive and compatible structure to the wholesale market. Such an approach will lower transaction costs in sales between states and regions, and will promote larger and liquid markets for electricity at the wholesale level. Appropriate regional differences should be respected and states have critical interests in the protection of retail customers. The MMSC approach offers a promising vehicle by which basic national consistency and flexibility to meet regional needs may both be addressed.

As I mentioned, these issues are similar in nature to the issues which the proposed Regional Energy Services Commission would have under the proposed new § 402 of the Federal Power Act. In that sense, we would prefer that the MMSC be allowed to proceed with its efforts until such time as the states in our region choose to form a RESC and it becomes operational.

I should also point out that under the definition section of the bill at § 1201 a "Transmission Organization" is defined in subparagraph (26) as being approved by either the FERC or a RESC. It might be helpful to clarify that for consistency the approval should be based on the same standards and criteria to be applied by either body. It is also critically important for the Midwest that those Transmission Organizations already unconditionally approved by the FERC do not need to seek further approvals.

RELIABILITY STANDARDS

The Midwest ISO generally supports the establishment of a self-regulating Electric Reliability Organization (ERO) to be approved by the FERC as contemplated by Subtitle D of the Staff Draft. Similar provisions can be found in § 206 of the Proposed Senate Counteroffer, § 104 of Senator Thomas' Electric Transmission and Reliability Enhancement Act of 2003 and § 7031 of the House Energy and Air Quality Subcommittee bill. However, I would note that under the new proposed § 215 (e)(4) of the Staff Draft the ERO would delegate its authority to a RESC for purposes of proposing reliability standards to the ERO and enforcing those standards. This delegation to regional authorities could result in varying reliability standards across the country.

OPEN ACCESS

The Midwest ISO generally supports the Open Access provisions in Subtitle E of the Senate Discussion Draft as a way to ensure that all transmission operates under the same rules at comparable rates while being used in interstate commerce. Similar provisions are contained in § 101 of the Thomas bill, in § 205 of the Senate Counteroffer and § 7021 of the House Energy and Air Quality Subcommittee bill.

TRANSMISSION INVESTMENT INCENTIVE

The Midwest ISO supports reasonable investment incentives such as those found in Subtitle E of the Discussion Draft, § 219 of the Senate Counteroffer and in § 7011 of the House Energy and Air Quality Subcommittee bill. We believe these provisions would encourage investments to expand transmission facilities that may not otherwise be undertaken. The Midwest ISO would also support a forum whereby affected states would have the opportunity to evaluate the impact of these incentives on their retail customers.

TRANSMISSION COST ALLOCATION

The Midwest ISO supports transmission cost allocation principles which recognize that the entity seeking to interconnect with the transmission grid should pay the cost for that transaction, as currently proscribed. Also, where the addition to the grid can be shown to provide benefits to existing load, those consumers with their state's concurrence, should pay a portion of these transaction's costs. Under all circumstances, the identification of these costs and benefits must be made by an independent transmission organization. Subtitle E of the Senate Staff Discussion Draft and § 219 of the Senate Counteroffer that directs FERC to undertake a rulemaking in this regard to ensure that all the costs are shared by all users that benefit from the expansion, appears to support this position.

TRANSMISSION ORGANIZATIONS (RTOS)

The Midwest ISO is in agreement with the legislative requirements for a viable and workable RTO as set out in the proposed new § 407 of the Federal Power Act contained in the Staff Draft. The Midwest ISO has already undertaken the process for recovery of legitimate, verifiable and prudently incurred costs of forming the RTO as contemplated by subparagraph (10) of that section. FERC has provided reasonable assurances that transmission owners that participate in the Midwest ISO will have an opportunity to recover operation and development costs incurred by the Midwest ISO. By order dated November 22, 2002, FERC conditionally accepted Schedules 16 and 17 of the Midwest ISO's Open Access Transmission Tariff, which provide for the recovery of costs associated with the creation of an energy market and Financial Transmission Rights ("FTR"). Midwest Independent Transmission System Operator, Inc., 101 FERC ¶ 61,221 (2002). Under existing law, utilities are

entitled to recover wholesale costs that have been approved by FERC. On February 24, 2003, FERC issued a Declaratory Order approving the general direction that the Midwest ISO is taking to develop energy markets and FTRs. Midwest Independent Transmission System Operator, Inc., 102 FERC ¶61,196 (2003). This order provides greater certainty to transmission owners that the costs incurred for these efforts are prudent and reasonable. And finally, on March 12, 2003, FERC issued a Declaratory Order stating that any transmission owner may file with FERC pursuant to Section 205 of the Federal Power Act in the event that they cannot otherwise recover the administrative costs billed to them by the Midwest ISO. Midwest Independent Transmission System Operator, Inc., 102 FERC ¶61,279 (2003).

In addition, while we certainly agree with the policy as set out in subparagraph (11) that RTOs should provide for the elimination of "pancaked" transmission rates within the RTOs region, we would suggest that the Committee might use this legislation to also eliminate "pancaked" rates between RTOs.

We are also in full agreement with the sense of the Congress provisions contained in § 212 of the Senate Counteroffer and § 7022 of the House Energy and Air Quality Subcommittee bill indicating that all transmitting utilities should voluntarily become members of RTOs and that the FERC should provide any transmitting utility that becomes a member of a RTO a return on equity sufficient to attract new investment capital for expansion of transmission capacity. I should also note that while Senator Thomas' proposed Electric Transmission and Reliability Enhancement Act does not directly address RTO issues, we would agree with the principle contained in the Senator's Introductory Statement that RTOs encompass large regional areas.

We believe it is particularly helpful that RTOs be provided with the tools to identify and manage congestion on the wholesale grid.

RENEWABLE ENERGY

In its regional planning process, the Midwest ISO has had the opportunity to develop scenarios for Renewable Energy based on the availability of various fuels. In the Midwest ISO operating area, the renewable fuel source that has attracted the most interest is wind. The Midwest ISO is currently working with officials from the Dakotas, Kansas and Texas to identify and model sources of wind power. Earlier this week, Midwest ISO had the opportunity to participate in Senator Dorgan's conference on Wind Energy. Working with affected parties, Midwest ISO is identifying transmission solutions that would allow for up to 10,000 MW of rural wind energy to serve urban markets to the east.

MARKET TRANSPARENCY, ANTI-MANIPULATION, ENFORCEMENT

The Midwest ISO fully supports the efforts in all of the subject legislation to prohibit fraudulent activities in the electricity market. Moreover, the Midwest ISO supports the requirement that FERC institute a proceeding to make information on availability and price of wholesale electricity and transmission services available. We believe such information, properly dispersed will increase the vitality of markets.

We would also note that Midwest ISO has an Independent Market Monitor who reports directly to its independent Board of Directors and FERC. Additionally, we believe that enforcement of these legislative provisions would need to be coordinated between FERC and the RESC to ensure that potential improper behavior could be monitored across the boundaries of regional organizations.

CONCLUSION

In conclusion, Mr. Chairman, the Midwest ISO believes that the legislation being considered by Congress can bring significant benefits to energy consumers. The Midwest ISO has been on the forefront of: RTO development; regional oversight of transmission and electricity markets between states and the federal government; regional planning; attracting crucial investment to our electricity infrastructure; planning for grid enhancements necessary to utilize wind resources; and vigilant monitoring of our energy markets.

The Midwest ISO looks forward to continuing to build on its activities to date in these and other areas. Many people have worked diligently forming the Midwest ISO. We look forward to continuing our work to make available to the states the benefits of efficient wholesale transmission and electricity markets. The states have shown that they are in the best position to determine the method of allocating these benefits to their retail consumers. Together with our states we will continue to identify and capture these benefits.

The Midwest ISO looks forward to working with you, Mr. Chairman and this Committee in these important matters.

The CHAIRMAN. Thank you very much.

Let me ask just a couple of questions and then I will yield to you, Senator Bingaman.

Mr. Para, you suggest a congressional ban on SMD?

Mr. PARA. Yes, sir.

The CHAIRMAN. Do you not think that if we did that, FERC would continue to apply SMD-like principles on a case-by-case basis using their authority in any event?

Mr. PARA. Well, I think that would be a danger, but I think then FERC would understand that the Congress agrees that a single standard for the country is too far to go. I cannot predict what FERC would do.

The CHAIRMAN. Do either of the other of you have a thought about that? That is a suggestion, as you know, that puts something on an appropriation bill and take away the authority, which I assume could be done and it would pass, I assume, the way things are now.

Mr. GLAZER. Mr. Chairman, this is one of those tough issues, sort of how much do you standardize something versus how much do you allow regional flexibility. I know FERC—I do not want to speak for them, but clearly they have gotten the message loud and clear that maybe we need regional approaches.

But I sort of analogize this back to the interstate highway system. If I go from State to State, I have got green signs that tell me it is an exit. I have got blue signs that tell me there is a hospital or a place to eat, et cetera. That consistency is important when I drive from State to State. On the other hand, there is regional flexibility. There are different routes. There are different speed limits. There are different number of exits, et cetera, different maintenance practices.

I think some balance between those two is needed. An incremental approach. That is what we have learned in our Mid-Atlantic region and in the Midwest region: an incremental approach is what is needed.

I think FERC is going to go there anyway, but that is sort of our lesson. I do not think Congress ought to ban it because then it would ban any standardization at all, and I think that would create some of the problems that I mentioned like we would have with the highway system.

The CHAIRMAN. Mr. Torgerson.

Mr. TORGERSON. Mr. Chairman, I think it would be helpful to have basic consistencies between the different regions, between the RTOs. So some standardization I think is helpful from an operational standpoint. But I think there are regional differences that have to be respected. So I think that is what is going to be needed throughout this.

The CHAIRMAN. So would your answer be if that happens, you assume that FERC would proceed in any event? That was kind of the question. Do you not think they would, on a case-by-case basis, do what everybody is concerned about anyway? One answer is they might, but it would not be nearly as bad or some such effect.

Mr. TORGERSON. Not speaking for FERC, but I think they would proceed on some basis with regional differences being addressed.

Mr. GLAZER. Mr. Chairman, they respond to cases that are before them. And we do not put proposals before them that have not been thoroughly vetted with our own stakeholders. I would say about 99 percent of our proposals in fact have gotten extensive approval from all different sectors of the industry and State utility commissions. So I do not think they would just go off and march. In fact, they would have proposals in front of them that already had stakeholder support or it never would have gotten there in the first place.

The CHAIRMAN. Senator Bingaman.

Senator BINGAMAN. Thank you very much.

Let me just give sort of my broad perspective on this. My impression is that this whole exercise we have been going through here for several years of trying to enact Federal legislation related to wholesale electricity markets is a result of the reality on the ground, which is that we are moving to more and more of a national transmission system and there is, in fact, more and more interaction between the various regions and within the regions and more groupings taking place. So we are trying to essentially find a way to modernize or update the legislation which was passed back in the 1930's so that it accommodates this new reality. That is what I have always thought, and I think you stated it very well, Mr. Harris, when you said that that involves a balancing of to what extent do you standardize and to what extent do you make accommodation to regional differences. I think that is what we are working through.

Many in Congress have felt like, by issuing this standard market design and trying to do as much as that proposes to do, FERC has gone too far too fast, and that should not be allowed to happen.

At the same time, my own view is that the general direction toward moving us to have a national system and the benefits of competition within that system, the benefits that accrue to consumers within that system, makes a lot of sense. So I think that is sort of what has been driving this whole exercise.

I guess I would ask Mr. Harris first and then the other two witnesses if you agree with that general view. You think I am off-base with that view. I would be anxious to hear your thoughts.

Mr. GLAZER. Yes. That is Mr. Glazer substituting for Mr. Harris who is on his way over.

Senator BINGAMAN. Sorry. Mr. Glazer. Excuse me.

Mr. GLAZER. It is a great question, Senator.

This is the difficulty. That is why it has been so difficult to legislate in this area. You have got a speed-of-light product that does not respect State borders, does not even respect national borders. Yet, you have a history of it being regulated at the State and local level and you have each utility sort of financed and planned its own system, almost like silos. And the trick is to balance all of those and come up with a solution that respects that history but moves us forward into the future.

I think it is happening. I mean, the good news is it is happening in the Mid-Atlantic region. We are working very closely with Midwest ISO to have a large 27-State market that will have it happen voluntarily. It is a voluntary market. That is the key point.

I think the 1930's act is actually flexible enough at this point in time to allow that to happen. I think Congress needs to monitor it very closely, but I am not sure this is the time to legislate. I think FERC is actually moving in the right direction. I think they are realizing, as we realized in the Mid-Atlantic, you have got to do it step by step. Not every region is going to be there at the same time. But do we eventually need some common rules of the road? Absolutely.

Senator BINGAMAN. Mr. Para, did you have a comment?

Mr. PARA. Yes, Senator. We agree with you that we need to continue to go forward. We also agree that it needs to be step by step. We think the FERC has the appropriate authority and that FERC has been listening to what people have been saying. We look forward to seeing their white paper at the end of April, and we expect to see where FERC can show that they have been listening to the concerns. And we think that the movement toward voluntary RTOs is a giant step in the direction of dealing with the issues that you bring up.

Senator BINGAMAN. Mr. Torgerson.

Mr. TORGERSON. Senator, I would agree. We are moving to more of a national system. The electric system was designed originally to bring generation to a specific load within a utility. It was not designed originally to be the interstate highway system. But that is where we are heading. And we are there already with much of the trading that goes on today. So we have to accommodate this new reality. And there are benefits we see from the wholesale transactions. But we need new transmission and transmission investment in order to accommodate the new reality that you talked about.

Senator BINGAMAN. Let me just ask one question since I have still got a few seconds here.

There is a lot of consolidation going on or being discussed. The Midwest ISO has pursued consolidation with the Southwest Power Pool, with members of PJM. PJM has tried to negotiate consolidation with MISO, the New York ISO, and the ISO for New England. All of that seems to me to be beneficial, all of that discussion that is going on.

I am concerned that this proposal to establish these regional energy service commissions might inhibit that. Is that a valid concern?

Mr. GLAZER. Senator, I think you raise a good point. One of the concerns with the language is it does not define a region, and a region could end up not being a natural market area. It could be just some gerrymandered thing that people came up with in a back room.

We are really not doing consolidation with the Midwest ISO. I think we are actually sort of one step beyond that, and that is we are creating a natural market that will span this large region but we are still respecting that we are two separate institutions. We are not looking to merge. We are two separate companies, and we have got our own State commissions and our own regional practices to deal with. So my compliments to the Midwest ISO. I think we have sort of gone beyond any kind of consolidation to let us get the

real product to the customer which is a voluntary wholesale market.

Senator BINGAMAN. Mr. Torgerson.

Mr. TORGERSON. I think the Midwest ISO was going to merge with the Southwest Power Pool. That has been called off. The transmission owners just simply did not end up joining, sufficient numbers of them.

But to answer your question, Senator, if we had the RESC in place already, it would depend on which States were involved. Which geographical footprint would we be looking at, and would some States want to have a consolidation and would others not? So it could be an impediment. It could be a help depending on which States were actually involved.

Between us and the Southwest Power Pool, we believe there was one market there. We still believe that is the case, and it might have been helpful, but only if all of the States had been involved in it, which, since it is voluntary, it is hard to determine that could have occurred.

Senator BINGAMAN. Thank you, Mr. Chairman.

The CHAIRMAN. Well, Senator Bingaman, I am going to yield to Senator Thomas in a minute. But I think your question is a good one. It is generic to any major transition. If you are making a major transition to a new system, there would have to be rules that would permit the ongoing activities of mergers and acquisitions that were in process. You could not have them all held in abeyance or canceled, even under an SMD I would assume. If he was doing some of that, he would provide for that. But I think it is a genuinely valid concern.

Senator Thomas.

Senator THOMAS. Thank you.

Well, thank you. I agree with the things you have said. I think that is really the purpose of much of what we are trying to do here, is to set up these RTOs that work, leave the authority there to make the differential among areas. And I think we could do that.

Mr. Glazer, you are an ISO?

Mr. GLAZER. We are a regional transmission organization. We have been certified by FERC.

Senator THOMAS. You are not in the generating business.

Mr. GLAZER. No. We are basically the air traffic controller that runs the grid and we also——

Senator THOMAS. If I was in the generating business in your area and wanted to ship power out, the market power, how do I get on the transmission outside of your area?

Mr. GLAZER. Our whole market—reserving transmission is all done over the Internet. We have tools on the Internet where people can go on and order transmission capacity to our border. At that point, there is a hand-off to the next entity.

Senator THOMAS. Beyond your border is what I am talking about.

Mr. GLAZER. Yes, beyond our border then, what we are working through—and this is what we are going to do with Midwest ISO is to not have a seam between us and Midwest ISO, for example, so that power could move with one system, that it would be transparent to the customer.

Senator THOMAS. That is what we are talking about doing here, is it not, is to have RTOs that have local authorities and then set up a nationwide system so that can move? And someone has to be in charge of that, I believe, do they not?

Mr. GLAZER. Well, Senator, the way we are doing it with Midwest ISO is that for the customer it looks like it is one system. They put in one order in one place. Behind the scenes there in the back room, there are two different entities, one in Carmel, one in Valley Forge, Pennsylvania, that are actually processing that——

Senator THOMAS. How about Wyoming? We want to ship some out there.

Mr. GLAZER. I am sorry?

Senator THOMAS. We would like to ship some power out there.

Mr. GLAZER. We would love to have it.

Senator THOMAS. Well, we have to have a way to do that.

Mr. GLAZER. Right.

Senator THOMAS. I mean, I agree with you guys entirely, but I do not think just doing the RTOs is going to settle this whole change that is taking place in the country. And I think you all said that.

Are there not some other things that we ought to be talking about? How about reliability and how about conservation? This is a policy. We are trying to set up an energy policy. So it goes a little beyond what you are doing today, but rather a view of where we want to be tomorrow in the overall, not just transmission, not just generation.

For instance, what are we going to use for fuel? I think we are going to find that the fuel we have the most supply of is probably coal, but the way things are now with transmission, why, we are doing gas-fired, small units close to the market. Is that the policy we need to have over time? I do not know.

I guess what I am asking you, even though you seem to be reluctant to take up anything in electric energy, would we not be wise to have sort of oversight among these RTOs and have some direction in where we are going, Mr. Para?

Mr. PARA. Yes, sir. I would agree that you need an oversight, and I think the FERC can provide that.

I think more important what you said was that we are talking about an energy policy here, and we cannot think that we can deal with one piece of it without dealing with all the pieces. We have to think about the fuels. Indeed, we have to think about how that fits in with the clear skies proposal. If we know that coal is going to be a big part of our resources in the future, we need to make sure that we deal with that appropriately on the environmental side as well. There we look to you, sir.

Senator THOMAS. My point is I just hope we can think of it in as broad a scope as possible because that is what this is, is a policy. This is not a regulatory activity.

Mr. TORGERSON. Senator, in the Midwest ISOs planning process, which our initial plan will be out in the next couple of months, we look at whether generation of electricity is the best way to solve constraints whether you need to build new transmission, whether a demand-side resource can help relieve constraints and add to the resource adequacy.

We then also look at the different scenarios such as is wind power an alternative that could be utilized. Is investing in more coal resources, more coal generation a possibility? Or what would happen if we do with natural gas? So we are looking at these different scenarios and looking at the impacts it would have on the transmission system. We are not totally addressing the policy issue, but we are looking at the economic impacts of these different things in our plan.

Senator THOMAS. That is great. I hope you will share.

I think it is basically Congress' role to take a look at policy and not get into the day-to-day details as much as it is to set up a framework within which you all can work. Again, I am very impressed with what all three of you had to say. That is what we are seeking to do, is to set up these regional kinds of operations. So, thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Did our questions prompt something that any of the three of you think you ought to add here before we excuse you? Mr. Para?

Mr. PARA. No, sir.

The CHAIRMAN. Mr. Glazer.

Mr. GLAZER. Just a quick comment, picking up on Senator Thomas' point. The language in the staff draft, for example, on transmission incentives sets an appropriate—it sends a sense of Congress. It does not try to then micro-manage and say, you know, you have to do it this way or that way. That is, I think, an example of Congress setting the policy, which Congress ought to be doing. I think those are good parts of whatever we come up with.

But the bottom line is we ask you sort of do no harm to the markets that are working in the region, learn from those lessons, and I think with an incremental approach, we are going to get there and find the balance that Senator Bingaman and you, Mr. Chairman, talked about as well.

The CHAIRMAN. Very fine. Thank you all very much.

We are going to take about a 15-minute recess, and then the next panel will follow. That is the panel that is led by Glenn English.

[Recess.]

The CHAIRMAN. The committee will come back to order. thank you all for being patient.

I went down to the Armed Services Committee to see if I could inquire of the Secretary of Defense, but there are still a number of Senators. So I thought maybe we would try to finish here and then I perhaps would get a chance.

We will proceed now with this panel. Why do we not start this way with you, Mr. Franklin, then Mr. English, Mr. Richardson, Mr. Tollefson, and Mrs. Moler? Please proceed.

STATEMENT OF H. ALLEN FRANKLIN, CHAIRMAN, PRESIDENT, AND CEO, SOUTHERN COMPANY, ON BEHALF OF EDISON ELECTRIC INSTITUTE

Mr. FRANKLIN. Thank you very much, Mr. Chairman. My name is Allen Franklin. I am president and CEO of Southern Company, a large utility in the Southeast. I am here testifying on behalf of

the Edison Electric Institute which is the trade association that represents investor-owned utilities in this country.

As you have heard several times, this is a very difficult and turbulent period in the history of our industry, the electricity industry and electricity markets. But I think I understand the views from different parts of the country. You have to understand that the impact of these difficult times is very, very different from one part of the country to the other. From the west coast where both customers, investors, utilities, and all market participants have been devastated in one way or the other, to the Southeast, for example, where there really are very few problems from the standpoint of consumers—the reliability is good. Costs are low. Investors have not lost money. Regulators are happy and customer service is high.

So when you hear comments about regional differences, they are very real. They are not fictitious and they explain why different parts of the country have such a different view of sweeping changes to the regulatory scheme for this country related to electric power.

The central issue that you have talked about and I want to talk about also is standard market design because this is a very important issue for this industry and all participants. I can say, even though there are somewhat different views from different companies in different regions on the standard market design, I can say with confidence that every utility that we have talked to that is a member of EEI supports and likes parts of standard market design. Every utility we have talked to dislikes parts of the standard market design. And I think everyone agrees that if SMD goes forward, it must be with changes.

Some of the things that are in standard market design that are universally supported by EEI members is, first, the objective; that is, to create better, more efficient wholesale markets. And I will also say in the South, even where States oppose standard market design, I think regulators also support that objective.

Everyone in EEI that I have talked to also supports the need for and value of independent control of transmission so that no one can use transmission to favor their generation or their power. And everyone agrees that some broad guidelines or market rules of the road need to be applied across the country. We agree with that.

I think where the disagreement comes, especially when you look from region to region, are in other areas. And areas that EEI believes that need to be addressed that are not addressed or changed in SMD, one is native load priority. And I have heard people give short shrift to that. It is a real issue and a serious issue.

For example, if you are a customer in a State anywhere and for years you have paid for transmission and it has been in your electric rates since the transmission was built and if there is really not enough transmission to accommodate the retail user going forward and the new generation being built for export, it is not a trivial issue and it is not fair in my judgment to say just because someone located generation in that State to export to another State, that somehow the retail customer has to give up part of their transmission rights. And the likelihood—and this is not again a trivial issue—or the possibility is that lights would actually go out in that State for retail customers so that power can be exported elsewhere.

In addition to that practical issue, the concern about making sure native load customers' lights stay on is a huge part of the reason you see objections to SMD among local and State political leaders. So it is not only a technical issue, it is also a political issue.

Other areas where we disagree with the standard market design is in transmission pricing. We believe very strongly in the industry that cost shifting, as a result of change in Federal policy, should not take place. In other words, those that cause additional transmission costs should pay, and those costs should not be socialized and put on retail consumers.

The third area that we think is important is especially in States that are still vertically integrated where retail access is not in place, where States regulate the total cost of power to retail consumers. We think, going forward, that should continue, that FERC should not assert jurisdiction over the transmission component of retail rates. That is a technical issue, but it is also a very political issue in certain parts of the country where the States do not want to lose that jurisdiction that they have had or at least exerted forever.

There are some very difficult challenges. Given the need to move forward nationally, but needing also to recognize these very real and substantial regional differences, we are starting from very different points as far as market structure, cost, reserves. So we have to take into account the regional differences but also hopefully, as you have pointed out, move forward on a national basis.

Looking at the chairman's draft, it is an intriguing, innovative, and interesting proposal. And I think it tries and makes a good faith effort to deal with this conflict between national effort and regional differences and I think long term could have some potential.

But, on the other hand, I think there are many, many difficult, unanswered questions, and I think it would take a very, very long time to work through those. In some cases State law will actually have to be changed to implement that proposal. And I think we are in a position today that we need more clarity sooner as opposed to later. As opposed to adding a new regulatory body, which this proposal would do, and a third level of regulation, which could turn into an even greater bureaucracy, I think it would be much wiser for Congress to simply clarify and instruct more clearly the existing regulatory bodies as opposed to creating a third regulatory body to deal with.

An approach that we think makes sense—and not the only approach—is to reach an agreement, probably through Federal legislation, that lays out the broad areas where every region needs to comply to make the markets work. That would be things like independent transmission control. It would be things such as make sure the scope of the RTO was large enough. It would include other broad provisions that really are needed across the country to be sure some consistency is applied across the country. But it should be a limited number of principles. But reach agreement on those, maybe codify those in legislation, and then leave it to the regions, leave it to the States to work out the details. I believe we probably ultimately will go that way, one way or the other, and I think Congress could help push that issue along a bit.

A lot of other issues in my testimony and issues that you asked us to speak to. I will answer questions, but I will not try to address those now.

One issue that is important that I will just mention briefly is—and referring to one of the Senator's comments earlier—we do not have a national market. I do not think we are moving to a national market yet. We are talking about it, but until we have the capability and the transmission capacity to move power between these regions—and that is very limited now—it is going to be more talk than actual markets. So I think we need to concentrate not just on how to divide up the current limited transmission capacity, but also find some ways to increase the transmission capacity so we can really take advantage of cost differentials in different regions.

Some things that would help. I think in some cases many of our members would support some kind of limited Federal backstop siting authority in areas where transmission is desperately needed for inter-regional transactions and it simply cannot get done without it.

Improvement in the Federal permitting process where it does not take so long to get a permit across Federal lands would be helpful.

Financial incentives to bring capital into the market to go into new transmission would be most helpful.

Let me just conclude, Mr. Chairman, with that, and I will be happy to address any specific questions you have.

[The prepared statement of Mr. Franklin follows:]

PREPARED STATEMENT OF H. ALLEN FRANKLIN, CHAIRMAN, PRESIDENT, AND CEO, SOUTHERN COMPANY

Mr. Chairman and Members of the Committee: My name is H. Allen Franklin, and I am Chairman, President and CEO of Southern Company. Southern Company is the parent company of Georgia Power, Alabama Power, Savannah Electric, Gulf Power and Mississippi Power. These five operating companies serve 4 million customers in Alabama, Florida, Georgia and Mississippi. We are a vertically integrated utility business with over 38,000 MW of generation, 28,000 miles of transmission lines, and sales of 180 billion kilowatt-hours. I am testifying on behalf of the Edison Electric Institute (EEI). EEI is the association of U.S. shareholder-owned electric utilities and industry affiliates and associates worldwide. We are pleased to have the opportunity to testify today on several electricity proposals from last Congress and this Congress.

I plan to discuss EEI's priorities in an electricity bill and comment on specific provisions in the various electricity proposals. But, first, I would like to provide a brief overview of the current financial crisis affecting our industry, which serves as a critical backdrop against which you are considering legislation.

FINANCIAL CHALLENGES FACING THE ELECTRICITY INDUSTRY

The electricity industry is facing its worst financial crisis in decades, as the aftermath of the Enron implosion, a boom and bust cycle in generation in some areas and the economic slowdown have combined to erode investor confidence. This has had a devastating impact on the ability of many utilities to access capital on reasonable terms. As the most capital-intensive industry in the country, the higher cost of capital makes it more difficult to finance infrastructure projects to maintain reliable electric service. EEI submitted a written statement explaining in greater detail the financial conditions facing our industry for this Committee's hearing on March 4 on this subject.

Utility stocks used to be the safe haven for "widows and orphans," who relied on steady utility dividends to help meet their income needs. Now, however, the capital markets view much of the electricity sector as high risk. Consolidation in the banking industry and federal barriers to investment in the electricity industry increase the difficulty of finding willing investors who are able to provide the needed capital infusions to the electricity industry.

The last year has seen a "return to basics" movement in the industry. Utilities and their customers have been painfully reminded by the upheaval in electricity markets that electricity is not just another commodity, but is instead an essential service for all consumers. And, we have recognized the importance of assuring the integrity of electricity markets to investors, customers and the public at large.

OVERVIEW OF ELECTRICITY LEGISLATION AND EEI'S PRIORITIES

According to the Department of Energy, competition in wholesale electricity markets reduces consumers' electricity bills by nearly $13 billion annually. While experience with retail competition clearly has been mixed, wholesale competition can benefit consumers. Congress should focus its legislative efforts on promoting the benefits of wholesale competition, while ensuring that retail consumers continue to receive affordable and reliable electricity.

Congress can promote a more efficient competitive wholesale electricity market by addressing those electricity issues that only federal legislation can resolve in a way that provides the right incentives to increase capital investment in the nation's energy infrastructure, ensures efficient and reliable wholesale markets, and sets a clear direction for the future.

Many in our industry are concerned that federal electricity legislation could add to the industry's challenges in these financially turbulent times if legislation decreases regulatory flexibility or increases the uncertainty and costs of providing affordable electric service to our consumers. To put it in engineering terms, the margin for error in our industry is significantly reduced right now.

IMPROVING WHOLESALE ELECTRIC MARKETS

EEI supports the development of more liquid, transparent wholesale electricity markets that provide regional flexibility for participants to design those markets to best fit regional needs while fostering greater efficiency. The Federal Energy Regulatory Commission (FERC) issued last summer its proposed Standard Market Design (SMD), which was intended to resolve some issues that the Commission believes are impeding robust competition. EEI believes that FERC was trying to achieve the right goals in issuing the SMD NOPR—most notably to bring certainty and efficiency to wholesale markets. And while the SMD proposal appeals to some EEI members more than others, and some regions more than others, there is universal agreement that changes are needed to the proposal. SMD must be formulated in a way that makes it workable both in regions that have chosen to deregulate retail markets, and those regions that have chosen to continue the vertically-integrated, utility franchise model of electric service.

There are elements of the SMD proposal that we do agree with. Specifically, we support the development of regional markets that have the following characteristics:

1. Independent system control, by either not-for-profit or for-profit regional transmission organizations (RTOs), that have no financial ties to market participants. However, FERC has focused too narrowly on structural divestiture as the test for independence and has disregarded state decisions preferring integrated utility companies. For example, FERC's proposed policy offering an additional 150 basis points to return on equity demonstrates its preference for transmission divestiture. In addition, FERC is threatening to impose standards of conduct that unnecessarily interfere with least-cost planning and corporate governance. Integrated utilities should not have to divest transmission or adopt extraordinary measures beyond those in Order Number 2000 in order to establish independence of transmission operations;
2. A role for independent transmission companies within RTOs;
3. Establishment of real-time markets;
4. The elimination of pancaked transmission rates within regions to promote wholesale trade;
5. A means for managing congestion on transmission networks;
6. A regional approach on issues such as transmission planning, resource adequacy and transmission siting decisions, possibly through a multi-state entity; and
7. Finally, the same rules must apply to all transmission facilities, including those owned or operated by entities that are not currently subject to FERC jurisdiction.

There are, however, significant regional differences in matters such as the extent of retail competition, generation reserves, past organization and uses of the grid, the role of various fuel sources such as hydro, and the extent of development of competitive markets which affect the potential economic benefits of wholesale regional mar-

kets to ultimate customers that have caused the SMD proposal to be extremely controversial in many quarters. Part of this divide is simply due to the fact that the economic benefits of wholesale markets to ultimate customers can be much greater in regions which allow retail competition than in states where pervasive retail regulation remains. These regional differences cause the cost benefit of implementing a detailed SMD to be very different in different parts of the country and account for the vastly different views of, and political support for, FERC's SMD.

Therefore, because there are real and legitimate regional differences, we believe that FERC has to give much greater credence, to and allow much more flexibility for, regional concerns. This is particularly important with respect to the following issues:

1. Assurance that native load will continue to have priority in use of the transmission system that was built to serve their needs. In the case of states that have retail competition, the transmission rights should follow the load and go to whomever serves the retail customer.
2. Pricing of transmission expansion and interconnections, including participant funding concepts, so that costs of new facilities are not imposed on customers who do not benefit from those facilities. This issue is particularly important in regions where generation is being built far from load to take advantage of fuel availability, siting considerations, and for other reasons. Solving this issue will also go a long way to assuaging state opposition to siting facilities that primarily benefit out-of-state users and removes a hurdle to state support for RTOs in some regions.
3. Allocation of the costs of the existing transmission system. In regions where significant generation is being constructed for export, or significant amounts of power are being transmitted through the region, these wholesale users of the transmission system should pay an equitable share of the fixed costs of the existing system.
4. State control of rates for bundled retail transactions.

Many question whether FERC's rules and decisions will allow for adequate regional flexibility on these issues. And while not all EEI members agree, many believe that Congress needs to deal with these issues in energy legislation to ensure that regional differences are properly accounted for by the FERC. This would clearly increase political support in some regions for moving forward with RTOs. One approach might be to statutorily require FERC to give substantial deference to the views of states and regional organizations in the process of approving the formation of and changes to regional transmission organizations, especially related to the four items listed above. We would be pleased to work with the Committee to further develop these concepts.

REGIONAL ENERGY SERVICE COMMISSIONS (RESCS)

Clearly, one of the most controversial issues that has been raised by the FERC SMD proposal is how to align competitive wholesale markets that operate on a regional basis with state responsibilities over retail sales and service. We have long advocated close cooperation between FERC, the states and stakeholders in designing regional institutions, and we certainly recognize the difficulties in designing any institution that achieves the right balance between legitimate state and federal concerns. We believe the Committee RESC proposal, outlined in the March 20, 2003. Senate Staff Discussion Draft ("Senate Staff Discussion Draft") is a good faith effort to address this problem, and we commend the Committee for floating a potential model for addressing the tensions between state and federal regulation. But as currently drafted, we believe the proposal raises more questions than solutions. The proposal is much more problematic and appears to add more uncertainty and complexity than needed.

There is the fundamental constitutional question of whether Congress may delegate to the Department of Energy (DOE) authority to approve a multi-state agreement. There are also questions as to what standards DOE must apply to approve such an agreement and what criteria DOE could apply to disapprove a RESC submission. We have major concerns about the inability of interested parties, particularly those who own, operate or would use regional transmission facilities. to comment on any RESC submission.

As drafted, the RESC would add a third level of rate regulation unless the RESC covered an entire interconnected network (an unlikely outcome). And, it would still leave FERC with significant regulatory authority and the last word in resolving issues. This is clear if we look at the West. If we were to have two or more RESCs (a very likely option), FERC would continue to regulate transactions between the RESCs. FERC would also continue to regulate transactions between a RESC and

any state that did not join a RESC. This would create two levels of interstate regulation—the RESC and FERC. In the West, this is very likely to lead to a significant FERC role since so much power is imported from or exported to different regions. If a RESC continues to allow a state to regulate bundled retail transmission (as many would), we would have three layers of regulation.

In addition, under the draft, FERC would resolve disputes between states and RESCs and between RESCs. It is not clear what criteria FERC would apply. It is also not clear whether FERC could impose new standards or requirements on RESCs. However, it is clear that FERC would have the "last word," which ultimately provides very significant power.

If the RESC regulates interstate transmission within the RESC, a number of important practical, due process and transitional questions arise. The suggestion that the RESC "have the capability to address rate requirements" is very unclear. Must the RESC apply the standards of Section 205 and 206 of the Federal Power Act, or may it apply different standards? How is the transition to RESC-approved rates conducted? What happens to rates that have previously been approved by FERC and that come under RESC jurisdiction? Are those decisions grandfathered or must every transaction be resubmitted for RESC approval?

What is the process for judicial review and what are the rights of parties? Will transmission owners, operators, users and other interested stakeholders have rights to participate before the RESC and to appeal RESC decisions? The draft is silent on this very important issue. Are appeals by parties submitted to FERC, state court or federal court? Can these parties participate when a state or RESC seeks FERC resolution of a dispute? If FERC does not hear appeals of RESC decisions, how are FERC dispute resolution decisions reconciled with inconsistent court decisions arising from an appeal of a RESC decision? Can a RESC decision preempt conflicting state law? If a RESC standard conflicts with a FERC standard, how is the conflict resolved? Where does a RESC get its enforcement authority?

The organizational structure of the RESC raises a fundamental issue of state input. Will all states agree to have only one vote or will populous states want a larger say? Is the RESC a governmental agency that must comply with procedures like those in the Administrative Procedures Act, or do references to its "charter," "protocols," and "by-laws" suggest the RESC is more of an advisory or consultative body? And, why must a state be limited to a single RESC if it operates in more than one electrical interconnection?

The potential breadth of RESC authority, while desirable in many circumstances, also raises many questions. Any regional organization should be able to assert authority over all transmission-owning entities. However, with the exception of the provisions authorizing federal utilities to participate in a transmission organization approved by a RESC, there is no clarification of RESC authority over other government-owned utilities or cooperatives. Also. the RESC's authority over "reliability standards and rules" should be more carefully defined to assure consistency with the reliability section of the Senate Staff Discussion Draft.

While EEI supports regional flexibility in the development and design of wholesale electricity markets, we believe that the RESC proposal, while very well intentioned, does not achieve the proper balance of interests between the states, the federal government, owners and users of the grid and other affected parties. And, this proposal threatens to add redundant regulation and far too much uncertainty to an industry that needs more certainty, not less.

We appreciate the attempt to devise a creative solution to a complex issue and are pleased to continue to work with the Committee, FERC, the states and other shareholders to refine a workable regional approach. However, an issue this complex will take time to work out. In the interim, we believe that issues of state and federal jurisdiction under the current regulatory framework need to be addressed, as discussed earlier in this testimony.

IMPROVING THE OPERATION OF, AND INVESTMENT IN, TRANSMISSION INFRASTRUCTURE

Healthy competitive wholesale markets depend on robust transmission systems to move power to where it is needed. Unfortunately, transmission growth has not kept pace with electricity demand. Our current transmission infrastructure was never built for the purpose of moving large quantities of power across long distances. According to the North American Electric Reliability Council (NERC), the volume of actual transmission transactions has increased by 400 percent in the last four years. Increased congestion on transmission lines not only increases costs to consumers, but it also threatens the system's reliability.

At the same time that congestion is increasing, investments in transmission have actually been declining. Over the past 25 years, investments in transmission have

fallen at a rate of $103 million per year compared to the investment needed just to maintain the current level of transmission adequacy. Difficulties in siting new transmission lines, on both private and public lands, and in raising capital are significant obstacles that have contributed to this decline in transmission investment.

In addition, most new transmission currently is being built to serve local load and to connect new generation to the grid, instead of the high-voltage wires needed to strengthen regional electricity markets. The relative annual growth rates in lower voltage lines and higher voltage lines have changed significantly since the early 1970s. In the early 1970s, the annual growth rate in lower voltage line-miles (69 kV and below) that support localized grid operations and interconnections was 1.9 percent, while the annual growth rate for high-voltage line-miles (115 kV and higher) was 3.2 percent. By the latter half of the 1990s, this relationship had reversed: the higher voltage line-miles were growing at only 0.3 percent, while lower voltage line-miles were growing at 3.5 percent.

We were very disappointed that the electricity title being negotiated as part of last year's energy bill appeared unlikely to include any provisions designed to improve our transmission infrastructure. Therefore, we are encouraged that a number of electricity proposals being considered this year include provisions to enhance transmission infrastructure. We strongly believe that these issues should be addressed in any final electricity title approved by Congress.

Reliability—Increasingly competitive wholesale electricity markets and traditional voluntary reliability standards are no longer compatible. We need a new reliability regime capable of developing mandatory reliability rules that are enforceable on all users of the transmission system.

We believe the reliability provisions in S. 475, the electricity bill introduced by Senator Thomas, best meet this objective (the "Thomas bill"). The Thomas bill reflects the latest consensus among stakeholder groups that have been working on reliability legislation for several years now. We strongly support its inclusion in the electricity title to be considered by this Committee.

Open Access (FERC Lite)—The benefits of a robust transmission system are threatened not only by insufficient investment in transmission infrastructure, but also by the lack of FERC jurisdiction over government-owned and cooperatively owned transmission facilities, which constitute almost 30 percent of the nation's interstate transmission system. In the Pacific Northwest, the federal Bonneville Power Administration (BPA) alone owns and controls nearly three-quarters of the region's high-voltage transmission capacity. The entire state of Nebraska and most of Tennessee are served by non jurisdictional utilities, creating huge geographical gaps in FERC's authority.

According to a December 2002 GAO report, "Lessons Learned From Electricity Restructuring," because of this lack of jurisdiction

> FERC has not been able to prescribe the same standards of open access to the transmission system. This situation, by limiting the degree to which market participants can make electricity transactions across these jurisdictions, will limit the ability of restructuring efforts to achieve a truly national competitive electricity system and, ultimately will reduce the potential benefits expected from restructuring.

We believe that this bifurcated regulation of interstate transmission lines is ultimately unsustainable as the industry's structure continues to evolve. The nation's transmission and is physically integrated. Electrons do not recognize boundaries between public and private transmission ownership.

We believe sound public policy to protect consumers would mean putting all utilities participating in interstate wholesale electricity markets under FERC's full "just and reasonable" requirements. At a minimum, EEI's member companies strongly support inclusion of an effective "FERC lite" provision in any electricity bill. We believe that the March 24 version of the Senate Staff Discussion Draft meets these objectives.

With regard to a provision in both the Thomas bill and the Senate Staff Discussion Draft, we note that the ability of government-owned utilities to finance transmission facilities with tax-free "private use" financing no longer provides a barrier or excuse for their failure to participate in RTOs or to offer open access upon terms comparable to that required by FERC. Last year the Treasury Department promulgated regulations that permit "private use″-financed transmission facilities to participate in FERC-approved RTOs. As a result, the provisions referring to "private use" are no longer necessary.

FERC Backstop Siting Authority—We believe that state siting processes will continue to be adequate for the construction of most new transmission and that limited, new FERC backstop authority will be used only as a last resort in very limited in-

stances. However, we believe that the authority could be critically important in those instances.

Wholesale electricity markets are becoming increasingly regional as power flows across multiple states and as multi-state RTOs gain operational control of utility transmission lines. Most state siting laws do not recognize the role new entities such as RTOs will play in transmission planning nor do they specifically allow for the consideration of regional, not just state benefits of new transmission lines. If states consider only intrastate benefits and not regional benefits, they may have little choice under state law but to reject the proposed line, even if the benefits to the region are significant.

Regional electricity markets require a siting process that has the ability to consider regional and even national needs. FERC has jurisdiction over wholesale electricity markets, but it currently does not have the authority over transmission siting to help ensure that there is sufficient transmission capacity to support those markets. In comparison, FERC has the authority to site interstate natural gas pipelines. We believe the Commission should have at least limited backstop siting authority.

We believe that the limited FERC backstop transmission siting provisions included in both the Senate Staff Discussion Draft and the House Energy and Commerce Committee Draft Electricity Title ("House Committee Draft") are intended to achieve this goal. We would be happy to work with the Committee to fine-tune this language.

Federal Permitting of Transmission Lines—The length and complicated nature of the federal permitting process makes it difficult to address transmission infrastructure issues adequately and in a timely fashion. The federal permitting process for rights-of-way when multiple federal jurisdictions are involved is fragmented and duplicative, with each agency working under its own deadlines and without any coordination with the state process.

Indeed, we are finding that our member companies are going to extraordinary lengths to avoid siting on federal land if at all possible because of that process. This places a greater burden on private lands and, in some cases, state lands to meet the nation's needs for grid infrastructure enhancement. The byproduct is the potential for more conflict with private landowners and an underutilization of federal lands, even where those lands may be best suited to help fulfill the nation's infrastructure needs.

The House Committee Draft generally addresses our objectives in improving the federal permitting process, and we strongly support including these provisions in the electricity title to be considered by this Committee. The Thomas bill also recognizes the need to address federal permitting issues by including provisions on federal agency coordination and rights-of-way across federal lands, although these provisions are not likely to be as effective as those in the House Committee Draft because of the highly decentralized way that transmission and distribution facilities are certificated.

The House Committee Draft provisions would provide the opportunity for the Department of Energy to serve as a lead agency and would give that agency the authority to develop and set deadlines for the federal environmental review and permit process and to coordinate the process with state siting processes.

In addition, the House Committee Draft includes helpful provisions on interstate compacts, and we believe the House Committee on Resources is likely to address federal corridors. We have a concern with the application of the House Committee Draft's savings clause that we would be happy to work with this Committee to remedy. Finally, in this area, we would be concerned if this Committee adopted a provision that would, intentionally or unintentionally, require a federal agency to foreclose the opportunity to site a transmission line on land within their jurisdiction that is presently available, albeit under considerable restrictions. to site transmission.

Transmission Investment Incentives—While FERC has existing authority to address transmission pricing issues, this has not been a high priority of the Commission's. In addition, while FERC's recent pricing initiatives appropriately provide incentives for independent operation and control of transmission facilities, FERC has focused too narrowly on complete divestiture of transmission facilities and has not adequately recognized vertically integrated utilities that are turning operational control, but not ownership, of their transmission lines over to regional transmission organizations (RTOs). Congressional encouragement to FERC on transmission pricing would be helpful.

Both the House Committee Draft and the Senate Staff Discussion Draft would direct FERC to issue a transmission pricing policy rule within one year to promote investment in new transmission and address cost allocation issues.

Regional Transmission Organizations—We are pleased that none of the electricity proposals being considered at this hearing include mandatory RTO participation provisions. EEI's member companies are moving aggressively to comply with FERC Order Number 2000 on RTOs.

We believe it is essential to eliminate any legal uncertainty about whether federal utilities can delegate authority over their transmission systems to a RTO. We believe the provisions in both the Senate Staff Discussion Draft and the House Committee Draft accomplish this goal. However, we encourage this Committee to add the House language clarifying existing statutory obligations.

REMOVING FEDERAL BARRIERS TO WHOLESALE COMPETITION AND INVESTMENT

Among the electricity issues that only Congress can address are repeal of the Public Utility Holding Company Act (PUHCA) and reform of the mandatory purchase obligation under the Public Utility Regulatory Policies Act (PURPA). The structure and regulation of electricity markets have changed dramatically since these federal statutes were enacted, and they are in desperate need of reform. PUHCA was enacted in 1935 during the New Deal; PURPA represents the only part of the Carter Administration's 1978 energy plan still in effect.

PUHCA Repeal—We strongly support PUHCA repeal, which has been part of every major electricity bill and has long been recommended by the Securities and Exchange Commission and other federal agencies. PUHCA is a long-standing barrier to capital investment in the utility industry, the creation of independent regional transmission companies and the entry of additional players in wholesale and retail electricity markets. The current capital investment crisis in the utility industry makes PUHCA repeal more important now than ever.

We believe that the PUHCA provisions included in the Senate Staff Discussion Draft should be included in any electricity title considered by this Committee. These provisions both repeal PUHCA and protect consumers by providing FERC and the states with enhanced access to holding company books and records.

PURPA Reform—PURPA's mandatory purchase obligation is incompatible with competitive wholesale electricity markets. PURPA requires electric utilities to purchase power from certain legislatively-favored generators at government-determined prices.

These prices were supposed to ensure that consumers would pay no more for PURPA power than for other power. Unfortunately, due to a confluence of factors not foreseen by the authors of PURPA, FERC or state regulators, this has not been the result. Instead, long-term PURPA contracts generally have proven to be at rates far above competitive market prices of electricity.

Competition in electricity generation has been unleashed by the enactment of the Energy Policy Act of 1992 and the issuance of FERC open-access rules in 1996 (Orders No. 888 and 889). Consequently, electricity generators and wholesale customers have access to each other under the same terms and conditions applicable to the utility owning the transmission wires. QFs favored by PURPA have the right to request transmission service and to sell power to any wholesale customer, just like any other generator. They do not need the special privilege of being able to sell to a purchasing utility at the utility's "avoided cost" rate.

We oppose predicating repeal of PURPA's mandatory purchase obligation on FERC findings that certain market tests have been satisfied. For example, the test included in the October 16, 2002, Senate Offer ("Senate Offer") was derived directly from FERC's proposed Standard Market Design (SMD) rulemaking. Memorializing in legislation the specific market attributes proposed by FERC in the SMD would codify a rigid view of what constitutes a workably competitive electricity market. FERC, itself, subsequently has indicated that there should be greater regional flexibility in structuring markets than this test envisions and has already approved an RTO with a real-time but no day-ahead market.

We strongly support the PURPA provisions contained in the Thomas bill. These provisions should be included in any electricity title considered by this Committee.

RETAIL ELECTRIC SERVICE ISSUES

Net Metering—Because net metering is a retail electric service issue, we are pleased that the net metering provisions in the Senate Staff Discussion Draft, the Senate Offer and the House Committee Draft are all a PURPA Section 111(d) requirement that the states consider such a program. We oppose a federally mandated net metering program that would preempt state decisions or existing programs.

To the extent that any state follows the net metering provisions in these drafts as guidelines, we do have a number of concerns. The provisions that would prohibit any standby, capacity or interconnection charge create an uneconomic subsidy when

such charges are economically justified. In addition, the provisions that would measure net metering "in accordance with normal metering practices" are confusing because net metering is not the norm at this time, and this language implicitly prevents the use of more advanced "smart" metering technologies. The better approach is to require simultaneous metering of energy sold to and sold by an on-site generating facility.

In addition, these proposals go beyond encouraging renewable energy resources when they endorse net metering for combined heat and power facilities up to 500 kilowatts in size at commercial facilities. As we have learned from PURPA, cogeneration in and of itself does not always mean a facility that is more energy efficient or desirable.

Real-Time Pricing and other PURPA Standards—Real-time pricing and time-of-use metering obviously are retail electric issues that should be addressed by the states. If these issues. as well as other such retail electric issues, are addressed in a federal electricity bill, we believe they should be PURPA 111(d) requirements. We prefer the provisions in the House Committee Draft to the Senate Staff Discussion Draft with regard to the adoption of additional PURPA standards.

PROMOTING RENEWABLE ENERGY RESOURCES

EEI's member companies support a growing role for economically affordable renewable energy resources in meeting our energy needs. We support extending and expanding the Section 45 production tax credit, as well as increased funding for renewable energy research and development. However, because of the significant regional differences in availability, amount and types of renewable energy resources, we believe it is important for the states to determine whether requiring a certain percentage of electricity to be generated from renewable energy resources makes sense for their consumers.

States already are encouraging the development of renewable energy resources through a variety of programs that best fit their own circumstances. More than 90 utilities in 30 states have implemented or announced green pricing programs to support investment in renewable energy technologies. Forty-three states support programs that offer incentives, grants, loans or rebates to consumers using renewable energy resources. And, 13 states have adopted renewable portfolio standards. Electric suppliers in nine states with competitive retail markets are offering green power products to consumers.

MAINTAINING MARKET INTEGRITY

The integrity of wholesale electric markets must be restored and maintained. The public, our investors and our customers must have confidence in our markets. That is why EEI supports FERC's efforts to foster transparent, liquid regional wholesale electric markets. We believe such markets will provide the basis for price transparency and an effective platform for market monitoring and oversight. We also believe that FERC's authority to assure that rates are just and reasonable gives it broad authority to prohibit fraudulent and deceptive practices.

Anti-Manipulation and Enforcement Provisions—The three most recent electricity proposals—the Senate Staff Discussion Draft, the Thomas bill and the House Committee Draft—address several market manipulation concerns. The market transparency provisions would make sure that FERC develops appropriate price and market information. Round trip trading, which we agree is improper, would be prohibited. The Senate Staff Discussion Draft and the Thomas bill also appropriately prohibit the filing of false information. In addition, all of these proposals would beef up FERC's enforcement authorities and make the refund effective date essentially the date that a complaint is filed. In light of events that have occurred in electricity markets over the last several years, we understand Congress's desire to make these changes to the Federal Power Act.

Our biggest concern with these provisions is that they do not extend to all participants in interstate wholesale electricity markets. Neither the Thomas bill nor the Senate Staff Discussion Draft cover non jurisdictional utilities because they are not a "person" under the Federal Power Act and must be specifically referenced, pursuant to Section 201(f) of the Federal Power Act in order for the section to apply to them. Use of the word "entity" alone is insufficient.

CONSUMER PROTECTIONS

FERC Refund Authority—We strongly urge the Senate to include language in its electricity title that would give FERC authority to order refunds from government-owned utilities and electric cooperatives that it determines have charged unjust and unreasonable rates. We believe this provision is essential to protect consumers from

any electricity supplier that overcharges consumers. The House Committee Draft takes a first step in this direction, although that provision is too narrowly drafted and has so many qualifications as to be virtually ineffective.

No market participant in interstate wholesale electric markets should be immune from FERC's investigative and remedial authority. Recent news accounts make it clear that alleged improper activities in electricity markets are not limited to jurisdictional utilities. The state of California and other parties recently submitted a massive filing to FERC that, according to news stories, alleges that California municipal utilities engaged in a number of Enron-type manipulative market strategies. These alleged market schemes include municipal utilities engaging in "Ricochet" trades, involving selling power out of state and then back into the state to avoid price caps, and "Death Star," in which companies created false congestion on the transmission system and then were paid a premium to remedy the problem. We note that the alleged "Death Star" activities were facilitated because the California Independent System Operator does not operationally control government-owned utilities' transmission systems.

We firmly believe that all participants in competitive interstate wholesale markets, including government-owned utilities, should be subject to the same rules and requirements and to FERC's full rate refund authority. As California's electricity crisis painfully demonstrated, retail consumers desperately need the consumer protections offered by FERC's "just and reasonable" rate standard and refund authority applied to all electricity suppliers.

Consumer Privacy/Unfair Trade Practices—The provisions relating to consumer privacy and unfair trade practices (prohibiting slamming and cramming) are essentially identical in both the House Committee Draft and the Senate Staff Discussion Draft. We support these provisions.

Information Disclosure—The Senate Staff Discussion Draft includes provisions requiring the Federal Trade Commission (FTC) to issue rules proscribing what type of information must be provided to electricity consumers. While we believe the FTC already has the authority to issue "truth-in-advertising" rules, we are concerned about forcing utilities to track and report the share of electricity generated from each type of energy resource and the generation emissions characteristics of electricity.

CONCLUSION

As we have stated, only Congress can address a number of critically important electricity issues. We hope our comments on these electricity proposals are useful to the Committee as it prepares to mark up a comprehensive energy bill. We look forward to working with you to produce the first comprehensive energy bill since the passage of the Energy Policy Act of 1992.

The CHAIRMAN. Thank you very much.

Mr. English, a former member of Congress. Glad to have you here.

STATEMENT OF GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. ENGLISH. Thank you very much, Mr. Chairman. I appreciate it. I am Glenn English, the chief executive officer of the National Rural Electric Cooperative Association. We represent nearly 1,000 electric cooperatives in 47 States, which is privately owned by some 35 million consumers. And I am very pleased to be here, Mr. Chairman.

Mr. Chairman, much of the discussion that we have heard today both from members of the committee, as well as from those who are testifying, have alluded in one way or another to the whole question of instability, talked about instability in the electric utility industry. And there is no question we have seen tremendous instability in recent months, and from what we are told by those who are analysts and experts in the industry, we are probably going to see even more in the not too distant future.

Mr. Chairman, I think we have got to look to the causes of much of the difficulty that is coming about in the electric utility industry, and not all of it I think can be pointed to from a standpoint of legislation or change within the industry. We have also got to take a hard look at the actions of the people within the industry. We have had scandals and we have had some very bad business decisions by those who are involved in this industry that have brought about much of this uncertainty, this insecurity.

If you talk to the financial markets, you find that there is no single answer other than the fact that the whole electric utility industry seems to be unstable, and there is not a willingness to invest money. I know in the discussions that we have had—and certainly the testimony we have heard before this committee and the other body—have really focused on the question, well, is the answer incentive rates? We simply have to put more money in to build more transmission.

Is that the only answer? What we are told by those who are in the business of investing that money, you can reach the same kind of destination if you reduce the risk if you bring about more stability.

I think that Senator Thomas certainly put his finger on it that it is the job of the Congress to establish policy. Certainly there is a need for the Congress to bring about some stability in the electric utility industry at this time, to bring some common sense to this business so people have some kind of certainty, some kind of expectation.

I would suggest to you, Mr. Chairman, that as we look at the four pieces of legislation that you asked each of us to examine, we endorsed the legislation that came forth from this body last year, H.R. 4. If we were required to make a decision today, would we endorse H.R. 4 as it stands? I think we would have to say no. The reason we would have to say no is because H.R. 4 was based on the assumption that we were going to be operating under FERC Order 888, but we cannot say today we are going to be operating under FERC Order 888. And this completely changes everything as to whether or not electric cooperatives would find that they could carry out their responsibilities.

Standard market design is a very uncertain thing, and I would suggest that all the elements of the various pieces of legislation that are going to be affected by standard market design or in some way related to standard market design really should be withheld until we know for certain what we are dealing with.

It is true from a policy standpoint, the Congress may need to address these issues again when the Federal Energy Regulatory Commission finally works its way and completes the rules and regulations. True, we will have the white paper next month, but until we see those final rules and regulations, we do not know for certain what we are dealing with and we do not know what kind of changes need to be brought about.

Certainly, as we look at this issue of taking a time out on those kind of SMD-related issues, does not mean that Congress could not move forward with regard to other pieces of legislation. Reliability, many other elements may need to be advanced and included in any kind of an energy bill. We are not suggesting an energy bill be held

up, but we would feel much more comfortable if we knew that the Congress intended to act on electricity legislation after we knew what the final rules and regulations are.

Mr. Chairman, that may be a result of my experience as a legislator, and far too often I have seen legislation that I have been a part of crafting go to regulators and see it changed and implemented in ways that I never intended. So perhaps I am being a little too cautious, but I think not.

Let me also suggest, Mr. Chairman, that what has taken place in the last few months, what we are learning about this industry, the scandal and the bad management that has taken place, I think also urges the Congress to include consumer protection as one of the elements that they have as their policy. Certainly merger review is very important, but it has been suggested and contained in virtually every one of the proposed pieces of legislation that the Public Utility Holding Company Act be removed. We would much prefer to see that modernized and updated to fit the situation we are dealing with, but that does not seem to be an option that the Congress is considering.

As a result of that, we would certainly urge that it be replaced with consumer protection. We do not think that you can simply trust that everyone will do the right thing, and certainly that is not true in the electric utility industry anymore than it is true anywhere else in the country. We need rules and regulations to deal with wrongdoing.

Let me also say, Mr. Chairman, that small utilities should be considered. I know in the proposed legislation over on the House side as it originated, we had small electric cooperatives that would be having to report to the Federal energy regulatory agency. In one case we had one cooperative that only had five employees that was going to have to deal with the same regulatory hurdles as some of the largest electric utilities in this country. That simply does not make sense. We would hope that the Congress would include, as a part of its policy, the fact that these resources, very limited and scarce resources, be focused on where the problem lies, be focused on the area in which we have come to recognize the most abuse is taking place, to come to recognize that it would be focused on the area where they would have the greatest return.

I would be happy to answer your questions, Mr. Chairman.

[The prepared statement of Mr. English follows:]

PREPARED STATEMENT OF GLENN ENGLISH, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

EXECUTIVE SUMMARY

Congress should take a "time out" on comprehensive electricity legislation. The forces underlying the current industry turmoil are not clearly understood by the industry or the public.

- Many elements of electricity legislation are inextricably tied to the Federal Energy Regulatory Commission's proposed Standard Market Design. It is important to give FERC time to more fully explain its implications. The White Paper from FERC requested by Senator Domenici is an important step in informing Congress for how they should approach the SMD proposal legislatively.

Legislation should not impose burdensome new regulatory obligations on electric cooperatives. FERC Chairman Wood says that new regulations on cooperatives are unnecessary.

A critical statutory duty of FERC is to establish "just and reasonable" policies. Therefore proposals to restrict FERC's current ability to protect consumers by narrowing their options to respond to evolving markets and regional differences should not be codified. Such harmful provisions include mandates for particular forms of transmissions pricing, transmission structures, and transmission functions.

The laws that are designed to protect consumers in the electric utility industry have never been more important particularly as we transition to a competitive market place. This is not the time to repeal the Public Utility Holding Company Act (PUHCA) without careful thought and replacement of consumer protections or undermine FERC's current merger review authority.

The federal Power Marketing Administrations' and TVA's statutory and contractual obligations to their consumers and their regions must not be overridden.

When Congress considers an electricity title, it should enhance FERC's existing authority to protect consumers without limiting FERC's discretion and flexibility or distracting it from its core mission of ensuring just and reasonable rates, terms, and conditions of interstate transmission and wholesale electricity sales, by:

- Giving FERC clearer authority to ensure that utility mergers are in the public interest;
- Encouraging FERC to review the standards under which it approves market based rates;
- Providing for limited federal siting authority for facilities determined by a regional planning process to serve consumers in the region;
- Creating an industry-based national self-regulating reliability organization;
- Providing for greater market transparency;
- Prohibiting round trip trading;
- Enhancing criminal and civil penalties for violations of the Federal Power Act; and,
- Moving up the refund effective date under Federal Power Act § 206 to the date that a complaint is filed at FERC.

INTRODUCTION

Chairman Domenici and Members of the Committee, I appreciate this opportunity to continue our dialogue on the restructuring of the electric utility industry. For the record, I am Glenn English, CEO of the National Rural Electric Cooperative Association, the Washington-based association of the nation's nearly 1,000 consumer-owned, not-for-profit electric cooperatives.

These cooperatives are locally governed by boards elected by their consumer owners, are based in the communities they serve and provide electric service in 47 states. The more than 35 million consumers served by these community-based systems continue to have a strong interest in the Committee's activities with regard to restructuring of the industry.

Electric cooperatives comprise a unique component of the industry. Consumer-owned, consumer-directed electric cooperatives provide their member-consumers the opportunity to exercise control over their own energy destiny. As the electric utility industry restructures, the electric cooperative will be an increasingly important option for consumers seeking to protect themselves from the uncertainties and risks of the market. I would like to thank you, Mr. Chairman, and Members of the Committee for your receptiveness to the concerns and viewpoints of electric cooperatives.

TIME OUT ON ELECTRICITY

Congress should take a time-out on comprehensive electricity restructuring. It should take time to review the failed deregulation schemes of recent years before it acts. Further, because many elements of the electricity title are closely tied to the Federal Energy Regulatory Commission's proposed standard market design, Congress should wait on electricity legislation until FERC has completed that broad rulemaking process. And, Congress should avoid bogging down important energy legislation with a controversial electricity title.

The electricity industry is in a state of turmoil and rapid change. In some parts of the country, the competitive wholesale power marketplace is rapidly developing. In other regions, wholesale competition is developing at a more deliberate pace. Retail competition continues forward in a few states, has stalled in many, and is in full retreat in some others. Wall Street, FERC, and the industry are all still trying to determine what lessons we should take from the disaster in California's market, Enron's bankruptcy, and the rapid decline of many power marketers, independent power producers, and investor-owned utilities. Investors, the Commission, and the industry are still working to piece together the causes of this turmoil.

Now, therefore, is not the time for Congress to act on comprehensive electricity restructuring. If Congress moves now, and enacts electricity legislation before the causes of the turmoil have been thoroughly analyzed, Congress risks codifying the very problems that it seeks to solve.

Just as important, the Federal Energy Regulatory Commission is in the process of drafting its dramatic new standard market design proposal. While NRECA believes that rule needs significant changes if it is to bring consumers the promised benefits of robust wholesale markets, NRECA believes that FERC should be given the time to reconsider, refine, and remake its standard market design proposal before Congress acts on electricity legislation. Many elements of proposed electricity legislation are closely intertwined with SMD. For example, legislative proposals with respect to incentive rates, participant funding, FERC's jurisdictional reach, and even PUHCA repeal have the potential to undermine FERC's ability to promote a robust wholesale electric market and protect consumers.

If, after FERC has completed its SMD, Congress concludes that FERC has erred, that would be the time for this Committee to hold hearings and call the Commissioners back to their task. And if that fails, the time will be ripe for Congress to enact an electricity title that corrects the Commission's failures. But we are not yet at that point.

By acting now, Congress risks denying FERC the resources and flexibility it needs during this time of change. While the Commission has the authority today to respond quickly to evolving conditions and the expertise to anticipate the consequences of its actions, the same cannot be said of any rigid congressional mandate. Given the rapid pace of change and the existence of enormous regional differences in power markets, a policy that might make sense today in one part of the country may not make sense tomorrow or in another part of the country.

THE COMPETING ELECTRICITY BILLS

The Committee asked that witnesses address the provisions of four bills, the Senator Thomas' electricity bill S. 475, Staff Discussion Draft, the House draft that was marked up on March 19, and the 2002 Senate Counteroffer.

As I've noted, NRECA does not believe that this is the time for a comprehensive energy title. Nevertheless, I'm pleased to discuss these proposals with the Committee.

First, in light of our belief that Congress should take a time-out on electricity legislation, we believe that Senator Thomas' more minimalist approach is the wisest. Senator Thomas does not restrict FERC's flexibility with respect to Regional Transmission Organizations, transmission pricing, and transmission cost recovery; does not repeal FERC's merger review authority; and does not address any retail electric issues. His bill does, however, properly include the NERC reliability legislation and repealing prospectively the mandatory purchase and sale requirements. We are concerned, however, that S. 475 repeals PUHCA without enacting sufficient market power and consumer protections to replace the Holding Company Act.

In the 107th Congress, NRECA supported the Senate Energy title. That bill contained many admirable provisions. It included NERC's reliability title, PURPA reform, and several critical market and consumer protections, including enhanced FERC merger review authority. NRECA was also pleased that it lacked provisions restricting FERC's flexibility with respect to transmission pricing, transmission cost recovery, and Regional Transmission Organizations.

This year's Staff discussion draft includes some interesting ideas. However, as discussed in detail in the written comments, NRECA believes it requires a great deal more discussion. The important details of scope, jurisdiction, and authorities of regional energy services commissions do not yet appear to have been adequately worked out.

NRECA would like to see the reliability provisions revised to be consistent with the NERC proposal. Due to changes in FERC regulation, NRECA believes that the so-called "FERC-lite" provisions need to be revised and updated.

And, because the bill repeals PUHCA, NRECA would like to see more market and consumer protections included in the bill as well.

SPECIFIC ISSUES WITHIN THE COMPETING BILLS

Regional Energy Services Commissions

NRECA certainly understands the problems that underlie the desire to develop something like RESCs. Along with many others, NRECA has called on the FERC to be more sensitive to regional differences. We understand as well as anyone that what works in PJM will not work in the Northwest. Nevertheless, NRECA believes that the concept of a Regional Energy Services Commission found in the Staff Dis-

cussion Draft needs more discussion and development before Congress should adopt it.

As we read the Staff Discussion Draft, the RESC would be a mini-FERC, but with much broader jurisdiction and nearly unlimited authority with respect to interstate transmission and wholesale markets.

Unlike FERC, RESCs would apparently have full jurisdiction over municipal utilities, Federal power agencies, and cooperatives with financing from the Rural Utilities Service. The RESCs could adopt regulations that conflict with the PMAs' statutory obligations or RUS regulations, apparently without any process for resolving disputes.

Unlike FERC, it also appears that RESC's would not be required to follow the "just and reasonable" standard or the decades of jurisprudence defining it. In fact, the draft appears to lack standards governing the RESC's decisions with respect to rate design, open access, reliability, or it's other functions.

Unlike FERC, it also appears that RESC's would not be subject to the Administrative Procedures Act. It is unclear whether RESCs would have to follow any particular procedures, provide hearings, or otherwise ensure procedural due process. It is even unclear whether the decisions of RESCs could be appealed to federal court.

Finally, while the Staff Discussion Draft includes processes for resolving disputes between RESCs and states, or between RESCs, there does not appear to be a procedure to help those multi-state utilities that might serve consumers in more than one RESC, or in an RESC and a state that is not in an RESC. Utilities could find themselves subject to numerous conflicting obligations that increase the cost of service and decrease reliability.

Reliability Standards

NRECA supports the North American Electric Reliability Council's legislative proposal to create the North American Electric Reliability Organization as a single national self-regulating reliability organization with the authority to set mandatory reliability standards applicable to all users of the bulk transmission system. That proposal is critical to the continued reliability of the interstate transmission grid in a competitive environment. For that reason, NRECA supports the language in the House draft of the bill.

Open Access (FERC-lite)

NRECA opposes any expansion of FERC jurisdiction over cooperatives. Such expansion is unnecessary, as cooperatives have not denied third parties access to their transmission systems. Provisions subjecting cooperatives with RUS financing to additional FERC jurisdiction are simply a solution in search of a problem.

Even had cooperatives not provided open access to their systems, FERC already has adequate authority to protect other market participants. Under Sections 211 and 212 of the Federal Power Act, as amended and expanded by the Energy Policy Act of 1992, FERC has the direct and explicit authority to require transmission-owning cooperatives to provide transmission service to third parties at just and reasonable rates. Under the principle of reciprocity, FERC has also required cooperatives to provide transmission service to public utilities pursuant to terms and conditions comparable to those FERC imposes on those public utilities.

Even the Chairman of the FERC has stated that the Commission does not require any additional jurisdiction over cooperatives. Speaking to reporters in January, Chairman Wood stated "FERC would not seek congressional authority over municipals and co-ops, preferring voluntary approach to entice such utilities into the marketplace." "Wood Says He Wants Munis, Co-ops To Want To Be Part Of SMD, But Won't Force Them," Platts, Electric Power Daily, Thursday, January 30, 2003.

NRECA recognizes that it supported the 2002 Senate Counteroffer even though it included a "FERC-lite" provision. That was because when the idea of "FERC-lite" first appeared, the "Commission rules" referenced and applied to cooperatives by the provision were Order 888 and its progeny. Since Order 888's reciprocity provisions already required to some degree that cooperatives provide service comparable to that imposed on public utilities by Order 888, "FERC-lite" did little more than codify an existing regulation with which cooperatives were already complying.

Today, however, the "Commission rules" that would be incorporated into the statute are in FERC's standard market design requiring transfer of operational control over transmission facilities that they built to serve their own member owners. This would require electric cooperatives that are not now subject to FERC jurisdiction to:

- Incur the substantial transaction costs required to establish an ITP that operates their transmission facilities, a day-ahead energy market, a real-time energy market, and any other mandates that are part of a final SMD rule.

- Incur costs required to schedule service for member-owners in the SMD markets.
- Pay congestion charges for use of their own facilities, built to serve their own member-owners.
- Participate in auctions to obtain congestion revenue rights for use of the transmission facilities that they built to serve their own member owners.
- Permit third parties to take transmission service out of, or across their transmission facilities without making any contribution to the fixed costs of the system.
- Be subjected to market monitoring and mitigation procedures and the associated costs.

These obligations go far beyond the requirements to which cooperatives are currently subject, and far beyond what could possibly be necessary to ensure third parties fair open access to the limited transmission facilities owned by rural electric cooperatives with RUS financing. These obligations could deny cooperatives control over and reasonable access to the very facilities that their members own, paid for, and built to serve their own needs. Such a broad expansion of FERC authority over these facilities threatens cooperatives' ability to meet their core purpose: to bring reliable, affordable electric service to their member-owners.

For these reasons, NRECA is far more concerned by the language in the 2002 Senate Counteroffer, Thomas bill, and Staff Discussion Draft, than it is by new language in the House draft that would require cooperatives to provide transmission service "on terms and conditions (not relating to rates) that are comparable to those under which such unregulated transmitting utility provides transmission services to itself. . . ." This language would not subject cooperatives to the broad burdens of SMD.

On the other hand, NRECA prefers the small distribution utility exemption found in Senator Thomas' bill and the 2002 Senate Counteroffer to the language found in the other two drafts. For a couple of reasons, the exemption is even more important to NRECA's small members and their consumers this year than it was in the past.

First, FERC decided for the first time in its SMD NOPR to take jurisdiction over and regulate bundled retail transmission. That means that "FERC-lite" would now apply not only to those cooperatives providing wholesale transmission service, and to those very few cooperatives providing unbundled retail transmission, but also potentially to hundreds of distribution cooperatives that use a small amount of radial, high voltage transmission line to serve bundled retail consumers. These distribution only entities whose facilities could not possibly have any use to the competitive wholesale market could be subjected by "FERC-lite" to all of the expensive and complicated burdens imposed by SMD.

Second, in several cases FERC has asserted that any facility that carries a wholesale electron is transmission subject to its jurisdiction, even if the facility would otherwise be considered a local distribution line. That means that any distribution-only cooperative that serves only bundled retail consumers could also be subjected by "FERC-lite" to all of the expensive and complicated burdens imposed by SMD if a single retail consumer installs their own generator no matter how small and no matter how little role the generator could play in the wholesale market.

For these reasons, it is more important than ever, that Congress adopt the small utility exemption contained in last year's Senate Energy bill or the Thomas bill.

FERC Refund Authority

NRECA was pleased to see that the 2002 Senate Counteroffer, Senator Thomas' bill, and the Staff Discussion Draft all lack a provision found in the House draft that would, for the first time, subject RUS borrowers' wholesale rates to FERC review and regulation. At a time when Congress and FERC are seeking to move towards a competitive wholesale market for electric energy, this provision of the House draft would move in the opposite direction, increasing the regulatory burden on electric cooperatives that seek to sell power in the wholesale market. Yet, electric cooperatives have not been part of the problem. Not-for-profit electric cooperatives have not gamed markets, they have not abused consumers, and they have not exercised market power. It would be impossible for them to have done so. Cooperatives do not own enough generation and are not large enough players in electric markets to exercise market power. All together, electric cooperatives generate only about 5% of the electric power in the country, which is less than half of the power they need to serve their own consumers. All combined, electric cooperatives' sales to public utilities represent less than 1% of all sales in the wholesale market.

Instead of solving a problem, the House draft would distract FERC from its core responsibilities and increase uncertainty for electric cooperatives, their member-owners, and their creditors. To date, cooperatives have been one of the most finan-

cially stable sectors of the electric utility industry. While other sectors have seen their credit ratings decline precipitously, cooperatives have experienced more credit upgrades than downgrades. Because cooperatives stuck to their knitting and did not engage in speculative generation construction or speculative trading, they have continued to have access to the credit they need to serve their consumers' electricity needs at a reasonable rate. Increasing FERC jurisdiction over RUS borrowers' wholesale sales threatens that stability.

Transmission Siting

NRECA supports the requirements found in the Thomas, House, and Staff Discussion drafts requiring coordination among federal agencies to simplify and speed the process of siting transmission facilities across federal lands.

NRECA also understands that limited federal siting authority may be necessary to permit the construction of some regional transmission facilities and upgrades that are critical to the continued reliable and economic service of consumers. Nevertheless, NRECA believes the rights of permitting; siting and eminent domain authority come with the responsibility for serving the public interest. That means that any provision providing for federal permitting, siting, or grant of eminent domain must meet the following criteria:

- Federal permitting, siting, and eminent domain must be used solely to create an interstate high voltage transmission grid that will help utility systems meet their obligations to the states and their consumers;
- The facility for which federal permitting, siting, or eminent domain authority is sought must have been specifically reviewed and determined by an RTO-led or other appropriate multi-state regional planning process to be necessary for the reliable and/or economic operation of the regional transmission grid, and thus provide benefits to the consumers within the region; and
- Federal permitting, siting, or eminent domain must be used only as a backstop to state permitting, siting, or eminent domain authorities.

Both the Staff Discussion Draft and the House draft make a good start in that direction. The limited federal authority they provide is restricted to interstate transmission and may only be used as a backstop where state authority fails.

Moreover, as a member of the Secretary of Energy's Energy Advisory Board, I supported the idea of having the Department of Energy identify those congestion points on interstate transmission system that affected the national interest. That was one approach that would ensure that federal siting authority would not be broadly granted to every transmission project proposed by transmission investors. It is not necessarily, however, the best approach. The drafts' requirement, for example, that facilities receiving federal siting and eminent domain authority be within federally determined interstate congestion areas is both somewhat too broad and somewhat too narrow. On one hand, not all transmission upgrades within a congested area may be properly located or designed to address the congestion. Thus, some facilities built within "interstate congestion areas" or "congestion zones" might receive federal siting authority without providing significant benefit to the consumers within a region. On the other hand, the process for designating interstate congestion areas appears ill suited to identifying the most serious problems in regional transmission grids. Conducted in Washington, D.C. only once every three years, the process seems rather too distant both physically and temporally from the problems to be addressed.

NRECA believes it would be more effective to trust the regional planning processes conducted by FERC-approved Regional Transmission Organizations or other multi-state entities to make good, timely, decisions about the transmission requirements of their regions. Transmission construction proposals that meet the other criteria for federal siting should qualify where a regional planning processes has determined that the proposals are necessary to serve consumers within the region more reliably and more economically.

Transmission Investment Incentives

For several reasons, NRECA believes that Senator Thomas' bill and the 2002 Proposed Senate Counteroffer address this issue best: by not addressing it at all.

First, it is unnecessary for Congress to legislate on the issue. The Federal Power Act already provides FERC with the authority to approve incentive rates to the extent that they are just and reasonable. FERC has had a pricing policy for many years that encouraged transmission owners to come forward with incentive rate proposals. And, FERC has already begun work on a new transmission pricing policy that offers specific incentives, including higher rates of return for new transmission construction, participation in an RTO, and transfer of transmission facilities to an

independent transmission company that is participating in an RTO. Congress does not have to force FERC to do something it is already doing.

Second, NRECA believes it is wrong for Congress to restrict FERC's discretion to adopt those approaches that it believes will best encourage the construction of needed transmission facilities and otherwise serve the public interest. As discussed above, with the market in the beginning of an evolutionary process, a good approach to transmission pricing today in one part of the country may not be a good approach tomorrow or in a different region. FERC already has authority today to adopt a transmission policy with incentives—and is doing so. It also has the authority to rescind or alter that policy if, at a later date, it considers incentives to be unnecessary or contrary to the public interest. The draft House bill would deprive the FERC of that critical authority. FERC would have to include incentives in its transmission pricing policy no matter how unnecessary, unjust, or unreasonable, it later considers them to be.

Finally, NRECA believes that arbitrary increases in rates of return are already an unnecessary and unwise approach to encouraging investment in needed transmission facilities. As explained by the Department of Energy's National Transmission Grid Study, "authorizing higher rates of return is not the only approach to stimulating needed investments in transmission facilities over the long term. Reducing regulatory uncertainty should also be a focus of efforts to stimulate needed investments" (NTGS at 31) As the NTGS notes, the rate of return required by investors varies with the level of risk. The lower the risk, the lower the return required to attract capital.

Similarly, the Department of Energy's Energy Advisory Board looked at how best to encourage the construction of needed new infrastructure, given that "there is a clear reluctance from the financial community to finance transmission projects." (Report at 22.) The Board determined that "[I]investment in the grid will only occur when regulatory policy provides (a) reasonably certain cost recovery, (b) regulatory certainty, in terms of who can operate the system and under what rules and (c) provides a return that makes investment in transmission a reasonable option, considering other available investment options." (Id).

That conclusion is significant. As NRECA has been saying for several years, FERC can best encourage the construction of new transmission facilities by providing investors with certainty that they will recover their costs. While the rate of return may be important, the level of return required to attract capital investment is a product of the level of risk faced by investors: the lower the regulatory risk, the lower the rate of return required to attract investment.

NRECA believes it is far better to increase regulatory certainty than to simply throw more money at the transmission shortage. By increasing regulatory certainty, Congress and the Administration can attract greater investment in transmission infrastructure without raising rates of return. That approach keeps costs down for consumers and strengthens electric markets by permitting more generation from across a region to compete economically. Higher rates of return should be a last resort, not a first resort.

The competing approach, granting transmission owners higher "incentive rates" would raise costs for consumers and narrow electric markets by building tollgates between generators and consumers. Interestingly, recent Moody's reports indicate that the regulated (i.e., transmission) component of the industry may now provide a more attractive investment vehicle than the unregulated (i.e., generation and trading) component of the industry. Similarly, Fitch recently rated the newly formed American Transmission Company's senior unsecured debt "A" because:

> Cash flow is expected to be stable and healthy. ATC is a monopoly provider whose transmission franchise is supported by state regulation and [FERC] approved tariff. Its costs are recovered through an annual revenue requirement allocated as fixed demand charges to regional electric utilities using the transmission network.[1]

In other words, ATC has an excellent debt rating (and associated low cost of capital) because it faces low risk.

If Congress adopts language such as that in the House draft or in the Staff Discussion Draft, that requires FERC to adopt transmission pricing policies that support transmission expansion, the language needs two significant amendments. First, the language should clearly state that FERC could adopt other policies—besides transmission pricing policies, which it believes will better promote economic transmission expansion, such as policies that reduce risk to transmission investors. Sec-

[1] Yahoo! Finance Press Release, "Fitch Rates American Transmission Company LLC 'A/F-1'" March 16, 2002.

ond, the language should clearly state that FERC should only offer transmission pricing incentives where that approach will encourage needed transmission investment at the lowest cost to transmission customers. Why should FERC bribe investors with consumers' money when it could encourage the same investment at lower cost?

Transmission Cost Allocation (Participant Funding)

Again, NRECA believes that Senator Thomas' bill and the 2002 Proposed Senate Counteroffer best address this issue by not addressing it at all. NRECA also recognizes and appreciates that the Staff Discussion Draft includes a narrower approach to participant funding than that found in the House bill. Although, as discussed below, NRECA does not believe Congress should legislate on this issue, NRECA does believe that the Staff Discussion Draft could, with a few minor language changes, be consistent with the approach to transmission cost allocation that NRECA has itself promoted.

First, the Federal Power Act already provides FERC the authority to allocate the costs of transmission investments as it believes best serves the public interest and FERC is already considering adopting participant funding for certain transmission facilities as part of its SMD rulemaking. Congress need not order FERC to do something it already intends to do.

Second, NRECA believes it is wrong for Congress in this bill to restrict FERC's discretion to adopt those approaches that it believes will best encourage the construction of needed transmission facilities and otherwise serve the public interest. The House draft would deprive the FERC of that critical authority. FERC would have to permit participant funding even if it later considers participant funding to be unnecessary, unjust, or unreasonable.

Third, NRECA believes that a broad participant funding mandate will discourage the construction of much needed transmission facilities, raise costs to consumers, and entrench existing market power.

NRECA does not oppose the concept of participant funding of transmission. Like many others, NRECA supports participant funding for those transmission facilities that would not be required but for the interconnection of new generating facilities that plan to export power outside of the region where they are sited. That approach protects native load consumers in one region from paying for transmission facilities that provide them no benefit. If the new transmission facilities benefit a generator, or consumers in another region, the generator or the consumers in the other region should pay the costs of the transmission facilities.

On the other hand, NRECA believes that the cost of any new transmission facilities required in a region to serve consumers in that region reliably or economically should be rolled into the cost of transmission in that region. NRECA and many others, including the Louisiana Public Service Commission, believe that this is the equitable approach. If consumers in a region benefit from a particular transmission upgrade, those consumers should all pay the cost of the facilities.

NRECA also believes that this is the best approach to encourage investment in needed transmission facilities. Rolling the costs of new transmission facilities determined by a regional plan to provide benefits to consumers in the region into the regional revenue requirement gives investors precisely the assurance they need that they will recover the costs of their investment as well as a reasonable rate of return. Participant funding as envisioned in the House bill, on the other hand, makes cost recovery extremely uncertain. Under the House participant funding approach, investors receive no direct income from the use of their facilities. Instead, they receive "congestion revenue rights," or CRRs. CRRs, however, only entitle their holders to revenue in the event of congestion, which may be substantially reduced or even eliminated due to the construction of new transmission. An allocation of CRRs alone thus discourages investment in new facilities, or at the least creates a perverse incentive to undersize upgrades to maintain congestion on the system, since that is the only way they get paid.

Transmission Organizations/RTOs

NRECA strongly supports the development of RTOs. Nevertheless, it believes that Congress should take only a very limited role with respect to RTOs, at least for the present. Thus, NRECA agrees with the Sense of the Congress in the House draft supporting the formation of RTOs. NRECA also supports the very simple provision in the Staff Discussion Draft authorizing the PMAs and TVA to join RTOs subject to their existing statutory and treaty obligations.

On the other hand, NRECA is concerned by language in the Staff Discussion Draft that outlines in detail the necessary elements and functions of Transmission Organizations. While NRECA does not necessarily disagree with any of the elements

listed in the Staff Discussion Draft, NRECA does not believe it is wise to freeze them in place in law. Over just the last few years, we have already seen movement from regional planning groups, to Regional Transmission Groups (RTGs), to Transcos, to ITCs, to ISOs and now to RTOs. As wholesale markets evolve in the next few years, we are likely to see further evolution in best practices for regional coordination and operation of the transmission system. This is one of the issues on which a "time-out" is particularly important.

PUHCA and Market Power

NRECA opposes the repeal of PUHCA. Now is the wrong time to repeal PUHCA. While it has not been adequately enforced, PUHCA is more critical today than ever to protect consumers from abuses in the utility industry. It was PUHCA that prevented Enron from owning, and abusing, more than one electric utility. It was PUHCA that should have prevented Enron and many other companies in the industry from shifting the risks of their unregulated and offshore activities to retail consumers in the United States.

If repealed, NRECA believes it should be replaced with modern legislation that takes a practical approach to controlling market power, focusing on the substance of consumer protection and market power abuses, as well as the acquisition of undue market power through ownership and affiliation. Such legislation should give federal regulators an array of tools that they can use to protect consumers and enhance competition in electric markets. If circumstances require it, regulators should have the authority to impose structural solutions that will prevent investor-owned utilities from accumulating undue market power, or remedy already existing market power that threatens competitive markets.

For these reasons, NRECA also was pleased that Section 7101 of the House draft—which repealed FERC's authority to review dispositions of jurisdictional property, including utility mergers—was deleted during mark-up. Section 7101 moved far in the wrong direction. Without PUHCA it is more important than ever that FERC not only exercise its existing authority to review utility mergers but also new authority. As the 2002 Senate Counteroffer provided, FERC needs new authority to review transfers of generating facilities and clearer authority to review mergers between electric utility holding companies. The standard of review for large utility mergers should also be strengthened to ensure that such mergers enhance competition. At a time when competition is just beginning to develop in the nascent wholesale electric market, Congress and FERC should not allow it to be choked through the rapid consolidation of generation assets in the hands of a few large companies.

NRECA also believes that Congress should encourage FERC to reconsider the standards FERC uses to grant utilities and others the right to sell power at market-based rates. As FERC has conceded, inadequately competitive wholesale markets have often led to exorbitant rates for consumers. Thin markets, inadequate transmission, market power and market manipulation have singly or together caused rates to rise far above just and reasonable levels. Under such conditions, only traditional rate regulation can ensure that rates are consistent with the law and that consumers are protected from abuse. The 2002 Senate Counteroffer provided a good start in this direction, though the language could still be improved.

PURPA

NRECA supports the PURPA reform language in Senator Thomas' bill. NRECA believes that PURPA imposes on the electric utility industry regulatory and financial burdens that far exceed any benefit that the Act might still provide. In many cases, application of the Act increases the retail cost of electricity.

Net Metering and Real-Time Pricing

Net metering, real time pricing, and advanced metering are all policies that can play an important role in some states, under some circumstances. There are cooperatives today already providing net metering, time-of-use pricing, and advanced metering to their member-owners either under state law or because the cooperatives have concluded that those policies best serve their members' interests.

The value of each of these policies, however, is very situation specific. Handled incorrectly, or adopted under the wrong circumstances, each of these policies could dramatically increase costs to consumers while providing little or no benefit.

NRECA believes that Senator Thomas's bill best addressed these issues. Our second choice would a voluntary approach, much like the one employed in the Staff Discussion Draft, the House draft, and the 2002 Senate Counteroffer. States and cooperatives are already considering these policy ideas, and in many cases adopting them. Over 34 states already have net metering policies. In any event, NRECA is pleased that none of the bills being considered by this Committee impose strict man-

dates on states or cooperatives to adopt broad, inflexible net metering, real-time pricing, or advanced metering policies.

Renewable Energy

NRECA supports fuel diversity, including the use of renewable resources where they can be economically integrated into the resource mix. Many electric cooperatives are actively using and developing renewable resources, including hydropower, wind, solar, and landfill gas. Dozens of cooperatives are also offering their members special "green power" choices, where consumers can demonstrate their support for renewable energy by paying a little extra each month to cover the incremental cost of renewable power.

NRECA believes there is an important federal role in supporting the development of renewable energy through research and development and through financial support for some renewable technologies. Nevertheless, NRECA would oppose a federal mandate requiring all utilities to include a fixed percentage of renewable power in their resource mix. In most circumstances, renewable resources are still considerably more expensive than traditional generation technologies. Wind and solar are also intermittent resources, whose value to consumers varies considerably depending on weather and time of day. They must still be "firmed" with dispatchable generation resources. Because of these characteristics, an inflexible federal mandate could dramatically increase power costs to consumers. For this reason, NRECA is pleased to see that the House draft, Senator Thomas' bill and the Staff Discussion Draft all lack mandatory renewable portfolio standards.

Market Transparency, Anti-Manipulation, Enforcement

NRECA supports provisions found in the Staff Discussion Draft, Senator Thomas' bill, and the House draft that authorize FERC to collect data from sellers of electric energy about the availability and market price of wholesale electric energy. To prevent manipulation of market prices, market price information must be transparent to buyers and sellers. NRECA believes, however, that this section should include language that ensures that data collection is implemented in a manner that minimizes the cost and burden to those that must provide the information and requires all relevant agencies to coordinate with one another to prevent duplicative requirements. By focusing on aggregate sales information, the two Senate bills probably do this best.

NRECA also supports language in the three bills prohibiting round trip trading; enhancing criminal and civil penalties for violations of FERC rules; and moving up the refund effective date to the day that a complaint is filed with FERC. NRECA also supports language in the Thomas bill prohibiting the provision of false information to any entity for fraudulent purposes. Each of these provisions enhances FERC's existing ability to protect consumers without limiting its discretion and flexibility or distracting it from its core mission of ensuring just and reasonable rates, terms, and conditions for interstate transmission and wholesale electric sales.

Consumer Protections

NRECA believes it is important that consumers be protected from abuses in the wholesale markets. The provisions discussed above under PUHCA and Market Power and Market Transparency are all important for that purpose. NRECA is less convinced that Congress needs to address retail issues in this bill, though it does not oppose any reasonable provisions of law required to protect consumers.

The CHAIRMAN. Thank you very much. I would say the Chairman of FERC has indicated that a white paper is going to be forthcoming. I am very pleased that that commitment was made in response to an inquiry by me as chairman in behalf of a number of Senators. We will have the Chairman before us here today, and we will find out with more certainty about his agenda for that white paper and other questions that will bear on some of the things you have raised and others have raised today.

Let us proceed now to you, Mr. Richardson, please.

STATEMENT OF ALAN H. RICHARDSON, PRESIDENT AND CEO, AMERICAN PUBLIC POWER ASSOCIATION

Mr. RICHARDSON. Thank you, Mr. Chairman. My name is Alan Richardson. I am the president and CEO of the American Public

Power Association representing the interests of the Nation's 2,000 publicly owned electric utilities located in virtually every State.

Mr. Chairman, I would like to respond to a comment that you made in your opening statement first before addressing some other issues. You had noted that there are essentially two camps and said that public power opposed open access and opposed SMD. And in fact, public power has not opposed open access. We are one of the leaders in efforts to amend the Federal Power Act in 1992 to promote open access, and in fact we have been the victims of discriminatory access for decades. And so open access and competition is very important to us, and we have benefitted from it.

Now, we do have some members that have some concerns about standard market design and we also have concerns about whether the goal is to promote competition or whether competition is simply a means to an end of just and reasonable rates that benefit consumers. I think my members believe that it is the latter, not the former. So just comments on your opening statement.

I do have a formal statement organized along the lines recommended or requested by the committee that I have submitted for the record, and I ask that that be inserted.

Senator Thomas, you mentioned the need for energy policy and electricity policy. Electricity is a derivative of many different sources, as you know, from coal to wind to hydro. And we do support an energy policy bill that deals with the need for diverse supplies of energy and deals with things like clean coal technology, reauthorization of the Price-Anderson Act, Senator Craig, hydroelectric relicensing and licensing reform, which is a critically important to us, renewable energy programs such as REPI and so forth. All of those I think fit into the issue of energy policy and they are elements of electricity policy.

We do have some serious concerns about whether we need electricity policy and an electricity title in legislation at this point. We are concerned that there are some things that should be done that would not be done, some things that would be done that should not be done.

This is one of the most difficult times that has been faced by the electric utility industry certainly since the late 1920's and the 1930's. The industry is in turmoil. A shorthand list of things include deceitful reporting of natural gas prices, withholding of capacity in Western States—California is shorthand for the Western energy crisis—the Enron implosion, debt and liquidity crises for numerous traders and marketers, legislative and regulatory uncertainty leading to investor uncertainty, and legislative retrenchment in a number of States, pulling back from restructuring, and the embrace of retail deregulation. These problems we have encountered, particularly in the West, in the last 2 years.

These are issues that are the subject of ongoing investigations by the Federal Energy Regulatory Commission. Yesterday they received a voluminous staff report outlining problems in the West. I have not even begun to try to digest that, but I think there are many issues there that should be addressed, should be considered by this committee and this Congress before moving forward on electricity legislation.

In addition, there has been much debate about standard market design in this hearing, and as was mentioned, both the Federal Energy Regulatory Commission, as well as the Department of Energy, are coming forward with their reports on standard market design, and it seems prudent to wait to see what they have to say before moving forward with legislation. It may well be that looking over what the Commission has done or is likely to do with respect to its investigation of problems in the West and what the commission is proposing to do with standard market design could help develop the consensus that is necessary to move electricity legislation, but we do not see that consensus at the present time.

While the industry has been severely stressed, public power has been doing quite well. Our ratings are stable. We have the ability to raise capital, to invest in needed infrastructure to meet the needs of our communities, and obviously, we do not want to see any changes in Federal legislation that would undermine our ability to continue to perform this valuable public service.

If you are going to move forward on electricity, we have concerns that have been expressed by others in this panel and prior panels. We are very concerned about repeal of the Public Utility Holding Company Act. We do not think that this going to spur investment in new facilities. It is simply going to facilitate investment in existing facilities as assets change hands.

If the act is to be repealed, Senator Bingaman, you had some very good proposals in your proposals last year and your comments this morning about things that needed to be done. We certainly agree with those recommendations in terms of merger review authority, expanding the role of the commission to deal with different types of mergers than they currently are authorized to do under existing law.

I also agree with the comments that John Anderson made earlier this morning that while that is important, we do not think that is sufficient. There are other issues that need to be addressed, including market transparency, market manipulation, practices that need to be understood and addressed and prohibited, market-based rate authority when it is appropriate, when it is inappropriate, and how it should be withdrawn. All of these things I think need to go into a mix, and frankly, we do not see that mix congealing into the kind of electricity legislation that we would find appropriate. So in sum, we do believe that now is not the time to move forward on electricity legislation.

We have been asked to address the RESC issue. This is a very new proposition for us. It is obviously an attempt to address regional differences. I think regional differences can be addressed in different ways. We do see some problems in terms of jurisdictional conflicts, conflicting interpretations of the underlying statute, the Federal Power Commission forum shopping, the fact that utility boundaries are not the same as State boundaries, that are not the same as regional transmission organization boundaries, and we see all those as causing potential problems as well.

I see my time is expired, Mr. Chairman. Thank you very much again for the opportunity to testify. I look forward to answering your questions.

[The prepared statement of Mr. Richardson follows:]

PREPARED STATEMENT OF ALAN H. RICHARDSON, PRESIDENT & CEO, AMERICAN PUBLIC POWER ASSOCIATION

Mr. Chairman and members of the subcommittee, my name is Alan Richardson and I am the President and Chief Executive Officer of the American Public Power Association (APPA). Thank you for the opportunity to appear before you today to discuss APPA's views on electricity legislation.

APPA represents the interests of more than 2,000 publicly owned electric utility systems across the country serving approximately 40 million customers. APPA member utilities include state public power agencies and municipal electric utilities that provide electricity and other services to some of the nation's largest cities. However, the vast majority of these publicly owned electric utilities serve small and medium-sized communities in 49 states, all but Hawaii. In fact, 75 percent of our members are located in communities with populations of 10,000 people or less.

The first and only purpose of public power systems is to provide reliable, efficient service to their customers at the lowest possible cost. Like hospitals, public schools, police and fire departments, and publicly owned water and waste water utilities, public power systems are locally created governmental institutions that address a basic community need: they operate to provide an essential public service at a reasonable, not-for-profit price. Publicly owned utilities also have an obligation to serve the electricity needs of their customers and they have maintained that obligation, even in states that have introduced retail competition. And, because they are governed democratically through their state and local government structures, public power systems operate in the sunshine, subject to open meeting laws, public record laws and conflict of interest rules. Most, especially the smaller systems, are governed by an elected city council, while an elected or appointed board independently governs others. Democratically governed, not-for-profit, obligated to serve all customers—understanding the underlying structure and mission of public power is essential in promoting policies that will maintain industry diversity and protect the consumer interest.

While the majority of my testimony will focus on those provisions directly related to electricity, I will briefly review several other areas of interest to APPA. As has been the case since President Bush introduced his national energy policy plan in 2001, APPA believes that there are a number of areas where the Administration and Congress should act to maintain or enhance the viability of traditional fuels used to generate electricity, promote the commercialization of new, alternative sources of electricity, increase energy conservation, provide adequate energy assistance to low-income households, and maintain infrastructure security.

APPA supports the inclusion of provisions in an energy bill that address the following:

Hydroelectric Relicensing—Over the next 15 years, two-thirds of all non-federal hydroelectric capacity—which totals nearly 29,000 megawatts of power and can provide enough electricity to serve six million retail customers—must undergo the Federal Energy Regulatory Commission (FERC) relicensing process. The relicensing of each hydro project may potentially result in a significant loss of existing capacity due to the exceedingly complex, fragmented, costly and inefficient relicensing process. Such lost capacity must be replaced by less efficient generation sources that both impose additional costs to the consumer and produce greenhouse gas emissions.

Therefore, we believe improvements to FERC's hydroelectric licensing and relicensing processes are needed. Specifically, we support legislation that will allow current licensees, for the first time, to offer alternative conditions to those mandated by the federal resource agencies under Sections 18 and 4E of the Federal Power Act as long as those alternatives accomplish the same level of environmental protection. In addition, federal resource agencies should be required to document that they gave "equal consideration" to the economic, environmental and other public impacts of their mandatory conditions before imposing them on licensees—something that agencies are not doing now.

Renewable Energy Production Incentive—APPA supports the reauthorization of and changes to the Renewable Energy Production Incentive (REPI) proposed in S. 421, recently introduced by Senators Cantwell, Murray, Smith and Feinstein. REPI was established by the Energy Policy Act of 1992, and authorizes the Department of Energy (DOE) to make direct payments to publicly- and cooperatively-owned electric utilities for electricity generated from solar, wind, landfill-gas, and certain geothermal and biomass projects. Since 1995, REPI has funded more than 36 renewable energy projects in 17 states. REPI's authorization is set to expire in September of this year.

Future plans for acquiring or installing additional renewable capacity will in large part be dependent on the continued availability of REPI funds to help offset the ad-

ditional cost to our customers. As the only incentive available to locally-owned, not-for-profit utilities to make new investments in renewable energy projects, REPI delivers important and significant air quality benefits to the communities served by project owners and operators. The REPI program merits extension, requires reform, and deserves congressional attention.

Price-Anderson Act Reauthorization—The Price-Anderson Act, a law that indemnifies DOE contractors and Nuclear Regulatory Commission (NRC) licensees for damages resulting from nuclear incidents, is scheduled to expire this year. APPA supports the reauthorization of the Act.

Clean Coal Technology—Legislation is needed that will authorize and fund the development of a program at DOE to deploy clean coal technologies. APPA supports clean coal technology research and development, as well as incentives as long as they are linked to a tradable tax credit available for public power and rural electric cooperatives.

Energy Conservation—APPA supports the authorization of increased funding for energy efficiency and conservation efforts. Specifically, APPA supports an increase in the funding authorization for the Low Income Home Energy Assistance Program (LIHEAP) and weatherization assistance. Recent weather and economic conditions underscore the need for an increase in this federal program that helps thousands of families pay their home energy costs.

APPA supports the inclusion of the provisions mentioned above in an energy bill. As it pertains to electricity, APPA believes that electricity should not be part of an energy bill at this time. In a February policy meeting, APPA members unanimously voted in favor of a resolution urging Congress to review the results of various ongoing investigations into consumer abuses and market manipulation in western electricity markets and then develop consensus for further action based on those results before imposing any new requirements on electric industry participants, or experimenting with further industry restructuring.

Before proceeding with electricity legislation it is critical that there be a full understanding of the western energy market crisis. The crisis has had and continues to have broad and far-reaching adverse effects throughout the West. The western energy crisis resulted in huge increases in the wholesale price of electricity that will ultimately cost consumers billions of dollars. The crisis has forced several companies to file for bankruptcy resulting in thousands of employees losing their jobs and in some cases their pensions. Ongoing discoveries of market manipulation and abuse by energy traders and others continue to send shockwaves through the industry and prompted credit downgrades of numerous investor-owned utilities.

We realize that last year the Senate debated and passed an electricity restructuring title as part of a comprehensive energy bill. However, events in our industry, including FERC's dramatic proposal for a standard market design, have progressed during this same time frame. In addition, restructuring proposals advanced in the past were premised on the expected near-term success of competitive wholesale electric markets operating in a world populated with many energy traders and independent power producers. That certainly has not happened.

Revelations in recent months have made it more clear that the results of these deregulation efforts have been disastrous in the West and questionable elsewhere. Rather than proceed with legislation modeled on the failed Enron vision of the industry, we believe that Congress should take a fresh look at the electricity industry and examine the characteristics that are fundamentally different from those of other industries. These characteristics include, among others, the fact that electricity is a real-time product produced and consumed simultaneously, cannot be stored, is a necessity of modern life, and has no reasonable substitute. Delivery of electricity requires hard-wire connections, making this function a natural monopoly that must be regulated in some manner. Further, it is a complex network industry and all parts—generation, transmission and distribution—must work together. This situation necessitates planning to ensure optimum use of individual facilities and the network, as well as associated infrastructure investments. All of these unique characteristics make it very difficult to displace regulation with a purely competitive market in the electricity industry.

Despite promises that the deregulation of both wholesale and retail markets would be beneficial to consumers by reducing electricity prices, the western experiment caused power costs to skyrocket and has had a detrimental impact on consumers and investors. We urge Congress to reevaluate the merits of moving forward with legislation until there is a greater understanding of what can be done by FERC under existing law to ensure effective competition, including how FERC may proceed on proposals to institute a standard market design. Only then will it become clear as to what legislation, if any, is required.

The Committee requested that in my testimony I address specific issues outlined by the Committee. My comments on those issues are below.

Regional Energy Service Commissions—The Regional Energy Service Commissions (RESC) outlined in the Committee's draft electricity title is a new concept that merits further study. Since this is such a new concept APPA has no formal policy position on the creation of RESCs. Among the issues that need to be carefully considered with respect to the proposition are: the probability of inconsistent interpretations of the Federal Power Act by different RESCs; whether RESCs will promote certainty and stability in this critical industry; the seams issues and other difficulties that will arise when the RESC footprint does not match the footprint of individual utilities within the RESC or the footprint of a regional transmission organization; and the additional costs of proceedings before RESCs with subsequent appeals to FERC.

Reliability Standards—APPA believes that ensuring the reliability of the interstate electric transmission grid is one of the most fundamental functions of electric utilities. Industry restructuring and the resulting increase in transactions on the grid have made it increasingly difficult to ensure reliability. Over the last few years APPA has worked with a coalition of industry representatives to develop legislative language granting NERC the ability to enforce national reliability standards. The consensus reliability language developed by the coalition is included in Section 104 of S. 475, and APPA supports this language with minor technical changes. The special treatment of New York State in the energy bill proposed by Congressman Barton and recently marked-up by the House Subcommittee on Energy and Air Quality, is problematic, particularly if it prompts other states or regions to seek their own exemptions or exceptions.

Open-Access (FERC-Lite)—Open, non-discriminatory access to the interstate transmission system has been a longstanding principle of public power. FERC Order 888 required jurisdictional entities to file an open access tariff and to provide transmission service based on the principles of comparability and reciprocity. The FERC-Lite agreement reached in 1997 represented an understanding that while public power systems, as well as other non-jurisdictional entities such as rural electric cooperatives and federal power marketing administrations (PMAs) were not required to file tariffs under Order 888 they would be required to file a tariff at FERC consistent with Order 888. FERC would review the tariff to ensure that it met the conditions of comparability and reciprocity before approving the tariff, but would not have the authority to set the actual rates for transmission services. Rates would continue to be set at the local level under the relevant existing regulatory authority. If FERC found that the rates where somehow inconsistent with the comparability requirement, it could remand the rates to the local authority for re-consideration and/or modification, but FERC could not itself change the rates.

APPA continues to support FERC-Lite language that clarifies that FERC-Lite is limited to the review and approval of transmission service tariffs for consistency with the comparability standard. This language is contained in Section 7021 of the House energy bill and is supported by APPA. FERC-Lite language contained in the Senate Committee's draft and S. 475, introduced by Senator Thomas, does not reflect the comparability standard and original intent of the FERC-Lite agreement.

Transmission Siting—APPA recognizes that federal backstop siting authority is a necessary tool to facilitate the siting of new transmission lines that are stymied by the current balkanized, state-by-state siting approval process. In most cases difficulties associated with the siting of transmission, not the lack of capital or insufficient rate of return, act as obstacles to the development of transmission. Transmission lines are necessary to support interstate commerce, as well as security interests, and thus a federal role in the siting of these lines is appropriate. APPA would strongly urge that every reasonable effort be made first at the local and state levels to resolve siting issues and that federal siting authority should only be used as a last resort.

Transmission Investment Incentives—APPA is opposed to legislation that would require FERC to adopt "incentive transmission pricing" rules. FERC, under the Federal Power Act and Order 888, already has sufficient authority and flexibility to design transmission rates to "promote economically efficient transmission and generation of electricity." For example, the Commission on January 15, 2003, issued a proposed policy on incentive transmission rates and already has approved incentive rates based on the facts in individual proceedings. These rates remain subject to the "just, reasonable, and not unduly discriminatory or preferential" standard that has been the hallmark of FERC ratemaking authority for decades. Further, mandatory incentive pricing would lead to higher transmission rates that would ultimately be passed on to consumers.

Proponents of this language have asserted that incentive pricing is necessary in order to raise the capital needed for investments in new transmission facilities. They argue that incentives are justified because transmission investment is risky. This is clearly not the case.

In fact, as Wall Street representatives have testified before Congress, transmission is a safe and stable investment and current rates of return are sufficient to attract needed capital. Moreover, the widely recognized need for additions to the currently constrained system indicates the prudence of this type of investment. A case in point is the infamous Path 15 in California where approximately a dozen entities responded to the Department of Energy's request for proposals to finance the new line. Developing new transmission facilities is difficult, but the problem is not lack of financing. There are substantial obstacles involved in the siting and permitting processes. Rights of way may be denied for parochial reasons with no consideration given to broader public interest considerations. Many of these obstacles to transmission development will be resolved by the enactment of federal siting language.

Congress should allow the Commission to continue to assess the facts and provide for rates of return on a case-by-case basis.

Transmission Cost Allocation (Participant Funding)—FERC already has sufficient authority to permit or require participant funding where appropriate. Therefore, reiterating in legislation this ability is unnecessary and would in fact create a preference for participant funding. Furthermore, "participant funding" is an untested concept and, in most parts of the country, is likely to delay and limit transmission construction at a time when congestion and curtailments are increasing, to the detriment of consumers.

Transmission Organizations/RTOs—FERC has maintained in Order 2000 and subsequent orders and proceedings, that it has the authority to order RTO participation by jurisdictional utilities to remedy undue discrimination or facilitate competition. In addition, the substantial authority already provided to FERC under the Federal Power Act to promote the creation of RTOs and to determine the appropriate size, scope and functions to be performed, makes legislation unnecessary.

In regard to federal transmission-owning entities, it is critical that any legislation addressing their participation in RTOs not impair the existing statutory authorities and obligations of those entities. Further, the rights of federal transmission-owning entities to withdraw from an RTO should not be impaired by legislation. It should be no more difficult for a federal transmission-owning entity to withdraw from an RTO than for any other RTO participant. The energy bill recently marked-up in the House Energy and Air Quality Subcommittee stated that a Federal Power Marketing Agency would have withdrawal rights from an RTO "in the event of a material breach by the regional transmission organization of the contract, agreement or other arrangement necessary to allow the Federal utility to transmit electric power or to comply with applicable statutory requirements." APPA views this language as problematic since "material breach" can be difficult to prove and could involve time-consuming litigation before a decision would be made.

PUHCA—The Public Utility Holding Company Act (PUHCA), enacted as a companion to the Federal Power Act, establishes passive restraints on the structure of the electric utility industry in order to mitigate the formation and exercise of market power, preclude practices abusive to captive consumers and competitors, and facilitate effective regulation. Those advocating repeal argue that the Act no longer serves its original purpose of protecting investors, consumers and the general public interest. This is simply not the case.

In fact, the turbulence in the utility industry over the past two years—financial and accounting abuses, improper affiliate transactions, market manipulation and consumer abuse—underscores the importance of retaining and strengthening consumer and investor protections provided by PUHCA. It is APPA's belief that many of the serious financial and other problems facing the electric utility industry can be traced directly to exemptions from PUHCA that were enacted by Congress in the 1992 Energy Policy Act. The 1992 Act exempted developers of independent power generation facilities, called Exempt Wholesale Generators, whether they were owned by operating utilities, utility holding companies, or parties not involved in the electric utility business. This exemption resulted in a substantial number of electric utilities and utility holding companies taking advantage of the new freedom from Securities and Exchange Commission scrutiny to create unregulated power production subsidiaries—the very subsidiaries placing many operating utilities in financial jeopardy today.

APPA has a long-standing position to oppose any efforts that repeal PUHCA unless they are accompanied by appropriate structural and regulatory safeguards designed to promote fair and open competition and satisfy the underlying purposes of

the Holding Company Act: consumer protection, effective oversight and accountability, prevention of undue market concentration and fair competition.

The electricity industry is in a state of turmoil. In 2002, 182 investor-owned utilities received credit downgrades from Standard & Poor's. Given the current turmoil in the industry and considering the adverse consequences of the partial repeal of PUHCA in 1992, it is APPA's belief that now is not the time to repeal the Holding Company Act.

However, if Congress does go forward with repeal of PUHCA there are certain structural safeguards that must be in place to protect consumers. First, FERC must be given strong authority to establish clear rules for determining when competitive market conditions exist and when suppliers can charge market rates. FERC should be required to review markets in which a public utility is authorized to sell wholesale electric energy at market-based rates to determine whether such sales are subject to effective competition. If FERC determines that the sales are not subject to effective competition FERC should be required to modify or revoke market-based rate authority. Lastly, FERC should be required to take corrective action, when necessary, to enforce market rules, protect consumers and prevent market abuses and manipulation. If FERC finds that a public utility has intentionally engaged in an activity that violates any rule, or tariff or has engaged in fraudulent, manipulative, or deceptive activities in wholesale electric energy markets FERC should be required to immediately revoke or modify the authority of that public utility to sell electric energy at market-based rates. Many of these provisions are contained in legislation Senator Cantwell introduced last week, S. 681, that APPA supports.

Repealing PUHCA will eliminate legal barriers for certain utility mergers and acquisitions and lead to increased consolidation and reduced competition in the industry—and could lead to higher prices for consumers. To offset this impact, APPA has consistently urged adoption of a higher merger standard in the Federal Power Act that would condition merger approval upon an affirmative finding that the proposed merger will promote the public interest, as opposed to the current standard that only requires the merger to be consistent with the public interest. In addition, FERC's merger authority needs to be clarified and expanded to cover mergers of utility holding companies as well as the disposition of generation assets by jurisdictional utilities and "convergence" mergers of electric and gas utilities.

PUHCA repeal should also be accompanied by provisions that protect consumers from the costs and risks of utility diversifications and prevent utilities from unfairly subsidizing affiliates that compete with independent businesses. In addition, state and federal regulators should be given enhanced access to books and records. Legislation repealing PUHCA in the bills outlined by the Committee sharply circumscribes the access that would be permitted. Regulators must have full and complete access to holding company books and records. The current language places the burden on the regulator to show, with some degree of specificity, why requested books or records are relevant to jurisdiction over rates. However, given that a holding company may have hundreds or even thousands of subsidiaries (Enron—an exempt utility holding company—had thousands of subsidiaries), it would be extremely difficult for regulators to find the relevant books and records.

Net-Metering & Real-Time Pricing—While there can be positive benefits to net metering, such as its potential to increase the use of renewable resources and provide generation alternatives, net metering is essentially a "retail" program and is best left to the jurisdiction of states and local entities. In addition, 34 states currently have some form of a net metering program in place. While Congress may have a role in ensuring that net-metering receives appropriate consideration, decisions as to how and if it should be implemented are best made at the local level. Therefore, the best way for Congress to deal with these issues, if it addresses them at all, is by requiring the consideration of standards but leaving the adoption of those standards to the appropriate regulatory authority. This is how those issues are handled in the Committee staff draft and the Barton bill.

Real-time pricing can provide a price signal to customers and give them a monetary incentive to reduce their demand when the supply of power is limited and demand is high. However, like net-metering, decisions related to the implementation of real-time pricing programs are best made at the local level.

Renewable Energy—APPA supports legislation and programs that provide incentives to investments in renewable energy. Recently, Senators Grassley and Baucus introduced legislation, S. 597, which creates tradable tax credits that provide an incentive for public power to generate from renewable resources and clean coal. APPA supports this legislation.

As it pertains to renewable energy mandates or portfolio standards, APPA believes that these decisions are best made at the local level. Numerous states have already implemented renewable portfolio standards and many utilities offer green

power-pricing programs to their customers. Furthermore, the opportunities for developing renewable energy are not equally available across the country.

Market Transparency, Anti-Manipulation, Enforcement—The market transparency provisions outlined in the Senate Energy Committee's draft only require FERC to provide "statistical information" regarding the availability and market price of wholesale electricity and transmission services. APPA is concerned that limiting the release of information to "statistical information" will not provide an adequate picture of the marketplace. Rather, APPA prefers the broader transparency language in Congressman Barton's bill that does not limit the release of information to "statistical information." In addition, legislation should clarify to FERC that close calls regarding whether information will be made public should be resolved in favor of transparency, not secrecy.

As mentioned previously, APPA supports the market manipulation language contained in Senator Cantwell's legislation, S. 681. In cases when a public utility has been found to have engaged in market manipulation or fraudulent practices that entity should immediately lose its privilege to sell electric energy at market-based rates. Also, rather than identifying a specific manipulative practice, such as round trip trades, the legislation should give FERC broad authority to identify the type of activities that are prohibited (in general terms, just as the antitrust laws define in general terms what is prohibited).

Consumer Protection—Subtitle I, Sections A and B of the Committee's draft requires the Federal Trade Commission to promulgate rules in regard to information that each utility would have to provide to their customers concerning: the nature of electric service being offered; the price of electricity including a description of any variable charges; a description of all other charges; the percentage of electricity generated by each fuel mix; and the environmental emissions produced in generating the electricity. These types of decisions are best made at the local level. While the means and frequency of providing this information has yet to be determined, this could be extremely burdensome and costly to small and mid-size utility systems.

FERC Jurisdiction—One additional provision I would like to comment on is contained in Section 7092—Jurisdiction over Interstate Sales, of Congressman Barton's bill. This provision would unnecessarily extend FERC jurisdiction over public power systems by imposing FERC's refund authority over the spot market sales made by public power systems. This language is an encroachment on local authority that is neither prudent nor warranted. Public power systems have been regulated differently under federal law for more than 66 years. This is neither an accident nor an oversight, but rather good public policy that recognizes the differences between not-for-profit public power systems operating in the public interest and regulated at the local level, and multi-state, investor-owned private utilities. Public power systems do not represent a significant presence as sellers in the wholesale markets, and public power systems are, and will continue to be, net purchasers of electricity. The limited volume of surplus energy from public power systems precludes their ability to set a market-clearing price—public power systems are price takers, not price makers.

Service Obligation—APPA supports language that would ensure that both transmission owners and transmission dependent utilities (investor-owned utilities, rural electric cooperatives, public power systems, and the federal Power Marketing Administrations) holding firm transmission rights under long-term contracts would be able to meet their wholesale and retail service obligations under federal, state, or local law or long term contract. This legislation simply reaffirms the existing rights of load serving entities so that regardless of the transmission regime in the future—SMD or otherwise—they would be assured firm transmission access in accordance with the terms of their existing contracts. The essential elements of this concept were embodied in an amendment offered on the Senate floor last year by Senator Kyl during consideration of the Energy Policy Act.

In conclusion, it is critical that Congress understand the lessons of the western energy crisis, and the reasons behind the industry's financial crisis, before proceeding with changes affecting the $200 billion wholesale electric utility market. Enacting electricity legislation without a full understanding will almost surely result in unintended adverse consequences that will cause further harm to energy markets and the overall economy as well as consumers. For these reasons we urge you to oppose efforts to include an electricity title in an energy bill.

Senator CRAIG [presiding]. Alan, thank you very much for your testimony.

Now let us move to Phil Tollefson.

STATEMENT OF PHIL TOLLEFSON, CEO, COLORADO SPRINGS UTILITIES, ON BEHALF OF LARGE PUBLIC POWER COUNCIL

Mr. TOLLEFSON. That is correct.

Senator CRAIG. Thank you. Colorado Springs Utilities.

Mr. TOLLEFSON. My name is Phil Tollefson. I am the CEO of Colorado Springs Utilities in Colorado. I am here today testifying on behalf of The Large Public Power Council which represents 24 of the largest public power systems in the Nation. Our members directly or indirectly provide service to about 40 million.

Thank you for the opportunity to appear before you today to express the views of LPPC on your draft energy legislation. I will not be commenting on all of the different provisions of interest or concern to LPPC today but will, instead, focus on several issues of primary concern to our members, that of FERC jurisdiction, service obligation, and the regional organizational options.

First, I would like to address the need for market reforms at this time. Similar to several previous speakers, we recognize that Congress has struggled with electricity restructuring legislation for several years. Over the course of that debate, the industry has undergone tremendous change. Once-robust IOUs are now in serious financial shape with many credit downgrades in the last year. Some have filed for bankruptcy, major instabilities. You have heard all of that.

What we are seeing, however, is that in the midst of this turmoil, that there are many, many allegations having been made and many questions raised and many investigations have yet to be initiated, yet alone completed. As a result, many LPPC members and our customers have serious concerns about legislating major changes to electric power markets at this time, concerns which are shared in our cities and towns.

Let me turn now to our issue of primary concern today. That is the issue of expanded FERC jurisdiction. LPPC and its member companies support open access transmission. LPPC has worked with Congress to guarantee open access transmission by non-jurisdictional entities. Public power agreed that limited FERC jurisdiction could be extended to public power systems and cooperatives in order to assure that open access would be provided to all market participants on an equal and comparable basis. That is the provision that is traditionally referred to as FERC-lite. LPPC continues to support this limited expansion of FERC jurisdiction for the purpose of open access transmission.

However, a recent Supreme Court decision and a subsequent issuance of FERC's proposed standard market design rule have raised questions that the current language of FERC-lite may be read to allow expansion beyond its original intent, possibly to impose full FERC jurisdiction over public power systems and cooperatives, which is unacceptable.

Your draft electricity title currently includes a provision on open access transmission. However, the provision, as currently drafted and in particular proposed section 211A(a)(2), cannot be supported by LPPC unless the language is modified to restore its original intent. In particular, the modification that we seek to FERC-lite would make it clear that FERC may require public power, co-ops, TVA, and PMAs to provide open access transmission services; that

is, service to others that is comparable to the service they provide themselves. This is completely consistent with FERC's reciprocity requirements in Order 888.

Recently, the House Subcommittee on Energy and Air Quality reported out their legislation which contains language that is acceptable to LPPC on this matter, and we urge this committee to take a similar approach to FERC-lite and restore this provision to its original intent.

Also, it bears remembering that public power systems continue to be constrained to some extent by private use rules from the IRS. Certainly we appreciate that the IRS has recently issued some rulings which clear up many of those questions, but there are still a number of outstanding issues related to bond covenants and the applicability of some State statutes.

Now, with regard to service obligation, the ability of public power systems to serve our local communities is an issue of paramount concern. Let me just reiterate, we do support open access transmission. However, we do not want to risk the reliability and reasonably priced power that our customers expect and are entitled to receive.

In summary, the key point for us is that our customers should not have to pay twice for their transmission systems, first to build it and then again to use it when someone else outbids our customers. Our customers have paid for the critical transmission lines necessary to move power from our sources to meet service obligations, and if we are required to pay congestion charges whenever our use and the demands of others exceed the capacity of the line, then in effect, our customers would be double-billed for the same transmission capacity.

For that reason, last Congress we supported the service obligation amendments that Senator Kyl and others put forward.

Lastly, to sum up, as this committee is well aware, the FERC is considering a significant rulemaking initiative denominated as standard market design. We have submitted other comments to you twice in writing and believe that the SMD proposal, as currently configured, is unworkable.

With respect to the regional energy services commission, we echo some of the comments that you have heard earlier today. It is a notable recognition of regional differences. It is a step towards a more productive dialogue, but there are still many, many questions that need to be studied before we can reach any conclusive recommendation to you.

Thank you for the opportunity to comment.

[The prepared statement of Mr. Tollefson follows:]

PREPARED STATEMENT OF PHIL TOLLEFSON, CEO, COLORADO SPRINGS UTILITIES, ON BEHALF OF THE LARGE PUBLIC POWER COUNCIL

My name is Phil Tollefson and I am the Chief Executive Officer of Colorado Springs Utilities, located in Colorado Springs, Colorado. I am testifying today on behalf of the Large Public Power Council (LPPC), an association of 24 of the largest public power systems in the United States. LPPC members directly or indirectly provide reliable, affordably priced electricity to almost 22 million customers. Our members own almost 33,000 miles of transmission and control over 61,500 MW of generation. LPPC members are located in states and territories representing every region of the country, including several states represented by members of this Com-

mittee—including my home state of Colorado, as well as Arizona, Tennessee, Florida, New York, California, and Washington.

LPPC has testified before the Committee in previous Congresses during consideration of energy policy and electric restructuring.

Thank you for this opportunity to express the views of LPPC on your draft energy legislation. I will not be commenting on all provisions of interest or concern to LPPC members today but will, instead, focus on several issues of primary concern to our members—FERC transmission jurisdiction, service obligation, and the regional organizational options. Attached to my testimony is a short outline of the issues on which the Committee requested comment and LPPC's position on those issues.

PUBLIC POWER IS UNIQUE

Public power systems are owned by the communities we serve, not by investors. We are not-for-profit entities, which makes us different. Public power systems have been a part of the nation's electric system since the late 1800s, with many created as a part of city governments. Many LPPC member systems continue to provide numerous services to their communities in addition to electricity, such as flood control and natural gas, water and wastewater services, like we do in Colorado Springs. In fact, Colorado Springs Utilities is one of the largest four-service utilities in the country.

Electricity is a vital component of our lives now and is a cornerstone of the economy. There are dire consequences if electricity is not reliable and affordable.

As the electric supply of the country has been "deregulated," many providers of electricity have sold off their generation or transmission assets or have severed their direct relationship with electric customers. But public power systems still have an obligation to serve the customers for which their systems are built. This service obligation is generally imposed by state law or local ordinance, sometimes by the statute creating the public entity. As a result, all available resources go first to serving those customers. Power is sold and surplus transmission made available only if it is surplus to those needs.

Our rates reflect the fact that we are not-for-profit entities. Our rates include only the costs of producing and delivering power to our customers and, in some cases, payments to our governing boards or municipal entities as a component of the local budget. Our system, for example, Colorado Springs Utilities, contributes $24 million annually to general fund of the city. Since public power systems are locally controlled, decisions about policies such as rates are made by people who are in touch with local concerns. A city council sets policies for many LPPC members, while other public power systems have a separately elected or appointed utility board that governs their policies. Local control helps ensure that we respond to community needs. In addition, since public power systems are community based, our revenues stay close to home. This helps keep the local economy strong.

THE NEED FOR MARKET REFORMS

Congress has struggled with electric restructuring legislation for several years. Over the course of that debate, the electric utility industry has undergone tremendous change. Once robust investor-owned utilities are now in serious financial shape with 180 rating downgrades in the past year. Some significant players in the market have filed for bankruptcy. There are instabilities in the market at this time. The capital market for utility infrastructure has basically collapsed. Many LPPC members and our customers have serious concerns about legislating major changes to electric power markets at this time, concerns which are shared by our cities and states.

Standard & Poor's recently issued a credit analysis report on the public power sector that noted that the credit rating stability of public power "is a testament to the sector's ability to withstand periodic shocks as well as respond to new challenges." More than 80% of the public power sector has an "A" rating or better at this time and public power systems are functioning well in competitive wholesale markets. A strength of public power systems is our focus on providing the lowest-cost power to our customers.

EXPANSION OF FERC JURISDICTION (OPEN ACCESS—FERC-LITE)

Our issue of primary concern today before this Committee, one that affects our willingness to continue to support legislative action and our ability to exhibit the strength and resilience market watchers see in our sector, is the issue of expanded FERC jurisdiction.

LPPC and its member companies support open access transmission. LPPC has worked with Congress to guarantee open access transmission service by non-juris-

dictional entities. Public power agreed that limited FERC jurisdiction could be extended to public power systems and cooperatives in order to ensure that open access transmission service would be provided to all market participants. That is the provision that is known as "FERC-lite." LPPC continues to support this limited expansion of FERC transmission jurisdiction—for the purpose of open access transmission. A recent Supreme Court Decision and the subsequent issuance of FERC's proposed Standard Market Design rule have raised concerns that the current language of the FERC-lite provision could be read to allow expansion beyond its original intent, possibly to impose full FERC jurisdiction over public power systems and cooperatives, which is unacceptable.

The staff discussion draft dated 3/26/03, Electricity Title, includes a provision on "Open Access Transmission." However, the provision, as currently drafted, and in particular the proposed Section 211A(a)(2), cannot be supported by LPPC—unless the language is modified to restore its original intent. The modification we seek to "FERC-lite" would make it clear that FERC may require public power, coops, TVA and PMAs to provide open access transmission services—that is, service to others that is comparable to the service they provide themselves. This is completely consistent with FERC's reciprocity requirements in Order 888. We remain committed to providing such open access transmission.

Recently, the House Subcommittee on Energy and Air Quality reported out their legislation which contains language that is acceptable to LPPC in Section 7021. We urge this Committee to take a similar approach to FERC-lite and restore the provision to its earlier intent. This will respect the long-standing agreement between LPPC and policy makers and will ensure that open access transmission service is provided in furtherance of a robust competitive wholesale market.

FERC Chairman Pat Wood has not asked Congress to expand federal authority over public power systems, preferring a "voluntary approach to entice such utilities into the marketplace." The Administration and Commission have generally supported the concept of open access transmission but have not sought additional jurisdiction over the transmission assets of public power. We hope that the Chairman and this Committee recognize this issue and return FERC-lite to its original intent—a limited extension of FERC jurisdiction to ensure open access to the transmission system.

It bears remembering that public power systems continue to be somewhat constrained by IRS "private use rules" from providing open access transmission service using facilities financed with tax exempt bonds. We appreciate that the Senate understands that the ability of public power to make its transmission facilities available to all users depends on a solution to the private use problem. Last year's Senate bill reflected that understanding, as does the current staff discussion draft by including subsection (f) in the Section 211A. The IRS did issue final regulations on private use which resolve many of the issues facing public power. However, the regulations do not address all situations or concerns that may arise with bond covenants and, as a result, public power may be restricted in its ability to provide open access transmission service in all circumstances. Therefore the Senate language is still necessary.

SERVICE OBLIGATION

The ability of public power systems to serve our local communities is an issue of paramount concern to LPPC member systems. Let me just reiterate—we support open access transmission policies. However, we do not want to risk the reliable, reasonably-priced power that our customers expect and are entitled to receive. We hope that you will address this issue because, for us, it is about protecting our customers.

Public power systems are established by state law and are obligated, generally by state law, to provide electric service to their customers. We need to maintain and preserve the ability to fulfill this obligation. Some LPPC member systems have built their transmission system specifically to serve their customer base, as is the case with Colorado Springs Utilities. This transmission has been and is being paid for by our customers/owners. Our customers want to be assured that the transmission system which they paid for and which provides them their electric power at reasonable rates, will continue to be available to them first—with any excess to be made available to others who are not customers.

LPPC members have also entered into long-term bilateral contracts in making their long-term generation and transmission decisions. These firm commitments allow for stable and secure electric rates and reliability. They provide for certainty in the market and allow the parties to make operational and investment decisions over the long-term, decisions that are necessary for the continued expansion of a functioning electric generation and transmission system. Without this kind of cer-

tainty as to the future, obtaining approval from public governing bodies for generation and transmission investments will be difficult, if not impossible.

In summary, the key point for us is that our customers should not have to pay twice for their transmission system—first to build it and then to use it when someone else outbids our customers. Our customers have paid for the critical transmission lines necessary to move power from our own or distant generation sources to meet our service obligation to our communities. If we are required to pay congestion charges whenever our use and the demands of others exceed the capacity of the line, our customers would, in effect, be "double billed" for the same transmission capacity. Although the SMD NOPR seeks comment on a transition proposal that offers limited protection against this outcome, we think that direction from Congress is needed.

For that reason, last Congress, we supported the Kyl amendment—SA 3184—placed in the record during the Senate debate on S. 517. We believe that the amendment is good energy policy and good public policy. It protects our consumers and helps ensure the reliable delivery of electricity to our customers. Under the amendment, a utility that has firm transmission rights (by ownership or under contract) can retain those rights to meet its state law service obligation. The amendment makes it clear that customers don't have to pay twice for transmission: once to build it and then a second time to use it if congestion occurs. The amendment is consistent with FERC policy objectives and has wide support from industry—both transmission owners and transmission dependent utilities.

REGIONAL ENERGY SERVICES COMMISSION

LPPC has no formal position on the new proposal by the Committee on Regional Energy Services Commissions (RESCs).

LPPC continues to believe that regional differences need to be respected in any legislative or regulatory framework and we are appreciative that this proposal recognizes that principle. As an organization of 24 member systems from all over the country, we are very well aware of the distinctions that exist in the markets around the country. We have member systems located in New York State that are fully participating in the NY ISO. Other member systems are located in ERCOT. Still other systems are in the Pacific Northwest, the Southeast, Midwest, and the West. Genuine diversity exists among our members. This leads to an awareness on the part of LPPC that "one size doesn't fit all"—especially in the West. The RESCs may be intended to address this fundamental issue. But the proposal is so sweeping, so new, that we feel that more details will have to be known and understood by all parties before we would feel comfortable commenting substantively.

STANDARD MARKET DESIGN

As this Committee is well aware, the FERC is considering a significant rulemaking initiative denominated as Standard Market Design. The LPPC and many of its members filed comments on this proposal. Colorado Springs Utilities made two filings, one addressing issues unique to the Western Interconnect. In its comments Colorado Springs Utilities opposed implementation of SMD, particularly in the Western Interconnect.

Speaking for my own company, Colorado Springs Utilities favors open access transmission and was one of the first nonjurisdictional utilities to file a reciprocal open access tariff with the FERC. Colorado Springs Utilities has participated in a number of initiatives to create Regional Transmission Organizations. Nevertheless, Colorado Springs Utilities believes the SMD proposal is unworkable, especially in the Western Interconnect, and will impose significant new costs upon electric consumers without any corresponding benefit.

TRANSMISSION INVESTMENT

Many LPPC members have built transmission systems to accommodate load growth. To the extent permissible under the private use rules, any excess is made available to the market. It is in our members' best interest to both build for load growth and to make excess transmission capacity available to the market place. Load serving entities and their customers who prudently built transmission to accommodate future load growth should not be deprived of the benefit of that investment by having their future right to use that transmission taken away.

There are mechanisms in place by which entities can assure that transmission upgrades are made when transmission customers are willing to bear the cost of those upgrades. We believe that the building of new transmission should be encouraged and believe that properly structured incentive rates might be able to encourage such investment. However, any incentives must be tied to acceptable and demonstrable

benchmarks of performance. Most importantly, the form of incentives or savings must not disadvantage or discriminate among different types of wholesale energy customers or transactions. Moreover, any incentives or savings should not be imposed on all systems or in all circumstances.

This Committee and FERC have both expressed an interest in encouraging investment in transmission facilities. In this respect, public power is part of the solution, not the problem. Unlike most of the industry, LPPC member systems, such as Sacramento Municipal District (SMUD), the Lower Colorado River Authority (LCRA), Long Island Power Authority (LIPA), JEA, and the Salt River Project (SRP), are continuing to invest in transmission upgrades and expansions. In some cases, we are building transmission for others. It is our understanding that the Committee is looking for a mechanism that makes sense, allows for planning, and facilitates reliable expansion. We will be happy to work with the Committee and demonstrate how public power is helping to build needed new transmission today.

ENERGY CONSERVATION

LPPC supports increased funding for energy efficiency and conservation programs. Low-income families spend a significant portion of their income on energy costs. Colorado Springs Utilities and the other LPPC members are committed to providing our eligible low-income customers with the assistance they need and continue to strive for rates as low as possible so that our customers can have an easier time paying their utility bills.

CLEAN COAL TECHNOLOGY

Although this is not a primary issue for the LPPC in the context of the electricity title, LPPC strongly supports fuel diversity. Colorado Springs feels strongly that a national energy policy must recognize the role that coal plays as part of a diversified fuel base for the generation of electricity. There are some that advocate the elimination of coal. Colorado Springs believes this is the wrong approach.

Our nation has an abundant supply of coal that is inexpensive and can be easily delivered using existing technology and infrastructure. Coal is a domestic energy source that is not tied to foreign suppliers and exists in such quantity that we can supply our energy needs for generations to come. Our existing fleet of coal based generation supplies approximately 43% of the current electricity consumed in the United States.

Congress should recognize that coal is a fundamental part of our energy supply portfolio and allocate resources to address the major challenge to coal as a generation fuel. Scientific research and federally supported projects to explore and demonstrate new and better methods to eliminate the emissions of coal based generation is needed to help address the concerns related to human health and the environment.

LPPC POSITIONS ON THE ISSUES ON WHICH COMMITTEE STAFF REQUESTED SPECIFIC COMMENT

Regional Energy Services Commissions

LPPC has no official position on the staff discussion draft dated 3/26/03 at this time. LPPC continues to believe that regional differences need to be respected in any legislative or regulatory framework. As an organization of 24 member systems from all over the country, we are very well aware of the distinctions that exist in the markets around the country. We have member systems located in New York State that are fully participating in the NY ISO. Other member systems are located in ERCOT. Still other systems are in the Pacific Northwest, the Southeast, Midwest, and the West. Genuine diversity exists among our members. This leads to an awareness on the part of LPPC that "one size doesn't fit all"—especially in the West. The RESCs may be intended to address this fundamental issue. But the proposal is so sweeping, so new, that we feel that more details will have to be known and understood by all parties before we would feel comfortable commenting substantively.

Reliability Standards

LPPC supports mandatory reliability criteria and standards developed by national or regional reliability organizations overseen by FERC. We supported the NERC reliability consensus legislation last Congress, which was included in the Senate counter-offer dated 10/16/02. LPPC believes that there is a need to clarify FERC authority over reliability, that there should be binding electric reliability standards, and that there should be a clear mechanism to enforce these reliability standards.

Open Access (FERC-Lite)

LPPC supports open-access transmission. However, LPPC cannot support FERC-lite as contained in the staff discussion drafted dated 3/26/03 unless the language is modified to restore its original intent. The House bill reported out of the Energy and Air Quality Subcommittee dated 3/19/03 moves in that direction.

Transmission Siting

LPPC does not have a position on the staff discussion draft dated 3/26/03 at this time. LPPC supports giving FERC carefully circumscribed authority to provide the right of eminent domain where the installation of transmission facilities is required to ensure adequate and reliable service. However, the role of the state and local governments must be given adequate weight.

Transmission Investment Incentives

LPPC does not have a position on the staff discussion draft dated 3/26/03 at this time. LPPC believes that incentive rates may be appropriate in limited circumstances, if properly tied to acceptable and demonstrable performance benchmarks. However, LPPC does not support mandating universal application through legislation.

Transmission Cost Allocation (Participant Funding)

LPPC does not have a position on the staff discussion draft dated 3/26/03 at this time. LPPC believes that there are circumstances under which transmission cost allocation may be useful. However, LPPC does not support mandating universal application through legislation.

Transmission Organizations/RTOs

LPPC opposes the concept of an RTO mandate. There are legal constraints—such as private use tax restrictions, bond indenture requirements, and state statutory obligations—that are unique to public power. Most of our members are currently working voluntarily to join RTOs. RTOs, to be effective and worth the initial costs, will have to deliver the promised benefits to consumer and LPPC strongly feels that any participation must be accompanied by consumer benefits.

PUHCA

Each of the proposals would repeal the Public Utility Holding Company Act (PUHCA). LPPC believes that PUHCA should be modernized. If PUHCA is repealed, FERC's merger authority under section 203 of the Federal Power Act should be strengthened, not eliminated, and consumer protection provisions must be enhanced. FERC must be provided with adequate tools to review mergers, including holding-company-to-holding-company mergers, and to prevent abuses of market power.

PURPA

LPPC has no position on the staff discussion draft.

Net Metering & Real-Time Pricing

LPPC does not have a position on the staff discussion draft dated 3/26/03 at this time.

Renewable Energy

LPPC supports legislation that provides incentives to investment in renewable energy, including tradable tax credits and the REPI program.

Market Transparency, Anti-Manipulation, Enforcement

Public power believes that there should be strong mechanisms to ensure market transparency and prevent manipulation in the market. As governmental entities, public power systems are subject to "sunshine" laws and good governance principles, requiring complete pubic dissemination of information and openness of decision-making. We support provisions such as those contained in the House draft bill dated 3/19/03 and believe they can be strengthened.

Consumer Protections

Public power has continued to advocate for strong consumer protection provisions in federal legislation.

Senator CRAIG. Well, thank you very much, Phil.

Now let us move to Betsy Moler, executive vice president, Government and Environmental Affairs and Public Policy for Exelon Corporation.

Welcome back to the committee.

STATEMENT OF ELIZABETH A. MOLER, EXECUTIVE VICE PRESIDENT, GOVERNMENT AND ENVIRONMENTAL AFFAIRS AND PUBLIC POLICY, EXELON CORPORATION, ON BEHALF OF ELECTRIC POWER SUPPLY CORPORATION

Ms. MOLER. Thank you very much, Senator Craig. It is a pleasure to be here today.

Exelon is a registered holding company. Our utility subsidiaries, Commonwealth Edison in Chicago and PECO Energy in Philadelphia, serve over 5 million electric customers, roughly 15 million people. We have the largest customer base of any utility in the United States.

I am here today representing the Electric Power Supply Association, known as EPSA. EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators, power marketers, as well as some major utilities. These suppliers account for more than a third of the Nation's installed generating capacity.

Unlike some of my fellow panelists, EPSA strongly urges you to enact long overdue energy legislation. In addition, EPSA agrees with Senator Thomas' recent statement that if we pass a comprehensive energy bill, it must include an electricity title.

Various electricity marketing reforms have been pending before this committee for nearly a decade. On March 4, this committee heard compelling testimony that highlighted the financial crisis facing our industry and that Allen Franklin mentioned to you. We desperately need legislation that will provide much needed reform outdated laws that hamper our access to capital and thwart infrastructure development. Congress came close to passing an electricity title in the comprehensive energy policy legislation last year. Unfortunately that effort fell short. We urge you to act this year.

We believe that the focus of any legislation should be on repealing outmoded laws that impede competition and capital formation, further the progress of wholesale competition, and assure reliability. Wholesale competition, incomplete as it is, has already benefitted consumers. Inflation-adjusted electricity prices decreased from 1985 to 2001, the latest year for which statistics are available. They decreased on average by 31 percent for residential customers and by 45 percent for industrial and commercial customers. Studies have repeatedly shown that efficient wholesale markets bring real benefits to consumers. Actions such as forming regional transmission organizations could save consumers as much as $60 billion by 2021.

At your staffs' request, my written testimony today focuses on the four major proposals before the Congress either this year or last: Senator Thomas' bill, the majority staff draft, the Senate offer from last year, and the electricity provisions of the House Energy and Air Quality Subcommittee bill.

By focusing on the list of proposals that are or have been pending and analyzing them very carefully, it is obvious that, contrary

to the impression you may get from today's discussion, we believe the differences are actually narrowing among the proposals. EPSA believes that by taking various parts of the four pending proposals, that this committee could forge a compromise proposal that would have very broad industry and stakeholder support.

In the limited time I have today, I do want to focus on one brand new topic, that is the proposal by the majority staff discussion paper to create regional energy services commissions, or RESCs. The staff draft, unveiled last week, does propose a fundamental shift in the way the electricity industry would be regulated. By authorizing RESCs, Congress would be signaling the end of a system of regulation that has brought this Nation an electricity network that is the backbone of our modern economy and the envy of the modern world. The staff RESC proposal is not a minor or incremental change. It represents a radical shift in the regulation of wholesale electric power markets.

EPSA simply cannot support the RESC proposal. We do recognize that it is a well-intentioned proposal to address the jurisdictional questions that have arisen in the wake of FERC's standard market design initiative. But the RESC proposal, as it currently stands, further complicates an already too complicated jurisdictional split between FERC and the States.

We also believe that it raises serious constitutional questions and those constitutional questions are outlined in some detail in my testimony.

It also has a bunch of practical issues. It would create another layer of bureaucracy with authority over rates for transactions in interstate commerce. The industry would be hamstrung with multiple overlapping layers, including FERC, State PUCs, RESCs, RTOs, electric regional organizations, and municipal and cooperative entities. Our goal should be to simplify and streamline the regulatory model, not to complicate it.

We also have serious questions about the transition to RESCs. There are staffing issues. There are State issues with respect to requiring legislation to implement it. There are funding issues when States are having financial crises. There is a question of recruiting appropriate staff to run these organizations and people these organizations, and there is a question of whether they could handle the caseload.

We think that RESCs would exacerbate the seams problem rather than help them. A State could opt in one year, opt out the next year, as Virginia has just done, opt in the next year, and where would you be? In short, we think it is a mess.

Mr. Franklin's testimony on behalf of EEI had some further practical questions, and I would also call your attention to some testimony that is being submitted for this record by the North American Electric Reliability Council which calls into question the reliability implications of this proposal.

We do understand that one goal of the staff draft is to stir creative thinking, and we give them a great deal of credit for that. We do believe that there are aspects of our industry that would benefit from greater cooperation among the States. The include regional transmission planning, including expansion of the transmission grid, and regional approaches to determining generation adequacy.

We would urge Congress to focus on incremental improvements to enhance regional efforts rather than adopting the RESC approach.

EPSA does support passage of an electricity title that includes reliability language, FERC-lite provisions, PUHCA repeal with safeguards to ensure that there are no cross-subsidies by utilities, access to books and records by State commissions, prospective PURPA repeal, voices support for RTOs, has market transparency, anti-manipulation and enforcement provisions, information disclosure, consumer privacy, and unfair trade practices provisions. Some of these issues have been highlighted, particularly by Senator Bingaman, as a precondition for his degree of comfort with repealing PUHCA.

Exelon does support the Barton draft siting proposal, and I would note that there are three panelists on this panel that are members of the Department of Energy's Electricity Advisory Board. We helped develop that proposal and we are delighted to see it emerge in the Barton bill.

Again, I do believe that this committee has a wonderful opportunity to forge a consensus where a consensus has eluded the committee for years, and we would urge you to put your efforts to that task.

Thank you.

[The prepared statement of Ms. Moler follows:]

PREPARED STATEMENT OF ELIZABETH A. MOLER, EXECUTIVE VICE PRESIDENT, GOVERNMENT & ENVIRONMENTAL AFFAIRS & PUBLIC POLICY, EXELON CORPORATION, ON BEHALF OF THE ELECTRIC POWER SUPPLY CORPORATION

Mr. Chairman and members of the committee, thank you for the opportunity to testify today; it is a pleasure to be back before this Committee. I am Elizabeth A. (Betsy) Moler, Executive Vice President, Government and Environmental Affairs and Public Policy for Exelon Corporation. Exelon is a registered utility holding company. Our two utilities, Commonwealth Edison (ComEd) of Chicago, and PECO Energy of Philadelphia, serve over 5 million electric customers, the largest electric customer base in the United States. We have more than 40,000 MW of generating capacity, the second largest portfolio in the United States. Our wholesale power marketing division, known as the Power Team, markets the output of our generation portfolio throughout the 48 States and Canada with a perfect delivery record.

I am here today representing the Electric Power Supply Association (EPSA). EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, which account for more than a third of the nation's installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. On behalf of the competitive power industry, I thank you for this opportunity to comment on pending energy legislation.

I strongly urge you to enact long-overdue energy legislation. In addition, EPSA agrees with Senator Thomas' recent statement that, "If we pass a comprehensive energy bill, it must include an electricity title"[1] Various electricity market reform bills have been pending before this Committee for nearly a decade. On March 4, 2003, this Committee heard compelling testimony that highlighted the financial crisis facing our industry; we desperately need legislation that will provide much-needed reform of outdated laws that hamper our access to capital and thwart infrastructure development. Congress came close to passing an electricity title in the comprehensive energy policy legislation last year; unfortunately that effort fell short. We urge you to act this year.

We believe that the focus of any legislation should be on repealing outmoded laws that hinder competition and capital formation; furthering the progress of wholesale

[1] "Secretary Abraham and Senator Thomas Agree; Electricity Essential for Comprehensive Energy Bill," Press Release (February 27, 2003).

competition; and assuring reliability. EPSA members agree with the vision statement from a recent Western Business Roundtable proposal[2] that recommends, "All transmission users enjoy access to a robust regional transmission system capable of efficiently moving adequate supplies throughout the grid." Wholesale competition—incomplete as it is—has already benefited consumers; inflation-adjusted electricity prices decreased from 1985 to 2001 on average by 31 percent for residential customers and by 35 percent for industrial/commercial customers.[3] Studies have repeatedly shown that efficient competitive wholesale markets bring real benefits to consumers. Actions such as forming Regional Transmission Organizations ("RTOs") could save consumers as much as $60 billion by 2021.[4] Congress can foster further savings by encouraging the use of the most economically efficient generation and opening up the transmission system. Consumers in areas of the country which do not have robust wholesale markets are not reaping the full benefit of competition-if markets were established in which the least expensive and most-efficient generation had the opportunity to be deployed first, regardless of ownership, all electricity customers would save.

At your staff's request, my testimony today will discuss three major proposals pending before the Congress: S. 475, Senator Thomas's Electric Transmission and Reliability Enhancement Act of 2003 ("Thomas Bill"); the Majority Staff Discussion Draft, dated March 20, 2003 ("Staff Draft"); the Senate Offer of October 16, 2002 ("2002 Senate Offer"); and the electricity provisions included in the comprehensive bill reported last week by the House Energy and Air Quality Subcommittee ("Barton Bill"). As your staff requested, the testimony is organized to focus on specific areas of concern to this Committee.

Our analysis of these three proposals keeps in mind three basic principles:

- First, any structural or procedural change brought about by legislation must be aimed at providing consumers with the lowest-cost reliable power available;
- Second, maximum consumer benefits will flow from competition built around seamless regional markets in which power is generated at the least expensive and most efficient facilities regardless of who owns them; and
- Third, the basic concept of "first do no harm" should apply—the collateral effects from incomplete or poorly thought out policy changes could have a negative impact on all electricity users.

REGIONAL ENERGY SERVICES COMMISSIONS

The Staff Draft, unveiled last week, proposes a fundamental shift in the way that the electricity industry would be regulated. By authorizing the creation of "Regional Energy Services Commissions" ("RESCs") Congress would be signaling the end of a system of regulation that has brought this nation an electricity network that is the backbone of our modern economy; it provides reliable service, at reasonable cost and is the envy of the world. The Staff Draft RESC proposal is not a minor or incremental change; it represents a radical shift in the regulation of wholesale electric power markets.

EPSA simply cannot support the Staff Draft RESC proposal. We recognize that it is a well-intentioned proposal to address the jurisdictional questions that have arisen in the wake of the Federal Energy Regulatory Commission's ("FERC") recent market design initiatives. But the RESC proposal, as it currently stands, further complicates an already too-complicated jurisdictional split between FERC's regulatory authority over wholesale sales and transmission under the Federal Power Act and the states' authority to regulate retail matters.

As a threshold matter, we believe that the RESC proposal, as drafted, raises significant issues under the U.S. Constitution. The Commerce Clause of the Constitution grants to Congress—and solely to Congress—the power to regulate commerce among the states. Supreme Court precedent has long established that transmission of electricity is commerce among the states—out of reach of state regulation under the Commerce Clause.[5] In addition, the RESC concept implicates issues under the

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[2] Western Market Design, A Proposed Model to Encourage Greater Investment in Western Wholesale Electricity Markets," Western Business Roundtable Proposal, www.westernroundtable.com.

[3] The "2003 Data Update: Assessing the 'Good Old Days' of Cost-Plus Regulation" prepared for EPSA by the Boston Pacific Company.

[4] "Economic Assessment of TRO Policy" for FERC by ICF Consulting on February 26, 2002.

[5] The very case cited in the Staff Draft as the introduction for the creation of RESCs, *Public Utilities Comm'n v. Attleboro Steam & Electric Company, 273 U.S. 83 (1927),* held that a direct transfer of power from a utility in Rhode Island to a utility in Massachusetts is in interstate commerce and cannot be regulated by the states, even though there was no federal authority then to regulate those transactions. *Federal Power Commission v. Florida Power & Light Co.,*

Appointments Clause by legislating a new level of regional government that is not contemplated by the Constitution. Congress can, of course, abolish FERC's authority to set transmission rates, but it is not at all clear that Congress can delegate that authority to the states, or to congressionally appointed executives.

The RESC proposal raises significant practical concerns, and it would create another layer of bureaucracy governing some unquantifiable percentage of transactions in interstate commerce. The industry would be hamstrung with multiple overlapping layers of jurisdiction including regulation by FERC; state regulation through public utility commissions ("PUCs"), RESCs, RTOs, Electric Reliability Organizations ("EROs"), and municipal and cooperative entities. Our goal should be to simplify and streamline the regulatory model, not to complicate it.

The proposal builds on a questionable model: the multi-state compact. These organizations, even when successful, tend to move slowly, and are ill equipped to respond to rapidly evolving, dynamic circumstances. They require state legislation for approval and lack federal enforcement authority. I think that one must be very careful before turning over regulation of an essential commodity, which is the basic engine of our economy, to a new and unproven regulatory regime when so much is at stake.

RESCs could quickly become a hodgepodge of highly-politicized regulatory organizations that would practically guarantee huge "seams" issues, as even the most fundamental definitions and rules of the road get set locally. A state could opt-in to an RESC one year, and opt-out the next, which by the Staff Draft's contiguous requirement could immediately disqualify other states from being part of the RESC. Some states would have RESCs; others would not. Additional "seams" would be created as additional regional organizations come and go. This is just one example of how one state's action could impact the interstate transmission market in multiple states.

Further development of competitive wholesale markets would be thwarted as different regions develop different rules. Whole new regional bureaucracies would have to be created, funded, and qualified staff recruited in an era of unprecedented state budget deficits. We do not believe that is likely to happen smoothly. Furthermore, the RESCs simply would not be prepared to handle the caseload.

I could elaborate on the list of questions that have been raised since the proposal was revealed last week. The Edison Electric Institute ("EEI") testimony, and the North American Electric Reliability Council ("NERC") testimony, elaborate on many of the practical issues presented by the Staff Draft.

Representatives of the capital markets that testified at the FERC's capital availability technical meeting on January 16, 2003, uniformly advocated that clear rules and regulatory certainty are a prerequisite for the return of affordable capital to this industry as a whole. RESCs, as formulated in the Staff Draft, likely would create even greater uncertainty for an even longer time as they progress through the state approved process, get organized, and sort out responsibility. In the meantime, a financially beleaguered industry would be unable to take sure steps to recovery.

The goal of Congress should be to encourage competition at the wholesale level, and to simplify rather than complicate the regulatory regime ("do no harm"). Putting all interstate transactions under FERC jurisdiction, as provided in the Thomas Bill, rather than adopting the Staff Draft can achieve this goal. EPSA members agree with Senator Thomas' conclusion that the current [wholesale] electric market is inefficient and fragmented; it does not allow the industry to provide consumers with the savings they could otherwise receive with a system that works.[6]

We understand that one goal of the Staff Draft is to "stir creative thinking" about solutions to problems in our industry. EPSA believes there clearly are aspects of our industry that would benefit from greater cooperation among states. These include regional transmission planning, including expansion of the transmission grid; and regional approaches to determining generation adequacy. We would urge Congress and FERC to focus on incremental improvements to regional efforts, rather than adopting the radical RESC approach.

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404 U.S. 453 (1972), held that power generated and delivered solely within Florida was nonetheless transmitted in interstate commerce because it commingled in a bus with power from another state. *New York v. Federal Energy Regulatory Commission,* 535 U.S. 1 (2002) held that the transmission of power, even for retail services, was interstate commerce, subject to Federal Power Act jurisdiction. These cases make clear that the Commerce Clause of the Constitution precludes states from regulating transmission of power in interstate commerce.

[6] *Supra,* n. 1.

RELIABILITY STANDARDS

EPSA supports the passage of electric reliability language establishing a nationwide organization that would have the authority to establish and enforce reliability standards with the oversight of FERC. Although we are not yet convinced that any of the proposals is ideal, we believe that the reliability language contained in the Thomas Bill represents the best approach of the four bills under discussion.

OPEN ACCESS ("FERC-LITE")

The expansion of FERC authority to include limited jurisdiction over the transmission systems of public power and cooperatives is a very important step toward creating an integrated national transmission grid. We urge Congress to include the FERC-Lite provisions because they will: support competitive market development; help prevent gaming of the transmission system; and promote reliability by eliminating the "holes" in the regulatory oversight of the system. According to a December 2002 GAO report, "Lessons Learned From Electricity Restructuring," because of this lack of jurisdiction:

> FERC has not been able to prescribe the same standards of open access to the transmission system. This situation, by limiting the degree to which market participants can make electricity transactions across these jurisdictions, will limit the ability of restructuring efforts to achieve a truly national competitive electricity system and, ultimately will reduce the potential benefits expected from restructuring.

In theory, sections 211 and 212 of the Federal Power Act allow any person to request FERC to issue an order requiring interconnection and the wheeling of electricity. In practice, proceedings under sections 211 and 212 are expensive, time consuming and are a poor substitute for a requirement that all transmitting utilities provide open, non-discriminatory access under comparable rates, terms and conditions. Access under these cumbersome rules and procedures merely perpetuates opportunities for abuse and foot dragging by non-jurisdictional, transmitting utilities until the competitive threat they face disappears. One of the principle reasons that FERC initiated the Order No. 888 open access rulemaking initiative in 1996, while I chaired the Commission, was the recognition that individual case-specific adjudications over the scope of open access requirements were simply not working.

Unless FERC-Lite is included, regulation of the transmission grid will continue to look like "Swiss Cheese" where the holes are the Bermuda Triangles of competition. We endorse giving FERC the very limited authority called for in the Staff Draft, the Thomas Bill or the 2002 Senate Offer. We also believe that the refinements to the FERC-Lite provisions contained in the Barton Bill have the potential to make the FERC-Lite provisions acceptable to a broader audience of industry participants.

TRANSMISSION SITING

EPSA does not have an official position on transmission siting, but its members do support the timely expansion of the transmission infrastructure to support delivery of needed generation. Exelon as an owner of generation and transmission assets does support providing the FERC limited "backstop" authority to issue a certificate of public convenience and necessity to site transmission needed to relieve "National Interest" bottlenecks as is called for in the Barton Bill. The Barton Bill implements the recommendations of the Department of Energy's Electricity Advisory Board ("EAB"). It was my privilege to chair the Transmission Grid Solutions Subcommittee of the EAB, which developed the recommendations. The EAB includes representatives of a broad cross-section of the economy, including regulators, environmentalists, financial services, utilities, public power and consumer groups. In September 2002, the EAB published a comprehensive report,[7] which contained a set of recommendations that were provided to the Secretary of Energy. The report identified "important initiatives that must be undertaken in order to ensure the nation's transmission grid continues to be a reliable, strong engine for our economy." The report recommended that the FERC backstop authority should be provided only if the pending application for siting of a "National Interest Transmission Facility" is not acted on by State and/or Federal authorities after 12 months of its filing.

We believe that this carefully crafted approach will provide Federal siting authority only for a limited number of critical projects found to be in the national interest.

[7] "Transmission Grid Solutions Report," Electricity Advisory Board (September 2002). Both reports can be found at www.eab.energy.gov.

It is responsive to those that have opposed a very broad grant of Federal siting authority by balancing national interest with the concern of overriding existing state siting processes. Exelon endorses the Barton Bill provision. The Staff Draft provisions are not acceptable because they include cross-references to the RESC proposal.

TRANSMISSION INVESTMENT INCENTIVES

EPSA has no position on whether there is a need to adopt statutory provisions to encourage transmission investment. We certainly recognize the need for a robust transmission system that will support a reliable, efficient system. We have filed comments in support of the pending FERC Policy Proposal to develop a pricing policy for efficient operation and expansion of the transmission grid; those comments strongly endorse the Commission's primary objectives of promoting RTO membership and encouraging efficient infrastructure investment. We have made some specific suggestions on how FERC should improve its policy proposal.

EPSA believes that efficient transmission investment is stalled and should be promoted; investors considering transmission expansion projects need to see commensurate reward for their commitment of capital. We recognize that transmission owners must be able to recover their investments, plus a fair return on those investments, in order to encourage the necessary grid expansion. We believe that transmission incentives should be tied to creating RTOs and developing competitive market structures. The Barton Bill, the Staff Draft, and the 2002 Senate Offer are acceptable. We are especially supportive of the Staff Draft's addition of provisions calling for proper price signals and reduction of congestion on transmission networks.

TRANSMISSION COST ALLOCATION (PARTICIPANT FUNDING)

We do not believe that Congress needs to include any statutory language to address the transmission cost allocation issue; intrusive federal legislation on this topic could be both unnecessary and harmful. Cost allocation is a quintessential example of the type of work that is performed best by regulatory agencies, rather than enacted into statutory law; the regulators are best-suited to address the specifics facts of the cases requiring their expertise. Any transmission cost allocation should provide flexibility and ensure that transmission costs are born by those who benefit from the transmission. Mandating one type of funding for expansion of the transmission system, however, would be a serious mistake. We support participant funding in the context of RTOs and competitive market structures as a general rule, but do not believe the requirements should be set forth in a statute.

TRANSMISSION ORGANIZATIONS/RTOS

EPSA believes that forming RTOs is a crucial next step towards furthering more competitive wholesale markets and that FERC has ample authority under existing law to promote the formation of RTOs. Congress should steer clear of proposals that would inhibit RTO formation.[8] With the "do no harm" principal in mind, EPSA opposes the RESC section of the Staff Draft because it would throw serious doubt on the future viability of RTOs, and be deeply harmful to the operation of the transmission grid. We endorse the Barton Bill provision on RTOs, which supports membership in an independent RTO, requires a report to Congress on pending RTO applications and authorizes Federal utilities to enter into an agreement transferring control of all or part of their transmission system to an approved RTO.

PUHCA

PUHCA repeal is an important and long-awaited move towards eliminating expensive, pointless restrictions that only create additional regulatory costs and limit the ability of companies to provide much-needed investment in the electric sector. PUHCA repeal is included in the Thomas Bill, the Barton Bill, the 2002 Senate Offer, and the Staff Draft. The draft bills all provide FERC sufficient authority to ensure that utilities do not take enter into abusive transactions with their affiliates that would harm utility customers. They also provide states with an appropriate means to secure access to utilities' books and records so that they can do their job. We endorse including PUHCA repeal in any electricity bill approved by this Committee. We specifically endorse the PUHCA repeal provisions in the Thomas Bill;

[8] One such proposal is being considered as a possible amendment to the Barton Bill. It is an amendment by Rep. Norwood that would severly restrict FERC's authority over interstate commerce by overturning a recent landmark Supreme Court case reviewing FERC's authority, *New York v. FERC,* op. cit. n. 3.

the Staff Draft provisions are not acceptable because they include cross-references to the RESC proposal.

PURPA

EPSA supports prospective PURPA repeal in regions where competitive wholesale markets exist. PURPA facilities are currently an important and efficient generation source. The current PURPA ownership requirements, however, should be repealed in all cases, because they are outdated limitations that are no longer required to promote diversity in generation ownership. The Staff Draft provisions are not acceptable because they include cross-references to the RESC proposal.

RENEWABLE ENERGY

EPSA supports renewable energy and specifically endorses the extension and expansion of the Section 45 production tax credit to include the full range of renewable sources. This provision is not included in any of the bills currently pending before this Committee because the Senate Finance Committee has jurisdiction over tax credits. EPSA believes that, if Congress chooses to adopt an RPS, it should be set at a level that is supported by market demand, and should include a broad definition of renewable resources. The Barton Bill contains a number of useful provisions that support broader development of renewable energy options, including renewable energy production incentives, inclusion of landfill gas as a Qualifying Renewable Energy Facility, and reports to Congress on use of renewables on federal lands and an assessment of renewable energy resources by the DOE.

MARKET TRANSPARENCY, ANTI-MANIPULATION, ENFORCEMENT

FERC has substantial authority under existing law to address issues of market transparency, and manipulation. The recent enforcement activities on the part of the Department of Justice ("DOJ") definitively make the case that there is not a regulatory "gap" among Federal agencies charged with enforcing the laws against market manipulation, collusion, anti-competitive pricing, and other illegal activities. Nonetheless, we welcome additional statutory authority that complements the FERC and DOJ activities on this front. Members of FERC, the Bush Administration, the Senate and the House of Representatives have all supported increasing civil and criminal penalties under the Federal Power Act. EPSA supports these efforts because they give the proper authorities additional tools to punish bad actors. The penalty provisions in the Thomas Bill, the Barton Bill, the 2002 Senate Offer and the Staff Draft are virtually identical, and we would endorse including them in any bill reported by this Committee.

CONSUMER PROTECTIONS

EPSA supports information disclosure, consumer privacy, and unfair trade practices provisions. The Staff Draft would direct the Federal Trade Commission to take appropriate steps to provide consumers additional information about prices and sources of their electric energy, and would avoid some unsavory business practices that have emerged in the telecommunications industry. We are encouraged that the Staff Draft provisions are applicable to all entities, including municipals and cooperatives, because all electricity consumers deserve this protection.

Thank you again for the opportunity to testify. EPSA, and Exelon, look forward to continuing to work with you to promote effective competitive electricity markets.

The CHAIRMAN. Thank you. We will certainly try.

Let us start with the questions. Senator Bingaman, you are first.

Senator BINGAMAN. Thank you very much. Thank you all for your excellent testimony.

Let me start with Mr. English and ask you to respond. Your suggestion, as I understand, your view is that until FERC completes whatever it is going to do with this standard market design, Congress should hold off trying to legislate. Now, Betsy Moler has just testified very differently that she believes we should proceed to legislate, that we have had this before the committee for 10 years and it is time we went ahead and legislated on the things we could agree on and that there is a whole list of things that she believes has pretty broad consensus on, and she listed those off. What is

your response? Do you disagree that there is reasonably broad consensus on a variety of things we ought to go ahead and do?

Mr. ENGLISH. And I think that is the key that you made, is with regard to consensus, those things that are not going to be affected by SMD are in some way in which the Congress could make certain are not going to be affected by SMD.

The point that I was trying to make is that any of these items that are going to be affected in some way by standard market design, we are putting the cart before the horse. If the Congress can pass those and then suddenly we find out we have got—and even if we had the white paper, Mr. Chairman—and I want to applaud you for encouraging that to come forward. Until we know for sure that is it, then suddenly we are into a situation, we have passed a policy assuming one thing and we are dealing with something else.

The other thing that troubles me a little bit—and again, I may be overly cautious, Senator, but the thing that bothers me a little bit is that I have been on the receiving end far too often as a legislator of passing something, assuming certain things are going to happen, and then when it gets within the regulatory body, that is not the way that it is actually implemented. What I would like to feel a bit of a comfort level about here is if I knew there is something hanging in the wings, there is a legislative vehicle in which we can come in and deal with or make changes or make sure that we get it right in line with what the regulatory body is doing. That just raises my comfort level.

Senator BINGAMAN. Let me ask Mr. Franklin. How do you come out on this question about whether we should wait on SMD or go right ahead and do a list of these things that Ms. Moler went through in her testimony?

Mr. FRANKLIN. Senator, I think you can almost argue that either way. Glenn and I were talking about it earlier, and since he argued that we should hold off, I will argue that we should go ahead.

Here is the situation in many States and many regions of the country. There is an impasse. At this point let me speak for the Southeast not for EEI. There is an impasse between the FERC and the States on how to proceed. As much as we all talk about getting past that impasse, I do not see that we are making a lot of progress. I think the white paper coming out from FERC, if it accommodates the regional differences adequately, could help.

I have a concern if Congress does nothing, that we will not proceed, we will not proceed, will not proceed to an orderly regional market RTO scheme in many parts of the country. It will simply continue to have this impasse between the States and FERC.

It would be helpful—and it will have to be done skillfully—that if Congress could lay out some basic parameters, that could better define, first of all, the sense of Congress as to how the market should develop and, number two, could clarify these jurisdictional issues, I think that would relieve some of the tension between the States and FERC and perhaps let us go forward more orderly than simply hoping that the States and FERC ultimately will work this out because I just do not see, at least in the Southeast, those two parties getting closer.

Senator BINGAMAN. Let me ask, Ms. Moler. Betsy, did you have anything else you wanted to add on this issue?

It does seem to me that that is sort of the crucial question before the committee right now. Do we basically hold off and wait to see what FERC winds up with or where they wind up on this standard market design, or do we proceed to legislate in all of the areas you have described? And do you see that we would be in any way impeding or altering the way FERC would be coming out on SMD by virtue of doing what you think we ought to do legislatively?

Ms. MOLER. Senator Bingaman, I think you have waited long enough. This process is not known for its speed. It is rather tortoise-like. And I feel fairly confident that we will have plenty of opportunity to review the standard market design, the changes that the FERC is going to make in the standard market design before we get to the Rose Garden. So I would urge you to go full speed ahead, certainly keeping track of what FERC is up to.

There is a myth—and I call it that—that FERC is not accommodating regional differences. I could tote down a bunch of regional differences that they have already accommodated. I still read FERC orders. I do not write them anymore, but I still read them. Pricing flexibility, resource adequacy, planning, RTO governance. There is just a whole host of things where they have already accommodated regional differences as they have acted on individual RTO orders.

I feel fairly confident that they will recognize that in the white paper, and I hope that, as Mr. Franklin said moments ago, the white paper, if it accommodates regional differences, could help. Assuming that that happens—and I think it will—then I would absolutely urge you to go full speed ahead.

The Wall Street implications of the financial crisis, the access to capital markets, what has happened to lots of utilities is very serious and it needs to be dealt with.

Senator BINGAMAN. Thank you very much, Mr. Chairman.

Senator THOMAS. Thank you, Mr. Chairman. Thank you all. I think that was very helpful.

Mr. Franklin, you I thought mentioned better wholesale markets, independent transmission, some countrywide rules. I think that is good.

You indicated that there is no likelihood of a national market. Last time we dealt quite a bit with the Louisiana to Wisconsin transmission. We talk about Wyoming to Chicago. Is that not pretty much of a national market?

Mr. FRANKLIN. When I said I do not think we are moving to a national market and not likely to have a national market, I am speaking in the broadest sense. I do not think within the foreseeable future, you are going to see power generated in Georgia and sold in California. I do not think you are going to see any major contribution to electric power source in New England from the Southwest, for example. So I do not see a national market as we see in many other commodities.

I think clearly we are evolving to regional markets, and as more transmission is built, if it is economically justified, I think those regions will get larger and larger. But I think we are long way from what we traditionally think of as a "national" market.

Senator THOMAS. Well, you are probably right, but I think we are going to move outside of what we know now as RTOs. That means we have to have some arrangement that goes beyond the RTOs.

Mr. FRANKLIN. I think what will naturally happen, Senator, is if we can get these—and do not assume we have not had regional markets for a long time. There has been power moved around in these regions for many, many years, economy transactions between utilities. What we are trying to do is simply make these regional markets more efficient and more systematic with more players. So we are not going from not having regional markets to having regional markets.

As these regional markets develop and as we begin to see price differences between markets, that is going to create the opportunity for somebody to make money by moving power from one regional market to another. I think just the economics will drive those regions to be larger as we go forward.

Senator THOMAS. We also have to proceed for the consumers' benefit, not only for the producer.

Mr. FRANKLIN. I think that is the only reason to proceed is for consumers' benefit. I do not think we should be developing legislation to favor one producer over another. It seems to me the whole purpose of moving in this direction is lower cost to consumers and more reliability for consumers.

Senator THOMAS. Glenn, you mentioned small co-ops. Is 4 million megawatt hours elimination—does that deal with most of your members?

Mr. ENGLISH. Well, that certainly helps and I think that you have a very good understanding of electric cooperatives and the transmission and the realities between those. That I think gets into this question of whether there is going to be a bright line test between those that are truly distribution cooperatives as opposed to those that are generation, and that has been a problem.

Could I follow up just a little bit on the question that you previously had? And you hit the point and I think it is an excellent point.

I am not sure at this time that the Congress has really focused on this issue of a transmission system that will provide for the inter-regional sales of electric power as perceived under the 1992 act. I think there is a real question here on the way that it is being approached. We have had this analogy from time to time, the interstate highway system, and I think it is a good one. We do not seem to be following that or looking at that. It is all or nothing. In our case it is a small distribution that has a line of a certain magnitude. Because of the distance, they have to have that to be able to move that power. They are looked at in the same way as what we would any kind of interstate system.

The question is whether we should, in fact, be a bit bolder and look beyond this and truly try to establish a differentiation between those high voltage systems that are inter-regional or interstate in nature as opposed to those that are not.

Senator THOMAS. I agree. I hate to be redundant. I mean, in this whole energy thing, there is where there is production and where there is consumption. And they are not necessarily the same. We

have not had the demands to move that energy in the past, but we are going to I believe.

One final quick one, Ms. Moler. I think you mentioned investment and all that. We had a panel here a while back, and they claim there is $120 million a year reduction in investment in transmission. Generation has not been kept up as it has in the past. There has been production. What can we do to encourage the kind of investment in transmission that you talk about?

Ms. MOLER. The DOE Electricity Advisory Board that I mentioned did create a transmission subcommittee. I chaired the subcommittee. Mr. Franklin and Mr. English were also members of the subcommittee as well. We looked at this issue.

We believe the backstop siting proposal for national interest lines—not every line, but national interest lines—would be very beneficial. We also think that you have to have more appropriate returns that recognize the risks and the permitting times that are involved in siting transmission. We also need planning on a regional basis so that there will not be as much opposition, that people in the region will understand that you have to have the facilities. And then proper pricing.

Senator THOMAS. It is interesting. California had a big problem partly because they did not want any transmission, did not want any generation, but they wanted a hell of a lot of power.

Ms. MOLER. You need both.

Senator THOMAS. It is a tough deal.

Yes, sir.

Mr. RICHARDSON. If I could just add APPA's voice on this also. We also support Federal eminent domain authority as a backstop. So this is a very tough issue to deal with and I understand that, Senator. This is a very tough issue to deal with. Transmission is the weakest link in our industry. It is the most critical issue. We have members that are building suboptimal generation because of concerns over transmission. Dealing with the seams issue, dealing with the transmission of power in some cases we think is going to require some Federal presence.

Senator THOMAS. Thank you.

Mr. FRANKLIN. May I comment on that?

Senator THOMAS. Yes, sir.

Mr. FRANKLIN. I agree with what the other panelists have said, but there is another very important impediment to building transmission for inter-regional transactions. And that is that, first of all, the States have primary siting authority and permitting authority for transmission. Some States are very concerned that a great deal of transmission will be built in their State to export power outside and the parties outside the State will benefit and the State where the transmission is built will be stuck with the cost of the transmission and no benefit. So you cannot de-link getting the pricing of transmission right.

One of the issues that we are very interested in is participant funding, that is, let us make sure that as we build all this new transmission, that the people that benefit pay. And that will go a long way to relieving State opposition to transmission because there would be assurance that their customers would not be paying.

Senator THOMAS. We got into an endless discussion about that last time. It happened to be in Louisiana going up to Wisconsin. But the problem is if you do it based on benefits, why, the close people get some benefit but strengthening the transmission line so it will be predictable, and they should not have to pay. But you are right. That is really one we have to deal with.

I am taking too much time.

The CHAIRMAN. No, that is fine, Senator.

Senator Craig.

Senator CRAIG. Well, let me thank all of you for your testimony. As we try to sort this out, it is a difficult issue in my opinion about an electrical title. It has been pretty clear throughout this until the financial side of the industry sorts itself out a bit, and yet, at the same time, there are those who argue—and Betsy just has—that we might offer some stability here. I would like to think we could do that. I am not confident we can do that.

The CHAIRMAN. Well, you should sleep well, and the more you sleep, you will get more confident.

Senator CRAIG. Is that it? All right.

[Laughter.]

Senator CRAIG. I will work on rest over the weekend, but only on the weekend.

The CHAIRMAN. Rest before we meet. Then you will feel very confident.

[Laughter.]

Senator CRAIG. Mr. Franklin, it seems to me that many of the electricity provisions that we will be considering during the next weeks' markup have a distinct purpose, and that is to make the vertically integrated utility model obsolete. Do you believe the vertically integrated utility model can continue to be viable in an era of competitive wholesale electricity markets?

Mr. FRANKLIN. Absolutely. I not only think it can be viable, it has served customers extremely well.

Let me speak for Southern here because we are vertically integrated as opposed to EEI. If you look at the regions of the country which have had the least problems, where investors have suffered least, if at all, where consumers have benefitted most and where there has been the greatest stability, it is where there is vertical integration of utilities. Utilities were vertically integrated to begin with because there are real economies of scale in vertical integration.

Even with vertically integrated companies, a competitive wholesale market can still be beneficial because those companies still have to either build generation or go out and buy in the wholesale market and have a competitive wholesale market. It can be an economic plus to consumers even where you have vertical integration.

Senator CRAIG. Do you agree that utilities should be allowed to continue to reserve transmission capacity for their native load customers even in an era of wholesale electricity competition?

Mr. FRANKLIN. Absolutely, especially in the transition period. There are a lot of the concerns of States where there is not enough transmission to continue to serve retail consumers and accommodate all the new generation that is being built. So I think it would be a huge mistake to take away transmission that was built for re-

tail consumers, dedicated to retail consumers, so that we can export power from one region to the other. I think politically that would be a very serious problem. I think from a fairness standpoint, it makes no sense at all.

Senator CRAIG. Well, I think the FERC has shown that it is seeking to assert jurisdiction over all transmission facilities and is even trending toward expanding its jurisdiction over all retail services. If Congress acts to protect the reservation of transmission capacity for native load customers, but does not address the Federal-State jurisdictional issues, would that be sufficient to protect customers?

Mr. FRANKLIN. I think it is one step short of what many companies and most State commissions would like to see, especially in those States that still have vertically integrated companies and regulated retail markets. I think that would be seen as a half-measure in the regions where there is vertical integration and regulated retail rates.

Mr. RICHARDSON. Senator Craig.

Senator CRAIG. Yes.

Mr. RICHARDSON. Could I just add one point on the reservation of transmission so that it is not lost?

Senator CRAIG. Yes, please.

Mr. RICHARDSON. The comments that have been offered so far have been offered in terms of transmission owners and the transmission facilities that they have constructed that they need to serve to meet their own service obligation to the extent that they have a service obligation. And that is a very legitimate concern.

But there are a large number of public power systems and some rural electric cooperatives as well that are transmission-dependent utilities who have contractual rights to transmission, and their need is every bit as significant in terms of using those facilities for which they have contracted to meet their own service obligations. So I want to make sure that that point is not lost.

Senator CRAIG. Okay, thank you.

Phil, you are head of a large public power entity. Have you been asked to provide open access transmission?

Mr. TOLLEFSON. Yes, we have. In fact, we were one of the first——

Senator CRAIG. How many times, do you know?

Mr. TOLLEFSON. Once that I can recall.

Senator CRAIG. By whom?

Mr. TOLLEFSON. I believe that was by West Plains Energy, a private IOU in the area that was looking to do some maintenance on some of its system, and certainly we agreed to do so.

Senator CRAIG. You did grant the request.

Mr. TOLLEFSON. Yes.

Senator CRAIG. Alan Richardson, Mr. Franklin of Southern Company says this has been a terrible time financially for investor-owned utilities. In fact, I think we have all understood that in general. There have been over 180 IOUs downgraded and pending bankruptcies of the merchant power sector. These are, indeed, tough times. How has the public power sector fared during the same period?

Mr. RICHARDSON. The public power sector has fared very well. Our model is obviously one that has demonstrated that it can work

in these difficult times. I believe there have been perhaps 12 to 15 downgrades and almost an equal number of upgrades, and the credit rating for public power going forward is very stable.

If I could add one more point on Wall Street implications and financial security. You get different answers from Wall Street depending upon who you ask.

Senator CRAIG. I was just going to say, what is Wall Street saying?

Mr. RICHARDSON. Who is Wall Street? I have talked to a number of the rating agencies, and what they want is security and stability, not turmoil and churn. And they look very favorably on the regulatory safety net, and they are concerned, in fact, about the standard market design and its implications for financing going forward because they recognize that while it may be a long-term solution, it is a long-term solution, if that, and there will be instability during the period of time when it is challenged in court and is being implemented.

Senator CRAIG. Are you building transmission?

Mr. RICHARDSON. Yes, sir, we are.

Senator CRAIG. What is your debt load?

Mr. RICHARDSON. I would have to answer that for the record, sir. Across the board, I could not say.

Senator CRAIG. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Bingaman, did you have any follow-up questions?

Senator BINGAMAN. No, I did not, Mr. Chairman.

The CHAIRMAN. I have a number that I am going to submit to you, and if you would answer them for me, in a week to 2 weeks. I would comment, Mr. English, your statement that we ought to perhaps wait until we get more clarification—oh, Senator Kyl. You had not been here before. Let me withhold my last comments and yield to you.

Senator KYL. Well, thank you. Mr. Chairman, it is true I was not here at the beginning. We had to deal with getting some judges out of the Judiciary Committee which met at the same time. So I apologize for not being here to hear all of the testimony. But I did hear the comments of this panel. It was just that I am so far down here, I know it is kind of hard to see me down here. So thank you for calling on me.

The CHAIRMAN. You are welcome.

Senator KYL. I had a couple of questions. Let me just make sure that I understand the position, Mr. Richardson, that you articulated and that, Mr. Franklin, you articulated is essentially consistent with respect to the concerns expressed about the standard market design and also specifically the question that Senator Craig asked about the protection of native load. Is there a difference of opinion between you there or is it consistent?

Mr. FRANKLIN. I do not believe there is a difference. I think what we are saying is that retail customers that have helped pay for transmission and depend on their transmission to keep the lights on should not give way to new players that have an economic interest in moving power across the region, that the retail customer should have some priority. And that applies to transmission-dependent public power entities that also depend on that trans-

mission and over time has helped contribute to the payment of it. I certainly have no disagreement with that concept.

Mr. RICHARDSON. And, Senator, in principle, yes, I think we agree. But as you know, the devil is in the details, and I think you had two or three or four alternative proposals that went through different iterations before they were even publicly released. This is a tough issue. In concept, yes, I think we do agree, but how it is accomplished legislatively is a tough issue.

Senator KYL. Sure. Well, the point I wanted to make is there seems to be a substantial agreement, at least among a lot of Senators, that this notion of protecting native load is very important, and while we do need to be careful how we do it, obviously I wanted to be sure that there was a consensus there.

Also, is it your view, Mr. Richardson, that it would also be important, as Mr. Franklin noted, that not only is it important to do that, but also we have got to deal with this Federal-State jurisdictional issue with respect to the application of FERC jurisdiction?

Mr. RICHARDSON. As an association, we have not taken a position in opposition to the standard market design or requested Congress to either pull the plug or put a halt to that. We do recognize and urge the commission to recognize regional diversity. You have PJM, for example, that is a 75-year-old institution where some of the proposals that they are advancing fit very well, and you have the Pacific Northwest or your region in the Southwest where the configuration of the utility industry and the transmission and the generation is significantly different. They are not as mature in terms of an organizational structure as PJM, and FERC simply has to address that. That is the association's position.

Now, as you know, you have some members in your region, public power systems in the Pacific Northwest who are pretty concerned about where the commission is going and would like to see the standard market design simply taken off the table.

Senator KYL. That is what I am hearing. You are right.

Let me ask you a question, Mr. Gifford. I am hearing a lot from regulators in my State expressing concern about the peculiarities of differences among regions, the point that was just made by Mr. Richardson. Based on your experience as a regulator, are there circumstances that you are aware of that are peculiar to the western region that would cause particular concern about the standard market design proposal?

I am sorry. Did I say Mr. Tollefson? I am sorry. I meant to refer that to you. I am sorry.

Mr. TOLLEFSON. I believe in the West there are certain differences. For example, the Western Area Power Administration facilities are ubiquitous throughout many of the Western States and are capable of carrying a lot of transmission a long way. Certainly there are a number of different entities operating there.

But it is my sense that the issue in the West is not so much access to transmission, primarily because of WAPA and some of the other larger utility systems that are out there, but rather certain congestion points. In Colorado, for example, along the front range, it is difficult to import power from the West and from the North. And certainly additional transmission would be very beneficial there. We are working with a number of folks to see how that can

be accomplished, but it is, I think, more of an issue of congestion in the West as opposed to the East where it is more of an access issue.

Senator KYL. Thank you. I guess my time is up. Thank you and thank you, Mr. Chairman.

The CHAIRMAN. Are you finished, Senator Kyl?

Senator KYL. Yes, sir.

The CHAIRMAN. Thank you very much.

I was just going to say I do not think we want to wait, although your reasons and justifications clearly have some merit. I assume we are going to move as quickly as we can. We have plenty of people giving us advice and plenty to look back on and review.

We want to thank all of you for your testimony.

I would comment on the staff draft of the new idea. We have heard a lot of concern about it and a lot of ideas. It clearly is a very difficult to implement entity, but I am not sure that, in reading the legislation and in writing it, that the staff put down what they had intended as they told me in that there is nothing voluntary about what they do once you are in. Once you are in, they have the same power that the Federal Power Commission gives to FERC. So part of it, getting in, is voluntary and choosing, but once you are in, it will not be just sitting around doing planning. They will have tariff responsibilities just as FERC does under the Federal Power Commission. Of that I am certain. I am not sure in reading it that people understood that.

It still has all the other impediments that have been spoken here to today, and I understand that.

Did you have some comment?

Senator BINGAMAN. Mr. Chairman, could I just ask that we include in the record a statement that the Union of Concerned Scientists has sent in?

The CHAIRMAN. That will be made a part of the record.

Now, we have a hearing with the Commissioners, including the Chairman, scheduled for 2 o'clock, but I understand, Senator Bingaman, we have three or four consecutive votes at the same time. So, Mr. Wood and the fellow Commissioners, if you would be here at 3 o'clock, we will have the hearing then. It should not take more than an hour, hour and a half, I would think, although a number of Senators left saying they wanted to come back and interrogate.

Thanks to all of you. Nice to be with you all.

[Whereupon, at 12:47 p.m., the hearing was recessed, to reconvene at 3 p.m., this same day.]

AFTERNOON SESSION—3:00 p.m.

The CHAIRMAN. The committee will please come to order.

We have three witnesses this afternoon. Senator Bingaman will be along shortly. The first witness will be the Honorable Pat Wood, Chairman of the FERC. Our second witness will be the Honorable William Massey, Commissioner, and third, the Honorable Nora Mead Brownell, Commissioner.

Would you please lead off, Mr. Chairman? We are glad to have you and both Commissioners with us today.

STATEMENT OF PAT WOOD III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

Mr. WOOD. Thank you, Mr. Chairman and Senator Craig. We are also glad to be here and we appreciate the opportunity to comment on the important concept of Federal electricity legislation. I know from last session of Congress these issues are familiar to the committee.

Senators, I am sorry. I did not see you over there, Senators Wyden, Cantwell, and Feinstein.

The issues raised on the several bills that you all asked us to look at are very important and ones that the committee has looked at over the past couple of years in some detail. So rather than go through a lot of that, I would just ask if our written testimony from the three of us could be in the official record here.

As stated in that testimony, I generally support, with very few modifications, the FERC-type language in the electricity proposals here. There has been a lot of, I think, negotiation among interested parties over the past couple of years on these important issues, and I think they will certainly give some guidance and balance to the industry.

I think from just our point of view, it is important to just get an answer. I think what we have tried to do is fill in the vacuum here, and as you know and certainly you have commented to me personally and to others, Senator Domenici, it is time to kind of nail down what it is we want power markets to look like.

FERC has put forth some outlines of a vision there last summer after consultation with a broad bunch of people for the prior year. We have gotten a lot of comment on that, as I mentioned to you, Senator Domenici, back in January. The Commission is working on a white paper which will be basically the current statement of where we see the best way to go forward being on the issues raised on wholesale power market design. We anticipate, as I mentioned to you in January, putting that out in the month of April.

As you know, yesterday, the Commission took a lot of action, although not final action, on a number of items related to the 2000-01 electricity and power and now gas market issues in California and in the other Western States. We have had really a tremendous commitment of resources at our agency and from parties across the West to getting some resolution on those issues. I do think that the end is in sight, but we do have, as a result of yesterday's disclosures or findings, a number of issues that still are before the commission and need to be wrapped up. So we are trying to do that.

It is important to learn and remedy everything that we can under the law with what has happened out in the West in 2000-01, and it is important for us and I think we are all committed to making sure that we lay the groundwork for the rules and the framework and the platform so that that does not happen again anywhere else in the country, not just in California.

So that is what we are about. We are trying to fix the past and also lay down a future that for the electric customers in this country is better than the one we have had to live through.

We as always, of course, appreciate and welcome any congressional guidance on how we should best accomplish that effort. I think that the vehicles before you today, before the committee, be-

fore ultimately the Congress are an excellent way to get that moving and allow us to get the uncertainty behind us and get a positive future before us.

So I appreciate the opportunity here today and welcome any questions from the committee.

[The prepared statement of Mr. Wood follows:]

PREPARED STATEMENT OF PAT WOOD III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

SUMMARY

Federal electricity legislation can help make existing regional competitive electricity markets work to benefit all of the American customers they now serve. The legislative proposals under consideration today generally recognize the realities and challenges of regional electricity systems and would benefit energy customers in numerous ways. I generally support the FERC-related parts of the legislative proposals, with minor modifications and certain additional provisions. For example, I support Congressional proposals allowing for greater transparency in energy markets and customer access to the broadest range of useful market information. I also favor legislative proposals that would increase significantly the penalties available under the Federal Power Act in order to further discourage potential market manipulation. In addition, I support legislative proposals that would provide greater customer protection by changing the refund effective date under Federal Power Act section 206 and extending refund liability.

STATEMENT

I. BACKGROUND

Thank you for inviting me to testify on the legislative proposals to restructure electricity regulation. These legislative proposals address a wide range of electricity restructuring issues confronting our Nation. I will focus on the issues affecting the responsibilities of the Federal Energy Regulatory Commission (FERC or the Commission). On these issues, the legislative proposals generally respond to the challenges facing competitive wholesale electricity markets to meet our future electricity needs. I would suggest a few modifications and some additional provisions, as described below.

Before discussing specific issues, I would emphasize the overall need for certainty. For more than a decade, the wholesale power industry has been stuck in the transition from its heavily-regulated past to a competitively-driven future. The uncertainty of this transition has discouraged investment in transmission and generation infrastructure. Almost as important as the outcome the Congress may reach on each issue under consideration at today's hearing is the need for a decision of any kind. Once the Congress reaches resolution on these issues, then utilities, their customers and others can implement appropriate plans for the future, without having to hedge these plans against legislative uncertainty.

II. PENDING LEGISLATIVE PROPOSALS ON ELECTRICITY REGULATION

A. Regional Energy Services Commissions

Section 1211 of the Senate Staff Discussion Draft would authorize States to enter into agreements to establish "Regional Energy Services Commissions (RESC)." A RESC would be composed of one member from each State in the RESC, appointed by the Governor as provided by state law. A RESC could be vested with jurisdiction over, inter alia, transmission planning and siting, interconnection of generating facilities to the interstate transmission grid, rate design and revenue requirements for transmission and wholesale sales, incentive rates for transmission, market power review and market monitoring, formation and approval of "Transmission Organizations," reliability standards and rules, and adequate enforcement mechanisms.

A RESC or State regulatory authority may petition the Commission to resolve a conflict on transmission of electric energy or wholesale power sales between adjacent regions. Public utilities in States in a RESC would not be subject to Commission authority under Federal Power Act (FPA) Part II, except for section 204 and parts of sections 202 and 209, as well as any authorities not exercised by the RESC.

The Commission has long supported regional efforts, including Regional Transmission Groups in the early 1990s, Independent System Operators (ISOs) in Order No. 888, and Regional Transmission Organizations (RTOs) in Order No. 2000. More

recently, we have supported greater state involvement in RTO policies through Regional State Committees (RSCs) and Multi-State Entities (MSEs). All of these efforts recognize that power systems are regional, and most significant policy issues must be addressed on a regional basis by entities with accountability to make the system work. The RESC proposal appears to recognize the regional nature of today's power systems and is consistent with the goal of establishing better regional governance to solve regional problems. Certainly FERC would have less of a void to fill if regional problems are resolved in the regions. Therefore, I support the objectives of the RESC proposal and would like to help advance regional governance to address regional issues.

Based on a quick review of this new draft RESC proposal, I have some concerns that it may significantly delay the modernization of the nation's electric grid and its operations due to the time needed to establish the RESC institutions. I honestly do not think we can afford that much time anymore. I am concerned that the proposal may not adequately preserve current features of the Federal Power Act. The draft language is unclear on whether the procedural protections in FPA Parts II and III extend to the actions of a RESC. These protections include the due process right to notice, an opportunity to be heard at the Commission, and judicial review of Commission decisions which is a fundamental right now afforded to all affected parties in any Commission proceeding. Another example is the right to file a complaint against existing rates, terms and conditions. Also, it appears that public utilities governed by regional commissions would not be required to have rates on file for public inspection.

The RESC draft proposal may also result in gaps in regulation in cases where regional boundaries overlap and are smaller than the Eastern or Western Interconnect. Many RTO regions have significant power flows and transactions between and through neighboring regions. Management of these seams between regions significantly affects reliability, efficiency, and the opportunities for manipulation. As to size, a RESC should be no smaller than the U.S.-jurisdictional part of an existing NERC region.

It is unclear whether RESCs would be bound by the provisions in the legislative proposals on, e.g., transmission rate incentives and interconnections. There may also be broader legal issues concerning the current draft language on RESCs. These issues include, for example, questions involving the Compacts Clause and the Appointments Clause of the U.S. Constitution. Commission Staff and I would be happy to provide more detailed comments in the future.

B. Reliability Standards

Each of the legislative proposals under consideration at today's hearing addresses the establishment and enforcement of electric reliability standards for the bulk-power system. Under these proposals, the Commission could designate an "Electric Reliability Organization (ERO)," which would have authority to set and enforce such standards subject to Commission review. The ERO would be allowed to assign to a regional entity the ERO's authority to propose and enforce reliability standards.

The approach to reliability in these proposals is a step in the right direction. I am told that federal legislation is needed to ensure the enforceability of reliability standards. The legislative proposals take a reasonable and efficient approach to this problem.

C. Open Access (FERC-Lite)

The legislative proposals would allow the Commission to require open access transmission service by transmitting utilities. Currently, the Commission has authority to require such service only by public utilities, and the legislative proposals would expand this authority to the large part of our Nation's transmission grid controlled by non-public utilities.

The proposals differ in one key respect. In one version (e.g., section 101 of S. 475), the terms and conditions of service must be comparable to those "under Commission rules that require public utilities to offer open access transmission services and that are not unduly discriminatory or preferential." In the other version (e.g., section 7021 of the House Subcommittee bill), the terms and conditions of service must be comparable to those "under which such unregulated transmitting utility provides transmission services to itself and that are not unduly discriminatory or preferential."

The former version would appear to do a clearer job of ensuring that all customers can get the same high quality of service, regardless of whether the portion of the grid they need to use is owned by a public utility, a municipality, a RUS-financed cooperative or otherwise.

D. Transmission Siting

In recent years, the expansion of our Nation's transmission infrastructure has lagged behind the need for expansion. One obstacle to needed expansions is the process of obtaining siting authority.

Several of the bills under consideration would address this problem. For example, section 1222 of the Senate Staff Discussion Draft would give the Commission siting authority for transmission facilities in "congestion zones" determined by the Department of Energy if a State fails to start action on an application within 60 days of its filing and finish within 18 months. However, the Commission would have no authority if the State has vested its siting authority in a Regional Energy Services Commission. Section 210 of the Senate Counter-Offer would allow two or more States to enter into a compact for regional transmission siting agencies. Section 7012 of the House Subcommittee bill includes many of these same points, but without the concept of a Regional Energy Services Commission.

Congressional action on this issue is appropriate to help ensure that enough transmission is built to provide customers with reliable and reasonably-priced electricity. I am not advocating that FERC must have a role in siting; Congress can best make that determination.

E. Transmission Investment Incentives

Several of the legislative proposals would require the Commission to adopt rules on transmission pricing to encourage, inter alia, the economically efficient enlargement of transmission networks, the deployment of transmission technologies to increase capacity and efficiency, and the reduction of transmission congestion. Ensuring an adequate return on equity invested in transmission facilities is also listed as a goal in the proposals.

I support these proposals and note that the Commission has already taken steps in this direction. On January 15, 2003, the Commission issued a "Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid" (Proposed Pricing Policy) on incentive rate treatments to promote transmission independence and enhancement. This Proposed Pricing Policy is consistent with the transmission pricing incentives and other language in the proposed legislation. The Proposed Pricing Policy encourages investments in grid expansion by allowing a higher return on equity when a utility participates in an RTO, sells its RTO-operated transmission asset to an independent company, or pursues additional measures that promote efficient operation and expansion of the transmission grid. Under the proposal, a utility's return on equity could be increased by 50 basis points for joining a Commission-approved RTO, 150 basis points for selling RTO-operated transmission assets to an independent company and 100 basis points for investing in new transmission facilities found appropriate pursuant to an RTO planning process.

F. Transmission Cost Allocation (Participant Funding)

Section 210 of the Senate Counter-Offer would require the Commission to adopt new rules on transmission pricing, including rules to "define the costs and benefits of new transmission facilities and how such costs should be allocated."

Section 1243 of the Senate Staff Discussion Draft would require the Commission to adopt rules on allocating the costs "associated with the interconnection of new transmission facilities as well as the modification, expansion or upgrade of existing transmission facilities. . . ." The rules must ensure that all users of a transmission expansion "bear the appropriate share of its costs." The cost of transmission expansions not providing "system-wide benefits" and instead primarily benefitting only a subset of users or market participants must be recovered from that subset incrementally. System-wide benefits would include providing reliability and adequacy for regional needs; accommodating load growth on a regional level; increasing transmission capability into congested areas; and facilitating major regional and interregional power transfers.

Section 7011 of the House Subcommittee bill provides that "upon the request of a regional transmission organization or other Commission-approved transmission organization, new transmission facilities that increase the transfer capability of the transmission system shall be participant funded." The Commission would be required to "provide guidance as to what types of facilities may be participant funded."

Allocating the costs of new interconnections and grid expansions has been, and remains, a contentious issue before the Commission. Allocating these costs in a way that ensures economic efficiency and fairness to all affected parties is always difficult. Cost allocation policies vary significantly from one region to the next, and on a case by case basis. Although we are attempting to define bright line distinctions in our current wholesale markets rulemaking, it is a difficult task for many reasons and is probably best left to regional variation. I am not sure that national legisla-

tion is the appropriate way to handle issues that may vary by region, depend on fact-based distinctions between investment types, and may evolve over time. The Commission has already proposed to allow participant funding in certain circumstances, if requested by an independent transmission provider. Thus, the Commission has the authority and the intent to achieve the goals of the legislative proposals. While I do not oppose the ideas in the proposed legislation, I am not persuaded that national legislation on cost allocation is prudent.

G. Transmission Organizations/RTOs

Section 1212 of the Senate Counter-Offer and section 7022 of the House Subcommittee bill state the sense of the Congress that all transmitting utilities "should voluntarily become members of independently administered regional transmission organizations [RTOs] that have operational control of interstate transmission facilities and do not own or control generation facilities used to supply electric energy for sale at wholesale." Both sections also state the sense of the Congress that the Commission should provide utilities joining an RTO "a return on equity sufficient to attract new investment capital for expansion of transmission capacity. . . ." Finally, both sections would require the Commission, within 120 days of the law's enactment, to submit a report to its oversight Committees in the House and Senate on the status of pending applications on RTOs.

Section 1211 of the Senate Staff Discussion Draft specifies requirements for a Transmission Organization within the jurisdiction of a Regional Energy Services Commission. These requirements are in some (but not all) ways similar to the criteria established by the Commission for RTOs. One key example of a difference is that, under the Commission's criteria, an RTO must operate the relevant transmission facilities, while, under the proposed bill, Transmission Organizations must control or oversee the operation of transmission facilities. "Oversight" is not defined. Additionally, the bill would appear to permit regional commissions to apply varying definitions of what constitutes "independence" for an RTO.

I believe RTOs (or Transmission Organizations) will benefit customers by operating the grid more efficiently, on a regional basis, than the fragmented arrangements used in most regions today. The Commission has strongly encouraged the formation of RTOs. Our policy has had some success. RTOs are being developed in most of the United States, and the Commission has approved many aspects proposed by those working on these RTOs.

Congressional encouragement of RTO formation, as in the Senate Counter-Offer and the House Subcommittee bill, may expedite the process. Thus, I support these proposals.

Section 1211 of the Senate Staff Discussion Draft assumes the formation of Regional Energy Services Commissions, which I have addressed above. Subject to the concerns identified above, I believe the provisions on Transmission Organizations are generally acceptable. I am concerned, however, about the fact that Transmission Organizations may only "oversee" but not operate the transmission facilities within their geographic boundaries. If these facilities are still operated by market participants, concern about discriminatory services may discourage investors from supporting new generation in a region, ultimately limiting the supplies available to serve the region's customers.

H. PUHCA

S. 475 and the other legislative proposals would repeal the Public Utility Holding Company Act of 1935 (PUHCA), but give the Commission and State regulatory commissions broad access to the books and records of holding companies and their affiliates. This is appropriate. PUHCA was enacted primarily to undo harms caused by certain holding company structures that no longer exist. In the almost 70 years since PUHCA was enacted, utility regulation has increased substantially under the Federal Power Act (including oversight of corporate restructurings such as electric utility mergers), federal securities laws and state laws, all of which ensure that customers are fully protected.

I. PURPA

I agree with the core concept of the legislative proposals that Congress should repeal PURPA but "grandfather" existing PURPA contracts. As in several of the proposals, it may be appropriate to limit its prospective repeal to those states where all generation entities have the ability to sell their output to the widest possible range of customers.

J. Net Metering & Real-Time Pricing

These provisions generally do not affect the Commission's responsibilities, but they are beneficial to infrastructure development needed to make power markets more efficient.

K. Renewable Energy

I have no comment on these provisions, since they do not affect the Commission's responsibilities.

L. Market Transparency, Anti-Manipulation, Enforcement

Some of the legislative proposals would require FERC to issue rules establishing an electronic information system, accessible by the public, specifying the availability and price of wholesale power and transmission services. I support such proposals because more transparency is needed in energy markets and customers should have access to the broadest range of useful market information.

I note that these proposals refer to "markets subject to the Commission's jurisdiction," but do not explicitly mention natural gas markets. I suggest modifying these proposals to clarify the Commission's authority to obtain information on natural gas prices (since these are an important factor in wholesale power prices), or that a separate section be added to the legislation clarifying FERC's authority under the Natural Gas Act (NGA) to obtain such information for purposes of price discovery.

The legislative proposals also would prohibit round trip trading and the filing of false information on wholesale power prices. Banning these practices will help ensure customers that power prices are not being manipulated.

The legislative proposals also would significantly increase the penalties available under the FPA. I have long supported increasing these penalties, and believe the increases proposed here are appropriate. I recommend including similar penalties under the NGA.

M. Consumer Protections

Several of the legislative proposals would change the refund effective date under FPA section 206, so that refunds would be allowed from the date on which a complaint is filed, instead of 60 days later. I support this change, and would support allowing refunds to the same extent under the Natural Gas Act.

The proposals also would extend refund liability under FPA section 206 to large non-public utilities for spot market sales violating Commission rules. I support this idea since I see no reason why only public utilities, and not other large sellers, should be liable to customers for refunds of spot market sales violating applicable Commission rules. In the Senate Staff Discussion Draft, however, it appears that these provisions would not apply to rates charged by public utilities that are governed by Regional Energy Services Commissions.

III. CONCLUSION

Thank you again for the opportunity to offer my views on the legislative proposals to restructure electricity regulation. While I have discussed the approaches in the bills generally, I would be happy to provide technical comments in the future or make our staff available as a resource if it would be helpful to the Committee.

The CHAIRMAN. How about the other Commissioners? Do you have anything to say? Did you have prepared remarks, Mr. Chairman, or are your remarks what you just said?

Mr. WOOD. My prepared remarks were filed testimony, and that was it. I do not have a written statement of what I just said.

The CHAIRMAN. That will be made a part of the record.

Mr. Massey.

STATEMENT OF WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. MASSEY. Mr. Chairman, I have a written statement as well, which I would like to be included in the record, and I will be very brief.

Yesterday, the Commission received and publicized a massive staff investigation dealing with price manipulation in Western markets. It made a number of very disturbing findings of manipu-

lation of epidemic proportions. The commission is still digesting this report and its implications for energy markets. Clearly this report will spawn new proceedings against several market participants who may have employed manipulative bidding strategies or engaged in other techniques.

And the Commission still must provide economic justice for Western markets. We have taken big steps in that direction, but more must be done. We must provide assurances that this kind of a debacle will never occur again. We must insist on markets that are well-structured, that markets produce prices that comply with the Federal Power Act's often repeated requirement that prices be just and reasonable, markets that cannot be easily gamed, markets with clear and enforceable rules defining acceptable and unacceptable behavior, markets with consumer protections built in, markets that are well monitored where manipulation is detected immediately and remedied. These are our goals.

A number of provisions in pending legislation will help to promote markets that work, mandatory reliability provisions, transmission investment incentives, some reasonable transmission siting authority at the Federal level, language promoting RTOs, a number of provisions toughening our enforcement authority and penalty authorities, language authorizing an office of consumer advocacy on FERC matters. These are all excellent provisions that I would recommend, and the list is longer than that, but I will cut my opening statement short and thank you for the opportunity to be here.

[The prepared statement of Mr. Massey follows:]

PREPARED STATEMENT OF WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION

I want to thank Chairman Domenici and the members of the Committee on Energy and National Resources for inviting me to testify about pending legislative proposals regarding electricity regulation.

All over the country, producers and transporters of energy want policies that encourage investment in critical infrastructure such as production wells, pipelines, high voltage electric transmission capacity, electric generation, and demand resources. Customers want the same things, plus assurances of reliability and reasonable prices. All seem to want a level playing field where everyone gets fair treatment. State regulators want their views respected. They want to be co-equal partners in regulatory policy, and they insist on being in charge of ensuring reasonable prices and fair treatment for end use consumers of natural gas and electricity.

Broadly stated, the Commission's mission is to make energy markets work for consumers. This has required a steady evolution of federal regulatory policies. The issue is no longer—and has not been for quite a number of years—whether to have wholesale markets for electricity and natural gas. The issue now is this—will we tolerate poorly structured markets, or will we insist on good markets, well structured markets that provide customer benefits?

This is an important question, because wholesale markets don't structure themselves and don't fix themselves. They don't oversee and monitor themselves. They don't establish or enforce the rules. These are the responsibilities of federal regulators under current law.

Markets that work—that is the clarion call at the Commission. Yet, we still have much old business to tend to. The Commission is now taking aggressive steps to take care of some old business even as we press a number of initiatives aimed at better markets.

The old business involves the herculean effort to resolve all of the pending issues and investigations arising out of the western energy crisis of 2000-2001. Last year, we charged our staff with getting to the bottom of all allegations of market manipulation and abuse in both natural gas and electricity markets. Yesterday, staff presented to the Commission a comprehensive report with recommendations for further

Commission action, including proposed remedies for the abuses they found. This may spur additional Commission proceedings necessary to ensure that justice is done.

This staff report has a bearing on the level of refunds that are necessary to make western customers whole for electricity prices during 2000-2001, that the Commission has already found were unjust and unreasonable.

This staff investigative report may also have relevance in resolving the litigation pending before the Commission over complaints about whether certain long term power contracts, negotiated when spot electricity prices were out of control, should be set aside by the Commission as either unjust and unreasonable or against the public interest.

The Commission must resolve these Western matters as soon as we can while ensuring that our investigation is thorough and our remedies appropriate.

Resolving this important old business involves huge levels of Commission resources. It also provides a painful daily reminder that poorly structured electricity markets can wreak economic havoc and fail miserably. The unfortunate result is loss of faith in electricity markets, massive investigations, two year old refund cases, contract abrogation fights, and lots of uncertainty for investors, lenders, market participants and consumers.

There must be a better way. Why not insist that wholesale markets are well structured from the start? By that I mean a market structure that relies primarily on long term contracts negotiated in the context of a transparent spot market that is producing just and reasonable prices and locational price signals. I mean independent grid and independent market operation to create a level playing field on which all resources—supply and demand resources, renewable resources, distributed generation—can compete; where there is no tolerance for affiliate abuse; where clear rules define acceptable and unacceptable behavior; where reasonable customer protections, reasonable price mitigation measures, and solid market power screens are built in to the market design; where there is potential for a robust demand response, and where there is a highly professional and aggressive market monitoring unit on the ground to serve as an early warning device should problems arise.

Wholesale markets that are fair to all, that spur investment, produce just and reasonable prices, and provide substantial consumer benefits. After all, these are the core values that define our role as federal regulators.

Two other related areas of electricity policy evolution are also critical. The first is the establishment of regional grid operation and market platforms we call RTOs. RTOs will create a level playing field by operating without bias toward particular merchant interests, and they will eliminate the multiple transmission rates over regions that can make transactions uneconomic.

The second is our proposal to streamline the process and agreements associated with generator interconnection. The thorniest issue in the interconnection arena seems to be how to price the grid upgrades necessary for the new generator. Traditionally, our policy has been to roll in most of the cost over time, but state commissions and some utilities have argued that the upgrades should be paid for by the generator and the customers or ratepayers who benefit from the upgrade. This concept of beneficiary pays, often referred to as participant funding, has been formally proposed by the Commission, and the concept is also being debated in the comments to our interconnection NOPR.

With this introduction, now let me turn to the specific legislative proposals on which I have been asked to comment.

II. PENDING LEGISLATIVE PROPOSALS

At the outset, in the interest of brevity let me point out that I am in general agreement with the testimony of Chairman Wood.

A. Regional Energy Service Commissions

I agree with the comments of Chairman Wood. Delegating federal powers to regional bodies of state policymakers and regulators may risk the regional balkanization of electricity markets. I am not yet persuaded, for example, that the interpretation and implementation of the "just and reasonable" standard of the Federal Power Act should vary from one region to the next.

I would recommend that the Committee consider whether the enactment of this proposal, representing a fundamental shift in the manner in which utilities and markets are regulated, would create uncertainty for an industry already burdened by the substantial uncertainty inherent in a decade-long transition to competitive wholesale markets.

Finally, I would suggest that the Committee consider whether regional regulatory bodies exercising broad federal authority may be an unnecessary new layer of regulation that would outweigh potential regional benefits.

B. Reliability Standards

I agree that legislation to enforce mandatory reliability standards for the bulk power system is necessary. All proposals seem to address this issue appropriately.

C. Open Access

I am generally in agreement with Chairman Wood. I would add that it remains my hope that municipals, rural electric cooperatives and other governmental entities will choose to participate in RTOs because they conclude that these institutions are structured and operated to provide substantial long-term benefits to all wholesale market participants.

D. Transmission Siting

I would recommend that the Commission at least have a backstop role where a state fails to act within a reasonable time on an application for new transmission facilities necessary to enable wholesale markets to produce just and reasonable prices. The congestion zone proposal of the Staff Draft is also a good step in the right direction. Authorizing states to address the siting issue through regional compacts is worthy of serious consideration, but perhaps there should still be a federal backstop role where the health of wholesale markets is at stake.

E. Transmission Investment Incentives

I agree with the thrust of these various proposals. The provision of the Senate Staff Discussion Draft is probably the closest to my thinking on this important issue.

F. Transmission Cost Allocation (Participant Funding)

The Commission has proposed generically that the concept of participant funding govern the allocation of costs for grid expansions within RTOs. I support this policy direction, and hence would support legislative proposals that move toward this concept as a national policy.

G. Transmission Organizations/RTOs

I endorse any legislative proposal that sends an unmistakable signal to the industry that these institutions are in the public interest and participation is expected. Both the Senate Counteroffer and the House Subcommittee bill meet this recommendation. I agree with Chairman's Wood's comments about the Senate Staff Discussion Draft.

H. PUHCA

In the wake of the collapse of Enron, I have mixed views about the repeal of PUHCA. PUHCA actually tilts toward regional concentrations of facilities that may be harmful to robust wholesale competition. This would argue for repeal. On the other hand, the PUHCA provisions that limit complex corporate structures and place reasonable limits on capital formation by holding companies may still remain in the public interest. An important consideration is whether other laws enacted since PUHCA provide similar protections that make PUHCA unnecessary. If PUHCA is repealed, it is certainly appropriate to ensure broad access to books and records of holding companies and their affiliates by the Commission and state regulatory bodies.

I. PURPA

Existing PURPA contracts should be grandfathered if PURPA is reformed. I support in particular the concept in the House Subcommittee bill conditioning PURPA reform on access to a well functioning wholesale market. I support a national policy of promoting renewable resources, so I would recommend that the Committee consider other effective ways to achieve such a goal in the absence of PURPA. A reasonable renewable portfolio standard is worthy of serious consideration.

J. Net Metering & Real-Time Pricing

I have not studied these provisions in detail, but I am generally supportive of net metering, real-time pricing and streamlining the standards for interconnection for distributed generation resources.

K. Renewable Energy

Please see my comments under Section I above.

L. Market Transparency, Anti-Manipulation, Enforcement

I generally support all reasonable proposals to provide greater market transparency via a public electronic information system with respect to natural gas and electricity sales and transmission services. I support proposals to ban both round trip trading and filing false information on wholesale transactions. I have long advocated an increase in and expansion of the Commission's FPA and NGA penalty authority. I support reasonable proposals to strengthen the Commission's authority to order refunds under section 206 of the FPA.

M. Miscellaneous

The provisions of the October 16, 2002 Draft with respect to the Commission's merger authority are reasonable, and I endorse them. The Draft also establishes an Office of Consumer Advocacy within DOE to represent consumers on FERC matters. This is an excellent proposal and I endorse it.

In addition, Senator Feinstein has introduced S. 509 and S. 517. Both bills would increase FERC's penalty authority and investigative powers in several respects, and ensure that derivative products for energy are regulated by the CFTC. I would recommend that these bills be given favorable consideration by this or other appropriate Senate committee. Senator Cantwell has introduced S. 681, legislation to strengthen the Commission's authority to remedy market manipulation and to ensure just and reasonable prices. I suggest that this consumer protection legislation be given serious consideration by the Committee.

The CHAIRMAN. Thank you very much.

STATEMENT OF NORA MEAD BROWNELL, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Ms. BROWNELL. Thank you, sir. I have a written statement that I would asked to be entered, and I know that you have had a busy day so I will keep my remarks short.

I appreciate and applaud the work that you are doing on restructuring and completing the restructuring of the electricity sector as well as creating a vision and a policy for the future. So we will join you in working towards the hard work that you have to do.

I particularly appreciate the bold thinking that has been shown on looking at regional markets and how we approach them because neither the Federal Power Act nor the State acts envisioned markets as they have evolved today.

But I think it is important to be clear and concise in how we assign roles and responsibilities so we do not end up in many years of litigation as we have seen in some of the other restructured markets. I think that this market needs certainty. I think that this market needs accountability. I think we did, in fact, make great steps forward yesterday, and I hope that as we move forward with energy policy, we will be informed by what we are learning in the ongoing investigations at the FERC.

But most importantly, I hope that we can bring this to conclusion so that we can begin to build for the future because this future I believe is in jeopardy by the uncertainty that has been created both by the mistakes that we have made—and there is plenty of blame to go around—and the need to build investment and infrastructure.

I enjoy many of the proposals made today, particularly the ones that have been outlined, and I have articulated those in my statement. I would be happy to answer any questions about those or anything else.

[The prepared statement of Ms. Brownell follows:]

PREPARED STATEMENT OF NORA MEAD BROWNELL, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

SUMMARY

I want to commend the Committee for pushing forward on the difficult issue of restructuring electricity markets. I believe that we are at a point where it is imperative for leadership to set the tone, the principles, and the framework for moving forward. We are at the point where, I believe, we need to make sound legislative and regulatory calls to restore confidence to customers and investors and bring the energy sector out of its battered and beleaguered state.

The legislative proposals address a wide range of electricity restructuring issues and contain numerous reforms to the current laws, many of which I believe will go a long way toward helping to create and sustain a healthy energy sector. I appreciate the willingness to think innovatively about regional approaches. The current federal and state regulatory framework did not envision regional markets so we must address roles and responsibilities. I do, however, have questions about the Regional Energy Service Commission proposal and would welcome the opportunity to work further with the Committee on thinking through the appropriate structures to address regional issues.

STATEMENT

I. BACKGROUND

Thank you for inviting me and giving me the opportunity to share my views on the legislative proposals to restructure electricity markets. I want to commend the Committee for pushing forward on some very difficult issues. I believe that we are at a point where it is imperative for leadership to set the tone, the principles, and the framework for moving forward. We are at the point where, I believe, we need to make sound legislative and regulatory calls to restore confidence to customers and investors and to bring the energy sector out of its battered and beleaguered state. We are witnessing a silent and insidious deterioration of our infrastructure.

The legislative proposals address a wide range of electricity restructuring issues and contain numerous reforms to the current laws, many of which I believe will go a long way toward helping to create and sustain a healthy energy sector. There are a few areas, as described below, where I believe further evaluation and discussion is warranted.

II. PENDING LEGISLATIVE PROPOSALS ON ELECTRICITY REGULATION

A. Regional Energy Service Commissions

As I understand it, Section 1211 of the Senate Staff Discussion Draft would authorize States to enter into agreements to establish Regional Energy Services Commissions (RESCs) that could then have jurisdiction over transmission planning and siting, rate design and revenue requirements for transmission and wholesale sales, market power review and market monitoring, formation and approval of "Transmission Organizations," reliability standards and rules, and enforcement mechanisms. Public utilities in States in an RESC would not be subject to Commission authority under the Federal Power Act (FPA) Part II, except for section 204 and parts of 202 and 209.

As the Commission has stated on numerous occasions and as the Discussion Draft reflects, energy markets are regional in nature. For more than 10 years now, from Regional Transmission Groups in the early 1990s to recent proposals for Multi-State Entities, the Commission has supported and encouraged regional solutions to energy issues in the energy markets. Presently, I believe we have success stories where States have worked together on resources and planning. I also know that there are hurdles to overcome if we expect States by themselves to move beyond opening lines of communication to actual implementation of solutions for the more intractable regional problems. I believe that such difficult issues as infrastructure planning, identification of resource needs, market monitoring and independent operation of the grid are among those that should be considered on a regional basis. I also believe that regional transmission organizations (RTOs) that are independent from market participants both in perception and reality and are guided by a consistent set of regulatory principles are the best forum for addressing these issues. We have also emphasized the important role for states in leading these policy discussions through multi-state entities or some other structure. While I share what I believe to be your vision for allowing state input and regional flexibility and variation, I am concerned

that the proposal largely eliminates any consistency in regulation as currently afforded to the industry under the FPA. I would suggest that we study the following:

- Presently all utilities enjoy a common set of rules and requirements provided for by the FPA. The Draft permits the creation of governor-appointed regulatory commissions, each of which could have different due process requirements (or decide to have none at all); different filing requirements for rates, terms and conditions of service; different rate policies and incentives and terms and conditions for interconnection to and access to the transmission grid. What are the practical effects of introducing regional variation in areas that have already been standardized nationally?
- RESCs only need to seek to ensure no undue discrimination; there does not appear to be any requirement to ensure just and reasonable rates, terms and conditions of transmission or wholesale sales of energy. Would the RESCs be charged with ensuring just and reasonable rates or would FERC retain jurisdiction to do so? If the RESCs are given such jurisdiction, what if just and reasonable rates are defined differently in each region? What if undue discrimination is defined differently in each region?
- It appears that the public utilities and market participants would have no ability to seek review of any decisions—either from the RESC or through appellate rights to the Commission or to a court. How will due process rights be protected?
- It is unclear from the Draft whether public utilities governed by RESCs would be exempt from the Commission's investigatory, enforcement, accounting and auditing requirements. Is that the Committee's intent? If not, will FERC have the information or tools necessary to perform these functions?
- Is it the responsibility of the appointees to be governed by state needs or regional needs?
- How does a multi-state utility whose territory covers multiple regions assure compliance to multiple sets of rules? How does it effectively participate in the stakeholder process? Will multiple rules require companies to restructure their companies by region? Will RESCs cause added personnel and regulatory and compliance costs? How will we measure the cost/benefit of the model? Could DOE provide a study? Could DOE provide an analysis of what regions should look like to maximize efficiency?
- The major criticism from investors, rating agencies, and bankers has been the lack of certainty caused by the failure to complete the restructuring started in 1992. Will the possibility of as many as 20 sets of regional rules on rates, terms and conditions of service, and cost recovery, among others, resolve those concerns?
- New technologies have been slow to be applied in this market place. Will regional variation on issues such as queuing, interconnection, transmission access, and technology application act as a barrier to entry? How will technology manufacturers adapt to variations? Will we lose manufacturing efficiencies?

I agree that the time has come for change. I believe that regional variation has been acknowledged and implemented in RTO dockets. Further, I believe that FERC has acknowledged the need for state involvement in regional planning, siting and market monitoring. But, we must look to solutions that create regulatory certainty and clarity and that reflect what we have already learned about the highly integrated and interdependent nature of this nation's energy markets.

B. Reliability Standards

Each of the legislative proposals under consideration today provide for an electric reliability organization (ERO) to develop and enforce reliability standards applicable to all users, owners and operators of the bulk power system. The Commission would certify an organization as an ERO and the Commission would approve the security and reliability standards and enforcement provisions of the ERO. All users, owners and operators of the bulk power system would be required to comply with the reliability standards. The approach envisioned by the legislative proposals is precisely what is needed in the evolving competitive electricity markets. What has been missing in the past and what this legislation adds for the future is accountability. Under existing law, there are no legally enforceable reliability standards. Compliance with the reliability rules established by the North American Electric Reliability Council (NERC) is voluntary. Therefore, it is difficult to assess (and impossible to ensure) whether the best job is being done by NERC and the market participants to preserve reliability.

C. Open Access (FERC-Lite)

Section 31 of the Senate Staff Discussion Draft and Section 7021 of the House Subcommittee version 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, with some exceptions, e.g., unless they sell no more than 4 million megawatt hours of electricity per year.

I support the intent of these provisions to ensure a properly functioning and transparent transmission grid. At the same time, I understand the concerns of parties not now subject to open access, and I believe that we must work to ensure that their rights are protected.

D. Transmission Siting

Studies report that the nation's infrastructure is lacking.

- Transmission investment is not meeting the growing peak demand—the amount of new transmission added in the past 2 decades has consistently lagged behind growth in peak demand.
- NERC reports that investment in new transmission facilities is lagging far behind in new generation and growth in electricity demand. Construction of high voltage transmission facilities is expected to increase by only 6 percent (in line-miles) during the next 10 years, in contrast to the expected 20 percent increase in electricity demand and generation capacity. The cost of transmission accounts for less than 10 percent of the final delivered cost of electricity in what is today a $224 billion industry.

Several of the bills under consideration address the siting problem. Section 1222 of the Senate Staff Discussion Draft would give the Commission siting authority for transmission facilities in "congestion zones" determined by the Department of Energy if a State fails to start action on an application within 60 days of its filing and finish within 18 months. However, the Commission would have no authority if the State has vested its siting authority in a Regional Energy Services Commission. As discussed above, I have several questions regarding the workability and implementation of RESCs. Section 210 of the Senate Counter-Offer would allow two or more States to enter into a compact for regional transmission siting agencies. Section 7012 of the House Subcommittee bill includes many of these same points, but without the concept of a Regional Energy Services Commission.

I believe that state-by-state siting of such transmission superhighways is an anachronism that impedes transmission investment and slows transmission construction. We should not allow this relatively small cost to prevent consumers from enjoying reliable service and the low cost of alternative supplies. It is past time that someone address this elephant in the living room. I am not wedded to any particular legislative approach, but I do believe that some Congressional action on this issue is needed to help ensure that enough transmission is built to provide customers with reliable and reasonably priced electricity. This is an area where a regional perspective is needed.

E. Transmission Investment Incentives

Several of the legislative proposals would require the Commission to adopt rules on transmission pricing to encourage the economically efficient enlargement of transmission networks, the deployment of transmission technologies to increase capacity and efficiency, and the reduction of transmission congestion. I support these proposals and note that the Commission has already issued a "Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid" that is consistent with the proposed legislation.

Some have expressed concern that incentives are extraordinary and unnecessary costs for consumers. They ignore three realities: transmission is 10% or less of the total bill, transmission enables access to lower cost generation which may well offset the costs of associated transmission, and the fragility of our nation's transmission system has serious security and economic repercussions which we cannot ignore.

F. Transmission Cost Allocation (Participant Funding)

Section 33 of the Senate Staff Discussion Draft would require the Commission to adopt rules on allocating the costs of "interconnect[ing] new transmission facilities as well as the modification, expansion or upgrade of existing transmission facilities. . . ." The rules must ensure that all users of a transmission expansion "bear the appropriate share of its costs." The cost of transmission expansions not providing "system-wide benefits" and instead primarily benefitting only a subset of users or market participants must be recovered from that subset incrementally. System-wide benefits would include providing reliability and adequacy for regional needs; accom-

modating load growth on a regional level; increasing transmission capability into congested areas; and facilitating major regional and inter-regional power transfers.

The House Subcommittee bill provides that "upon the request of a regional transmission organization or other Commission-approved transmission organization, new transmission facilities that increase the transfer capability of the transmission system shall be participant funded." The Commission would be required to "provide guidance as to what types of facilities may be participant funded."

I believe that the Commission needs to address issues surrounding cost allocation of new interconnections and grid expansions. This country desperately needs a strong transmission grid, which in turn necessitates a cost allocation mechanism that gets infrastructure built and encourages innovation and new technology. I believe that an independent transmission organization can ensure nondiscriminatory access and rate treatment.

G. Transmission Organizations/RTOs

Section 212 of the Senate Counteroffer and section 7022 of the House Subcommittee bill state the sense of the Congress that "all transmitting utilities should voluntarily become members of independently administered regional transmission organizations [RTOs] that have operational control of interstate transmission facilities and do not own or control generation facilities used to supply electric energy for sale at wholesale."

I continue to believe that creation of RTOs is the single most effective way of achieving a vibrant, competitive electric market. 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.

Therefore, I strongly support Congressional encouragement of RTO formation.

H. PUHCA

I believe that these legislative proposals strike an appropriate balance by replacing PUHCA with increased access by the FERC and state regulators to certain books and records.

I. PURPA

I support the general approach to PURPA included in the draft bills. I support prospective elimination of the forced sale provision of PURPA provided that qualifying facilities have access to a competitive market and provided there are appropriate transitions rules to recognize the rights and obligations of parties.

J. Market Transparency, Anti-Manipulation, Enforcement

Some of the legislative proposals would require FERC to issue rules establishing an electronic information system, accessible by the public, specifying the availability and price of wholesale power and transmission services. While I support the goal of transparency in energy markets, I believe that there may be more efficient ways of reaching that goal than having the government take over collecting and reporting information on prices.

The legislative proposals also would prohibit round trip trading and the filing of false information on wholesale power prices. Banning these practices will help ensure customers that power prices are not being manipulated.

The legislative proposals also would significantly increase the penalties available under the FPA. 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.

K. Consumer Protections

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. I also support the proposals to extend refund liability under FPA section 206 to large nonpublic utilities for spot market sales violating Commission rules.

III. CONCLUSION

Thank you again for the opportunity to offer my views on the legislative proposals to restructure electricity regulation pending before your Committee. While I have discussed the approaches in the bills generally, I would be happy to provide technical comments in the future if it would be helpful to the Committee.

The CHAIRMAN. Thank you very much.

We have a number of Senators who seem to have a particular interest in what you are doing of late that are here, and I am sure they are going to want to talk with you about that, although that is purely an accident. We did not invite you here for that. Nonetheless, Senators are Senators and you are here, and so there will be questions about it.

I want to ask a few questions about some other things, not your decision yesterday, although I might get to that.

First, when will the white paper be completed and could you clarify for the record what you are going to tell us about it, understanding, Mr. Chairman, and realizing that it was committed to us in an atmosphere of confusion about what you were going to be doing in the future on the one hand and maybe all the way over to anger about what people thought you might be contemplating under your concept and your talk about SMD. So, I would like you to tell us what do you think will be in generally and when will it be ready?

Mr. WOOD. Well, until about this time yesterday, we were up to here in the issues that I know we will be visiting about later. And we had worked certainly back in February on beginning the white paper, and it is being drafted in accordance with our directions today. So I expect that certainly by the end of the month of April and hopefully before then we will have it.

What is it, which is your question, a good one. I think I could characterize it as really the Cliff Notes version of what we intend the final rule to be, the response to and hopefully a readable response—I know the rule, the original proposal was quite long because there were quite a few interested parties that had comments that needed to be incorporated, but to tell the story about why we are doing what we are doing, what we have learned from the parties since we put out a proposal last summer. We have had probably over 1,000 written comments from different parties filed in three rounds of comments. We have had probably over 350 face-to-face meetings, us or your senior staff, with people from across the spectrum, across the country. So we have learned a lot and I think it is very helpful to you all, to our staff, to the outside world to know really what adjustments we are making to what we put out there.

So that is what I expect we will be able to do. Again, as I indicated to you, Senator Domenici, we would be glad to come back and visit with the committee either individually or en banc here.

The CHAIRMAN. I only hope that you will expedite it. Yet I know it is difficult. If you try to make it brief, it is harder to write, but we do expect that. We do not expect another rule, at least like the last one, because we will all be more confused than we were to begin with.

Let me move on. You understand that there is great concern about the SMD, and might you take a couple of minutes and tell

the committee why you think the various Senators representing constituents and various of our constituents have lodged their serious complaints and concerns? What are the principal concerns, as you see them, about this proposal?

Mr. WOOD. I think certainly there are probably five categories.

One is, is the cost of this, of getting a market platform in place across the country, greater than the benefits that we could reasonably expect to come from that? I know that, for example, the appropriation for our current budget that we are living under has directed the Department of Energy to do an assessment in that regard, as well as ones that we have done.

I think the second probably, a big one, is a concern by our colleagues at the State level that we are encroaching on their jurisdiction, their jurisdiction over the retail sales of power that they have regulated.

And a related issue is the protection of native load. Everybody is somebody's native load, but there are current expectations of uses of the grid that I think—at least certainly by what we published—appeared to be threatened, and I think we have got to address that and will. But as it stands now, there is a concern that the native uses, the current uses of the grid would somehow be relegated to a second tier status, and we want to clear up that misconception.

Two other issues are ones that I actually think we did indicate in the proposed ruled generally the right direction, but I think probably nobody read it more than it once, because it was so long that people have kind of departed from what we actually said. There are two things that have to be done in a market. There are a lot, but there are two that have attracted some concern.

The first is the need to have adequate resources, adequate supply. We call that resource adequacy. Basically we indicated that there is a need to make sure there is an insurance policy on the top of electric generation across the country, and if that role is not fulfilled by a State, then we proposed the solution. But we will clarify and make very clear that that is a State's role primarily. If they do not do it or want to defer to us, because of inter-regional needs, then certainly we need to play that role.

And similarly, transmission planning and the related result of actually building a transmission line are State issues, and we need to make sure that we clarify what we think our role is and not to try to take on ourselves.

I think those five issues, Senator, probably seemed to me to be why we have got a lot of, I think, angst about the Commission's rule, and we certainly intend to address each of those and others in the white paper this next month.

The CHAIRMAN. Thank you very much.

I am going to now move. Senator Bingaman is not here and he may not be able to make it. Let us follow the early bird rule. Is that all right with you all on your side? That means that Senator Craig, you are next. Senator Thomas, you are next. Then Senator Craig.

STATEMENT OF HON. LARRY E. CRAIG, U.S. SENATOR FROM IDAHO

Senator CRAIG. Well, Mr. Chairman, in this first round, let me make the opening statement that I did not make this morning and I will use that as my first round. There are several questions I want to ask the Commissioners.

Let me say at the outset, I appreciate all three of you being here.

Mr. Chairman, over a decade ago, Congress passed legislation that cautiously moved the electric industry away from its historically regulated framework toward a more competitive market approach for the sale and resale of wholesale electricity.

Some believe it is time for Congress to take bolder action. Most of these advocates represent a class in the industry known as merchant traders and merchant generators that I understand is suffering substantial financial distress.

It is instructive to me that most public power, co-ops, and investor-owned utilities are not clamoring for bold change.

It is also instructive that the pressure for bold action is coming primarily from electrical system geographical corridors located in the Northeast and parts of the Midwest. Apparently, Mid-Atlantic, Southeast, and Western electric system entities are content with the pace of the electrical industry evolution.

They obviously do not rely on merchant traders and merchant generators the way the Northeast region did, and it appears that those regions did not fall prey to the over-regulation experienced in the Northeast.

It certainly explains the outrage expressed by the South and West regions about the Commission's proposed standard market design that we now refer to as the SMD rule.

Chairman Domenici has aptly characterized the Commission's action on SMD as a serious overreach of its authority. And I and many others on this committee agree.

But what is equally troubling to me is the confusion created by the Commission's action since 2001. For example, the Commission's Order 2000 set out a voluntary incentive-based approach to restructuring that is clearly in conflict with the prescriptive approach set out in its proposed SMD. The industry spent about $100 million to form regional transmission organizations under Order 2000 that now appears to be money not well spent in light of SMD, if we understand it correctly.

Moreover, the Commission placed utility companies in settlement proceedings to form RTOs, only to disavow the results when the new Commission took over in 2001. It happened most dramatically in the Midwest where parties negotiated and the Commission approved two RTOs, one for-profit, one not-for-profit in May 2001.

In December, the Commission ignored its previous final action. In fact, the Commission questioned whether for-profit companies could become RTOs.

In the Northeast and the Southeast, the Commission opened marathon mediation efforts only to ignore the results. In the Northeast, the Commission originally required three RTOs to merge, then reduced the number to two, and acquiesced when the parties to the merger that would have established the two RTOs canceled their plans.

It seems to me that the Commission's policy lacks direction. Since 2001, there has been too much lurching forward in provocative ways and then retraction once it becomes clear that the Commission went too far.

It would be far better for the industry and consumers alike if the Commission would propose reasonable rules in the first place, in my opinion, rather than announcing ambitious programs that require later modification.

I believe it is far more prudent for this committee to exercise much closer oversight for the Commission's administration of its current authority rather than contemplating the value of giving the Commission more authority, which in my opinion would only give the Commission more opportunity to create uncertainty in the marketplace.

I have made no secret of my preference for Congress to go slow in determining whether electricity legislation is needed.

During the last 6 years, Congress has struggled to find consensus on what to do on this issue. That consensus, to put it bluntly, has been elusive.

We once again find ourselves on the eve of another effort to find that. The chairman is working hard to make that happen. I want to express my appreciation to the chairman for his effort to accommodate the many Western concerns that have been expressed by me and other colleagues on the committee. I am grateful for his willingness to think outside the box to ensure the traditional role of the States in this area is not compromised.

However, the draft legislation distributed by the chairman introduces, I think, a rather novel idea for regional control of electric regulation. Although it raises many attractive concepts for regional and local control, it demands more thought and I think careful analysis. Put simply, it needs more time to mature. We will work hard to see if we can do that.

Electricity regulation is, by nature, complex. In the short time I have had to review the proposal, I have developed many questions about the concepts of the chairman's proposal. We will be visiting with you, Mr. Chairman, about that to see if we can work those out. I would be much more comfortable about proceeding with the analysis if I was not confronted with the very short time line that we are dealing with in this energy bill.

But now we are focused on the FERC and its authority and its responsibility, and I have already expressed my opinions there. I am pleased you Commissioners are before us. I will have questions to follow in the next round.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Craig is next, Senator Alexander, and then we will move to your side.

Senator Craig.

Senator CRAIG. Craig Thomas.

Senator THOMAS. Craig Thomas. This is Craig over here.

[Laughter.]

Senator THOMAS. Thank you all for being here. I appreciate it.

I think we ought to get on with doing something. I disagree with my friend that we are not prepared to do something. I think we ought to be and we can be.

So of the topics that we have covered in the committee and so on, what would you identify as essential, bare essentials that ought to go into an energy bill?

The CHAIRMAN. You mean on this issue?

Senator THOMAS. Yes, on this issue. Sure, that is what we are talking about.

Mr. WOOD. I would broaden it a little bit because of the relatedness of gas and electricity, but the transparency type issues, ability to actually get information, quality information from the electric and gas markets, an enhancement of the Commission's ability to police that market through the penalties. I believe those were in your legislation as well, Senator Thomas.

You and I visited about your legislation last week. I think that that is a pretty streamlined bill and hits, I guess, without exception, all the high spots, the reliability language, the PUHCA and PURPA issues, which are certainly fixtures on the scene, but in moving to a different market structure, those are clearly impediments.

The FERC-lite language. The backstop language—I do not really advocate that FERC do that, but I think having an action-forcing item that allows inter-regional transmission to get a fair shake, which I do not know that it gets under the current way we do transmission siting, is important.

Senator THOMAS. So if the FERC's responsibility basically was limited in terms of operations to interstate movement, then that would be satisfactory with you, and the RTOs and so, the regional areas could do their own work within the regions.

Mr. WOOD. Are you talking about like the RESC concept here? Or just in general?

Senator THOMAS. No. I am just talking about setting up RTOs and with the necessary agreements among the States to be able to let the States go ahead and do their retail pricing intrastate and so on. Within the region, they could do their own.

Mr. WOOD. Absolutely. Again, just so you know, that is where we want to go. That is where we want the SMD to go. We do not want to go farther than that.

Senator THOMAS. Do you believe it is essential for WAPA and Bonneville and TVA to be active participants in developing RTOs?

Mr. WOOD. Yes, sir. They own significant mileage of transmission, and they are certainly, in the Western part of the country as TVA would be here in the east, a very critical part of the overall grid.

Senator THOMAS. In terms of PUHCA, with the Justice Department and the SEC, if there was transparency and we repealed PUHCA, is there not plenty of authority for the agencies to oversee trading and financial arrangements?

Mr. WOOD. I think there is as far as what PUHCA would otherwise have given us. Again on the gas issues, in particular, I have got a few concerns about our current—this is really new since I testified last session in light of what we have learned and released yesterday. But by and large, I think the PUHCA has a lot of re-

porting requirements, as I recall, from your bill. Is that correct, Senator Thomas? The reporting requirements are important to us and the States to allow those that are regulated in multiple States, for example, to have access to the books so you do not basically put a lot of costs in one State and then move them around. So to have the ability to look at what are increasingly becoming multistate utilities is a critical thing to preserve and really is the heart of what PUHCA is useful for to a regulator today.

Senator THOMAS. I said earlier—and I think I have visited with you about it—our role here really is to try and establish some policy. We are not into the detailed regulatory business here, but to decide, with the changes that have taken place and are taking place in the industry, to be able to deal with it in the future, for instance, to get more investment into transmission, to get more investment into generation, to be able to let the marketers move around for a market system. So that is I think our goal, and I hope we can pursue that and come up with some things.

Thank you. Thank you, Mr. Chairman.

Senator CRAIG [presiding]. Senator Alexander.

Senator ALEXANDER. Senator Smith was here before me.

Senator CRAIG. I am trying to read the list here of order. Senator Smith, then.

Senator SMITH. Senator Wyden was here before I was.

Senator CRAIG. Senator Wyden was here?

[Laughter.]

Senator CRAIG. See, you are such a tough bunch, they are deferring.

[Laughter.]

Senator CRAIG. Senator Wyden, the opportunity is yours.

Senator WYDEN. I thank my colleagues, and obviously we are going to work on all of these issues in a bipartisan way as Senator Smith and I have so often.

Let me just say to the folks at FERC that yesterday's decision was more horrendous news for Western ratepayers. You look at what California and Washington and Oregon have been through. The three of us all have ratepayers who have just been hammered by overpriced contracts that resulted from market manipulation. The energy traders were caught on tape talking about deliberate market manipulation strategies, that manipulation caused long-term prices to go up and those higher prices were reflected in the contracts that Northwest utilities, that Western utilities were induced to sign.

But somehow for some reason, the FERC cannot see the connection between those caught in the act, smoking gun memos and transcripts, and the higher energy prices that our constituents are now paying because of the market manipulation that has been detailed in these transcripts. And for Bonneville and Northwest utilities, we are talking about hundreds of millions of dollars, folks. We have the highest unemployment rate in the country. So this is of enormous importance.

I just want to ask you about a couple of examples which, it seems to me, show clearly why we should get relief from these overpriced contracts.

In one of the transcripts, a Reliant manager said, how did it work today. The Reliant trader said, 129 for the power exchange. The Reliant manager, yeah, I saw that. The Reliant trader, and then we trade up to 113 for the third quarter next year. Reliant manager, sweet. Reliant trader, we even had a senior manager down here. He just wanted to know he was—everybody thought it was really exciting that we were going to play some market power.

So my question to the panel is, do the Reliant transcripts not demonstrate beyond any doubt at all that market manipulation directly impacted not just the spot market, but also the forward markets and the prices that were paid for power in the West under long-term contracts based on those forward markets?

To me, that is the ball game, folks. That is as clear an example as you can get for why those Western ratepayers ought to get some relief from long-term contracts. What more do you all need? It is right there in the transcript. I would like to hear your response.

Mr. WOOD. Thank you. We announced yesterday the staff report of what we have got. We indicated that that is not the final action, Senator, on everything that we are doing. We do have some further work to do. It was important to make that public what we did know. Let the information—and you referred to one piece of it—be out so that the people know what happened or what we have got before us.

But on the contract issues, we discussed some of those yesterday. We did take action on the spot market issues in California and reinstated an action that I have discussed with the committee a while back on the dysfunctional spot market in the Pacific Northwest and have allowed those items to go forward because there were strong dysfunctions there. That work tied back to a lot of the activity that was laid out in the overall report.

Let me just say as a process matter what we are doing now is public, but what we are doing now is not complete. We have got some further investigation to do. We do think in the process of what we are supposed to do as a judicial agency to make sure that both sides get heard. We are going through that. And the analysis that comes out of that is something that again is a future event.

But we understand the issues and we are committed to taking action on those as we go through the proper judicial process.

Senator WYDEN. Mr. Massey? Just again, when you look at these transcripts, this is an open-and-shut case. The example I gave—I do not know how you reach any other conclusion than overpriced contracts based on manipulated forward market prices were what happened there and they ought to be voided. Disagree?

Mr. MASSEY. Senator, I do not want to get myself in the position of having prejudged this issue because we are still looking at it. But to me there is absolutely no question, based on what I have seen so far, but that manipulation of the market, which staff described as epidemic, had a huge impact on long-term contract prices. There is simply no question about it in my mind. We found that manipulation affected spot prices, both defined as daily, hourly. We found in the Pacific Northwest that the spot prices defined as a month or less were unjust and unreasonable and had been manipulated. To me it simply makes sense that the long-term contract prices were affected—and staff found that there was a cor-

relation between the out-of-control spot prices and the long-term contract prices. So to me we have irrefutable evidence.

So I am considering what the standard of review ought to be, whether it ought to be the just and reasonable standard, the public interest standard. But I am inclined to believe that some of these contracts are going to have to be reformed to meet our obligation under the Federal Power Act to ensure that only just and reasonable prices are charged in all contracts.

Senator WYDEN. My time is up, Mr. Chairman. But could Ms. Brownell respond to the same question?

Ms. BROWNELL. Senator, with the many, many complex issues before us, this was perhaps the most difficult because the record is deep, it is mixed, and we looked at and will continue to look at it, and as the Chairman described yesterday, evidence that has been entered in the 100-day discovery process, evidence that was entered by the report and the rebuttal testimony to the 100-day evidence is something that we still need to look at. But the totality of circumstances involved in the long-term contracts would suggest that far more damage would be done to the public by abrogating those contracts in even the short and the longer term.

Further, there are a variety of circumstances behind those contracts. There were, in most cases, choices. In one case the individual who entered the contracts is suggesting they are unreasonable and unjust was selling at prices at $1,100 a megawatt hour. There are complaints from people whose contracts were structural—where the risk was borne at the front end by the seller, and those prices were kind of below water in the early years, now that those early years are coming to an end, they want us to cancel those contracts.

Further, I think that the risk to the customer of abrogating contracts and setting in place in the West a situation where no one can count on sophisticated players entering into contracts that would be upheld will cause a risk premium that will far outlast the length of these contracts.

While we have an obligation and we will continue to look at the relationship between manipulation and shorter- and longer-term contracts, I think these were fully litigated proceedings. There is still one to go. The judges evaluated this evidence. There were studies that in fact did not agree that the evidence of manipulation and its effect on the short- and long-term contracts was conclusive. I think all of those were weighed, and the judges came to the conclusion that the Chairman and I did yesterday.

I understand that we disagree. We looked at the totality of circumstances and concluded that the public was best served by upholding these contracts.

Senator WYDEN. My time is up, Mr. Chairman. I would only say, Ms. Brownell, you are trying to make a very clinical and antiseptic case for why contracts based on fraud ought to be upheld, and I just am staggered that you would try to make that argument. You have said that the record is mixed. The staff said there was an epidemic of market manipulation. I do not find in the dictionary that epidemic is sort of the same thing as a mixed record. So I just hope you all take another look at this.

Thank you for the extra time, Mr. Chairman.

The CHAIRMAN. You are welcome.

Senator Cantwell, you are next, but I wonder if Senator Smith could go. He has to preside in a couple of minutes. Could he just take this time and you are next?

Senator CANTWELL. That is fine, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator SMITH. Thank you, Senator Cantwell. Thank you, Mr. Chairman, for your courtesy.

The CHAIRMAN. You are welcome.

Senator SMITH. I would like to have included in the record my full statement, if I may.

The CHAIRMAN. It will be.

[The prepared statement of Senator Smith follows:]

PREPARED STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Mr. Chairman, I appreciate your willingness to schedule this hearing on electricity legislation currently pending before the Congress. There are a variety of approaches contained in these various bills, and I look forward to hearing from the witnesses today about these differing approaches.

I remain concerned, however, about the wisdom of pursuing a comprehensive electricity title, particularly one that does not deal specifically with FERC's proposed rulemaking on Standard Market Design. I do not see that the retail customer, particularly on the west coast, is benefitting from the policies already approved by the FERC, or by the policies under consideration by the FERC and by some of these legislative proposals. Let's not forget, FERC actually approved the California restructuring before it was implemented.

In the Pacific Northwest, we are still feeling the financial effects of the volatile electricity market of late 2000 and 2001. Most ratepayers in the Pacific Northwest have seen their power rates go up by at least 40 percent, and BPA has begun another rate case to raise rates again next October. Meanwhile, our energy intensive industries are shuttered, and Oregon continues to have the second highest unemployment rate in the country.

This is the third Congress in which we have attempted to move energy legislation. I honestly believe there is no consensus on an electricity title because there is no consensus on what the industry itself should look like once we're done legislating.

There is no question that certain sectors of the electric utility industry face a wide range of financial challenges, particularly those corporations with merchant plants or energy trading and marketing operations. These challenges include: excess generating capacity and thin profit margins in parts of the country; extensive credit downgrades since 2001; high levels of debt; the need to refinance tens of billions of dollars in short-term debt; reduced electricity demand; and continued regulatory uncertainty.

What is clear to me, however, is that there is no "silver bullet" that will cure the myriad of ills facing certain electricity providers, particularly those with unregulated generation. In fact, from a regulatory and legislative standpoint, we seem to be rushing to save the merchant plant sector of the industry by sacrificing traditional, vertically-integrated investor-owned utilities and public power providers. Yet it is the investor-owned utilities, and public power providers, that have a legal obligation to keep the lights on in their service areas. Traditional utilities with regulated rates of return also represent the financially healthiest sector of the for-profit providers.

I, for one, cannot support a broad expansion of FERC's authority in any legislation. In fact, I agree with the Chairman's assessment that FERC has overreached its statutory authority in its proposed rulemaking on SMD. I think it is imperative that if we move any electricity legislation we clarify FERC's authority. Congress can make it perfectly clear that states, not FERC, have authority over the transmission component of bundled retail sales.

Mr. Chairman, I appreciate your leadership in addressing the complex regulatory issues facing the electricity industry, and your innovative proposal for regional energy services commissions. I look forward to hearing from the witnesses on this concept, that recognizes the regional nature of wholesale electricity markets.

However, I believe the Committee cannot act on an electricity title without directly addressing the proposed rulemaking on Standard Market Design. As you know, I have opposed this rulemaking, because I believe it is unnecessary and un-

workable, particularly in the Pacific Northwest. If there are instances of undue discrimination on the transmission system, I believe that the Federal Energy Regulatory Commission (FERC) has the ability, under Order 888 or in the development of tariffs for regional transmission organizations, to remedy such discrimination.

It is my understanding that, despite FERC's anecdotal evidence of the need for Standard Market Design, there are only four instances when the FERC has actually ruled that undue discrimination has occurred since Order 888 was issued. I intend to pursue this line of questioning when the FERC Commissioners appear before the Committee this afternoon.

Our goal must be to ensure that the universal availability of reasonably priced, reliable power is not compromised. We must move away from, not facilitate, policies that will allow gaming and market manipulation such as we saw on the west coast in 2000 and 2001, and are now seeing evidence of in Texas as well.

I appreciate the willingness of the witnesses to appear before the Committee today.

Senator SMITH. First of all, thank you all for being here. This is a very important hearing. I think our chairman is showing real leadership in trying to get an energy bill out that includes an electricity title.

But I want to say without any reservation I think, Mr. Chairman, that it is imperative that if we move on an electricity title, that we clarify FERC's authority and make it perfectly clear that States, not the FERC, have authority over transmission components and bundled retail sales. I say this because I am very concerned about this moving forward.

The whole idea of SMD I think is born out of good intentions, but is misapplied to the historic and regional development of energy transmission. I think it has worked in Texas because Texas, as I understand it, is a fairly holistic grid that serves all of Texas, part of Oklahoma. But it ignores the Tennessee Valley Authority and how that was developed or the Bonneville Power Administration.

I think it is fair to say that people in the West in particular have particular alarm about FERC's having authority to manage these because the message that comes across is we need to make the world safe for a better Enron. It seems to me to be saying that marketers are more important than local utilities and their judgments as to how to keep the lights on.

I want to be on record as highly opposed, deeply alarmed at this part of any proposal to have an electricity title. I think I speak, with few exceptions, for the publics, the privates, the utilities of all stripes in the State of Oregon, and I think Senator Wyden would agree with me.

Perhaps I am making a speech here, Mr. Chairman, but I would love to get your response. Our alarm is born out of the fact that the FERC, before any of you were there, actually I understand approved the California deregulation. And our State suffers to this day, as Senator Wyden and Senator Cantwell are about to make clear. And frankly, we are highly alarmed about turning over our region's planning to a national program that can come up with these kinds of results.

I would love to get your response to what I have said and help me understand why I should have any confidence in a proposal that to me says let us make the world safe for marketers without respect to local utilities.

Mr. WOOD. I would like to ask my colleague who actually was here before when these got set up—he made some pretty eloquent

remarks yesterday on the California issue that I think are useful for the committee.

But our point here is as it has been since I walked in the door, Senator. It is about the customer. It is not about the marketer. The marketer, if there is sufficient competition among them, and the rules are fair, which we did not see in the West, because they were not clear or there were not rules at all in a good part of the West, then the customer does not get the benefit of those people competing against each other. So please know that our goal here is not to benefit the marketer, a bankrupt one or otherwise, but to improve the lot as it has been seen in a good part of this part of the country that an organized and regional electricity grid has, in fact, created a much more efficient and well planned and well expanded network that benefits customers. So that is our goal.

Bill, did you want to——

Mr. MASSEY. Well, I was actually at the Commission when the California market design was approved. It was a homegrown market design that emanated from California, literally enacted by the legislature. The Governor supported it. It was proposed to us, and I regret the fact that we approved it but it was the interest of regional deference that we did so. And now we are cleaning up a huge mess that arose from that. It was a market that could be easily manipulated. It was a short-term market, which made no sense whatsoever.

What we are trying to do is say to the Congress and to the world that we do not want bad markets. We want well-designed markets. We want markets that cannot be manipulated. We want markets that are primarily long-term contract markets, and that is what we are trying to achieve.

We have to do a better job of respecting the interests that you raise, local interests, State interests. States want to be co-equal partners in this process, and I think my colleagues and want to be highly respectful of that and I think you will see some significant changes in this white paper.

The goal is to ensure that consumers out West and other parts of the country never have to go through this again in a market-based environment.

Senator SMITH. Well, I meant no disrespect to you, but I do want to register again my skepticism, even my concern and alarm, because right now Northwest customers are paying double what they used to, and SMD is projected to raise the costs even more. So I must be counted as opposed.

Thank you.

The CHAIRMAN. Thank you.

Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman. I would like to have a longer statement submitted for the record, if I could.

The CHAIRMAN. It will be made a part of the record, Senator.

[The prepared statement of Senator Cantwell follows:]

PREPARED STATEMENT OF HON. MARIA CANTWELL, U.S. SENATOR FROM WASHINGTON

Thank you, Mr. Chairman, for holding this important hearing on legislative electricity proposals as well as FERC's action—and inaction—yesterday on western market manipulation.

I hope the witnesses on the first few panels today will forgive me. I had every intention of coming to this hearing to discuss with them and with my colleagues the finer points of those issues that divide this Committee—primarily along regional rather than partisan lines—when it comes to the always-contentious issue of electricity legislation.

Yesterday, however, I believe the Federal Energy Regulatory Commission made some important decisions-and some monumental mistakes—all of which speak to the Committee's broader concerns regarding the appropriate levels of authority and discretion Congress should vest in this agency.

Unfortunately, if this Commission seriously intends to follow-through on the proposed treatment of the Northwest that a majority of its members outlined yesterday, FERC and its leadership will have earned a vote of absolutely, positively no confidence from the residents of my home state of Washington. This comes at a time when FERC is, in essence, telling the people of the Northwest to "just trust us; we've learned our lessons about how your region works," when it comes to its mind-numbingly complex Standard Market Design proposal. Mr. Chairman, I am astounded by the insensitivity and arbitrary nature of the Commission's apparent decision to tell the people of my state that, while it has finally unearthed what it deems to be convincing evidence that manipulation of markets took place during the crisis of 2000-2001 and our utilities could be on the hook to pay refunds to California, prospects for recovering any of the billions of dollars lost by entities in the rest of the West are exceedingly dim.

As my colleagues are aware, the Commission yesterday released a staff report, which Chairman Wood commissioned at the request of myself, Senators Wyden and Feinstein at this Committee's January 2002 hearing on Enron's collapse. This report substantiates what many of us have argued all along: that manipulation was pervasive in the western electricity markets during 2000 and 2001; that the Northwest and California markets are connected; and that spot market prices have an important—or in the words of the staff report, "statistically significant"—impact on forward market prices.

Despite these findings, a majority of FERC Commissioners also said yesterday that they do not envision granting any relief to utilities throughout the West which signed absurdly expensive long-term contracts during the height of the crisis.

I should note that I appreciate the fact that the Commission seemed to signal that it would consider Northwest refunds for short-term transactions. However, FERC failed to actually take any action on that matter. Further, as the Commission well knows, the majority of Northwest utilities' money is tied up in long-term contracts, simply because of the way business is transacted in our region.

Thus, my question is simple. How are residents of Washington supposed to understand that, while FERC has—after conducting a 13-month investigation—finally connected the dots so obvious to most, the Commission still believes residents of the Northwest and the utilities that serve them do not deserve the same treatment as their neighbors in California, simply because our markets are differently structured?

In essence, FERC proposes to penalize us because our utilities rely—and have always relied—more heavily on long-term contracts to meet their statutory obligation to serve customers. As I understand it, FERC itself encouraged utilities to get out of the spot market and enter into such contracts during the height of the crisis to mitigate price volatility.

Mr. Chairman, I know that many believe that the concept of "contract sanctity" is paramount. And I assure my colleagues, as a business woman, I clearly understand its importance. However, the western energy crisis of 2000-2001 was a market debacle of historically unprecedented magnitude. Do we really believe, as policymakers, that contracts resulting from manipulative business practices should be immune from reform? Do we really believe, after all we've learned about Enron, that millions of dollars of Northwest ratepayers' money should continue to flow—if not into the company's coffers, then into the pockets of either its creditors or bankruptcy lawyers? Do we really believe that FERC's proposal to revoke Enron's market-based rate authority more than a year after the company has filed for bankruptcy, after the company has admitted manipulating markets, and after some of its executives have plead guilty to felony charges, represents the actions of a "tough cop on the beat"?

As I said, the western energy crisis was a debacle unparalleled in the history of the industry—save, perhaps, for that infamous period in the 1920s and early 1930s that resulted in the Roosevelt Administration's passage of the Federal Power Act and Public Utility Holding Company Act of 1935. Still, the magnitude of the economic devastation caused by the latest crisis would take even Samuel Insull's breath away. According to a June 2002 study published in the journal *Competition and Trade*, the crisis has resulted in the West's loss of $35 billion in domestic eco-

nomic product—in other words, a 1.5 percent decline in productivity and a total loss of 589,000 jobs.

I ask my colleagues to consider this another way. Think about the extra money consumers and businesses are spending on utility bills in my state. Since the Bonneville Power Administration put in place a 46 percent rate increase in October 2001, Washington state consumers and businesses have paid $895 million more for power than they would have previous to the crisis, and the Pacific Northwest as a whole has paid an excess of $1.3 billion. These are purely energy costs, and do not account for their multiplier effect on associated economic activities.

Consider the fact that these costs essentially function as a tax on any economic activity that requires the use of power—for our purposes, we'll call it the Enron tax. Consider the fact that $700 million—the amount of Enron's contracts with BPA—is equivalent, in terms of Bonneville's revenue requirement, to between five to seven percentage points on its rates. Do any of my colleagues believe sound economic policy would be served if a similar five percent Enron tax were imposed on the rest of this nation, at a time when our economy continues to struggle to climb out of a recession? Do any of us believe this Administration would support such an initiative?

In my state, we have, over the past two years, seen our electricity and unemployment rates rise in tandem. And I'm afraid that the electricity policies of FERC and this Administration have effectively tied a 1,000 pound weight around our neck at precisely the moment in time when our economy requires inflatable water wings if it is going to learn to swim again.

Perhaps I'll hear something different from our FERC witnesses here today about the Commission's intentions toward the Pacific Northwest. Otherwise, I'm afraid this agency's response to the western market crisis can be portrayed as nothing less than pathetic, negligent and outrageously unfair.

I thank the Chairman for holding this important hearing.

Senator CANTWELL. I think the interesting thing about this hearing today is that the issue is not really whether ratepayers in my State have now had a 50 percent rate increase and will have so for the next 5 years. I do not really think it is the issue that Oregon and California have also suffered gravely from their economies being impacted by these high rates. One analysis said $35 billion in domestic economic product loss and a 1.5 percent decline in productivity, and almost 600,000 jobs lost. My colleagues are going to talk, I am sure, more about that.

But you know what? That is not even the issue today. The issue today is whether FERC is capable of doing their job.

Mr. Wood, you once responded that you were the cop on the beat, and I can guarantee you after seeing this report that any policeman on this beat seeing this kind of corruption would be relieved of their duty if they did not respond.

The issue today before this committee, certainly the issue as it relates to SMD is whether FERC is capable of doing this job. An entity that was created in 1935 and has had very little of the public spotlight ever shown on it, but now we are seeing possibly the inadequacy of the only Federal agency that is supposed to protect consumers from unjust and unreasonable price gouging. That is your duty. It is in the Power Act.

I would like to ask you a question, Mr. Wood, because you came before this committee and I asked you about this issue. I asked you specifically, my quote, "Do you think that market manipulation, if you found market manipulation, could it ever be just and reasonable or ever in the public interest?" And your reply to this committee and to myself was, "I cannot think of an instance when it would."

Do you stand by that testimony?

Mr. WOOD. I do.

Senator CANTWELL. What was your statement yesterday? What was your statement yesterday as it related to the report?

Mr. WOOD. That we were going to move forward on every one of the 31 recommendations in that report. We took action on some yesterday, some market-based rate authority revocations for, I believe, eight natural gas companies and five power marketers. We have got another 30 or so that we are continuing to review the record on because a number of pleadings came in last Thursday, a week ago today, from a number of parties in California and in the West that were subject to accusation, I suppose, from other parties that came in on March 3. So this is what we call the 100-day discovery evidence.

Please know we are still looking at a number of items in the report. We have got the report this month. It was imperative I think for us and for you all to get this out in the public, to put the full record behind it in the public for everybody to see, for us to continue our review——

Senator CANTWELL. Mr. Wood, just because I am going to run out of time.

Mr. WOOD. Yes, I am sorry.

Senator CANTWELL. I just want to make this point. You have a whole chapter, chapter 5, dedicated to the relationship between the spot market and long-term contracts, and the conclusion by staff was, quote, for contracts that are subject to a just and reasonable standard of review in the ongoing complaint proceeding, that they should send this analysis to an administrative law judge. You spent a whole chapter saying that they are related.

We want relief on those long-term contracts. We want the just and reasonable clause that you are empowered with under the Federal Power Act to stand. You have testified before this committee that you do not believe contracts that have been manipulated can either be just or reasonable or in the public interest. So I have a strong legal belief that you are going to have to use the just and reasonable clause, but it does not matter. You have testified before this committee saying neither of those kinds of market manipulations could be either in the public interest or just and reasonable. So I do not know why FERC is continuing to go so slow on what is known by the rest of this country and certainly felt by the ratepayers in Washington State.

Mr. WOOD. Well, certainly it is our intention to move forward as soon as we can. I would point out that the part you referred to in the staff analysis which did look at all the contracts that were entered into in this period made the direct correlation between the dysfunctional spot market and the shorter-term, the 1- to 2-year contracts. So there was a .33 correlation, a one-third correlation, between a dysfunctional spot market and those contracts. And I think that that, as I mentioned yesterday, is a factor that I weigh in when I look at the public interest standard in looking at any contract.

Senator CANTWELL. Well, we will get back to the public interest standard. But my time is expired. Mr. Chairman, thank you.

The CHAIRMAN. Thank you very much, Senator.

Senator Feinstein, you are next.

Senator FEINSTEIN. Mr. Chairman, I just want to say that I really concur with my colleagues that have just spoken.

I would like to enter my full statement. Plus, we have had an opportunity to analyze the California submitted documents and I would like to submit that brief analysis for the record, if I might.

The CHAIRMAN. It will be done.

[The prepared statement of Senator Feinstein and the analysis follow:]

PREPARED STATEMENT OF HON. DIANNE FEINSTEIN, U.S. SENATOR FROM CALIFORNIA

Mr. Chairman, thank you very much for holding this hearing. You have laid out an aggressive timetable to markup Comprehensive Energy Legislation this year in this Committee. While I am pleased we will be able to discuss these issues here in Committee before they come up on the Floor, I am worried that we are rushing to pass legislation without fully understanding how to properly fix our broken energy markets.

I strongly believe we should not rush this process, we must make sure we do it right.

Just yesterday, FERC released its "Final Report on Price Manipulation in Western Markets" which confirmed widespread and pervasive fraud and manipulation during the Western Energy Crisis and FERC announced that California would receive more than the $1.8 billion in refunds recommended by an administrative law judge in December. At the very least FERC is estimating refunds of around $3.5 billion.

The regulatory hammer has finally begun to drop. The question now is how hard. In view of the inflated profits that energy companies reaped at the expense of California homeowners and businesses—FERC should right this wrong and honor California's claim for $9 billion in refunds.

FERC must also re-examine the long term contracts signed by the State of California at the height of the Energy Crisis. Yesterday the FERC report acknowledged the significant linkage between spot prices and contracts. I strongly believe the evidence is clear that the contracts were entered into under extraordinary circumstances with rates inflated by market manipulation, and I believe failure to open up the contracts would be a big mistake.

However, I will give credit to the Commission where credit is due. FERC is finally headed down the right path and I want to commend the Commission for lifting its "Protective Order" and releasing thousands of pages of new documents which demonstrate that energy companies deliberately manipulated electricity and natural gas markets during the Crisis.

This abuse was pervasive and unlawful.

These now-public documents were submitted to FERC earlier this month by the State of California, the California Attorney General and the State's largest utilities. They provide strong evidence that there was a concerted effort to boost company profits at the expense of consumers.

Mr. Chairman, I would like to enter a summary of this documentation produced by my staff into the Record.

First, the documents detail new incidents when energy companies intentionally held their plants offline to drive prices up.

Second, the documents show energy traders were deliberately attempting to manipulate the Western market—frequently through strategies earlier Enron memos termed "Death Star," "Get Shorty," "Fat Boy," and "Ricochet," among others.

These strategies were implemented not just by Enron, but by energy companies across the board. For example:

- A conversation between a Mirant trader and a trader from Public Service of Colorado reveals an effort to engage in overscheduling energy—the "Fat Boy" strategy.

The trader from Public Service of Colorado states, "Why don't we just do something where we overschedule, overschedule load and share an upside, dude." The Mirant trader responds, "That's fine."

These were not isolated incidents. They were widely implemented practices designed to fleece consumers in the West.

Third, the documents lay out new evidence of possible anti-trust violations by energy companies. The filing shows the largest energy suppliers in California shared

non-public information through a third-party company called Industrial Information Resources. Traders called this company "The Mole."

Industrial Information Resources provided sellers detailed, non-public information on daily plant outages—essentially giving energy companies insider information on when an unplanned outage could transform an energy shortage into a Stage 3 energy emergency or blackout.

Yesterday, I wrote the Attorney General to ask the Justice Department to look into possible anti-trust violations by energy firms who used Industrial Information Resources to share non public information on plant outages in California.

Fourth, the documents provide new evidence of document destruction by energy companies to cover up details of their actions.

In the documents, an ex-Mirant employee disclosed that:

- He was instructed to delete certain files relating to the California markets from hard drives; and
- Key Mirant executives were instructed to turn in their laptops so that Mirant could clear their hard drives.

According to this employee, he was ordered to flagrantly destroy documents, which may have detailed market fraud. This means that we will never know the true scope of the gaming and manipulation.

I strongly believe this type of fraud and manipulation occurred, in part, because strong federal oversight of the energy trading system was non-existent.

For FERC to be an effective regulator, Congress must provide the Commission with more authority to punish violators with stiffer criminal and civil penalties under the Federal Power Act.

Mr. Chairman, I am pleased to see that your draft legislation proposes to eliminate the 60-day waiting period after a complaint is filed at FERC for a party to become eligible to receive refunds. This unnecessary 60-day waiting period may cost California billion of dollars in refunds because thus far the Commission has refused to grant refunds prior to October 2, 2000 despite the overwhelming evidence of fraud and manipulation before that date.

Mr. Chairman, I am also pleased to see provisions in your draft legislation that propose to increase criminal and civil penalties under the Federal Power Act. I would like to work with you to see these same penalties strengthened as part of the Natural Gas Act to punish abuse in the natural gas sector, not just the electricity sector. And refund authority should be part of the options FERC has at its disposal to punish those who manipulate the gas markets. As the FERC report on Price Manipulation in the Western Markets states, "markets for natural gas and electricity in California are inextricably linked."

There are other remedies to market power that Senator Bingaman and Senator Daschle included in the Senate Energy Bill last year that I would like to see the Committee include in an Electricity Title. I believe specific prohibitions on market manipulation, authority for FERC to review all mergers and acquisitions in the energy industry, and more authority for FERC to remedy market abuse must be part of any energy bill this committee reports to the Floor.

Mr. Chairman, I am interested to hear comments from our witnesses on the new idea you have proposed to create "Regional Energy Services Commissions." I would like to commend you for bringing forward this idea, but I think this proposal should be studied carefully by this Committee before we act on any proposal that could further balkanize the already fractured energy markets and take power away from FERC—at a time we should be providing the Commission more authority, not less.

Again, Mr. Chairman, I would like to thank you, the members of this Committee, and the Committee staff for holding this hearing and I look forward to the Committee's examination of these important issues. Thank you very much.

NEW EVIDENCE THAT ENERGY COMPANIES BESIDES ENRON MANIPULATED THE WESTERN ENERGY MARKET

(UNOFFICIAL REPORT—OFFICE OF SENATOR DIANNE FEINSTEIN)

After a 100-day discovery period that ended March 3, 2003, the State of California, the California Attorney General's Office, and the state's largest utilities filed over 3,000 pages of evidence at the Federal Energy Regulatory Commission to show how fraud and manipulation was pervasive throughout the Western Energy Crisis of 2000-2001. The market abuse was not limited to a few rogue traders at one firm, but was a widespread series of schemes perpetuated by many employees across most companies that supplied and traded in the West.

Highlights of the Information Filed by the California Parties

(This information was previously under a "Protective Order" at FERC)

- Details on new specific incidents when energy companies intentionally held their plants offline to drive prices up during 2000 and 2001.
- New transcripts of conversations between energy company employees revealing an intent to defraud and manipulate the California market.
- Reliant knew about transcripts proving their employees held power offline, but the company sat on the evidence for over a year before turning them over to FERC. (CA Parties brief, p122, footnote 375/Exhibit CA-218)
- New evidence of document destruction by energy companies to hide details of their behavior in the Western Energy Market.
- New evidence laying out possible anti-trust violations by energy companies.

The filing by the California parties shows that there was a extensive and coordinated attempt by energy companies to game the Western market to drive prices up by engaging in the following:

1. Withholding of Power—driving up prices by creating false shortages.

New evidence of Withholding of Power according to the California parties: (CA Parties brief, p28-31/Exhibit CA-9)

- On August 15, 2000 Williams reported that its plant in Long Beach called Alamitos 7 was unavailable due to NO_X limitations, but AES's real-time logs from that day show the plant was shut down because Williams directed it to be.
- Reliant failed to return its Etiwanda Unit 2 in Rancho Cucamonga to service for two days after repairs were completed on January 26, 2001, even though the ISO system was experiencing continuous Stage 3 emergencies in California.
- Redondo Beach Unit 6 power plant was shut down by Williams and AES April 3-April 6, 2000. Although the ISO was told the plant was offline due to a boiler tube leak, the plant records indicate this was a planned shutdown and the leak was an excuse concocted two days later.
- Dynegy shut down its El Segundo Unit 1 plant August 30-September 3, 2000 for repairs, but the repairs had been done and the plant was shut down to force prices up.
- Mirant held its Pittsburg Unit 1 plant offline until October 22, 2000 even though an external tube leak ended October 20, 2000.
- Duke delayed returning Oakland Unit 1 to service after repairs to a lube oil cooler and a cooling fan in November, 2000 despite ISO-declared emergencies.
- During an ISO-declared emergency December 19 and 20, 2000, Williams declared Redondo Unit 5 a forced outage due to a boiler tube leak. However, the control operator logs uncharacteristically put quotation marks around the outage reason, "Blr. Tube Leak" and later, after tests were done, the logs indicate that no leaks were found.
- Reliant delayed reporting the end of an outage at its Ellwood Unit in Goleta for more than twelve hours during peak demand in early April 2001.
- Between November 19 and December 5, 2000 Dynegy reported that its El Segundo 1 and 2 units (with a capacity of about 350 MW) were on "forced outage," but these units were actually shutdown because Dynegy claimed its operating staff was on vacation. Forced outages should not include vacation days—especially during ISO emergencies, which occurred on November 19 and 20.

2. Bidding to Exercise Market Power—suppliers bid higher after the California ISO declared emergencies, knowing the State would need power and be willing to pay any price to get it.

New evidence of Bidding to Exercise Market Power according to the California parties:

- A Mirant email to eleven traders in July of 2000 reveals this strategy:

  "load is average above 40 thousand during peak. So, submit revised supp. Bids and 'stick-it to 'em!!" (CA Parties brief, p42-43/Exhibit CA-141)

3. Scheduling of Bogus Load (aka "Fat Boy" or "Inc-ing")—suppliers submitted false load schedules to increase prices.

New evidence of Scheduling Bogus Load according to the California parties:

- A Dynegy trader confirms that Dynegy's load deviation in August 2000 is "probably because [the traders] are just doing some dummy load scheduling." (CA Parties brief, p48/Exhibit CA-202)

- A conversation between a Mirant trader and a trader from Public Service of Colorado reveal a joint effort to engage in "Fat Boy."

The trader from Public Service of Colorado states, "Why don't we just do something where we overschedule, overschedule load and share an upside, dude."

The Mirant trader responds, "That's fine." (CA Parties brief, p49/Exhibit CA-204)

- A Sempra trader states Sempra should submit "fake load" to the day ahead market. (CA Parties brief, p49/Exhibit CA-71)
- A Williams trading strategy is identified as "scheduling bogus load." (CA Parties brief, p49/Exhibit CA-22)

An internal Powerex memo documents that Powerex entered into a contract with the explicit purpose of "overscheduling" and "underscheduling" and for congestion manipulation. (CA Parties brief, p49)

4. Export-Import Games (aka "Ricochet or "Megawatt Laundering")—suppliers exported power out of California and imported it back into the State in an attempt to sell power at inflated prices

New evidence of Export-Import Games according to the California parties:

- Powerex's head trader congratulated its daily traders on their successful use of strategies to buy-ahead and sell back real-time. (CA Parties brief, p53/Exhibit CA-40)
- Reliant had "camouflage transactions" where the company sold power out of California day-ahead to Arizona and New Mexico utilities, and bought it back for sale in the real-time market. (CA Parties brief, p55/Exhibit CA-56)

5. Congestion Games (aka "Death Star")—suppliers created false congestion and were then paid for relieving congestion without moving any power.

New evidence of Congestion Games according to the California parties:

Other names like "Death Star" were given to these schemes: EPMI—Star, CISO—Death, Curious and George, Red and Green, Hungry and Hippo, James and Dean or Chinook and Atlantic and SCEM—Loopy. (CA Parties brief, p59/Exhibit CA-1)

- These congestion games were called "free money." (CA Parties brief, p59/Exhibit CA-145)
- A Mirant trader summed up the scheme, "I mean its just kind of loop-t-looping but it's making money . . . [laugh]." (CA Parties brief, p48/Exhibit CA-204)

6. Double-Selling—suppliers sold reserves, but then failed to keep those reserves available for the ISO.

7. Selling of Non-Existent Ancillary Services (aka "Get Shorty")—suppliers sold resources that were either already committed to other sales or incapable of being provided.

8. Sharing of Non-Public Generation Outage Information—the largest suppliers in California shared information from a company called Industrial Information Resources that provided sellers detailed, non-public information on daily plant outages. A one-year subscription to Industrial Information Resources cost $70,000. Providing multiple competitors the same, non-public, outage information signals all competitors to act in a parallel manner.

New evidence of Sharing of Non-Public Information according to the California parties:

- Duke energy traders called Industrial Information Resources "the mole." For example, Duke trader James Stebbins emailed: "I just heard back from the mole. He is reporting that the PV3 will be coming back on line 6 days earlier than expected. The new return date is March 3. Good luck and happy selling." (CA Parties brief, p70/Exhibit CA-95 and Exhibit CA-253)

9. Collusion Among Sellers—sellers were jointly implementing or facilitating Enron-type trading strategies.

New evidence of Collusion Among Sellers according to the California parties:

- Glendale traders learned manipulation from Enron and Coral traders. (CA Parties brief, p77/Exhibit CA-105 and Exhibit CA-1)
- Sempra provided Coral with advance information regarding the status of a plant. (CA Parties brief, p78/Exhibit CA-1)
- Transcripts of calls show traders from Public Service of Colorado and Mirant discussing "sharing" or "splitting" "the upside. (CA Parties brief, p79/Exhibit CA-204)

10. Manipulation of NO_X Emission Market—sellers manipulated the market for NO_X emissions in the South Coast Air Quality Management District through a series of wash trades that created the appearance of a dramatic price increase that may have been fabricated.

For example, Dynegy, together with AES and others, entered into a series of trades of NO_X credits in July and August 2000 by which Dynegy would sell a large quality of credits and then simultaneously buy back a smaller quantity of credits at a higher per credit price. (CA Parties brief, p90-93/Exhibit CA-11)

11. Wanton Document Destruction—sellers (not just Enron) flagrantly destroyed documents detailing behavior in the Western Energy Market.

New evidence of Wanton Document Destruction according to the California parties:

- Mirant—an ex-Mirant employee disclosed that he was instructed to delete certain files relating to the California markets from hard drives and that key Mirant executives were instructed to turn in their laptops so that Mirant could clear their hard drives. (CA Parties brief, p129/Exhibit CA-178)
- City of Glendale, California—a Glendale employee, Jack Dolan, told an ex-Glendale employee, Carl Edginton, that Mr. Edginton could destroy one of the documents that contained information about Enron's gaming strategies. (CA Parties brief, p129-130/Exhibit CA-213)

12. Negligent Document Destruction—sellers failed to retain documents detailing behavior in the Western Energy Market in accordance with FERC rules and the Federal Power Act.

According to the California parties, new evidence of Negligent Document Destruction by:

- Powerex
- Portland General Electric
- Reliant
- Bonneville Power Administration
- City of Glendale
- Northern California Power Agency (CA Parties brief, p130-132)

13. Traders Did Not Care How High Prices Went—sellers said that it did not matter how high prices went, as long as Californians paid and generators made money.

New evidence Traders Did Not Care How High Prices Went in the filing:

- Conversation between two Reliant employees on May 22, 2000:

Kevin: "Hey, guys, you know when we might follow rules? If there's some sort of penalty.
Walter: "That's right."
Kevin: "I would never suggest it, but it seems like the writing would be on the wall."
Walter: "Well, I mean, there's—you know, our position is if it's a reliability issue, then the reliability comes over the economics.
Kevin: "Right."
Walter: "So we don't have a problem with that. But it needs to be a reliability issue. If it's economics, and by God, that's what rules."
Kevin: "You'll let the California rate payers pay."
Walter: "That's right. I don't have a problem with that. I have no guilty conscience about that."
Kevin: "All right, man."

(CA Parties brief, p110-111/Exhibit CA-239)

Senator FEINSTEIN. The bottom line, in an answer to Senator Smith's question, in 1996 it is true, California passed a broken energy law, lobbied for by the energy industry, headed in the lobbying effort by Enron, signed not by a Democratic Governor, by a Republican Governor, and the broken market was created.

Since that time, a whole industry I believe has pervasively committed illegal acts, and we have an energy commission—and this is prior to both Mrs. Brownell and Mr. Wood—who did nothing, with exception of Mr. Massey who was a lone vote, who stood up, who knew something was wrong, and who tried to get at it. Those of us that sat down with the Commission got not to first base.

There was a noblesse oblige. There was a "we know it all." "It is all California's fault." And guess what? Now it turns out that that is not correct.

Where California I think made a big mistake was picking up billions of inflated energy costs because if those costs had been able to be onto the ratepayers, you would have had a yell and a scream that would have taken this place apart. But the State paid for it. It bankrupted one major investor-owned utility and nearly bankrupted the other.

And I pick up this FERC report and the Commission has given show cause to 30 companies to come and tell them why they should not have to give their profits back. And they are all the star companies of America. I am absolutely disgusted.

But you know what it shows? It shows that in a capitalist society, in a free market, you need regulation and you need people who are going to be courageous and who are not going to be bothered by the fact that their salaries are paid by the very industry they have to regulate but do their job: regulate that industry. And it has not been regulated.

Consequently, you have literally billions—probably one of the greatest frauds ever perpetrated on the entire West Coast. And as you read these transcripts, and you see trader language like "junkyard dogs," saying in essence, shove it to them—this is America's star energy companies. I am disgusted.

I would like to ask some questions.

The evidence makes clear that the type of fraud and manipulation was not confined just to Enron, Reliant, and BP Energy. The first question is, will the commission rescind market-based rate authority for other companies to ensure that this market abuse is properly punished?

Mr. WOOD. Yes, ma'am, we can. As I mentioned to one of your colleagues a moment ago, we are in the process of basically hearing the other side of the story, which was filed last Thursday, on each of these claims. One, for example, made a claim that the California ISO asked us to do this Enron strategy because they needed to keep the lights on.

Well, I am going to follow that up. I think it is important to both the ISO's reputation and to the accused party to make sure that before we move forward with a show cause to disgorge or to revoke, which are basically the two options for us, revoke the certificate or disgorge the profits, if there is in fact a tariff hook to go back and say you violated a law that was on the books at the time. That is what we are putting together this month. Again, that evidence just came in last week.

There were those companies that you referred to, Senator Feinstein mentioned, in the document——

Senator FEINSTEIN. Page 16 of your document.

Mr. WOOD. Yes, ma'am, in the footnote.

Senator FEINSTEIN. They are footnoted, but they are there.

Mr. WOOD. They are there.

There were actually kind of three camps of groups. The Enron gaming strategies which I should add were pointed out by an ISO report in January. So we did find issues, but I will give the ISO credit. They did a lot of the scrubbing of all the records for the

prior year for Senator Dunn's hearing and provided that record to us as well.

Some other people that were engaged in the Enron business relationships, which the staff turned up in its discovery over the last year, were kind of the outside of California parties that potentially facilitated some of these transactions.

And then the third category were about 10 companies that staff identified as having potentially performed economic withholding because their bidding strategies were anomalous to what the market rules were at the time.

So those three categories are really what we had hoped to have yesterday, but I think when we saw the volume of evidence that came in last Thursday, it is incumbent on our agency to review that before we send it over to trial.

Senator FEINSTEIN. I notice my time has run out. Will there be a second round, Mr. Chairman?

The CHAIRMAN. Yes. We will stay and do that, if you want. Thank you very much.

Senator Burns.

Senator BURNS. No. I think it is Senator Alexander.

Senator ALEXANDER. Thank you, Conrad.

I have one question. Thank you for coming.

The staff draft of the energy bill has what we call a FERC-lite section that would put many parts of TVA's transmission system under FERC. As we look at that in the Tennessee Valley, Mr. Wood, maybe you could help us think about how to look at that in terms of what are the pros and cons to the ratepayers of the Tennessee Valley and even to TVA itself of putting parts of the transmission system under FERC?

Mr. WOOD. I would like to actually think a lot deeper about that and give you and the committee something in writing, Senator Alexander, because I have not given the FERC-lite language a lot of deep thought lately.

But just in general, what this language really is and a lot of what we are talking about is integrating these grids into their neighboring grids more tightly so there is not, in effect, like a big wall around TVA—a ring fence I guess they have called it—but that there is more of an integrated approach toward more coal-fired power in the Midwest and natural gas-fired power in the South. Certainly depending on costs and time of year, those—TVA sits right in the middle of the grid, and I think from a national perspective, it is important to have TVA involved in the grid.

From the TVA customers' perspective, it is a similar benefit to have access to not only the power that TVA would generate, but for those customers, particularly if they have the ability to buy from someone other than TVA, to actually be able to reach the adjacent utility or some powerplant along the Ohio River or down in Louisiana and actually buy power contractually from those places, as well as buy it from TVA, so that they have got more competitive choices for their own retail customers.

So it is just, in effect, broadening the market and doing so through a form that allows for some uniformity of treatment of those by the TVA grid operator, the people at TVA that run the grid.

Senator ALEXANDER. I wonder if the other Commissioners have a comment on that.

Mr. MASSEY. Senator, my own view is that the Commission, at least under existing law, ought to try to make these RTOs and these markets attractive enough so that non-jurisdictional companies will want to participate in them. They will want to participate in RTOs because they see value to it to their customers. They see that it is in the national interest. So that is step one. It seems to me we have to be working to make that happen.

Senator ALEXANDER. Would one aspect of making it attractive be a transition period? One of the things about public policy in general I have observed over time is that when you make big adjustments, that the law of unanticipated consequences can come into play, and the big adjustments are sometimes easier to make gradually. As you do your planning and your thinking about these changes, do you think about transition time?

Mr. MASSEY. I think about transition time in lots of different ways. It seems to me the industry in general has been undergoing this transition to competitive markets for quite a while, and I think they are looking for some certainty. But new players who may want to participate in an RTO or who are jurisdictionally required to comply with FERC policies, yes, I think they need some time to get used to the idea. I am hoping that that is one of the issues that we can deal with in our white paper with respect to standard market design or RTO formation, what should be the sequence of events that will make this happen in an orderly fashion, respecting regional differences, respecting State commission rights. That is my hope.

Senator ALEXANDER. Ms. Brownell.

Ms. BROWNELL. Senator, I think your caution is well placed certainly by what we have learned, but some of my lessons were learned in PJM where indeed we did undergo a transition. Where we introduced new markets over time, we introduced ancillary services over time. There was a lot of testing. So I surely think that that will be part of any transition.

Indeed, that transition and period of evolution has already been laid out in many of the RTO dockets where people are on different tracks depending on where they are in terms of their own market design elements.

I would also add that the length of the transition period I think has made us all vulnerable, and the lack of transparency in some of our marketplaces and the lack of clear and consistent rules has, in fact, made the marketplace vulnerable not only to market manipulation and games, but more importantly, to the lack of efficiency that would bring value to customers, to the inability to introduce new technology into the marketplace that would benefit customers both from an environmental and efficiency perspective, and indeed, from some assurance that we are operating that grid as efficiently as we can and using economic dispatch. So I think we have to balance what our goals are.

Remember, this is not about throwing out what works. This is about building on it, which is what this country does when it restructures marketplaces.

Senator ALEXANDER. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Burns.

Senator BURNS. Thank you, Mr. Chairman.

I just got a couple of questions, and they are kind of along same lines as—oh, by the way, Mr. Chairman, I would like my statement to be made a part of the record.

The CHAIRMAN. It will be made a part of the record.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Mr. Chairman, I thank you for holding this hearing today. I appreciate your efforts to move the energy bill forward on schedule. It is important that we let the committee process work, and that we all have a chance to work out a bill in this room. Starting next week you have set up an ambitious mark up schedule, and I commit to working with you to produce an energy bill this Congress.

Electricity is never an easy subject, so this hearing is especially important. First of all, Mr. Chairman, I would like to say that the draft language your staff has distributed is a step in the right direction, since it focuses on a regionally based rather than a top-down approach.

I do believe there are steps we can take to improve reliability and to improve confidence in the electricity markets without putting consumers at risk. Some people believe that responsibility lies with FERC, but I do not necessarily agree.

SMD is a perfect example. The justification behind the Standard Market Design proposal is that we are in a desperate situation, and that FERC needs authority over every sector of electric markets to save the industry from itself.

The "We are the government and we are here to help" philosophy does not sit well with me.

I don't have great faith that FERC will wield its authority any more carefully with SMD than it has with the RTO's it ordered to be created just a few years back. In the Northwest, we have been trying to form RTO West at the order of FERC. This has been a long and painful process, not to mention an expensive one. The filing utilities, the State commissions, the cooperatives and BPA all spent thousands of hours, and literally millions of dollars negotiating the terms of the new RTO. They made real progress and then FERC swept in last year and announced SMD. Now this committee is advocating yet a different regional commission approach.

I would like someone to explain to me how this creates stability in the electricity markets. It doesn't look that way from where I'm standing. Whether or not you like the RTO approach, and plenty of Montanans did not like it, they are willing to see it through rather than change horses mid-stream.

I have been on this committee for a long time, and I have seen a lot of ideas come and go. One thing is for sure: every time Congress or the federal government acts to solve a problem in the electricity markets, we create a whole new one we didn't anticipate. I don't want to be part of a situation where the only job security we create is for lawyers.

Montanans were hit hard in the summer of 2000. Water was short, power was expensive, California energy prices hit record highs, and those high prices echoed throughout the West. We know more about the causes of that situation now then we did then, but it was by all accounts a failure. Is that why we are here? I would maintain that situation was created by a flawed State electricity policy in California at the time, and a failure by FERC to use its authority to fix the problem. A few people were asleep at the switch. FERC would like us to believe the California crisis was caused by a mechanical failure of the entire electric market—I prefer to think of the California situation as pilot error.

I bring up the California situation because I fear that good actors in the energy industry are being punished because of the actions of a few bad ones. Despite the horror stories, there are plenty of markets across this country that work pretty well. We shouldn't handcuff those that are doing a good job just to prop up the stock prices of the others.

As we move forward, let's focus on the facts, rather than the emotion of this situation. If we get caught up in trying to create the perfect competitive market, we will all be disappointed with the results. Any electricity policy we consider should have one goal: reliable delivery of affordable power to consumers and businesses.

Senator BURNS. As I look at this and not really being an expert on this particular subject, I have to look at it from the standpoint

of the cooperatives. The committee staff draft includes provisions that would subject rural electric distribution cooperatives to the jurisdiction of FERC. Mr. English noted that some of these operations employ as few as five people, and I personally have a problem with the idea that we are going to subject these small mom and pop rural electric distribution cooperatives to FERC oversight.

Do you believe that it is necessary to extend FERC jurisdiction over these small electric cooperatives in order to make the interconnected utility system work?

Mr. WOOD. No, sir. I am not sure. That was in the staff draft?

Senator BURNS. Mr. English testified to that.

Mr. WOOD. That it was in the FERC issue?

Senator BURNS. Yes.

Mr. WOOD. That issue they did raise with us and we clearly want to clear that up. They raised that back in November and I agree with that. We need to clarify that issue. That is not an issue we care at all about because distribution is local. Transmission is not and we need to keep focused on the transmission, not the distribution.

Senator BURNS. Do you agree with that, Mr. Massey?

Mr. MASSEY. I do, Senator. I have read their pleadings and I think they make very persuasive arguments.

Senator BURNS. Well, that sort of answers my second question then.

The CHAIRMAN. I believe Mr. English was speaking about being concerned about it but not saying it was covered someplace.

Senator BURNS. All right. I did not know about this. Well, that answers my second question. Those are the only two questions that I had other than the fact that I think the first thing I look for is stability and reliability as far as electricity is concerned. That is first.

And second, if we are subjected to some rules and regulations, especially in a State like Montana, that would be harmful to ratepayers higher than we have now, how do I explain that to my co-op members and of course, trying to solve a problem that basically we do not have. That is where I am kind of coming from on this. We shall monitor this as we move along.

But I think my main concern, though, is the cooperatives and whenever they fall under this jurisdiction. So you have answered that question and I appreciate that very much. And thank you for coming today. I appreciate your testimony. It is very interesting.

The CHAIRMAN. Thank you very much, Senator.

Senators Cantwell and Feinstein, did you want a second round, Senator Cantwell? Go ahead. Excuse me, Senator Craig, then Senator Cantwell. Go ahead, Larry.

Senator CRAIG. Well, thank you very much, Mr. Chairman.

Commissioner Massey, let me follow through with some questions in relation to California that always frustrate me. Obviously we are all frustrated by that. Senators from Washington are concerned and upset. Senators from Oregon, Senators from Idaho are upset and the reason is because our rates went up when California became so dysfunctional as power was pulled out of our system and the supply obviously was under high demand, and as a result of

that, we are still paying. And it was very disruptive to the economy of my State.

You said a few moments ago you were on the Commission when the FERC ruled in 1996-97 on the filings made to implement the California electric restructuring law. And I understand that you have now stated publicly just in the past year or so that the Commission's approval of the California plan was a mistake. Is that true?

Mr. MASSEY. You know, hindsight is 20/20, but I do think it was a mistake, Senator.

Senator CRAIG. That is the question or at least the line of questioning I want to pursue for the next moment about hindsight and also awareness of the time. I appreciate your acknowledgement. I think I agree that California's wounds were self-inflicted. They may have been signed by a Republican Governor. They were voted out by a Democrat legislature. So it is a bipartisan dysfunctionalism.

It is not to suggest that any one group had authority other than there were an awful lot of people, though, Commissioner Massey, that were out there in the marketplace with great knowledge saying it was a bad idea. We had people who came before this committee during the height of the California crisis who had been before this committee prior to it saying, wrong idea, California, do not go there. But they did.

And I guess my question is, was any attention brought to you as it related to the California plan before you signed off on it?

Mr. MASSEY. It was certainly well debated before the Commission. The argument that weighed heavily on the Commission I think was this is what a major region of the country wanted. They were first movers. This was a plan that they had devised with extensive proceedings, and the Commission essentially, in the interest of regional deference, approved it. It clearly was a well-intentioned plan, but a plan that relied almost exclusively on short-term contracts, which I think we certainly understand now was a huge mistake. So I do not blame the people of California. There is plenty of blame to go around for all of this.

Senator CRAIG. Did you have staff on the FERC provide you with arguments that would argue contrary to the plan?

Mr. MASSEY. Yes. There were members of our staff that were concerned about it. There were members of our staff that liked it very much. There was a debate about whether there ought to be a separate ISO and power exchange created. That was one of the big arguments. There was a debate on whether a short-term contract market would function well. There was a debate on whether there were sufficient consumer protections.

But I think the argument that persuaded the commission was that this was a market design that this major region of the Nation wanted, and the commission approved it. I think it was a unanimous vote.

Senator CRAIG. Did you find any merit in any of the comments filed by the intervenors raising concern about the California plan before you voted?

Mr. MASSEY. Yes, I did find merit to their concerns.

Senator CRAIG. My frustration here, Mr. Massey, is not with just you. It is with all of you before us today. You looked at a plan and

you signed off on it. It is probably going to go down in history as the greatest dysfunctional marketing plan in the history of this country for electrical energy. And now you are coming forth with a new idea and saying, buy this, Congress; buy this, consumer. We just got through signing off on something that did not work, so let us try this one.

And now you are out finding that there were those who could abuse and did abuse. Most did not but some did. We are going to hear from California and Washington on those who did as if they were the whole, and they were not the whole. There was a great disparity in supply also. But the plan was dysfunctional.

I guess my frustration is when do you know what is right, especially if you centralize that authority, as California did, and do so in a way that forced everybody to a short-term market, could not allow the flexibility that the market would have otherwise by a prudent investor demanded.

Is it true, Commissioner, that before the—for the past 6 years, there has been a constant chorus of concern raised by the FERC staff and the intervenors about the California market structure.

The CHAIRMAN. Before you answer that, let me just say, Senator, could you be here?

Senator CRAIG. Yes. My time is out. So let us do this and then we will move to the others.

The CHAIRMAN. Will you get another round and I will be right back?

Senator CRAIG [presiding]. Yes.

Mr. MASSEY. There has been a constant chorus of concern, and arguments on the other side that it would work. It worked generally well until May 2000, and then it went totally out of control. I appreciate and respect your outrage about that.

I simply say that we have learned from our mistakes I believe. I certainly have. I will never again vote for a market design that relies exclusively on short-term contracts. I will not vote for a market design that does not contain sufficient anti-manipulation provisions. I will not vote for a market design that can be easily gamed and manipulated, that does not have customer protections built in, and I will not vote for one that is not adequately monitored. And I do not think my colleagues will either.

All I can say is from this very, very painful, outrageous experience, we have learned a lot. That may not provide much comfort, but I think we have learned a lot and I think we need to ensure that this never again happens.

Senator CRAIG. Thank you.

Let me turn to Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman.

Mr. Wood, I am confused by apparently a statement you made yesterday that you did not believe that long-term contracts of Northwest utilities should be reformed because they did not meet the public interest test. Again referring to the chapter 5 that is very explicit, in your conclusions from staff, it says, if as we maintain in earlier chapters, spot power prices were distorted, these results imply that price distortion flowed through to forward power prices, particularly those for contracts of 1- to 2-year time delivery.

I think in your last statement you might have reaffirmed part of that.

My question is I asked you at a previous hearing whether in market-based rate contracts where FERC had never reviewed the contract for its just and unreasonable—in the first place, that the Federal Power Act standard should apply, not the public interest standard. And you said on the record, "In that case, you would have an unjust and unreasonable standard."

Do you stand by that testimony, Mr. Wood?

Mr. WOOD. I remember when you and I had that colloquy, ma'am, and I think the important issue that was not repeated just now was what the parties had actually negotiated for. I think that is where we have some different interpretations among the three of us. But if there is not a provision in there between the negotiating parties that indicates what standard ought to be applicable, then yes, I think the default would be a just and reasonable standard. Now, if the parties have provided otherwise, I think certainly that controls.

Senator CANTWELL. So a contract that did not say that it should be in the public interest, you should use the Federal Power Act of just and reasonable.

Mr. WOOD. A contract that did not have language that indicated how the parties agree changes to the contract ought to be handled should be handled as a just and reasonable type standard. Yes, I said that.

Senator CANTWELL. So what is the problem then moving forward? Why did not yesterday, given the conclusions of the report—your statement apparently was long-term contracts of Northwest utilities should be—you did not believe that they should be reformed because doing so would not meet the public interest test. What did yesterday's statement then mean?

Mr. WOOD. Yesterday—did we have any Northwest——

Senator CANTWELL. Those were your comments at yesterday's meeting——

Mr. WOOD. I do not think I limited that to a Northwestern contract. To a short-term contract, which there were a few yesterday before us. There were a few, but there were quite a few that were outside the 1- to 2-year window, and I take this evidence that the staff put out and it said basically this matters as to the shorter-term contracts, this linkage between the dysfunctional spot market and a long-term market. This matters on the 1- to 2-year contracts. There were a number of contracts before us yesterday that were quite a bit longer than that. So I did not take the recommendation here into consideration on those contracts. That was not the findings that we asked our staff to go do.

Does manipulation matter as to a short-term contract? Yes. In fact, we——

Senator CANTWELL. I do not understand why it would even matter. You have the Federal Power Act before you as a body who is supposed to be upholding it. It says use the unjust and unreasonable standard, and you are playing hijinks by trying to say that the Sierra/Mobil case that is a totally different case and different standard—now all of a sudden, you are going to apply the public

interest standard, a much higher legal standard, and say that these long-term contracts cannot meet that standard.

Mr. WOOD. Actually, that is not what I said yesterday and it is not what I have said today and not what I said last time. I think—and I think we are all a little different on this still—that if the parties agreed as to how their contract ought to be handled, that controls. If they are silent on that, then we use the just and reasonable standard.

Now, a number of these contracts did have how the parties think that these—as we found. We asked our judges to go in and find what do these contracts really mean, how should we interpret those. Did the parties agree that a higher standard ought to apply or that a lower standard ought to apply?

At the time we discussed that before, I did not know the correct answer to that. We sent that to a judge. The judges investigated the parties' intent when they formed the contract, and then we got a number of those back yesterday.

Senator CANTWELL. Mr. Massey, do you have a comment on this? Because I do not even know why we would have a Federal Energy Regulatory Commission and a Federal Power Act that said that your job and responsibility is to protect consumers against unjust and unreasonable rates if then in every contract that was negotiated, you could come up with some higher legal standard. Why would we even have FERC then if that was the case?

Mr. MASSEY. Senator, I agree that the default standard for the Commission ought to be the standards set out in the Federal Power Act, which I was just looking at. "All rates and charges made, demanded, or received by any public utility, all rules and regulations shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." I think we ought to stay firmly tethered to that.

There is case law indicating that under certain circumstances the public interest standard ought to apply, and that is what we are struggling with.

Senator CANTWELL. In that case, Mr. Massey, just to review, prior to the deregulation of market-based rates, when you were doing rate case approvals—and in this particular case, the Mobil/Sierra—Mobil/Sierra wanted to come back and charge higher rates. FERC had reviewed the contract to begin with and said it was just and reasonable. The court then came in and said, well, if the basic utility wants to charge a higher rate to consumers, they are going to have to show that it is in public interest because the FERC has already reviewed this as just and reasonable.

Then taking that decision by the court and trying to white wash all that has happened, the abuse to ratepayers, by now trying to have the public interest standard, saying that we in the Northwest have to meet the public interest standard or we are not going to get any relief from this market corruption is just absurd.

Mr. MASSEY. Senator, I think there is a good argument that the Mobil and Sierra standards do have their strongest applicability in a cost of service regime in which the contract has actually been approved by the Commission as just and reasonable. In that circumstance, it might make sense to change it, to say, well, we have to find that this contract——

Senator CANTWELL. That is not this circumstance.

Mr. MASSEY. True. It is not. I am trying to agree with you on this. I think you raise a very good argument, a strong argument, and I think we ought to take that into account.

Senator CANTWELL. Well, count me as one legislator who is not going to be fooled by this hijinks of a higher legal standard. I do not care if we go all the way to the D.C. or the Supreme Court on this. We passed a law in this country to protect consumers. It was called the Federal Power Act. It set out your specific responsibilities. It said that those responsibilities were to determine whether rates were unjust and unreasonable. You, Mr. Wood, have agreed in testimony before this committee on two occasions that you believe that that is the standard. Please apply it.

My time has expired, Mr. Chairman.

Senator CANTWELL. It has?

Let me turn to Senator Feinstein.

Senator FEINSTEIN. Thank you very much.

Mr. Chairman, I must say I agree with you about the fact that the 1996 California deregulation law was deeply flawed. However, that law did not provide for "get shorty" or "death star" or "ricochet" or "megawatt laundering" or "fat boy" or any of these schemes, schemes that were fraudulently devised by traders to game the marketplace. In the evidence put forward by California, there are new names: "curious and George," "red and green," "hungry and hippo," "James and Dean," "Chinook and the Atlantic." All these games were called free money. Free money.

A Mirant trader summed up the scheme: "I mean, it's just kind of loop to looping, but it's making money." For shame.

The evidence made public yesterday also shows that, according to the California parties, the largest energy suppliers in California shared non-public information through a third party company called Industrial Information Resources. Traders called this company "The Mole." This company detailed non-public information on daily plant outages, essentially giving energy companies insider information on when an unplanned outage could transform an energy shortage in California into a stage 3 energy emergency, or a blackout.

My question is, why did the Commission not immediately refer this to the Attorney General and ask them to look at possible antitrust violations?

Mr. WOOD. We addressed that particular claim in our refund order that we did put out yesterday, Senator. It turns out that that information was provided by the independent system operator to a public data clearinghouse which made that data available. For example, the data of the outages across the entire West, when they are scheduled to be back. That is actually published in trade publications that people can subscribe to. The Commission does that as well.

We will certainly follow up on that, but the initial take was that information was being provided by the independent system operator not by the individual utilities. So there is not the collusion issue there.

Senator FEINSTEIN. I am not really concerned with who provided the data. Is there such a publication called "The Mole," which is

an insiders' publication, which alerts people when they can take advantage of certain market conditions? Yes or no. Either that publication exists——

Mr. WOOD. I do not know the answer to that, Senator.

Senator FEINSTEIN. You do not?

Mr. WOOD. I do not know that. What we looked into was the allegation that the—what was the company, Nora?

Ms. BROWNELL. I cannot remember the name of it.

Mr. WOOD. Industrial Information.

Ms. BROWNELL. The company that was referred to—and this is preliminary research because this information all just came in. I actually went to the Internet. It looks like a fairly major data provider that provides information in a number of industries, including the gas industry, the electric industry, about things like factory outages, generation outages. I think it does need further investigation, Senator.

I could not find any suggestion of something called "The Mole." It looked like kind of a casual reference. There may be more to it than that, but I can actually get you the Internet site.

Senator FEINSTEIN. All right.

Let me ask another question. According to the California parties, the evidence made public yesterday suggests that energy companies may have intentionally destroyed documents to cover up fraud in the Western energy market. An ex-Mirant employee disclosed that he was instructed to delete certain files relating to these energy markets from hard drives, and key executives were instructed to turn in their laptops so Mirant could clear their hard drives.

Could you tell me if FERC has referred this matter to the Justice Department?

Mr. WOOD. Not at this time. The reply evidence came in last week, and that is this host of issues that we are actually working on now and expect to move forward on in April. If it is appropriate for criminal issues, yes, ma'am, we would certainly, as I indicated yesterday to a reporter's question, refer those to the Department of Justice.

Senator FEINSTEIN. Does it, Mr. Wood, make sense to establish the same penalties and refund authority under section S of the Natural Gas Act to deter fraud and manipulation in the natural gas sector since FERC found yesterday that markets for natural gas and electricity are inextricably linked?

Mr. WOOD. Yes, ma'am, and for that reason I endorsed that approach in today's testimony even though it was supposed to be focused on electricity.

Senator FEINSTEIN. Just two quick questions, if I may, Mr. Chairman, on the proposed electricity title. These would be new regional regulators encompassing several contiguous States.

My question is, will the creation of these regional energy service commissions further balkanize our energy markets? Can you comment on the difficulty of creating and organizing these new regional commissions?

Mr. WOOD. I think certainly the size would matter. If you had a large one that covered perhaps the whole West as, for example, our current market mitigation plan covers the entire West, if there was a regulatory body that was that big, I could see some good

issues there. I think the restriction of being at just 5 percent would create a balkanization. I do think it has just got to be sufficiently broad to cover the necessary area. And when you need 13 States to agree on that, I do think it is, as a practical matter, going to be difficult to get there. There is balkanization potential certainly. I would not discount that.

Senator FEINSTEIN. See, I am not so sure that this is not a good idea. One of the things I have learned back here is that what happens inside the Beltway is very different from how people think in the Western part of the United States. There is a big tendency here to play inside baseball and not to really understand the rest of the country. The east coast is very different from the west coast. It may well be that a regional commission would be much more responsive to Western needs because—I think you all know this—it has been pulling teeth to get FERC to do its job.

He is nodding.

Mr. MASSEY. Senator, I respect your frustration that you have stated very eloquently. My own view is that the best solution here is for FERC to do its job well as an overseer of wholesale markets in interstate transmission, do our job in a way that westerners broadly respect and trust.

Senator FEINSTEIN. One last question, if I might.

As I understand it, the regional service commissions would be created when States come together to forge a compact and draw up a charter. If we did proceed along those lines, do you believe that the Department of Energy should draw up the minimum standards that a compact has to meet before it is approved?

Mr. WOOD. I think that would be appropriate. I do think just a compact without maybe a little bit of structure there might be difficult. So I think that is appropriate. The Commission could do that as well.

Senator FEINSTEIN. Thank you very much.

Mr. Chairman, I would like to submit my letter to the Attorney General asking for an investigation for the record.

Senator CRAIG. Without objection.

[The letter of Senator Feinstein follows:]

UNITED STATES SENATE,
Washington, DC, March 26, 2003.

Hon. JOHN ASHCROFT,
Attorney General of the United States, Department of Justice, Washington, DC.

DEAR ATTORNEY GENERAL ASHCROFT: Now that the Federal Energy Regulatory Commission (FERC) has lifted its "Protective Order" and has allowed the public to review evidence of market manipulation in the Western Energy Market, I am writing to ask the Department of Justice to fully investigate and prosecute possible violations of anti-trust and fraud statutes by energy companies.

The State of California has filed thousands of pages of new evidence at FERC that further demonstrate how these incidents of fraud and manipulation were not isolated events attributable to a few rogue energy traders. Instead, the documents provide substantial evidence that energy companies engaged in well-established and coordinated strategies to deliberately withhold electric power and natural gas at critical moments during the Western Energy Crisis in a concerted effort to boost company profits.

The filing at FERC shows that there was a coordinated attempt by energy companies to manipulate the Western market and to drive prices up by engaging in the following schemes:

1. Withholding of Power—driving up prices by creating false shortages.

2. Bidding to Exercise Market Power—suppliers bid higher after the California ISO declared emergencies, knowing the State would need power and be willing to pay any price to get it.

3. Scheduling, of Bogus Load—suppliers submitted false load schedules to increase prices.

4. Export-Import Games—suppliers exported power out of California and imported it back into the State in an attempt to sell power at inflated prices.

5. Congestion Games—suppliers created false congestion and were then paid for relieving congestion without moving any power.

6. Double-Selling—suppliers sold reserves, but then failed to keep those reserves available for the ISO.

7. Selling of Non-Existent Ancillary Services—suppliers sold resources that were either already committed to other sales or incapable of being provided.

8. Sharing of Non-Public Generation Outage Information—the largest suppliers in California shared information from a company called Industrial Information Resources that provided sellers detailed, non-public information on daily plant outages.

9. Collusion Among Sellers—sellers were jointly implementing or facilitating Enron-type trading strategies.

I strongly believe the Department of Justice must investigate possible anti-trust violations by energy companies as detailed by the California parties in their brief. Allowing competitors to share non-public information on plant outages through Industrial Information Resources that traders called "the mole" seems to be an anti-trust violation on its face. As the California parties state, "even in the absence of a price fixing agreement, the exchange of price or output information can itself violate the Sherman Act as an unreasonable restraint of trade, if it causes anticompetitive effects." How can it be lawful for traders to obtain information from their competitors through an intermediary like Industrial Information Resources?

Furthermore, I urge that your department vigorously investigate the new evidence of intentional document destruction cited in the filing at FERC. During the 100-day discovery process, an ex-Mirant employee disclosed that he was instructed to delete certain files relating to the California markets from hard drives and that key Mirant executives were instructed to turn in their laptops so that Mirant could clear their hard drives. Similarly, a City of Glendale employee told an ex-Glendale employee that he could destroy one of the documents that contained information about Enron's gaming strategies.

I would like to ask the Department of Justice to use its investigative and subpoena powers to conduct a thorough review of the market abuse by energy generators, suppliers, and traders in the Western Energy Market. The mountain of evidence submitted to FERC requires a complete and thorough investigation to ensure families and businesses see an end to fraud and manipulation in our energy markets.

Thank you for your consideration of this request.

Sincerely,

DIANNE FEINSTEIN.

Senator FEINSTEIN. Thank you and I thank you all. Thank you very much.

Senator CRAIG. Thank you very much, Senator Feinstein.

I have a couple of more questions here and the chairman should be returning shortly to conclude this.

Let me ask a question of all three of you. Senator Cantwell was discussing it some a few moments ago, and I wish she were still here.

Part of your work yesterday addressed the issue of contract sanctity, but also without any final resolution. In my opinion, unless a contract provides otherwise, it should be overturned only upon the application of the highest standard of review, the public interest standard. And I say that because of an awful lot of court action over the years about the sanctity of contracts. To treat them otherwise, I think undermines the very sanctity.

Do you agree or disagree with that statement, Ms. Brownell?

Ms. BROWNELL. Senator, I agree. I think it is critical to the functioning of the economy in this country.

Moreover, I would add that we need to look at the totality of circumstances in which each of the buyers was also a seller. Some of the complainants who are complaining about contracts were selling and they were selling into the marketplace, as I said, for $1,100 a megawatt hour. That is a non-jurisdictional entity. Two-thirds of the people in the marketplace perhaps are under our jurisdiction. So do we, whether it is J&R or public interest, abrogate contracts for some and not all, particularly those who were selling at the kind of elevated prices like that?

I think that one must, when we talk about the totality of the circumstances, which is what the public interest standard tells us to do, look at those facts of the marketplace, more importantly, look at the real impact on that marketplace. The premium that the West would pay if we abrogated contracts today would be for the next 50 or 100 years and would far exceed even perhaps that $1,100 gouging price.

Senator CRAIG. Mr. Chairman?

Mr. WOOD. I think under whichever standard you review, as we indicated when we sent these to hearing, whether it is the just and reasonable or public interest standard, it is a very high burden to overturn a contract entered into. I think I just would echo Nora's issue. As we talked yesterday, when those issues come before us, we do have to look at the totality of the circumstances, but I do think it is something that we have to really wander into very carefully, if at all, for the reasons she laid out.

Senator CRAIG. Mr. Massey.

Mr. MASSEY. Senator, in Order 888, which went to the D.C. Circuit and the Supreme Court, the Commission said—I just reread it before I came over here—that the standard that we should apply is, generally speaking, the just and reasonable standard unless the parties specify a higher standard. The court decisions I find to be really all over the lot on this question.

In the proceeding before us, I am very concerned about the impact of manipulation on the long-term contracts. I also want to respect the sanctity of contracts, but I want to ensure that they are negotiated in an environment free from manipulation and market power.

So I am struggling with this. It may be that at some point the just and reasonable standard and the public interest standard merge, and I am thinking about that concept. But I certainly respect your views on this issue.

I am inclined to think that the Commission can reform some of these agreements and probably should, applying either the just and reasonable standard or the public interest standard, because it seems very clear to me that many of these contracts were infected with the taint of market manipulation. That greatly concerns me.

Senator CRAIG. Thank you.

Commissioner Brownell, a couple more questions I would like to ask of you. In discussing regional differences, do you view the exporting of electrical power from a low cost region and the resulting increase in the cost of electrical power to the low cost region as a meritorious basis for opposition to SMDs?

Ms. BROWNELL. I believe if that were the outcome to consistent market rules, yes, I think that would be a very real reason, particularly if I were a State commission. We have talked at some length about how to preserve that low cost power. I wish we had had it in Pennsylvania, frankly, because we were among the highest in the country. So I certainly respect that as an economic opportunity for the State and the region as a whole. I think that there are many ways to protect that low cost power, including long-term contracts. We have talked today about native load and have been talking within the agency before the white paper how to ensure that that native load is protected. So if I thought that were the outcome, sir, I would not be a proponent of regional market designs that were consistent and transparent.

Senator CRAIG. The reason I asked that question of you is because I see that as the ultimate test and the fear that many of us have by what you may be attempting to do—and I say "may." I am willing to look at your final work product, obviously—is a nationalizing of the costs of generation and transmission. For those in Idaho who have worked mightily hard to keep energy costs down, blessed by resource, but also by I think reasonably wise decisions over an extended period of time, they are fearful of the idea that the FERC by design is going to do just that, nationalize the general cost of generation and transmission. The regional advantage is gone, obviously, by that. And it infers an indirect tax, if you will, levied by the FERC against those who are least-cost producers certainly by the outcome of design.

I think that is the ultimate test that those of us in the Pacific Northwest and those in the South, Southeast, and a few others are going to put before you. And if you do not make that test, you fail.

Ms. BROWNELL. Senator, I have said publicly, as this oversight committee has raised these issues, that you are doing your job to hold me to do my job, which is to do what is in the best interest of the customers without compromising the local advantages. I would be the first to say that that economic advantage and the behavior and the leadership that the Idaho commission has shown to give you and keep those low cost opportunities ought to be preserved.

We have also talked a lot about cost causers, and to the extent that we allocate costs appropriately, we should not in any way jeopardize those who have done their jobs. That is not the intent, nor do I think that is the outcome.

I respect, in fact, the job you are doing in kind of holding our feet to the fire in asking those questions, and if we cannot answer them, well, then you ought to say no.

Senator CRAIG. Well, I thank you very much. The chairman is back and I will give my time back to him. But I want to say in his presence because he has been very helpful and helped lead in this, you have our attention. We simply hope we have yours because if we do not, there is more to come. We will ultimately get it if we do not have it now.

Thank you all very much for being here today.

Mr. WOOD. Thank you, Senator Craig.

The CHAIRMAN [presiding]. Thank you very much, Senator. I do not know what I missed, but it looks like it was a lot.

[Laughter.]

Senator CRAIG. Not really.

The CHAIRMAN. The air is kind of stern.

Senator CRAIG. No.

The CHAIRMAN. In any event, I want to thank you again for being here.

It is a tough issue. Just because I am smiling does not mean I do not think so. I think it will be very hard to put something together, but I do not think that means we are going to default out. We are going to do something to make sure that, as you go through this, you do some things that are the way we, the Congress, collectively think you ought to do them. You will not have all the liberty and freedom you have now to act. Let us hope that when we do that, what we force you to come up with that way is better for the people than what you would come up with otherwise.

That is a bit presumptuous, but that is what we are for. After all, you do work for us in a sense, not the reverse. You work for the people, but you do not have any power if we do not give it to you.

So having said that, just kind of a technical question. It had something to do with bundling and non-bundling. Where is the question?

There are some who advocate, Mr. Chairman, legislating a jurisdictional delineation between bundled and unbundled transmission. What are the advantages and disadvantages? Quickly.

Mr. WOOD. I think some clarification of that might actually lift a big cloud over this whole debate, and on that and those other four issues I mentioned to you at the beginning, Senator Domenici. Certainly I think if the Congress, which has this fortuitous opportunity with the bill open to nail down the parameters—I think that will really elevate the debate among all the market participants to the solutions as opposed to the jockeying and kind of this stagnation that we have been in for the last 6 months. So we would be glad to provide any input to the committee or to you on that issue.

The CHAIRMAN. I thank you very much. I was going to say there is not any question in my mind that the California situation cries out clearly for fixing. Certainly statutes were drawn wrong. Legislation was impropietious, and people did things wrong. I am hopeful that, whether you were there when they did it and you were not, you will use every bit of your discretion to see that it is corrected to the extent that what is past gets fixed, those who are responsible, if responsible, get so found, and justice is done to the extent that you all are involved. I assume that is what California wants and I join with that using my own way of describing it.

Thank you very much. We will see you soon. As we draft things, we will be in touch with you and your staff.

We stand adjourned.

[Whereupon, at 4:43 p.m., the hearing was adjourned]

APPENDIXES

APPENDIX I

Responses to Additional Questions

PUBLIC UTILITY LAW PROJECT,
Albany, NY, April 14, 2003.

Hon. PETE V. DOMENICI,
Chairman, Senate Energy and Natural Resources Committee, Dirksen Senate Office Building, Washington, DC.

Re: Follow-up Questions to Witnesses at March 27, 2003 FERC Oversight Hearings

DEAR SENATOR DOMENICI: I again wish to thank you and the Committee for providing the opportunity to testify for the National Association of State Utility Consumer Advocates (NASUCA) at the March 27, 2003 oversight hearings regarding proposals to modify the Federal Power Act. Because the primary purpose of the Federal Power Act is to protect consumers, NASUCA particularly welcomed this opportunity to share its views. On matters where NASUCA had not taken positions, I also put forward my views for the Public Utility Law Project (PULP).

Your letter dated April 3, 2003 invites witnesses to respond to follow-up questions from the Committee. As NASUCA has not taken a position on these issues, I will offer my comments for PULP.

Very truly yours,

GERALD A. NORLANDER, ESQ.,
Chairman, NASUCA.

RESPONSES TO QUESTIONS FROM SENATOR CAMPBELL

Question. It seems that, in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electricity sector?

Answer. NASUCA has not taken a position regarding the FERC SMD, and so I will state below my opinion.

States that did not "unbundle" the generation and transmission aspects of electric service presently fix full service rates for retail electric consumers. These full service "bundled" rates necessarily include a transmission component. The proposed SMD regulations would require control of all transmission assets to be turned over to Regional Transmission Organizations (RTOs) or "Independent Transmission Providers" who would operate private spot markets to set rates for wholesale energy and for transmission, including the transmission component of bundled rates.

NASUCA members from "bundled" states filed comments questioning the FERC's power to adopt the proposed SMD rules, raising concerns that rates for "native load" consumers will be increased or destabilized if the transmission portion of the rates, and short term energy transactions, is to be set in new private spot markets operating under FERC rules.

NASUCA members from some "unbundled" states whose utilities joined voluntary RTOs filed comments on the proposed SMD regulations, also raising concerns. These concerns include, for example, market monitoring and resource adequacy planning by RTOs.

Under the SMD, rates might be considered to be "deregulated" because they would no longer be filed subject to FERC review for reasonableness, and instead will be set in the private markets designed and approved by the agency. Oversight of these newly proposed markets, however, would require additional market monitors

at those markets and additional oversight by the FERC. Thus, what is being proposed by the FERC is not "deregulation," but a system which relies on market results to set rates.

Question. According to a private study conducted for a state task force, if Colorado's electricity market was opened to competition, electricity prices in Colorado would go up to more closely match rates in other Western states. Currently, Colorado ranks in the top quarter of least expensive states for electricity prices in the nation. Denver is one of the top five least expensive cities in the nation when it comes to electricity prices. However, SMD does not guarantee rate reductions for anybody. In fact, by changing regional rules to match those in the northeast, it might actually raise rates for some areas. How does SMD account for regional differences in electricity markets? How will this specifically affect western state utilities and their customers?

Answer. NASUCA has not taken a position regarding whether the FERC SMD adequately addresses state and regional concerns. A "white paper" to be issued by the FERC may contain revised interpretations of the SMD proposal, or may point the way to revision of specific SMD rules in response to state concerns.

Question. Many statements have been made that California's recent electricity crisis was a regional crisis. I know that when California needed or wanted water they got water from Colorado, now when they need power are they going to take Colorado power? What impact will California's current problems likely have on Colorado and the other Rocky Mountain states?

Answer. NASUCA has not taken a position on this issue. Events such as power plant outages occurring in one area of a synchronous regional electric power grid will affect other areas because, under the laws of physics, generation and load must be instantaneously maintained in balance. For this reason NASUCA has supported legislative proposals to reinforce the voluntary grid reliability standards established by NERC.

It is my understanding that while the causes of the California price and reliability crisis in 2000 and 2001 remain under investigation, there is an emerging consensus that it was due in significant part to manipulation or gaming of short-term natural gas and electricity markets.

RESPONSE TO QUESTION FROM SENATOR GRAHAM

Question. Economic dispatch has been discussed as an approach to facilitate the procurement of least cost power in the wholesale marketplace. What is your opinion of this concept?

Answer. NASUCA has not taken a position on this question.

Economic dispatch—using the most efficient resource to meet the demand for electricity—advances the important societal goal of energy efficiency. For many years economic dispatch, tempered by environmental concerns, has been an operating principle of cooperative power pools.

In some areas of the country, power plant output is now directed by RTOs. These entities dispatch power from electricity generating plants, based on physical conditions, contract commitments and a hierarchy of price "bids" by sellers established in a uniform price spot market auction. This auction system dispenses with filed rates based on costs. A theoretical assumption is that if there is no market power, bidders will offer the electricity produced at their plants at their marginal cost, to avoid running at a loss and to reap the margin when their costs are less than those of another seller who clears the market with a higher price paid to all.

Mathematical game theory analysis, economics laboratory simulation of spot market bidding behavior, and actual experience in the ISO and RTO spot markets all indicate there may be significant deviation from the assumption of competitive behavior and marginal cost bidding.

NASUCA has recommended that in those areas with RTOs there should be strong measures against the exercise of market power, vigilant market monitoring, and filing of cost data, so that sellers' spot market bids may be compared with their operating costs. In this way, the efficacy of the spot market auction mechanism in achieving economic dispatch could be more readily assessed.[1]

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[1] "The MMU [RTO Market Monitoring Unit] must have the authority to compel collection from all market participants, including those with bilateral contracts all relevant cost data, including, but not limited to, short-run cost, fuel cost, unit heat rate, start-up cost, environmental constraints, emissions allowances, evaluate the causes for outages, analyze cost of capital additions and capacity addition and upgrades, and fixed operation and maintenance cost. . . . The MMU should have the authority to immediately report to FERC and recommend refunds where prices depart substantially from marginal cost when in the judgment of the MMU the price is the re-

RESPONSES TO QUESTIONS PREPARED BY NEIL NARAINE

Question. Do you believe that Participant Funding combined with Tradable Transmission Right at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by FERC would increase the capacity of the transmission system? Clearly state your positions for or against this.

Answer. NASUCA has taken no position on this issue.

I believe the principle of participant funding is presently used to allocate the costs of transmission system improvements where investments are made primarily for economic reasons rather than for grid reliability. Potential investors in transmission facilities desiring assurance of cost recovery may prefer to connect generating plants with load serving entities with dedicated lines under long term contracts with stable rates.

The existing transmission system was built, and new capacity can been increased, in areas without spot markets for tradable transmission rights. Short term spot market price signals for use of congested portions of the existing transmission system would not necessarily lead to construction of new transmission facilities. Raising the costs of using certain congested transmission links could lead to increased construction of generation facilities (or reduced demand by interrupting large users or their self-generation) on the deficit side of a congested link, rather than construction of new transmission system improvements. The possibility of generation solutions with relatively short investment payback periods could deter investment in transmission solutions that may have lengthier siting proceedings and longer investment payback periods.

Question. There seems to be a widening rift between the States and FERC on the FERC's plans for energy markets. If we continue this path, we could be headed for years of litigation and no progress. What can be done now to avoid this continuing rift?

Answer. NASUCA has not taken a position on this issue.

I believe some states lack confidence that the SMD spot market models proposed by the FERC will work as intended to increase reliability and lower costs. In the absence of national consensus for changes in the Federal Power Act, the FERC will need to take incremental steps with less downside risk to consumers.

Existing provisions of the Federal Power Act allow bilateral contracts for wholesale electricity and transmission, usually for long term service. Refinement of standard bilateral contract products and terms, and rapid electronic posting by the FERC of approved contract rates, may foster more transparent, supervised, bilateral markets at the FERC.

In the spot markets, the FERC might ease concerns about market manipulation and advance its apparent policy of marginal cost pricing for short term wholesale energy sales by requiring generating utilities to file marginal cost rates and to demand no more than their filed rates in the spot markets.

Thank you again for this opportunity to respond to Committee questions. Please feel free to contact NASUCA for its views on this important subject.

RESPONSES OF JOHN ANDERSON, EXECUTIVE DIRECTOR OF THE ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON) TO QUESTIONS FROM THE COMMITTEE

Question 1. Do you believe that Participant Funding combined with Tradable Transmission Right[s] at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by FERC, would increase the capacity of the transmission system?

Answer. We are opposed to statutorily directing FERC to utilize Participant Funding as the standard for allocating costs associated with new transmission. We do not believe such legislation is necessary since FERC already has the authority to implement Participant Funding. In fact FERC, in its proposed Standard Market Design, stated that participant funding would be a standard (though not an inviolable standard) for funding new transmission. Decisions regarding funding of new transmission are by their nature regulatory, not legislative, in nature.

To repeat my prepared statement, as a practical matter, it is nearly impossible to determine who will benefit from transmission upgrades, and it is inevitable that such beneficiaries will change over time. In addition, since nearly all stakeholders agree that new transmission is necessary in some areas, I question why Congress would adopt a plan such as Participant Funding that will likely retard the growth

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sult of market failure or market manipulation." *Promoting Market Monitoring Functions Within Regional Transmission Organizations (RTOs) Whenever Such Regional Entities Are Created, NASUCA Resolution*, June 19, 2002.

of new transmission. All consumer groups and all non-utility generators—the groups most likely to suffer if new transmission is not built-believe that mandating Participant Funding will hinder, rather than help, the construction of new transmission.

We do not see how tradable transmission rights in anyway change this position (the issue of who should hold such rights, e.g., generators or end users, and how they should be awarded, is a debate for another day). In fact if new transmission is built and congestion is relieved, such rights would be worth less. And it is hard to see how such rights could be traded, since generators would need to have such rights over specific parts of the transmission grid (presumably starting with their own point of generation). If anything, Tradable Transmission Rights make the issue of Participant Funding more difficult to implement and add nothing that this positive.

It should be noted that too often incumbent utilities have called for Participant Funding as a means of protecting their own generation when challenged by generation from non-utility generators. Without new transmission, generation from other sources has often had a difficult time getting on to a constrained grid. Mandatory Participant Funding would exacerbate that situation.

As an aside, Participant Funding requires that the user who "causes" the need for new transmission to pay for the new transmission. A valid follow-up question is whether the person who pays for the new transmission then owns it.

Question 2. There seems to be a widening rift between the States and FERC on the FERC's plans for energy markets. If we continue this path, we could be headed for years of litigation and no progress. What can be done now to avoid this continuing rift?

Answer. Years ago someone more clever than I said that the greatest problem in dealing with electricity restructuring was not the issue of "stranded costs" but the issue of "stranded regulators." It is clear that the wholesale electricity market is interstate. The role that some state regulators had (wrongly) assumed was theirs should in fact be subsumed by federal regulators. Simply put, the transmission grid is interstate, it needs federal regulation as guaranteed by the "Commerce Clause" of the Constitution, and state arguments that such interstate commerce should still be subject to state regulation are both wrong and anti-competition.

We believe Congress can—and should—pass legislation amending the Federal Power Act clearly stating that the interstate transmission grid is subject solely to federal regulation. Such a statement would end the ambiguity and would make any litigation on the part of the states very difficult to pursue.

State regulatory commissions would of course retain jurisdiction over all retail issues, including intrastate lines (primarily utility distribution lines) as well as siting of generation and transmission pursuant to state law.

For obvious reasons, jurisdictional issues within ERCOT are unique and my statement does not necessarily apply.

April 17, 2003.

Hon. PETE V. DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Thank you for forwarding to me questions for the record of your Committee's March 27, 2003 hearing on various electricity proposals.

Enclosed are my responses. If I can be of further assistance, please do not hesitate to let me know.

Best Regards,

PAT WOOD, III,
Chairman, FERC.

RESPONSES OF PAT WOOD TO QUESTIONS FROM SENATOR CAMPBELL

Question 1. There seems to be a deep dilemma we are dealing with here: while we are trying to bring open competition to certain electricity markets, we are actively engaged in federal design of these same markets. It seems that, in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electricity sector?

Answer. The Commission's goal in the SMD proposed rule is to lay out a regulatory framework that allows the wholesale power industry to transition from its heavily-regulated past to seamless, regional markets for wholesale electricity, so that sellers can transact throughout broad regions and customers can receive the benefits of less expensive and more reliable electricity. The Commission is proposing

to establish common rules of the road for interstate transmission so as to have a stable and workable platform for competition in electric power. I believe that dependable, affordable, competitive wholesale energy markets require three key elements: adequate infrastructure, balanced market rules and vigilant oversight. The Commission is proposing a comprehensive plan that establishes these elements as well as includes regulatory backstop mechanisms to protect customers until truly competitive wholesale markets are in place. This would not greatly increase the size or the power of the Commission. Further, the Commission does not want to be, and will not be, the centralized electricity planning agent for the nation; however, markets are becoming more regional and the Commission is proposing methods for states and the Commission to collaborate on regulating regional interstate commerce in electric power. The Commission is encouraging the establishment of independent regional entities such as RTOs and ISOs that will be operating the transmission grid and administering the voluntary spot markets. This platform leaves plenty of room for regional variation with regard to a variety of functions, including transmission planning, resource adequacy, mitigation techniques and RTO governance.

Question 2. Can you provide specific examples of any public power system denying access to surplus transmission capacity to a requestor? Please list the systems that have made such allegations and the systems against which allegations have been made.

Answer. Because transmission owned by public power is not subject to the Commission's jurisdiction under sections 205 and 206 of the Federal Power Act, if a public power system with transmission did deny access to its surplus capacity, the party denied may simply not report this to the Commission. Consequently, the Commission is not in a position to have a comprehensive list of such denials.

However, under section 211 of the Federal Power Act, which Congress added in 1992, someone denied access by any transmission owner may seek an order from the Commission to obtain access. The process is considered cumbersome and is rarely used; for example, if one wants access to a temporary power supply for the next few hours, days or weeks, there is little incentive to begin a process that takes up to a year or more to obtain access. Nevertheless, there have been a number of section 211 requests brought to us for transmission access on public power systems. These are:

- Docket No. TX94-3, Minnesota Municipal Power Agency v. Southern Minnesota Municipal Power Agency
- Docket No. TX94-7, AES Power, Inc. (request for transmission service from Tennessee Valley Authority)
- Docket No. TX96-2, City of College Station, Texas (request for transmission service from City of Bryan, Texas and Texas Municipal Power Agency)
- Docket No. TX96-6, Montana Power Company (request for transmission service from Basin Electric Power Cooperative)
- Docket No. TX97-6, Idaho Power Company (request for transmission service from Bonneville Power Administration)
- Docket No. TX97-7, Missouri Basin Municipal Power Agency (request for transmission service from Western Area Power Administration)
- Docket No. TX97-8, PECO Energy Company (request for transmission service from Oglethorpe Power Corporation and Georgia Transmission Corporation)
- Docket No. TX97-9, Cinergy Services, Inc. (request for transmission service from Tennessee Valley Authority)
- Docket No. TX98-2, Public Service Company of Colorado (request for transmission service from Missouri Basin Power Project, including its Project Manager, Basin Electric Power Cooperative; Tri-State Generation & Transmission Association, Inc.; Rocky Mountain Generation Cooperative; and Western Area Power Administration)
- Docket No. TX02-1, Pinnacle West Capital Corporation (request for transmission service from Electrical District No. Three of the County of Pinal and the State of Arizona)
- Docket No. TX03-1, Mirant Las Vegas et al. (request for an order directing Los Angeles Department of Water and Power, Nevada Power Company, Salt River Project Agricultural Improvement and Power District, and the United States Department of the Interior, Bureau of Reclamation to establish an interconnection between their transmission systems and the Applicants)

Question 3. You participated in a symposium back in November 2002 sponsored by the Progress & Freedom Foundation. In that symposium, you talked about capturing the victories of competition. I am concerned that your SMD rule is going to capture a lot more than you intended.

You stated, "there are parts of the country and parts of individual small area that are not really competitive because of natural geographic reasons or historic concentration of ownership. And we've got to acknowledge that."

How does the SMD, in your words, "acknowledge that?"

Answer. By having special market power mitigation provisions for what we call "load pockets," the Commission's proposal acknowledges that some areas of the country are not competitive yet. This is not surprising, considering power competition was introduced in 1992 by the Energy Policy Act reforms. "Load pockets" are areas where ownership of generation is concentrated in the hands of a few sellers and where insufficient transmission or geographic features—for example, being on a peninsula—limit the ability to import power from outside the area. The market power mitigation part of our proposal calls for limitations on competitive bidding in loads pockets until the market power problem is resolved and competition can serve as an effective discipline on price.

Question 4. How does the SMD address Colorado's differences and ensure that ratepayers are not going to be detrimentally affected?

Answer. Colorado utilities are different from utilities in other states mainly by being part of larger organizations that traverse the Eastern and Western Interconnections in the U.S. Past Commission actions, as well as our proposed rule, would permit and encourage different treatment for entities in the East and the West. By accommodating Colorado's differences in this way, our proposal should benefit Colorado customers by providing for well functioning markets tailored to the needs of each region.

The electric utilities of Colorado are predominantly associated with the Western Interconnection, where the Commission has already approved considerably more latitude for regional differences than in the SMD rule itself. By way of background, Public Service Company of Colorado (PSCo) and Southwestern Public Service Company are now public utility operating subsidiaries of Xcel Energy, which also includes NSP Wisconsin, NSP Minnesota, Cheyenne Light Fuel & Power and Black Mountain Gas Company. These utilities, together with other investor-owned utilities and public power participants, are part of TRANSLink, the independent transmission company operating under Midwest ISO. In the order approving the TRANSLink proposal, the Commission noted that facilities that TRANSLink would operate are located in the Eastern Interconnection and would be part of the Midwest ISO; however, the transmission facilities of PSCo are located in the Western Interconnection. As a result, the Commission authorized the requested transfer of operational control of PSCo's transmission assets to TRANSLink with the understanding that the PSCo facilities will participate in the western RTO formation process through TRANSLink.

Three RTOs are forming in the West: RTO-West in the Pacific Northwest, the California ISO, and WestConnect in the Southwest. To date PSCo has not joined one of these, in part because it must connect to its western neighbors through the Western Area Power Administration (WAPA), which has not yet firmly committed to join. However, WAPA and PSCo are actively participating in WestConnect discussions of RTO features and of the costs and benefits of establishing WestConnect.

For both the Midwest ISO and for the Western RTOs, the Commission has approved many aspects of their RTO designs and committed that specific approved design features that suit the unique characteristics of each region would not be made subject to conformance with the corresponding features of the SMD final rule. For the West in particular, we have authorized a pre-existing western group called the Seams Steering Group—Western Interconnection, known as SSG-WI, to work out the features of a western market design that would meet the goals of the SMD rulemaking. We committed that a satisfactory common western market design developed by westerners through this process would not be subject to the detailed market design provisions of the SMD final rule.

The considerable latitude for regional variation, especially in the West, allows western stakeholders and state government representatives to develop market rules that suit the different characteristics of each region so that electric power customers in every region can buy electric power at the lowest possible price.

Question 5. Your SMD assumes that competition benefits everyone. Yet, some states have opted against opening up to competition. How can SMD respect states' traditional authority while compelling them to do something they have been unwilling to do all along?

Answer. The proposed rule only applies to matters affecting interstate transmission and wholesale, not retail, power markets. Some states have opened the retail service franchise to competition; others have chosen not to. That is a state choice, and nothing in the SMD proposal at all undermines the states' choices. Just as with wholesale natural gas competition, benefits under SMD can be achieved by

customers in states with or without retail access. Utilities would be able to buy electric power more readily to lower costs, or to sell excess power for a profit and thus reduce rates for their own customers. The SMD proposal accommodates state decisions to allow or not allow retail competition.

RESPONSES TO QUESTIONS FROM SENATOR CRAIG

Question 1. In your July 24th testimony, you called the gas pipeline system an example of a success story. Did the gas pipeline system have ISOs or RTOs? Did the gas pipelines have Standard Market Design? Rather, did not the gas pipeline system have better rates of return than you give electric utilities? Would you not say that pricing reform would make electric transmission a success story?

Answer. Because of the different operational and structural characteristics of gas pipelines and electrical systems, RTOs and ISOs are used for electrical systems, but not for gas pipelines. The different operational characteristics include the much greater ability of pipelines to physically control deliveries to the system and thus the lack of loop flow considerations that affect electric utilities. Finally, the gas industry has far less vertical integration than the electric industry. RTOs and ISOs were designed, in part, to address the potential for discrimination against other sellers that results from the extensive vertical integration in the electric utility industry.

Order No. 636, the restructuring rule that applied to gas pipelines, shares the same objectives as the Commission's proposal for Standard Market Design. Both were intended to eliminate remaining opportunities for discrimination against competing sellers and to ensure a platform of changes necessary for well-functioning wholesale markets.

Since I have been Chairman, the Commission has set returns for four public utilities, and one natural gas company: Consumers Energy Company, 11.77% equity return; Midwest Independent System Operator, 12.88% equity return; Northern Indiana Public Service Company, 10.39% equity return; International Transmission Company, 13.88% equity return; and Enbridge Pipeline, 11.83% equity return.

Thus, the average return on equity for electric utilities has been slightly higher (12.23% versus 11.83%) than for the one gas pipeline which has come before us since my tenure as Chairman.

Question 2. On January 29, 2002, you testified that the, "Enron collapse had little perceptible impact on the nation's commodity markets (electric and gas) which are FERC's primary regulatory responsibility." Would you agree then that the FERC does not need any new authority over the commodity markets?

Answer. Generally, yes. As I explained in my March 27 testimony before the Committee, however, I support some legislative proposals that would modify the Commission's existing authority, on issues such as civil and criminal penalties and refunds. In addition, some legislative proposals would require the Commission to issue rules establishing an information system, accessible by the public, specifying the availability and price of wholesale power and transmission services. I support such proposals because more transparency is needed in the energy markets and customers should have access to the broadest range of useful market information. I also support a similar approach under the Natural Gas Act.

Question 3. On the March 26, 2001 broadcast of Frontline you said:

"I think the current regulated market reacts very well to political pressure by large industrial customers who put pressure on the utility and the regulator under the regulated environment to get sweetheart deals, such as low rates and subsidized rates and interruptibility rates that are low rates in disguise. So my general response has been that the big guy is at the trough. Let the little pigs get it, too. That's why I have been a strong advocate for getting out of the regulated environment so I can go out and get a taste of some of this low-cost power just like the big guys do."

Would you say with Standard Market Design you are "getting out" of the regulated environment, when your SMD has 340 pages of preamble, 10 pages of regulatory text, 185 pages of the interim and Standard Market Design tariffs and a proposed rule that takes over State rules on reserve margins, forces divestiture of control to an independent transmission provider (ITP) and describes the governance of an entity in such detail that you prescribe the number of directors and even ask whether the ITP CEO should have a vote on the board?

Answer. I made the referenced comments while I served as Chairman of the Public Utility Commission of Texas, shortly after Governor Bush signed legislation opening up the retail electric franchise to competition for all customers.

The FERC's goal in the SMD proposed rule is to provide regulatory clarity as the wholesale power industry evolves from its heavily-regulated past to seamless, re-

gional markets for wholesale electricity, so that sellers can transact throughout broad regions and customers can receive the benefits of less expensive and more reliable electricity. In the current regulated environment, the regulator (whether state or federal) makes all the choices with regard to pricing and new infrastructure. In a market environment, the customers will have the opportunity to choose the options that are most favorable for them. The Commission is proposing to establish common rules of the road for interstate transmission so as to have a stable and workable platform for competition in electric power. To help get power sales at wholesale out of the old regulated environment requires better oversight of transmission in interstate commerce. Because power and transmission are so closely intertwined, new transmission regulations are needed to establish an appropriate platform for wholesale competition in the electric power business.

As I have mentioned on several previous occasions, I believe that dependable, affordable, competitive wholesale energy markets require three key elements: adequate infrastructure, balanced market rules and vigilant oversight. The Commission is proposing a comprehensive plan that establishes these elements as well as includes regulatory backstop mechanisms to protect the customers until truly competitive markets are in place. As markets are becoming more regional, the Commission is proposing methods for states and the Commission to collaborate on regulating regional interstate commerce in electric power. The Commission is encouraging the establishment of independent regional entities such as RTOs and ISOs that will be operating the grid and administering the energy markets. This platform leaves plenty of room for regional variation with regard to a variety of functions, including transmission planning, resource adequacy, mitigation techniques and RTO governance.

Question 4. I agree with the premise of your statement that regulation leads itself to political pressure and log rolling. Isn't your SMD the product of political maneuvering by the new entrants whom you seem to favor over the incumbent utilities on which you seem to place the costs and burdens of SMD?

Answer. No. SMD is the product of the need to reform wholesale power markets to provide greater benefits to customers. It is informed by many months of open meetings and conferences with utilities, customers, ISOs, new entrants, financial experts, academics and experts from around the world about how best to support the movement toward improved competition. SMD welcomes new entrants to the electricity marketplace, but it does not favor them over incumbent utilities; in fact, SMD seeks to provide a level playing field for all entities. All costs are ultimately borne by customers, not utilities, so we must be sure that the costs of reforms are reasonable for the benefits we expect to achieve.

Question 5. Last November 12, you testified on the Enron scandal that the FERC did not regulate the parent company, whose financial chicanery led to the corporation's bankruptcy and the suffering of many people, including hard-working employees who lost their pensions. Will the Standard Market Design prevent financial scandals such as the Enron debacle?

Answer. Standard Market Design would not prevent the financial scandals that led to the collapse of Enron, which were due to accounting and other financial practices. These practices are for the Securities and Exchange Commission and other federal agencies to address.

However, Standard Market Design would prevent the various trading strategies that were allegedly used for market manipulation by subsidiaries of Enron which operated in energy markets. The proposed market rules would eliminate the market design flaws that were the basis for these trading strategies. The strategies discussed in the Enron memoranda were mainly tailored to take advantage of flaws in the California market design, particularly its congestion management system. Standard Market Design uses a different congestion management system that would make most of these strategies infeasible. A few of the strategies in the Enron memoranda appear to depend on the marketer providing false information to the ISO. Thus, these strategies rely on evading or violating the market rules rather than on market design flaws. Standard Market Design addresses these types of strategies by requiring an active market monitoring program (independent transmission provider's Market Monitor and the Commission's Office of Market Oversight and Investigation) that will detect violations of market rules and take appropriate action against entities that violate the market rules. SMD also would require that each RTO have in place market power mitigation measures to prevent exercises of market power.

I should add that the Commission has already developed and implemented rules outside the context of this proposal to increase the clarity and transparency of market transactions. These rules—including Order No. 2001, which directs quarterly public reports on all jurisdictional electricity sales—will help market participants

and observers (including regulators) better understand and react to changing prices and conditions in the marketplace, and increase investor and participant confidence in the integrity of market transactions.

Question 6. Is it not the case that when you arrived at the FERC, utilities had filed for approval of regional transmission organizations all over the country, but that since then, GridSouth and GridFlorida that had obtained at least conditional approval fell apart because of state opposition, the merger between Midwest ISO and Southwest Power pool fell apart, the merger between New England and New York ISO fell apart, long after PJM abandoned the Northeast market where it belongs? Isn't it also true that PJM announced delay in its development and that the Midwest ISO with whom you required PJM to merge may miss the deadline you set? Why doesn't the Commission embrace the policies of Order No. 2000 that seemed to work, over its efforts in SMD?

Answer. From its beginning, the Commission's rulemaking has been intended to fill in the important details that Order No. 2000 did not address. The industry and its customers have learned much from the California experience and from the collapse of Enron. It is important to reflect that current understanding in our rules. Shortly after I joined the Commission in mid-2001, as we were processing a number of Order No. 2000 compliance filings, it became apparent that we were moving to approval of incompatible market design features, even in neighboring RTOs. If there was any clear lesson the agency should have learned from the Western Market crisis, it was the criticality of getting the right set of market rules. However, at that time, rather than moving forward to address critical market design issues head-on, the Commission decided to direct parties in the South and in the Northeast into mediation to form large single RTOs for those regions. I supported that proposal as a solution to the balkanization problem that was coming forth from the pending cases. Ultimately, however, for various reasons, the two mediations made insufficient progress to allow for healthy wholesale markets to develop. So, the SMD proposal, and the highly public process in 2001 and 2002 that led to its development is intended to get the Order No. 2000 RTO agenda, which is a good one, back on track, not simply by approving filings, but by making sure that they work well based on real world experience.

RESPONSE TO QUESTION FROM SENATOR GRAHAM

Question. Economic dispatch has been discussed as an approach to facilitate the procurement of least cost power in the wholesale marketplace. What is your opinion of this concept?

Answer. I strongly support the concept of economic dispatch. Economic dispatch has been used by each electric utility since the beginning of the industry to provide the lowest cost power to its customers. The SMD proposal would extend the basic concept underlying economic dispatch from single utility scope to larger, regional scope.

Economic dispatch is simply the process of using the lowest cost generator first, then the second lowest cost generator, and so on, until the total amount generated meets the total electric demand on the system at the time. Until recently, economic dispatch has been applied within only one utility's system, and only for network resources, which are primarily generators owned by that utility, aside from the three major power pools of the Northeast. A typical utility owns many generators dispersed throughout its service territory—and buys from neighboring utilities—and also has customers at diverse locations throughout its service territory. Because of this geographic dispersion, transmission constraints affect economic dispatch. At some point the next lowest cost generator cannot be used because transmission limitations keep power at that generator from reaching customers over lines that are already fully loaded by lower cost generators. As a result, economic dispatch means using the lowest cost generators that the transmission system will allow.

The SMD proposal would extend opportunities for economic dispatch to a multi-utility region. Use of economic dispatch over a large region with many utilities might seem at first to require a central authority to decide how to use all the generators in a large region to meet the region's total demand at lowest cost. But this is not the case if a market is designed to simulate the results achieved by economic dispatch. Where traditional economic dispatch relies on knowledge of generator costs and transmission constraints, the market relies on voluntary price bids as well as knowledge of transmission constraints to reach about the same result.

The SMD proposal would require the provider of transmission services to establish a spot market that collects bids from all willing sellers and buyers at all locations in its region and, taking into account transmission limitations, select the lowest priced generators to satisfy the spot market demand of the region.

Let me emphasize that selling into and buying from this market is entirely voluntary under the proposed SMD rule. I would expect that most traditional utilities would continue to use their own economic dispatch process within their own service territories to match their own generation with their own load. However, under the SMD proposal they would, in addition, have the opportunity to buy and sell voluntarily across a larger region using a process very much like economic dispatch so as to take transmission limitations into account and lower costs for customers throughout the region. I would also emphasize that, because a utility may be required by state law to use its lowest cost generators first for its own customers, it can offer left-over generating capacity into the spot market so as to lower others' power costs without in any way taking the lowest cost power from its own customers.

RESPONSES TO QUESTIONS FROM SENATOR SMITH

Question 1. I realize you were not on the commission at the time, it is my understanding that the FERC approved California's electric restructuring before it was actually implemented. Given that, in hindsight, this was a terrible market structure that enabled market manipulation and is still harming the northwest economy, what makes you so certain that FERC and the FERC staff have gotten everything right in the standard market design proposed rulemaking?

Answer. The SMD proposal is specifically designed to combat the well-known market rule flaws and structural shortcomings of the California market using tools that are being used successfully in other markets today. The following are a few specific examples:

- The California market faced severe shortages of generation capacity, largely due to obstacles to timely investment in needed generation to keep up with growing demand and hydropower shortages. The price signals produced under Standard Market Design will provide appropriate incentives for investors to develop electrical infrastructure (generation, transmission and demand response), so long as state laws and regulations on siting and resource adequacy, among other issues, will accommodate such development. Other successful markets in the U.S. and across the world have seen substantial new investment in generation due to constructive state and local policies, as well as clear market rules.
- The California market design relied on a less sophisticated method (a zonal method) for managing congestion that made it profitable for sellers to manipulate the system in a variety of well-documented ways. The SMD proposal uses locational price signals and Firm Transmission Rights to eliminate the profitability of these manipulation schemes. This method is working is U.S. power markets today.
- The SMD proposal recognizes that where sellers have market power, mitigation measures must be incorporated into the market design. Before-the-fact mitigation measures eliminate the need for the type of after-the-fact refund proceedings and litigation on contracts and market manipulation that followed the Western energy crisis. These sorts of mitigation measures are working in eastern markets today.
- Unlike the California design, which required that most power be procured through the California spot market, our proposal is built on the reality that in today's power markets, about 90% of energy is procured under bilateral contracts between customers and their suppliers—outside the spot markets. Spot markets under SMD are voluntary (unless you are long or short in real-time), and they are intended to facilitate congestion management on the transmission system and to provide a mechanism to buyers to secure lower-cost resources than those they own or have contracted for, when it is efficient to do so. Because only supplemental power is likely to be obtained through SMD markets, not the buyer's entire power supply needs, the consequences of any market design flaw will be significantly limited. This is a basic feature in all power markets today.
- The SMD proposal calls for each RTO to establish an independent market monitor that would, among other things, continuously monitor the market for design flaws and promptly report any need for market rule adjustments to the RTO Board and the Commission. To its credit, California had this feature in its market design from the early days.

Finally, a critical difference between SMD and the California market design of the late 1990s is that from the outset, the SMD rulemaking process has been geared to adoption of the best practices that are already working in the world's and America's markets. We have found and incorporated what is working today in the whole-

sale markets of the Eastern United States, Texas, Canada, Great Britain, New Zealand and Europe, as well as features that make markets work better for commodities, financial instruments and consumer goods. Virtually all of the solutions we propose have been explored and recommended by groups and authors ranging from President Bush's National Energy Policy to the Western Governors Association and innumerable blue ribbon panels, academics and public interest groups. SMD endeavors to bring these best practices together in a comprehensive way that will benefit the nation's energy customers.

Question 2. It seems to me that, in certain electricity market structures, there seems to be an enhanced ability to game or manipulate the market. Why would we want to pursue market structures that will facilitate gaming?

Answer. It is true that some market structures create or enhance the ability to game or manipulate the market, but other market structures limit or eliminate such ability. Based on the lessons learned in California and elsewhere, the Commission proposed the SMD market design to reduce gaming opportunities to a minimum.

I should point out that gaming probably cannot be entirely eliminated in any market design. Even under traditional cost of service regulation, regulators throughout the last century were constantly vigilant for attempts to improperly add assets to rate base, inflate expenses, manipulate accounting rules, and so on. A market approach can eliminate most of these gaming opportunities, but the need for vigilance against new gaming opportunities remains. The Commission is relying on strong market monitoring by the regional transmission provider's market monitor and the Commission's Office of Market Oversight and Investigations to ensure compliance with the market rules and to detect new market manipulation strategies.

Question 3. Does the market oversight that would be required under SMD require an activist FERC that is willing to intervene quickly when market anomalies are suspected? How do we know that there will always be an activist, rather than a laissez-faire Commission?

Answer. This Commission's commitment to prevent future market abuses, and to remedy past ones, is now a firmly established part of our agency's mission, and we will continue to strengthen our present coordination with other federal agencies to ensure that we effectively regulate energy industries so that customers and investors are fully protected. The Commission has institutionalized market oversight by creating the Office of Market Oversight and Investigations (OMOI), which should assure that the Commission remains active in market oversight. OMOI serves as an early warning system to alert the Commission when market problems develop, and allows the Commission to analyze and address any problems more quickly. We are also requiring the regional market monitors to provide timely data to relevant state regulatory officials so they can join with us in overseeing these markets.

Question 4. Regarding "Undue Discrimination" Claims Underlying Standard Market Design:

I want to focus on the FERC's legal basis for promulgating Standard Market Design. The preamble to the proposed rule lists the categories of alleged undue discrimination that the FERC wants to remedy through SMD. These include:

Question (a). Native load—the FERC alleges that vertically integrated utilities that have legal or contractual obligations to serve retail customers discriminate when they use their transmission grid for the benefit of these customers ahead of everyone else. Since state laws require that utilities give priority to native load, including load growth, and the FERC itself in Order No. 888 recognized the validity of protecting captive customers, utilities obeying the law and doing what Order No. 888 allowed can hardly engage in unlawful discrimination. Is this correct?

Answer. SMD does not propose to take transmission away from those who have existing rights to it or to interfere with the ability to obtain adequate transmission for native load growth; instead, it will preserve all the rights of existing transmission rights holders, including native load. When all these preexisting rights have been satisfied, any transmission capacity left over would be made available to all market participants on a non-discriminatory basis. This continues the Commission policy that has been in place without controversy since Order No. 888.

The Commission explained in the NOPR its concern that vertically integrated utilities may improperly use their state obligation to serve native load as a cloak to engage in unduly discriminatory behavior that has nothing to do with protecting native load. For example, the current pro forma tariff requires transmission providers to allow existing transmission customers to roll over their service agreements into new contracts. A transmission provider is allowed to recall that customer's capacity at the end of the service agreement only if its reasonably forecasted native load growth needs would prevent it from extending the contract and it noted that restriction in its initial agreement with the transmission customer. Some transmission providers, however, have attempted to terminate expiring service contracts to ac-

commodate alleged native load growth, even when they have not claimed in the initial service agreement that the transmission capacity in question may be needed in the future for native load growth. SMD seeks to provide adequate native load protection but, at the same time, to prevent abuses of the native load preference.

Question (b). Studies for interconnecting generators—the FERC claims that integrated utilities discriminate when they delay complying with interconnection requests from competing generators, as by delaying studies. Do you agree that transmission owners need to study the effect on the grid before going ahead with interconnections? Is it not true that Order No. 888 recognized the varying complexity of studies and did not establish strict deadlines for conducting studies, by saying that if they take longer than 60 days, the utility must notify the generator? How many adjudicated cases of discrimination through delay in interconnection studies can you point to? Could you name them and give me citations?

Answer. Yes, transmission owners need to study the effect on the grid before going ahead with interconnections. In the Order No. 888 pro forma tariff, the Commission stated that a transmission provider would use "due diligence" to complete the required studies within a sixty-day period, but if the transmission provider was unable to complete the required study within such a time period, it had to notify the customer and provide an estimated completion date with an explanation of the reasons why additional time was required to complete the studies. We also stated that the transmission provider was to use the same due diligence in completing the study for a customer as it used for completing studies for itself. While this provided some flexibility to transmission providers it was not an invitation to indefinitely delay customers' interconnection requests.

As an example, Kinder Morgan Power Company complained to the Commission that Southern Company had allowed interconnection applications to sit unreviewed for up to six months, and delayed completion of the interconnection systems impact study for approximately nine months. Kinder Morgan argued that the time lag slowed commercial development of generation projects, added uncertainty to interconnection customers' plans for developing new generation plants, and prevented or delayed the entry of new generation plants into markets where Southern's generation companies operated. The Commission found that Southern's interconnection application procedures were unjust and unreasonable because they discriminated against generation customers' ability to develop new projects. The Commission ordered Southern to revise its interconnection application review process so that the review of interconnection applications is completed within 30 days from receipt of an application or rejected as deficient. *Kinder Morgan Power Co.* v. *Southern Company Services, Inc.*, 97 FERC ¶ 61,240 (2001), *reh'g denied*, 98 FERC ¶ 61,044 (2002).

We have heard from several commenters in the SMD proceeding and the Standardization of Generator Interconnection Agreements and Procedures proceeding in Docket No. RM02-1-000 that discriminatory application of interconnection procedures, including delays in performing studies, constitutes a barrier to entry for new generation.

Question (c). Scheduling issues—the FERC claims that integrated utilities can favor themselves when reserving transmission capacity in order to gain access to generation in other regions for reliability purposes. The preamble mentions two cases in which the FERC found trouble. My research shows two others. The cases involve two utilities. Did any of them involve deliberate discrimination? How many reservations of such capacity have occurred since 1996 and Order No. 888? What percentage does four cases represent out of that number? The FERC also claims that vertically integrated utilities can treat themselves more leniently for scheduling errors. What evidence do you have of that? How many cases did the FERC adjudicate.that came to that conclusion? Please name them and give me citations?

Answer. No, we do not have additional examples at this time. As to whether discrimination was deliberate in the cases you cited, it is often difficult to determine intent; therefore, the Commission simply determines if its rules are complied with or violated. We do not have data regarding how many reservations of capacity were made since 1996, but the number is likely to be large. As discussed in the SMD proposal, a utility that is out of balance (fails to schedule exactly) may be able to avoid a payment for imbalance in a way that is not available to another transmission customer. However, the Commission has an affirmative obligation to prevent undue discrimination, including the obligation to prevent the conditions under which undue discrimination is likely to occur.

The North American Electric Reliability Council (NERC) is developing new market rules to alleviate this problem. Compliance with NERC rules is voluntary, so two NERC reliability councils also have filed Inadvertent Settlement Tariffs to make their rules relating to balancing energy mandatory. Those rules mandated cash payments for imbalances and eliminated returns of power in kind. The Com-

mission approved those tariffs. See Mid-Continent Area Power Pool, 96 FERC ¶61,150 (2001); East Central Area Reliability Council, 91 FERC ¶61,197 (2000).

The SMD proposal responds not just to documented instances of undue discrimination, but also to flaws in existing market structures that present opportunities for undue discrimination. As discussed in recent court opinions, the Commission does not necessarily have to find specific instances of discrimination in order to have a duty to act to prevent it; in fact, "the open access requirement of Order No. 888 is premised not on individualized findings of discrimination by specific transmission providers, but on FERC's identification of a fundamental systemic problem in the industry." *Transmission Access Policy Study Group* v. *FERC*, 225 F.3d 667, 683 (D.C. Cir. 2000). See also *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 998-99 (D.C. Cir. 1987); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985). SMD, like Order No. 888, is a generic response to defects in electricity market design.

Question (d). Information issues—the FERC claims that vertically integrated utilities can—and I emphasize can—post misleading information on their Web sites regarding how much transmission capacity they have to sell. While maybe they can do that, how many instances of deliberate misleading have you found in adjudicated cases? Could you name them and give me citations? Is it not a fact that one case you mention in the preamble comes from Enron's allegations and the case is still before FERC on rehearing?

Answer. The Commission has encountered some instances in which incorrect information was published on utility OASIS sites:

- *Morgan Stanley Capital Group* v. *Illinois Power Company*, 83 FERC ¶61,204, *reh'g denied* 83 FERC ¶61,299 (1998), *order granting reh'g in part and clarifying prior order 93 FERC* ¶61,081 (2000) (taking note of incorrect posting on utility OASIS site)
- The Washington Water Power Company, 83 FERC ¶61,097 (1998), *order on responses to show cause order* 83 FERC ¶61,282 (1998) (finding utility failed to indicate on its OASIS that it may have firm transmission capacity available)¶*Madison Gas & Electric Company* v. *Wisconsin Power & Light Company*, 80 FERC ¶61,331 (1997), *reh'g denied* 82 FERC ¶61,099 (1998) (explaining that Wisconsin Power & Light's steps to clarify terminology and procedures on the OASIS should reduce any confusion that may arise concerning future transactions under its open access transmission tariff)

In addition, the Commission has adjudicated cases involving incorrect calculation of available transfer capability:

- Opinion No. 437, 87 FERC 61,202 (1999) (finding, among other things, that El Paso had incorrectly calculated its available transmission capacity)
- *Wisconsin Public Power Inc. SYSTEM* v. *Wisconsin Public Service Corporation*, 83 FERC ¶61,198 (1998), *reh'g granted in part on other grounds* 84 FERC ¶61,120 (1998) (finding Wisconsin Public Service took capacity benefit margin into consideration when it calculated available transfer capability, but did not include this information in its tariff)

The above cases do not address the issue of intent, only whether the Commission's rules or the utility's tariff was violated. In addition, Commission staff is currently performing a staff audit of information on sites and turning up anomalies that companies are being asked to explain. This investigation is confidential under Commission regulations.

The NOPR preamble discusses a Commission order that directed Entergy and Southern Companies to employ an independent third party to operate and administer their OASIS sites. This direction was in response to a number of parties, including Enron, who raised serious concerns about the integrity of the postings of ATC on the Entergy's and Southern Companies' OASIS. *AEP Power Marketing, Inc., et al.*, 97 FERC ¶61,219 at 61,973 (2001), *reh'g pending*, Docket No. ER96-2495-016 et al.

Question (e). Transmission Loading Relief—the FERC claims that in the past few years, utilities have called more brownouts and blackouts. Even if true, what evidence do you have that this resulted from undue discrimination, rather than a lack of investment in new capacity, given the growth in demand for electricity? How many adjudicated cases of discrimination in transmission loading relief can you point to? Please name them and give me citation? Would you not agree that utilities that called blackouts unnecessarily would attract regulatory sanctions, lawsuits and great risks of exposing themselves to liability?

Answer. For purposes of clarification, the Commission stated that instances of Transmission Loading Relief (TLR) are increasing, but these rarely if ever have re-

sulted in blackouts or brownouts. The TLR was designed by the North American Electric Reliability Council (NERC) as an emergency management tool intended to protect the reliability of the grid in the event of a true emergency such a transmission facility outage. Although discrimination is a problem that must be addressed, these TLR events are the result primarily not of discrimination, but of routine use of TLRs for everyday congestion management. A better method for managing congestion is needed for transmission customers to have fairer and more reasonable conditions of transmission service. That said, the current situation leads power buyers to favor power from local sellers over power from distant sellers that may be subject to routine curtailment—a situation that can be exploited by those who own both transmission and generation who may be able to create congestion so as to help maintain their local dominance, despite our open access rules. However. such intent is extremely difficult to prove, and there have been no adjudicated cases that find discriminatory use of TLRs. Although unnecessary blackouts would seem to expose a utility to sanctions or lawsuits, use of TLRs does not. Both the FERC tariff and NERC rules require the use of TLRs to manage congestion on the grid when certain defined condition arise.

April 17, 2003.

Hon. PETE V. DOMENICI,
Chairman, Senate Energy and Natural Resources Committee, Hart Senate Office Building, Washington, DC.

DEAR CHAIRMAN DOMENIC: Thank you for including me in the March 27, 2003 hearing before the Senate Energy and Natural Resources Committee and for giving me this opportunity to respond to certain of the questions that have been submitted for the record. As always, it is a pleasure to work with you on these important issues.

Sincerely,

GLENN ENGLISH,
Chief Executive Officer, NRECA.

RESPONSES TO QUESTIONS FROM SENATOR CAMPBELL

Question. Allen Franklin says this has been a terrible time financially for investor-owned utilities. In fact, there have been over 180 IOUs downgraded and pending bankruptcies of the merchant power sector. These are indeed tough times. How has public power fared during the same period? What has Wall Street said about public power? Are you building generation and transmission? What is your debt load?

Answer. Cooperatives and public power are extremely strong today financially. Both Fitch and S&P have remarked that cooperatives have largely retained their strong investment grade ratings because they have stuck to their knitting. Cooperatives and public power have not engaged in risky financial speculation or constructed generation for the competitive market. They have instead continued their focus on building and acquiring generation and transmission capacity for their own consumer-owners.

Question. Allen Franklin testified earlier that public power should be subject to "full FERC jurisdiction" so others can gain access to its transmission. Do you agree? JEA is directly connected to Southern. Do you get requests for transmission access from Southern? Have you granted such access? Are you aware of any complaint issued by Southern or any other requestor of access that you have failed to give access to your surplus transmission?

Answer. There is no need for cooperatives or public power to be subject to "full FERC jurisdiction." Such proposals are a solution in search of a problem.

If Southern or another public utility believed that a cooperative were denying it transmission service it would have at least two options under current law. Its first option would be to file a complaint with the Federal Energy Regulatory Commission (FERC) under § 211 of the Federal Power Act. Expanded by Congress in the Energy Policy Act of 1992, § 211 permits FERC to require any non-jurisdictional transmitting utility to provide transmission service to other utilities at just and reasonable rates.

Southern's second option would be to take advantage of the "reciprocity" provisions of Order 888. Order 888 was FERC's primary open access order. In that order, FERC told all public utilities that they had to provide open access transmission service to everyone pursuant to a single standard contract, or "pro forma" tariff. Although FERC could not impose open access and the pro forma tariff directly on non-public utilities, FERC did so indirectly through "reciprocity." FERC told non-public utilities that if they wanted transmission service on transmission lines regulated by

FERC, they too would have to provide open access transmission service under a tariff comparable to the pro forma tariff. To enforce the reciprocity provision, FERC told the public utilities that they could deny transmission service to any non-public utility that failed to provide it with comparable transmission service.

Were cooperatives denying Southern or other public utilities open access to their transmission systems, one would expect that there would have been a lot of § 211 complaints filed at FERC, or that a lot of cooperatives would have been denied transmission service under Order 888's reciprocity provisions. But the opposite has been the case. There have been no § 211 complaints in the past few years against cooperatives and no instances that NRECA is aware of in which a cooperative has been denied transmission service pursuant to reciprocity. Even if cooperatives were inclined to deny third parties access to their transmission service, the threat of those remedies would have been enough to enforce fair access. Significantly, FERC listed in its SMD proposal numerous instances where investor-owned utilities were engaged in alleged discriminatory behavior yet not a single cooperative was referenced.

RESPONSE TO QUESTION PREPARED BY NEIL NARAINE

Question. Do you believe that Participant Funding combined with Tradable Transmission Right at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by FERC would increase the capacity of the transmission system?

Answer. NRECA does not believe that requiring the Commission to accept participant funding and tradable transmission rights would increase the capacity of the transmission system. In fact, NRECA believes that a strict participant funding approach would have opposite effect: it would dissuade investors from improving the transmission system and therefore undermine wholesale markets and increase the delivered cost of power to consumers.

If all transmission facilities required to serve consumers in a region had to be "participant funded" very little transmission would be built. First, transmission improvements are like improvements to the highway: once a new lane is constructed all drivers can use it and all drivers benefit from the decrease in congestion. There is, therefore, no effective way within a region to allocate the benefit and thus the cost of system upgrades. Few investors would be willing to fund all of the cost of an upgrade if they do not get all of the benefits.

Second, participant funding increases the risk to investors and therefore makes it less likely that they will invest in needed new transmission capacity. Under participant funding, transmission investors do not get paid by those who use the new transmission line or new transmission capacity. All investors get if they participant fund a line is the right to congestion payments. But, if investors properly design the line, there will be no congestion anymore, and thus no payments. The more effective the facility is at increasing transmission capacity, the greater the risk that investors will not recover their investment. Why, then, would they build transmission capacity?

By dissuading investors from making improvements to the transmission system, a strict participant funding approach would lock in existing congestion points on the transmission system, undermine wholesale power markets, and thus raise costs to consumers.

It would be better for Congress to leave issues of transmission pricing and cost allocation to the Commission. FERC has the authority today to adopt any policy, including participant funding, that it concludes is just and reasonable and not unduly discriminatory or preferential. The Commission is presently considering adopting a more nuanced approach to participant funding in its Standard Market Design rule.

If Congress does act in this area, NRECA believes that transmission facilities required in a region to serve consumers more economically or more reliably should be rolled into regional transmission prices and recovered from all consumers in the region. We will never be able to develop an interstate highway system for transmission if every industry participant is required to build its own private roadways.

On the other hand, NRECA does believe that transmission facilities that are not needed to serve load within a region, but are instead required by those selling power outside the region should be paid for by the power seller or the customers outside the region. Consumers within a region should not have to subsidize the poor siting decision of generators.

As a general principle, the best way to get transmission infrastructure built and to reduce transmission congestion is to address risk and focus on regional planning. More transmission would be built if Congress were to make it easier for investors

to build new transmission and more certain that investors would recover their costs. That is why NRECA has supported rolling in of transmission investment into regional transmission rates for those upgrades that a regional planning process has determined are required in a region to serve consumers more economically and more reliably. That is also why NRECA has supported limited federal siting authority for such facilities.

SOUTHERN COMPANY,
Atlanta, GA, April 17, 2003.

HON. PETE V. DOMENICI,
Chairman, Energy and Natural Resources Committee, U.S. Senate, Washington, DC.

DEAR SENATOR DOMENICI: Please find attached responses to the questions of members of the Energy and Natural Resources Committee that were provided to us in your letter of April 3. It was a pleasure to testify before your Committee on March 27, 2003 and I hope that these responses help to further the Committee's consideration of energy legislation in the current Congress.

In addition to responding to the questions that were posed directly to me or my panel, I have also provided answers to questions that directly relate to my testimony or to Southern Company. As I was testifying on behalf of EEI, my responses will reflect EEI positions, except where specifically noted.

Thank you for the opportunity to provide this response and further clarify the electric utility industry's perspectives on proposed legislation. We remain ready to help you in any way we can as the legislation progresses through your Committee and the Congress.

Sincerely,

ALLEN FRANKLIN,
President and CEO.

RESPONSES TO QUESTIONS FROM SENATOR CAMPBELL

Question. It seems that, in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that the current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electricity sector?

Answer. While centralized planning may overstate the impact of the Commission's proposal, SMD certainly does not amount to deregulation. APPA supports RTOs that perform the functions articulated in the proposed SMD rule, but cautions that the cost effectiveness of a proposed RTO must be shown before proceeding in each region. Further, badly designed and organized spot markets can do great damage to consumers and to industry participants.

Question. How does SMD account for regional differences in electricity markets? How will this specifically affect western state utilities and their customers?

Answer. The Commission has stated that it will allow regional flexibility in the implementation of SMD, particularly in areas such as the Pacific Northwest, with its substantial reliance on the coordinated, regional operation of multi-use hydroelectric facilities to accomplish a variety of conflicting objectives, including delivery of electric energy and capacity when and where it is most needed. The Commission's proposal has in fact given preliminary approval to certain RTO design elements that are seemingly inconsistent with the proposed rule, such as the physical transmission rights model adopted by participants in the West Connect RTO.

APPA has urged the Commission to proceed with RTOs and SMD cautiously, to allow regional consensus to be maintained and to provide sufficient time to conduct the cost-benefit studies that are required to give customers and the states confidence that the specific RTO design proposed in each region is workable and cost-effective.

Question. Many statements have been made that California's recent electricity crisis was a regional crisis. I know that when California needed or wanted water they got water from Colorado, now when they need power are they going to take Colorado power? What impact will California's current problems likely have on Colorado and other Rocky Mountain states?

Answer. The recent western energy crisis has reinforced the fact that wholesale electricity markets are interstate in nature and disturbances in the market cut across all industry segments. The failure of federal and state electricity deregulation in California has had, and continues to have, broad and far-reaching adverse effects throughout the Western States Coordinating Council region, including Colorado. Colorado was certainly not immune to the dramatic increases in the wholesale price of electricity that many consumers in the West were forced to assume.

Beginning in late 2000, APPA repeatedly urged FERC to stabilize the western electricity markets by imposing price caps. It was not until June 2001, well into the crisis, that FERC acted to impose credible pricing discipline on the dysfunctional western markets. While FERC's actions have brought stability to the western wholesale electricity market, that relief came far too late for consumers.

Until FERC acts more decisively to address market manipulation, including establishing clearer rules on the use and revocation of market-based rates, substantial price volatility may continue.

There is no legal mechanism through which California, or any other state, can "take" power from Colorado. It is possible that renewed price volatility or other factors, such as downed transmission lines or broken generating units, could result in an increased demand for available power in Colorado. However, absent any statutory or contractual obligations, there would be no requirement for generators in Colorado to sell energy to utilities in California or in any other state.

In rare circumstances, the Secretary of Energy may declare an electrical emergency that would direct all generators to make any surplus available to the capacity deficient system, but only after the generator had met all of its contract and native load service obligations.

Question. Allen Franklin, CEO of Southern Co. testified that public power owns and operated 30% of the transmission system in the U.S. And that they need to be "fully FERC jurisdictional" to ensure a competitive wholesale market.

Answer. The above question incorrectly states that public power owns and operates 30% of the nation's transmission system. Public power strictly defined (electric utilities owned by states or units of local government), in fact, owns approximately 8% of the transmission system. Mr. Franklin was perhaps referring to transmission facilities owned by the federal government as well as those owned by rural electric cooperatives in addition to those owned by public power. Under Section 211 of the Federal Power Act, FERC already has the authority to ensure non-discriminatory access to all transmission lines, including those owned by public power. Bringing those lines under increased FERC jurisdiction will not solve the major problems of siting and technology development and will not result in a more robust competitive wholesale market. In addition, APPA agreed several years ago to the language known as FERC-lite which gives FERC an additional tool to ensure that public power systems provide comparable treatment to other entities that wish to access our transmission lines.

Question. Allen Franklin says this has been a terrible time financially for investor-owned utilities. In fact, there have been over 180 IOUs downgraded and pending bankruptcies of the merchant power sector. These are indeed tough times. How has public power fared during the same period?

Answer. While some western public power utilities were hurt by the skyrocketing wholesale power prices during the energy crisis, they were able to minimize the effect on their consumers and remain fiscally responsible because of their flexibility and local control.

In contrast to energy trading companies and investor-owned utilities the credit ratings of public power systems have remained stable. During 2002, out of 197 public power entities evaluated by Standard & Poor's, there were only 14 downgrades. Furthermore, these downgrades were balanced by 12 upgrades during the same period. More than 80% of the total public power entities rated by Standard & Poor's are rated A– and higher.

Question. What has Wall Street said about public power?

Answer. In its "Outlook 2003: U.S. Power and Gas", Fitch Ratings states "Public power was by far the most stable utility sector in 2002, and the outlook remains clear for the coming year." Standard and Poor's and Moody's Investors Service also project a strong outlook for public power in 2003.

Credit rating agencies cite several reasons why public power has been able to weather the western energy crisis and maintain a stable outlook. The previously mentioned Fitch Ratings report "Outlook 2003: U.S. Power and Gas" states as an explanation of public power's success:

> "Part of public power's success reflects a conscious decision by utility managers and board of directors to avoid the riskiest parts of electric deregulation, such as wholesale power marketing and merchant transactions. By nature public power agencies tend to be a more conservative group. They view their primary mission as serving native load customers on a mostly not-for-profit basis."

Question. Are you building generation and transmission?

Answer. Public power utilities are continuing to build generation and transmission to meet their individual local needs. In fact, the recent market turmoil coupled with a lack of confidence in being able to obtain firm, reasonably-priced trans-

mission service (without significant risk of curtailments or hefty congestion charges), has prompted some public power systems to build their own localized generation.

While there are substantial obstacles involved in the siting and permitting processes for transmission, the investment in transmission continues to represent a safe and stable investment.

Question. What is your debt load?

Answer. Based on Energy Information Agency data for the largest public power systems (covering about one-fourth of all public power systems, but representing more than 70 percent of all sales to retail customers and all significant wholesale power systems) the total amount of bonds outstanding in 2000 was approximately $72 billion. In 2001, the total amount of outstanding bonds was $77.9 billion. The total long term debt, which includes bonds, advances from municipality and other long-term debt, and adjustments for unabortized premiums and discounts on long-term debt, was $81.3 billion in 2001.

RESPONSES TO QUESTIONS FROM THE COMMITTEE

Question. Do you believe that Participant Funding combined with Tradable Transmission Right at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by FERC would increase the capacity of the transmission system?

Answer. FERC already has sufficient authority to permit or require participant funding where appropriate. Therefore, reiterating in legislation this ability is unnecessary and would in fact create a preference for participant funding. Furthermore, participant funding is an untested concept and, in most parts of the country, is likely to delay and limit transmission construction at a time when congestion and curtailments are increasing, to the detriment of consumers. APPA does not believe that participant funding would ultimately increase transmission capacity.

Question. There seems to be a widening rift between the States and FERC on the FERC's plans for energy markets. If we continue this path, we could be headed for years of litigation and no progress. What can be done to avoid this continuing rift?

Answer. The rift between the Commission and the States comes directly from the failure to address the California and Western market debacle immediately after the symptoms of dysfunction first emerged in Summer 2000. The causes for the debacle are complex and the reports are both voluminous and still emerging. FERC's credibility as the agency with primary jurisdiction over the natural gas and electric energy and transportation markets was severely damaged in the process. FERC needs to complete its Western investigations promptly, while ensuring due process for affected customers and industry participants and then initiate a public inquiry into how it should regulate and oversee energy markets going forward.

Elements of this inquiry should include:

1. Standards for prohibited behavior as a condition of market based rates;
2. Transparency requirements, including industry reporting and disclosure of detailed market price and operating data on a close to real-time basis, subject to very limited commercial sensitivity limitations;
3. New standards for market based rates that ensure that entities with market power do not have the opportunity to exploit that ability in the first place;
4. Tangible steps to demonstrate the Commission and its oversight and investigations staff in fact has the capability and will to enforce these standards on a routine basis, not just when a crisis develops.

With respect to RTOs and the Commission's proposed Standard Market Design, it seems apparent that many regions do not now have and will not have RTOs operating the organized electricity spot markets discussed in the proposed rule for some time. Further, the Commission's oversight of natural gas markets has also proved wanting, in that a number of jurisdictional companies have been alleged to have manipulated natural gas prices at major trading hubs, as well as the prices reported to trade publications. The commission needs to articulate how it will monitor these markets as well.

In contrast, Chairman Pat Wood recently said that his agency intends to "articulate more clearly" how regional transmission planning and generation adequacy arc to be areas for state regulation, while independent transmission operators, locational pricing, firm tradable transmission rights, and predictable and balanced market mitigation are core elements of SMD. We will provide the Committee with our comments when the FERC SMD White Paper becomes available.

STANDARD & POOR'S,
New York, NY, April 22, 2003.

Senator PETE V. DOMENICI,
Chairman, U.S. Senate Committee on Energy and Natural Resources, Washington, DC.

DEAR MR. CHAIRMAN: As follow up to my testimony on March 4, 2003 regarding the financial conditions of the electricity market, I am providing answers to some of the questions that were submitted for the record. As I mentioned in my testimony, Standard & Poor's, a division of The McGraw-Hill Companies, provides independent financial information, analytical services and credit ratings to the world's financial markets. Standard & Poor's Ratings Services ("Standard & Poor's") does not advocate any specific industry structures or regulatory and energy policies and thus I am not offering answers to questions that would advocate specific policies.

Thank you for the opportunity to respond to your questions.

Sincerely,

SUZANNE G. SMITH,
Director.

RESPONSES TO QUESTIONS FROM THE COMMITTEE

Question 1. Explain the primary factors that have led to the current financial situation in the electricity sector.

Answer. The popular explanation for the industry's current decline in financial health has been to place the blame on the introduction of competition into the electricity market. Such a characterization would be an oversimplification of a complicated situation. A more accurate explanation of the industry's problems would be that the introduction of competition gave management the opportunity to make investments in areas, perhaps beyond their companies' expertise. A second cause of the industry's problems was that the rapid investments in generation capacity came on the heels of one of the largest economic expansions that the U.S. economy has experienced in decades. Since the bursting of that bubble, electricity demand growth did not materialize as many expected. For example, industrial demand for electricity has been contracting for the last few years. Another contributing problem was that debt was cheap and readily available. As a result many companies succumbed to the problems of over investment in risky assets or ventures.

Low margins on electricity sales, trading losses and excess leverage have substantially driven down cash flow and profitability for the merchant energy (the uncontracted-for) segment of the electricity business. The weakened economy and incomplete or partial deregulation have to the overall surplus of electric generation capacity that now exists in most regions of the United States. This surplus, which will likely remain for the next several years, means that the market is largely only compensating power plant owners for their variable fuel costs and not for capital recovery.

Last year, companies engaged in energy marketing and trading found themselves without sufficient capital at a time when they needed more liquidity to fund losses and to meet collateral calls. Loss of investor confidence caused industry stock prices to plummet and virtually shut many energy companies out of the equity markets.

The presence of contingent liabilities in loan agreements and trading contracts made the situation worse by creating "credit cliffs". Contingent liabilities exist where the terms of borrowing change (or repayment is accelerated) if debt ratings or financial performance, or both, deteriorate below specified levels. In the electricity markets, "ratings triggers" are used extensively by counterparties as a way to determine collateral requirements. A common trigger is the loss of an investment grade rating, which required some companies to immediately post hundreds of millions of dollars of increased collateral.

Lastly, another contributing factor to credit deterioration is financing practice. Many generation companies relied very heavily on the near-term debt markets, chiefly through the medium of short- and medium-term construction revolvers, acquisition bridge loans, and "mini-perm" loans to fund construction or acquisition of individual merchant energy plants and portfolios of merchant assets. This departs from the traditional way in which generating assets are traditionally funded, that is with more reliance on equity and long-term debt. Banks and borrowers as near-term lenders expected that their loans would be repaid within two to five years, mainly from proceeds from capital market "take-out" issues. Today, because of the uncertainties in the electricity sector, capital markets may not be a viable source of repayment for the banks. Making matters worse, some banks want to reduce their exposure to the electricity sector and are reluctant to roll over or refinance outstanding loans. Some companies are deeply exposed as the vast majority of their

capitalization consists of short- or medium-term bank loans that mature this year or next.

Question 2. To what extent do you think the challenges facing the electric industry are related to the general downturn in the economy?

Answer. Some of the challenges facing the electric industry are related to the general downturn in the economy. Generally, electric demand is closely related to changes in overall economic output. However, the collision of business and financial risks currently being experienced by the competitive segment of the electric industry is not closely related to the general downturn in the economy. For example, the generation overcapacity situation is not a result of rapidly falling demand for electricity, but more a result of overbuilding.

Question 3. The credit rating for many energy companies has been reduced, some to below investment grade. The credit rating agencies have been accused of reactionary downgrading and changing valuation criteria. How do you respond to those allegations?

Answer. Standard & Poor's downgraded an unprecedented number of energy and power companies in the past year due to the many factors cited in my response to question #1. This is an acceleration of a trend that started at least three years ago. The downgrades are justified based upon the deteriorating creditworthiness of certain companies.

Standard & Poor's continually seeks to enhance its process and procedures to ensure that its ratings meet investor needs and keep pace with new investment structures, accounting issues and market developments. These changes are made public and are widely distributed so that our ratings process is transparent to the marketplace. For example, last year, Standard & Poor's published an article (a copy of which is attached)* which describes Standard & Poor's' updated approach to rating U.S. energy trading and marketing firms. The article describes refinements to Standard & Poor's' methodology, which includes: enhanced liquidity analysis, fine-tuning assessments of two key components of capital at risk, and additional disclosure requests made to energy and marketing firms. However, Standard & Poor's has not made any material changes to its basic criteria for rating energy and power companies. Certainly the methodology refinements described above were not the sole cause for the downgrades.

Question 4. Do you think that developers overestimated the demand?

Answer. In part developers may have overestimated demand growth, particularly as the economy was rapidly expanding. There was much speculation that the dot.com revolution was going to need increasingly more electricity. In addition, some developers likely overestimated the demand for gas-fired generation on the premise that older coal-fired and nuclear power plants would retire as competition spread and under the assumption that natural gas prices would remain at levels well below today's prices. In many instances just the opposite occurred. Older plants, with little incremental investment, have greatly increased their availabilities and load factors since their variable costs are low. Hence, many companies are suffering losses from non-performing gas-fired power generation assets that are not being dispatched.

Question 5. Are the problems now faced by competitive generators due to overbuilding?

Answer. Excess generation capacity, or perhaps the wrong mix of generation, in most regions of the U.S. has contributed to the competitive generators' problems.

Question 6. What is your response to this potential issue of insufficient natural gas supplies and increased dependence on LNG?

Answer. The growing gap between U.S. gas production and demand suggests that the U.S. natural gas industry could be on the threshold of entering the ranks of major long-term LNG importers, such as South Korea and Japan. Indeed, since 1995, LNG imports have swelled from 5 billion cubic feet (BCF) per year to almost 155 BCF in 2002, albeit a fraction in the 23 trillion cubic feet (TCF) per year U.S. market and a very small part of the total imported gas.

To date Canada has filled the growing gap between U.S. natural gas supplies and natural gas consumption. But as reported in a recent study by Standard & Poor's, Western Canada, which has made up the U.S. production-demand deficit, may be hard pressed in the longer term to continue to do so as many have expected. According to a recent report in the Oil and Gas Journal, as well as other analyses, much like the Lower 48, higher development costs, smaller prospects, and rising depletion rates are challenging Canada's huge gas potential. Also, as in the U.S., Canadian demand is increasing because of gas-fired power generation and power needs associated with Alberta oil sands projects. The oil sands projects alone could potentially consume as much as 2 BCF per day of Arctic gas.

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*The article has been retained in committee files.

The nature of U.S. gas demand is changing as electricity generation growth replaces industrial gas demand and becomes willing to pay more for gas than industrial users. This development combined with declining gas production may be moving sustainable normalized gas pricing into the $3-4 per MCF range. Higher natural gas prices combined with falling LNG liquefaction and transport costs could be the developments needed to sustain a long-term U.S. LNG market. New LNG projects will need about $2.0 to $3.0 per MCF to cover capital costs from wellhead to shipping to storage/regassification terminal. Shipping will add between 30 cents and $1.25 per MCF depending upon distance. Therefore, if potential LNG developers expect gas prices to permanently move into the $3.00 to $4.00 range, U.S.-destined LNG projects may be feasible.

There is no shortage of potential greenfield projects in the Atlantic and the Pacific basins that are looking to supply the U.S. LNG market. In the Pacific basin, stranded gas reserves in Australia, Alaska, Indonesia, Malaysia, and Peru could support new or expansion projects. Similarly, in the Atlantic basin, Algeria, Egypt, Nigeria, Trinidad & Tobago, Venezuela, and West Africa could also support new projects dedicated to the U.S. Finally, in the Persian Gulf region, Oman and gas giant Qatar with almost 900 TCF of proven reserves—the newest LNG exporters—are anxious to monetize their stranded gas reserves.

Obviously, given the politically sensitive regions where some LNG projects might be located and the distances involved, a growing dependence on LNG could raise concerns about energy security and trade balance payments. But given the difficulties in siting LNG receiving terminals in the U.S. and the magnitude of LNG terminals needed to fill the growing production/supply gap, it seems unlikely that the U.S. will become as dependent on LNG as major importers in East Asia are, namely Japan and Korea.

Question 7. Do you think that companies will successfully refinance their substantial debt? Or should we prepare ourselves to see a series of generating assets fall into the hands of banks?

Answer. To date, companies have been refinancing their substantial debts. In most cases refinancings are better characterized as extensions or rollovers even though the companies have executed new load agreements. Most of the new facilities are short-term in nature—two to three years—and allow the companies to forestall bankruptcy by providing liquidity and time. It is fair to say that banks and borrowers are hoping that the market improves with time and that that will solve many financial problems. Few of the "refinancings" actually solve the energy merchants' problems of too much debt and too much capacity. In fact the financial conditions of some of these companies are so weak that the banks cannot charge interest rates commensurate with default risk or else the companies' financial positions would only worsen. Over the near term, Standard & Poor's expects that some generating assets will be handed over to banks, but most assets will remain in the hands of the borrowers, with the lenders taking a first lien on the asset. Should borrowers be unable to repay the loans over the next several years through internal cash generation or access to the capital markets, some banks will again be faced with the decision of whether or not to accelerate their loans and seize their collateral security.

Question 8. Given these constraints, will the merchant model survive?

Answer. The overhang of #90 billion in short-term debt that must be refinanced, as Standard & Poor's first reported in an article in November 2002, will not be the determinate as to whether the merchant generator model will survive. How and whether that debt is refinanced, restructured or written-off may decide who continues to participate in the business. One thing is fairly certain, given the capital requirements of competitive power, it will be very difficult for a companies with debt ratings in the single-"B" category to survive long. The challenges of the high cost of capital and the undermining of counterparty confidence will drive most out of the business, sooner or later unless balance sheets are substantially restructured.

The answer to the sustainability of the merchant generation model may rest with the policy and lawmakers. As Standard & Poor's reported in an article in March 2002, the merchant energy model—and, more broadly, the competitive power industry—may indeed still be viable. The model was perhaps never applied in a context in which it could succeed. The business institutions and market framework did not fully develop across the country. But a collision of business and financial risks may soon close the door on the merchant energy business unless something changes. Refinancing short-term obligations is proving difficult and the ability to attract new capital to competitive power may be almost impossible.

Through its Standardized Market Design (SMD) notice of proposed rulemaking (NOPR), the Federal Energy Regulatory Commission (FERC) has proposed bold reforms to promote a healthy, competitive electricity industry. But the complexity and

the scope of the proposal threaten its implementation. In addition, the political opposition to SMD may be appreciable enough to raise doubts as to whether FERC can push its reforms through—and ultimately whether merchant energy can survive.

Basic competitive industries, such as oil and gas, steel, pulp and paper, among others, need customer bases, or rather at least a fighting chance to reach customers. And therein lies electricity's rub. In the U.S., the institutions that merchant energy needs to support a competitive power market do not broadly exist. Transparency in pricing varies tremendously from market to market, as does access to transmission and electricity end-users. At times the price for power paid by consumers does not necessarily reflect its cost. Regulatory reform has not only progressed more slowly than many investments were predicated upon, but it has not spread widely. In theory, disaggregating vertically integrated utilities into their component parts of generation, transmission, distribution, and marketing and trading should foster efficiencies, innovation, and investor confidence. But the reality has been very different, particularly in generation and energy marketing and trading. In addition, California's experience dramatically illustrated the vulnerability of even the franchise service monopolies of distribution and supply if well-conceived, underlying institutions are not in place before introducing competition.

Parts of the nation's grid in particular have been frustrating the development of competitive power markets. In some markets independent or merchant power cannot deliver their low cost power to retail users because of artificial barriers to market entry. Industry participants have alleged to FERC that vertically integrated utilities are discriminating against low cost providers by restricting access to their transmission lines so that they can sell their own, often times more costly, generation to their native loads. In addition, seams issues between adjacent markets, such as Pennsylvania-New Jersey-Maryland (PJM) and the New York Power Pool, restrict commerce between regions due to a host of reasons, including, different reliability standards, generation ramp-up procedures, and computer systems, amongst others. Finally, some transmission systems hide price signals, which raises concerns about whether needed investments in generation or transmission are made or whether they are made in the wrong locations.

Given the various market problems, it is not a difficult case to make that business risk for the competitive electricity industry, which must rely upon open well-functioning markets, has become riskier than other basic industries and that the competitive generator model is at risk. Few other industries face the artificial barriers that have developed as a result of partial, or incomplete, restructuring of the industry. Moreover, the industry's problems come at a time that when it has seen the largest overbuild in capacity since its beginnings and at a time when load growth has fallen off. Merchant generation, at best, largely earns only marginal revenues with no little ability to cover fixed costs.

In the current U.S. environment, merchant energy or competitive electricity will have a hard time surviving and credit quality could further deteriorate.

Question 18. Competition in electricity brings volatility in prices, but does it also bring lower prices for consumers?

Answer. Merchant energy has delivered some of the intended benefits of deregulation. Power plants formerly owned by utilities, especially the older nuclear and coal-fired facilities, are now operating at much higher availabilities and capacity factors under their new owners. Wholesale power costs have fallen, albeit they are more predisposed to volatility than before. And ratepayers are not paying for the tremendous overcapacity in generation that characterizes the industry, as they did in the past; lenders and equity investors are now shouldering those costs.

Question 24. Standard Market Design (SMD) has been proposed by FERC to fix instability in the marketplace. Kentucky has the lowest residential electricity rates in the country. Do you believe that FERC's proposed SMD rule will work? Will the rule penalize states with low costs to benefit those with high costs? Do you believe that the proposed SMD rule takes into account unique regional differences and individual state interests?

Answer. The scope of Standard Market Design is very broad, but by some arguments, necessary. As Massachusetts Institute of Technology economists Paul Joskow and Richard Schmalanzee pointed out in their 1983 book on deregulation, "Markets for Power": "Transmission plays the most fundamental role in achieving the economics of electric power supply. . . . The practice of ignoring the critical functions played by the transmission system in many discussions of deregulation almost certainly leads to incorrect conclusions about the optimal structure of an electric power system."

If the transmission system does not address the needs of a competitive energy market, then financial and business risks for the industry will likely remain high,

which, in turn, does not bode well for the industry's credit ratings. That will translate to a higher cost of capital as investors and lenders move to protect themselves from uncertain credit risks. Markets will not fix a flawed market design, but financial markets will move to limit their exposure to a flawed market. Even if stronger demand works off the excess capacity and margins widen, the underlying structural problems will still exist.

April 28, 2003.

Hon. PETE V. DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Attached are my answers to the questions submitted for the record of the Committee's March 27, 2003 hearing on various electricity proposals.

Thank you for granting my request for an extension of time.

Sincerely,

WILLIAM L. MASSEY,
Commissioner.

[Attachment]

RESPONSE TO QUESTION FROM SENATOR CAMPBELL

Question. There seems to be a deep dilemma we are dealing with here: while we are trying to bring open competition to certain electricity markets, we are actively engaged in federal design of these same markets. It seems that, in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electricity sector?

Answer. Respectfully, I do not agree. Under SMD, planning for the electricity sector would be carried out regionally, with the states primarily in charge. On the issue of market design, wholesale electricity markets do not automatically design themselves or provide a level playing field. Under existing law, wholesale markets are within the jurisdiction of the Commission and are shaped, or "designed," pursuant to Commission policy.

RESPONSES TO QUESTIONS FROM SENATOR CRAIG

In light of the Commission's California refund actions on Wednesday, March 26, 2003, I think it is important for the Committee to fully understand the history of how the Commission got to this point.

You are the only sitting Commissioner who participated in the review and approval of the California electric restructuring plan. I appreciate your acknowledgment during the Senate hearing on March 27th that the Commission's approval of California's plan was a mistake. What is needed now is a full accounting that can lead to a better understanding of how and why this mistake happened.

In response to my questions during the March 27th hearing you stated that some on Commission staff thought the California plan to be flawed and that those concerns were brought to the Commission's attention prior to Commission action to approve the plan.

Question 1. Please describe fully your discussions with staff that were critical of the plan prior to the Commission's approval of that plan. Please provide descriptions of any internal memoranda or analysis, written or oral, raising concerns about California's plan before your votes, and copies of the written documents described. Please include all written documents, including e-mails and all handwritten notes from you, your staff, and Commission staff that are in your possession.

Answer. I agree with you that it is important for the Committee to fully understand the history of how the Commission got to this point.

In a nutshell, the Commission, in deference to the wishes of a major region of the country, approved during 1996 and 1997 a market design approved by the California PUC, legislated by the California General Assembly and strongly endorsed by the Governor. The complex plan enjoyed broad support within most segments of the industry. The policy of the State of California was to separate transmission from generation, rely upon wholesale markets, and move toward retail competition. The State could not do so, however, without the Commission's approval.

The Commission has a longstanding policy of working with states where possible to achieve common goals. This is an excellent policy. A rejection of the California plan at that time would no doubt have been viewed by California and other states,

and perhaps even by Congress, as FERC insensitivity to state and local needs. I do not believe that any other state intervened to object to the plan.

The Commission orders with respect to the California plan span more than 450 single-spaced pages and resolve literally scores of issues. Key features of the plan were required by California law. The separation of the ISO and Power Exchange, for example, was required by California law.

I know now that approval of the California plan—primarily the ISO/Power Exchange separation and the over reliance on the spot markets—was a mistake. Hindsight has 20-20 vision. At the time, however, I believed the plan to be in the public interest, as did all of my fellow Commissioners. All Commission votes on the California plan were unanimous.

The market opened in early 1998, and seemed to function reasonably well until May 2000 when prices began to spike wildly. The market was severely dysfunctional, manipulation occurred and market power was exercised, and the extraordinary prices were unlawful. Despite my early advocacy of full time price controls that would have ended the crisis, the Commission failed to intervene forcefully. This failure of intervene early was mistake number two. Fortunately, the Commission finally took forceful action to stop the economic carnage by imposing full-time price controls on June 25, 2001. Had the Commission intervened early in the crisis with effective price mitigation, this economic catastrophe could have been largely avoided. Opportunities for manipulation would have been substantially reduced early in the crisis, just and reasonable prices would have been largely ensured, and the need for refunds would have been sharply reduced or perhaps even eliminated. There would have been no or few long term contracts with unjust and unreasonable prices. These facts are also an important part of the history of how the Commission got to this point.

As mentioned earlier, the Commission's original actions to approve the California market design were taken during 1996 and 1997. Various aspects of the California restructuring were under consideration by the Commission for well over a year. I am sure I had ongoing discussions and meetings with Commission staff on a number of issues. I do not, however, have specific recollections about any particular meetings and discussions that occurred. Our orders dealing with the California plan resolved scores of issues raised by the parties. There could have been internal staff memoranda or analysis of California's plan, but I have no specific recollection of the content of such memoranda or analysis. I do not have in my possession any written documents or notes that would be responsive to your question.

I have a general recollection that staff raised issues about the separation of the ISO and Power Exchange, the reliance on short term markets, and market power mitigation. However, I do not recall a clear staff recommendation to reject these features of the plan. Our staff did, however, recommend a rejection of the state residency requirement for members of the ISO and Power Exchange boards, as well as the aggressive role of the state's Oversight Board over features that were jurisdictional to FERC. I agreed with staffs recommendation, as did my fellow Commissioners. I have a general recollection that FERC staff also expressed support for the structural unbundling of transmission and the transfer of operational control to the ISO. Staff supported the desire of California to rely on competitive wholesale markets. California's approach was consistent with the Commission's long-term policy goals. Overall, I have a general recollection that staff comments were much more supportive than critical of the plan.

Question 2. Please fully discuss what you did in response to the concerns raised? You mentioned at the Senate's March 27th hearing that you found merit in the concerns expressed by staff and in those comments filed by intervenors raising concerns about California's plan before you voted.

Answer. I read briefs submitted by the parties both supporting the California plan and raising concerns. I considered all of the views expressed along with any recommendations or opinions expressed by staff noting concerns or expressing support for the plan. I discussed these matters with my fellow Commissioners, and listened to their views. There was little or no interest among my fellow Commissioners in making major changes to the plan, although we did vote to eliminate the state residency requirement for the ISO and Power Exchange boards, and we limited the role of the Oversight Board. I satisfied myself that my vote would be in the public interest. I dealt with these issues the same way I deal with all matters to come before the Commission.

Question 3. Please describe the concerns that you found had merit and how you resolved those concerns to justify voting in favor of the plan. Describe changes to the plan that you recommended, if any, before voting.

Answer. I had some concern about the separation of the ISO and Power Exchange, the reliance upon short term markets, and the adequacy of market power mitigation

and monitoring. At that time, there was a vigorous debate within the industry about the wisdom of ISO/Power Exchange separation. There was certainly no consensus, however, that separation was a flawed concept. The ISO/Power Exchange separation was mandated by state law, and the California PUC insisted that load serving entities purchase all of their needs through the spot markets. This latter feature was a key part of California's stranded cost recovery plan for the utilities. Our Commission Chair did not recommend rejection of these features, and my fellow commissioners had little or no interest in modifying them. On balance, I voted for the plan because despite some concerns it seemed reasonable, and the Commission's policy at the time with respect to market structure was based upon a theory of regional deference. It was much earlier in the restructuring debate, and Commission policy was that a variety of wholesale market designs could be appropriate and in the public interest.

During our internal debates, I believe I made proposals to strengthen the plan's market power mitigation and monitoring features. I believe my proposals were accepted at least in part by our orders, but I have no written records and am relying upon memory. Hence, I am unable to provide details on the proposals I made.

Question 4. After you voted to approve this flawed plan, and California implemented the flawed new market structure, what changed your mind about having voted for the California experiment? Was that something that the Commission staff had predicted before you voted for the California Plan?

Answer. My mind was changed when the California market spun out of control in the summer of 2000 and the Commission failed to intervene effectively to ensure just and reasonable prices. I began to champion a more standardized market design that relied upon existing long term contracts, and strong up front market power mitigation and monitoring measures. This became the basis for our proposed Standard Market Design (SMD). I do not recall any specific predictions by our staff.

Question 5. Did you understand at the time you voted for the California Plan the bad impact retail rate caps would have if demand rose more than supply? If not, please explain why you thought they would not cause harm. If so, since the rate caps remained in place throughout the California debacle, please explain what made you realize the flaw in retail rate caps? Did you ever urge cap removal? If so, please document. If not, why not?

You said at the March 27th hearing that you will "never make that mistake again" of approving a flawed market and one that can be "gamed," as you put it. Recall that the California design emerged from very lengthy stakeholder meetings with the great experts of the time, similar to what you describe you are undertaking with respect to Standard Market Design.

Answer. Whether to have retail rate caps is solely a matter of state law or policy and is not for federal regulators to deternline under existing federal law. I did not urge retail rate cap removal. Had the Commission insisted through effective price mitigation that wholesale prices remain just and reasonable, retail rate caps would probably have worked fine. I did urge forceful wholesale price mitigation.

Question 6. Can you assure me that you would not make the "mistake" again of approving a flawed market that cannot be gamed? Do you think it ever possible to design a market that cannot be "gamed"? Please cite to me an actual electricity market that could not be "gamed"? I understand that even PJM, which the Commission likes to cite as the exemplar, has had problems with gaming. Please cite to me the Commission orders describing the incidents. Explain why you think you can do it when no one else yet has.

Answer. My testimony was that I would not again vote for a market design that can be easily gamed. I believe that policymakers can design an electricity market that cannot be easily gamed. Clear bidding rules, tough penalties, up front mitigation measures and effective market monitoring can make gaming a much less successful strategy.

I can recall three cases involving manipulation in PJM markets. In all cases, however, the problem was detected early by PJM or its market monitor, and corrections were proposed that effectively stopped the abuse well before there was a significant impact on consumers.

PJM Interconnection, L.L.C., 95 FERC 61,175 (Redistribution Order), *reh. denied*, 95 FERC ¶61,477 (2001). Docket No. ER01-1440.

PJM Interconnection, L.L.C., 95 FERC ¶61,330 (Seasonal Order), *reh. denied*, 96 FERC ¶61,206 (Seasonal Rehearing Order) (2001). Docket No. ELO1-63.

PJM Interconnection, L.L.C., 92 FERC ¶61,013 (Docket Nos. EROO-2445-000 and EL00-74-000) (2000), *reh. denied*, 93 FERC ¶61,157 (2000) (Minimum Run Time Order).

PJM Interconnection, L.L.C., 97 FERC ¶61,319 (Docket No. ELO1-122-000) (2001), *reh. denied* (PECO Order).

RESPONSE TO QUESTION FROM SENATOR GRAHAM

Question. Economic dispatch has been discussed as an approach to facilitate the procurement of least cost power in the wholesale marketplace. What is your opinion of this concept?

Answer. Economic dispatch is the industry standard and should continue to be utilized. It enjoys broad support at the Commission. In fact, the Commission's Standard Market Design proposal is for each RTO to establish a spot market that operates pursuant to a bid-based security-constrained dispatch in which the generators that bid the lowest are dispatched instead of more expensive generators.

RESPONSES TO QUESTIONS FROM SENATOR SMITH

Question 1. The proposed rulemaking has a series of financial tools that are supposed to address transmission congestion. It is my understanding that this financial instruments may be auctioned off. How do these tools benefit the retail customer—the mom and pop grocery store B in a transmission constrained area? What happens once these tools are no longer available, if new transmission has yet to be constructed?

Answer. I believe that the SMD Final Rule should simply assign these congestion rights (relying upon state recommendations) to wholesale customers who need them to meet their obligations to retail consumers. We must ensure that customers have protection from congestion costs equal to or superior to the pre-existing congestion rules. Certainly the protection from congestion costs provided by these instruments should be available during all periods of present or future congestion.

Question 2. What is the longest transmission contract that any new market entrant could get under Standard Market Design? Will that allow for lending for new investments, and for the recovery of capital investments on non-utility generation?

Answer. The SMD NOPR places no limits on the length of contracts.

Question 3. You provide financial incentives for utilities that relinquish control over their transmission assets. Have you calculated how much that will cost the retail customers nationwide?

Answer. The financial incentives are intended to ensure that the transmission grid is operated independently, and new transmission investments are made. These improvements in transmission will allow the cheapest generation to reach customers. Generation is more than half of the consumer's bill, while transmission is about 7 percent in most areas. Thus, our incentive policy should reduce costs to retail consumers nationwide.

Question 4. There is no question that certain sectors of the electric utility industry face a wide range of financial challenges, particularly those corporations with merchant plants or energy trading and marketing operations. These challenges include: excess generating capacity and thin profit margins in parts of the country; extensive credit downgrades since 2001; high levels of debt; the need to refinance tens of billions of dollars in short-term debt; reduced electricity demand; and continued regulatory uncertainty.

(a) Will SMD solve the problem of excess generating capacity in certain regions of the country?

(b) Will SMD solve the problem of thin profit margins in certain regions of the country?

Answer to 4(a) and 4(b). SMD will certainly help. By enlarging regional markets and eliminating trading seams among regions, SMD will provide greater market opportunities for cheaper generation to reach distant customers. This will provide profit opportunities for generators that can compete. This will benefit the customers as well, which is the primary purpose of SMD.

(c) Will SMD solve the problem that there is $90 billion worth of industry debt that needs to be refinanced in the next 3 years?

Answer. Again, SMD will help. Wall Street representatives who testified before the Commission at a day-long hearing in January 2003 were virtually unanimous in strongly endorsing SMD. They said that successful refinancing would be facilitated by an industry defined by reliable, stable, and enduring markets, clear behavioral rules, and effective monitoring and oversight. These are the hallmarks of SMD. Industry leaders and investors agreed that SMD would help to promote necessary capital formation, both debt and equity, in the energy industry.

(d) Will SMD solve the problem that, nationwide, demand for electricity is down about 4 percent from 2000?

Answer. The decline in electricity demand is primarily a function of a poor national economy. SMD will not solve this problem, but will ensure that customer-friendly electricity markets are in place when the economy revives.

RESPONSES OF JIM TORGERSON TO QUESTIONS FROM SENATOR CAMPBELL

Question. Why does it take so long to set up a voluntary RTO?

Answer. The amount of time it takes to set up a voluntary RTO is a function of many factors, prominent in the Midwest were:

1. Lack of a pre-existing tight power pool;
2. Establishing certainty as to structure and functions;
3. Establishing certainty as to geographic scope;
4. The interrelation of State and Federal regulatory approvals; and
5. Variations in motivations of transmission owners, regulators and other stakeholders.

My conclusion is that enough entities, their regulators and enough of their customers that represent a coherent geographic region have to agree to a core mission for the organization. Establishing that agreement on the core mission takes time. Everyone does not have to agree with every aspect of an RTO, but it has to be of value and be perceived to be of value to its key stakeholders in order for transmission owners to be willing to turn over functional control of their systems to an independent entity. The States whose customers will be impacted by these decisions must similarly recognize the value of the new arrangement. They must trust the structure set up for the RTO, often in advance of knowing who the people are who actually will lead it, its independent Board of Directors and Officers. The economic outcomes perceived to be likely from the transfer have to be regarded as fair for asset owners and customers. In different regions of the country the background circumstances facing the organizers of an RTO (retail rates, pace of retail choice or divestiture, presence of Federal Power Marketing agencies, difficulty of access to sources of power by TDUs, presence of a power pool or regional tariff, etc.) often differ. They also differ within a region over time. As stakeholders face the decisions necessary to move forward in the steps to create an RTO, they also need some degree of certainty as to the regulatory framework they will be operating under.

The timeline for creation of the Midwest ISO first as an ISO and then to transform it to become an RTO was as follows:

- Regional efforts at solutions to the contract path dilemma—1993 forward
- FERC Order No. 888—May 1996
- Initial negotiations—two years starting in 1996
- Initial application to the FERC—January 1998
- First FERC order approving the Midwest ISO—September 1998
- Independent Board elected—January 1999
- FERC Order 2000—December 1999
- Midwest ISO independent financing closed June 2000 ($100 million)
- RTO status sought January and August 2001
- RTO status granted December 2001
- Start of Midwest ISO transmission service February 2002

Question. Allen Franklin, CEO of Southern Co. testifies that public power owns and operates 30% of the transmission system in the U.S. And that they need to be "fully FERC jurisdictional" to ensure a competitive wholesale market.

Please give us specific examples of occasions when access to surplus transmission was requested and refused by public power systems. Can you name the public systems you haven't gotten access to?

Answer. Because the Midwest ISO operates the systems over which it has been given control and is not a participant in the transmission markets itself—that is the Midwest ISO has not and does not request transmission service over other systems—it has never been refused a transmission service request by any party. The Midwest ISO administers its transmission tariff over a system that includes some municipal or cooperative owned systems. For instance, the City of Springfield, Illinois Light and Water Department, Indiana Municipal Power Agency, Hoosier Electric Cooperative, Inc. and Wabash Valley Power Association are all Midwest ISO transmission owner members.

Question. Do you believe that Participant Funding combined with tradable Transmission Rights at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by FERC would increase the capacity of the transmission system?

Answer. The Midwest ISO supports cost allocation principles that recognize that the entity seeking to interconnect with the transmission grid should pay the cost for that transaction. Also, where the addition to the grid can be shown to provide benefits to existing load, those consumers with their state's concurrence, should pay a portion of these transaction's costs. Under all circumstances, the identification of these costs and benefits must be made by an independent transmission organiza-

tion. The addition of assigning tradable transmission rights to the parties that pay for upgrades is an important factor. The combination of the two principles should allow the construction of those facilities that would increase the capacity of the transmission system to deliver the capacity of new sources of electrical generation into the grid for the benefit of the local area and the wholesale market.

Question. There seems to be a widening rift between the States and the FERC on the FERC's plans for energy market. If we continue this path, we could be headed for years of litigation and no progress. What can be done now to avoid this continuing rift?

Answer. In the Midwest region, while there is some disagreement between the states and the FERC on some issues, generally, the states support a broad market scope, with minimal and rational economic seams for the region. The formation of the Midwest Multistate Committee for interaction with the Midwest ISO on various matters is an example of how, in our region at least, the rift can be bridged.

RESPONSES OF ALLEN FRANKLIN, CHAIRMAN AND CEO, SOUTHERN COMPANY, TO QUESTIONS FROM SENATOR CAMPBELL

Question. It seems in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electricity sector?

Answer. EEI members differ as to whether or not SMD will further or undermine electricity deregulation efforts. All EEI members support some parts of the proposed SMD rule, but none support all of its aspects. The association believes that regional differences must be accounted for in developing rules governing market design and institutions, and that the current proposal does not adequately account for such differences.

Southern Company, in particular, believes that the SMD proposal would greatly broaden FERC's size and power, and would unnecessarily place the Commission in the role of a centralized planner for regions and the nation. In our view, the proposal usurps many traditional state roles with respect to electric service, reliability and planning. In certain regions of the country, including the Southeast, the FERC's SMD proposal has been counter-productive to the formation of regional transmission organizations (RTOs) and the furtherance of wholesale competition in the region. The Commission's decision to assert authority over the transmission component of bundled retail sales, and its proposals that would remove the ability of utilities to give priority to their own customers has created a firestorm of protest and concern among the states. The Commission has proceeded with this rule in spite of the fact that we were already well along in the formation of an independent RTO for the region that would have met most of the objectives that the Commission seeks in its SMD proposal.

The SMD proposal is not the best way to proceed to achieve the Commission's goals for efficient and reliable wholesale markets that benefit end-use consumers. Market rules and institutions, in our view, must be tailored to regional needs and circumstances. The Commission must take regional differences into account in considering these significant changes to the regulatory framework for the electric utility industry.

Question. How does SMD account for regional differences in electricity markets?

Answer. Under its current formulation, the SMD proposal does not account for regional differences. It basically establishes a single set of rules and a single market design that all regions would have to follow. We believe that much more regional flexibility is required. The best way for FERC to proceed in this regard would be for the Commission to sit down work jointly with state regulators to implement market designs and institutions that are appropriate for each region.

Question. Why does it take so long to set up a voluntary RTO?

Answer. Insetting up a regional transmission organization, there are literally thousands of details that must be worked out and negotiated among the stakeholders. A new organization basically has to be started from the ground up, including the selection of a Board of Directors, the hiring of employees, the development of all the internal systems, etc. There are new software systems that must be developed to manage the transmission system, and telecommunications links have to be developed. Agreements must be reached between the transmission owners and the new organization on the details of transferring control over transmission, and a new tariff and operating protocols must be developed for the new organization. New markets must be established, and the rules of those markets must be negotiated. Software and hardware must be tested. And all of this must be done in a way that en-

sures that reliability is not harmed in the transition from utility operation to RTO operation.

Regulatory approvals are also required, both from the FERC and from all of the state commissions that have jurisdictional facilities that would be utilized. In most cases, this requires hearings and evidentiary proceedings. And all changes have to go back through a regulatory approval process. We are talking about a major change in the way that utility system are operated, and any such major change must be undertaken with caution and care, so that consumers are not affected. It is more surprising to me that we have been able to make such significant progress with RTOs in just a few short years since the concept was introduced with FERC Order 2000. Those who are impatient with the process probably don't fully understand the complexity of forming such organizations and getting them up and operating successfully.

Question. Please give us specific examples of occasions when access to surplus transmission was requested and refused by public power systems. Can you name the public systems you haven't gotten access to?

Answer. While we cannot speak to other investor-owned utilities, Southern Company has not been specifically refused access to public power systems in our region. In fact, we are working with other public power entities in our region to form the SeTrans RTO to continue to ensure that all utilities in the region will have fair and non-discriminatory access to transmission systems. We do believe it is important that all transmission owners, be they private, public, or cooperatively-owned, participate in competitive wholesale markets and play by the same rules. Since these non-private utilities control about one-third of the transmission system in our region, their participation is vitally important.

RESPONSE OF BUD PARA OF JEA TO QUESTION FROM SENATOR CAMPBELL

Question. Are you aware of any complaint issued by Southern or any other requestor of access that you have failed to give access to your surplus transmission?

Answer. Southern Company is not aware of any situations in which JEA has failed to provide access to their surplus transmission.

RESPONSE OF PAT WOOD, FERC, TO QUESTION FROM SENATOR CAMPBELL

Question. Your SMD assumes that competition benefits everyone. Yet some states have opted against opening up to competition. How can the SMD respect states' traditional authority while compelling them to do something they have been unwilling to do all along?

Answer. Southern Company believes that even those states that have decided not to move to retail competition and customer choice do recognize the value to consumers of competition in wholesale electric markets. In fact, almost all of these non-retail access states were moving towards the development of RTOs and the formulation of new wholesale market designs before FERC issued its SMD NOPR, mostly with the guidance of FERC Order 2000. We do not believe that FERC should compel states to implement SMD if the states do not believe it is in the best interest of their own consumers. Wholesale competition will have greater benefits in those regions that have retail competition. It is appropriate that other regions take a more measured approach and develop institutions and markets appropriate to their own circumstances over time. Such an approach is more likely to avoid years of litigation and will be more successful in achieving the goals that we all seek—reliable supplies of electric power at the lowest possible cost to consumers.

RESPONSES OF FERC CHAIRMAN AND COMMISSIONERS TO QUESTIONS FROM SENATOR GRAHAM

Question. Economic Dispatch has been discussed as an approach to facilitate the procurement of least cost power in the wholesale marketplace? What is your opinion of this concept?

Answer. Southern Company believes that utilizing economic dispatch as a means "to facilitate the procurement of least cost power in the wholesale marketplace" would have major impacts on current state regulation of electric service to retail consumers, particularly in those states that have decided to continue to have that service provided by vertically-integrated, regulated utilities. It has the potential to cause significant cost increases to retail customers by requiring states to move from cost-based economic dispatch to bid-based, competitive economic dispatch. While the

idea is admirable—that utilities should look at lower cost alternatives available in the wholesale marketplace in determining what plants to run on an hourly basis, attempting to actually include wholesale alternatives in economic dispatch would create major disruptions to utility operations and create significant additional costs.

Utilities already base the dispatch of their generators not only on an economic dispatch of resources we own, but by also considering generation resources available from the market. Since the passage of FERC Order 888, we have willingly accepted, solicited, and provided voluntary market-based bids/offers from/to the wholesale market. We have a regulatory obligation to evaluate opportunities available in the wholesale market not only on an economic basis but on the wholesale supplier's ability to deliver, as well. A few of the issues we must evaluate include generation operational issues, commitment costs of generators, transmission limitations, or as we have seen in the recent past, creditworthiness. Likewise, we have an obligation to serve our native load today and will have this obligation in the future, as well. Therefore, we must evaluate our market bids/offers with a longer term outlook than many other market participants. Furthermore, our PSC mandate to provide long-term reliable service forces us to evaluate the long-term effects of any short-term opportunity. Our evaluations must focus on providing a balance between providing energy at the lowest cost possible while maintaining the reliability levels our customers have come to expect and the type of service they expect in the future.

Southern Company is actively participating in the formation of SeTrans which proposes to utilize a market design that includes a spot market. All generators that are not committed under bilateral contracts will have an opportunity to bid into the spot market, and load-serving entities will be watching the spot market for opportunities to buy lower cost power to replace their own resources. This is a much more logical mechanism for ensuring the use of the lowest cost resources. Including wholesale supplies in economic dispatch would thus be an interim solution only, and a solution to a problem that doesn't exist.

RESPONSES OF FERC CHAIRMAN AND COMMISSIONERS TO QUESTIONS FROM SENATOR LANDRIEU

Question. Do you believe that Participant Funding combined with Tradable Transmission Rights at the discretion of a Regional Transmission Organization (RTO), or a transmission entity authorized by the FERC would increase the capacity of the transmission system? Clearly state your positions for or against this.

Answer. EEI does not have a position on participant funding, but does believe that costs of transmission improvements should be paid for by those who create the need for and benefit from the improvements. Participant funding is but one way that this principle can be satisfied.

Southern Company does believe that participant funding with tradable transmission rights is the best way to ensure that both generation and transmission owners have the right price signals to build new generation and transmission where it is needed and where it will save consumers the most. And if those who fund transmission improvements can capture the economic value of their investments via tradable transmission rights, then capacity that reduces congestion is much more likely to be built than in a pricing regime where someone has to pay for transmission but can not reap the benefits of the investment. We believe that in a market design that relies on congestion pricing and tradable transmission rights to hedge congestion, participant funding is critically important to ensure the development of efficient markets.

Question. There seems to be a widening rift between the States and the FERC on the FERC's plans for energy markets. If we continue this path, we could be headed for years of litigation and no progress. What can be done now to avoid this continuing rift?

Answer. Southern Company agrees that if we continue down the current path planned by FERC for energy markets, we will be in for years of litigation and increased uncertainty. The best way to avoid this continuing rift is for the FERC to work directly with states to tailor market design and institutions to meet the needs of individual regions, rather than relying on a cookie-cutter approach to a national standardized market design. In particular, FERC must work with states to ensure that the needs of retail and other native load customers are addressed, that planning and reserve margins are tailored to regional needs, and that transmission pricing and interconnection costs are paid for by those who create and benefit from the incursion of those costs. Furthermore, Congress should settle the jurisdictional fight over bundled retail transmission by clarifying that states that continue to regulate bundles retail sales will continue to have jurisdiction over all aspects of those sales.

RESPONSES OF PHIL TOLLEFSON'S TO QUESTIONS FROM SENATOR CAMPBELL

Question. It seems that, in many ways, SMD actually undermines electricity deregulation efforts. Would you agree that current SMD regulations allow FERC to greatly increase its size and power; in effect making it the centralized planning agent for the entire electric sector?

Answer. This question goes to the heart of one of our central concerns with the SMD proposal. The Federal Power Act establishes the FERC as a regulatory body. The SMD proposal clearly demonstrates that the FERC is not satisfied with its role as regulator, but rather wants the opportunity to redesign the electric industry in a fashion of its liking; it is assuming a planning function and neglecting the regulatory role Congress has delegated to it.

At a time of traumatic market dislocation, the market participants in the West—thankfully with the help of members of Congress—have had to goad the FERC to address the pervasive market manipulation that resulted from the failed California experiment in industry restructuring. When the FERC should have been acting aggressively as a regulator to address the unjust and unreasonable prices existing in the West, instead it chose to "one-up" the California market planners by creating the FERC's own "better mousetrap" for industry restructuring in the guise of SMD. The electric industry and its consumers would all be better off if the FERC devoted its attention to its role as regulator, the role assigned to it by Congress, and left arcane aspects of theoretical market efficiencies to college professors.

Question. How does SMD account for regional differences in electricity markets? How will this specifically affect western state utilities and their customers?

Answer. As proposed, the SMD rule makes virtually no account for regional differences. Regional differences are significant and, as this has been pointed out, the FERC has made statements, often vague and contradictory, about its willingness to recognize and accommodate these regional differences. Colorado Springs Utilities has not taken any great comfort from these statements.

As is recited in the comments submitted by Colorado Springs Utilities in the SMD docket, the West differs from the PJM region in numerous significant respects. The Western Interconnect is geographically expansive and sparsely populated; PJM is geographically compact and densely populated. The topographic and meteorologic features of these two regions are vastly different and have resulted in different utility system designs and constraints. The Western Interconnect is heavily reliant on hydropower resources, PJM is not. An additional and often overlooked difference is the regulatory nature of the utilities in the Western Interconnect. Many of the utilities in the West are not FERC-jurisdictional. In fact, geographically a majority of the West is served by municipal utilities, cooperatives and tribal authorities and much of the regional transmission backbone is owned and operated by federal power marketing authorities.

The FERC is trying to pound square pegs into round holes. Given the recent refusal of the FERC to recognize and effectively address the market dislocations resulting from the failed California restructuring experiment, we are very concerned about the willingness of the FERC to acknowledge and deal with the market dislocations of its own creation if SMD is implemented in its present form.

Question. Many statements have been made that California's recent electricity crisis was a regional crisis. I know that when California needed or wanted water they got water from Colorado, now when they need power are they going to take Colorado power? What impacts will California's current problems have on Colorado and the other Rocky Mountain States?

Answer. This is a good question, and the answer is complicated. During the California blackouts, when it appeared that California was in desperate need of power, Colorado Springs Utilities as well as many other systems throughout the Western Interconnect did their level best to provide any excess power to assist the residents of California. We did this for two reasons: First, we function in a market economy and it was beneficial for Colorado Springs Utilities to provide excess power to California. Second, and every bit as important, the people who work within the traditional "natural monopoly" utility industry are thoroughly imbibed with the belief that reliability is "job one". If another utility is facing an operational threat, we will do everything within our power to assist.

Practically our ability to assist California was hindered by transmission constraints. But this gets back to the point of the regional nature of the California crisis; even though Colorado utilities could provide little power into California due to transmission constraints, prices for power increased dramatically throughout the West. When Colorado Springs Utilities encountered unit outages, and unfortunately we did during this period, the prices we had to pay for replacement power were quite high. What is particularly disturbing is that it is now clear that many of the

California power "shortages" were the cynical creations of market manipulation. The electric industry and its customers throughout the West suffered great economic harm, and the FERC has still not effectively addressed the underlying issues of market manipulation.

As the chief executive officer of a utility that takes its obligations to provide reliable service to the public seriously, we are concerned about the lingering impacts of the California restructuring experiment and fear the repercussions of the SMD experiment, if it moves forward. That is why we favor provisions that recognize native load responsibilities and afford protections for native load service.

Question. Have you been asked to provide open access transmission? How many times? By who? Did you grant the request?

Answer. Colorado Springs Utilities was one of the first non-jurisdictional utilities to file an open access transmission tariff with the FERC. Until recently we had no requests for service under this tariff. The Front Range Power Company is about to go into commercial operation with a generation facility south of the Colorado Springs metropolitan area. Colorado Springs Utilities will provide transmission service to Front Range under its open access tariff. We also anticipate a request for transmission service from the City of Fountain for the delivery of wholesale power through our system, and we believe we will be able to accommodate this request.

Before we filed our open access transmission tariff with the FERC in 1997, Colorado Springs Utilities received only one request to wheel through our system. In 1994 through 1996 WestPlains was allowed to wheel through our system to accommodate them until they completed building their tie. Colorado Springs Utilities has never declined a transmission request.

Question. Allen Franklin says this has been a terrible time financially for investor-owned utilities. In fact, there have been over 180 IOUs downgraded and pending bankruptcies of the merchant power sector. These are indeed tough times. How has public power fared during the same period? What has Wall Street said about public power? Are you building generation and transmission?What is your debt load?

Answer. Standard & Poor's recently issued a credit analysis report on the public power sector that noted that the credit rating stability of public power "is a testament to the sector's ability to withstand periodic shocks as well as respond to new challenges." More than 80% of the public power sector has an "A" rating or better at this time and public power systems are functioning well in competitive wholesale markets. A strength of public power systems is our focus on providing the lowest-cost power to our customers.

Many LPPC members have built transmission systems to accommodate load growth. It is in our members' best interest to both build for load growth and to make excess transmission capacity available to the market place. Load serving entities and their customers who prudently built transmission to accommodate future load growth should not be deprived of the benefit of that investment by having their future right to use that transmission taken away. There are mechanisms in place by which entities can assure that transmission upgrades are made when transmission customers are willing to bear the cost of those upgrades. We believe that the building of new transmission should be encouraged and believe that properly structured incentive rates might be able to encourage such investment.

As of December 31, 2002 Colorado Springs Utilities total asset value is $2.07 billion with $1.04 billion in long-term debt.

Response to Question From Senator Graham

Question. There seems to be a widening rift between the States and FERC on the FERC's plans for energy markets. If we continue this path, we could be headed for years of litigation and no progress. What can be done to avoid this continuing rift?

Answer. The litigation to which you refer has a schizophrenic nature. Much of this litigation is a reaction to the efforts of the FERC to extend its jurisdiction into areas traditionally reserved to the States, while at the same time victims of the Western energy markets are going to court to force the FERC to perform the regulatory functions delegated to it. Congressional action can help on both fronts. Legislation that clearly delineates the bounds of FERC authority would be helpful. It would also be helpful for the Congress to remind the FERC that its first responsibility is that of a regulator ensuring that wholesale electric rates are just and reasonable.

APPENDIX II

Additional Material Submitted for the Record

WESTERN BUSINESS ROUNDTABLE,
Golden, CO, March 27, 2003.

Hon. PETE DOMENICI,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I am writing on behalf of the Western Business Roundtable. Our members represent a broad base of industry sectors across the West, including construction, manufacturing, retail sales, refining, iron and steel, mining, electric power generation and oil and gas exploration and development.

The Roundtable wishes to provide comment on the March 20, 2003 Senate Energy and Natural Resources staff discussion draft of a proposed electricity title to comprehensive energy legislation. Specifically, we would like to express concern regarding the language that would create so-called Regional Energy Service Commissions (RESCs).

We applaud staff for attempting to move along the discussion regarding clarification of federal vs. state authority in the development and governance of the wholesale electricity market. We agree that, ultimately, the only way out of the long-time jurisdictional quagmire that has hampered development of robust regional electricity markets is through a model that allows stakeholders within regions an adequate role in the development and operation of those markets.

However, we believe that the model articulated in the staff draft will not prove effective in expediting solutions to the significant electricity infrastructure challenges facing the West. In fact, as currently structured, the model will likely add further regulatory uncertainty and delay into an already unsettled market environment.

The Roundtable has developed a model for "Regional Market Design" that we believe strikes a more appropriate balance of power between the states and the Federal Energy Regulatory Commission, and which can be instituted without upsetting long-standing authorities granted to FERC under the Federal Power Act.

We respectfully request that our proposal, which is attached, be entered into the record. Thank you very much.

Sincerely,

JAMES T. SIMS,
Executive Director.

REGIONAL MARKET DESIGN

A PROPOSED MODEL TO ENCOURAGE GREATER INVESTMENT IN WESTERN AND OTHER REGIONAL WHOLESALE ELECTRICITY MARKETS

I. BACKGROUND: STORM CLOUDS ON THE HORIZON

Over the past decade, unprecedented changes in the electricity industry have uncoupled the historic link between new electric generation and transmission construction. While competitive wholesale electricity markets depend on a strong transmission system to flourish, uncertainty has arisen about the roles and responsibilities for developing infrastructure.

While electric utilities in the West have done an excellent job of ensuring the reliability of the transmission systems serving their native load, few new Western regional transmission improvements have been made in the last 20 years.[1] Worse yet,

[1] The grid (the so-called "Western Interconnect") is composed of the geographical area containing the synchronously operated grid in the Western part of North America, including parts of

Continued

little is on the drawing board for the next 10 years. This inertia has occurred while the West's electric load has grown explosively—60 percent between 1982 and 2002 and another 20+ percent expected over the next decade. While thousands of megawatts of new natural gas generation capacity located near load has been added to meet much of this growth, the lack of significant transmission expansion has created a situation where the West is increasingly exposed to the fuel price volatility of natural gas.

A major lesson learned during the 2000-2001 Western electricity crisis was that transmission grid deficiencies exacerbated a cascade of problems. Supply scarcity, market manipulation and input fuel price volatility all led to dramatic electricity price spikes that heavily burdened all consumers and drove a number of important Western industries to the edge of extinction.

Western Consumers Facing New Price Pain

Now, consumers in some parts of the West are being threatened with rising electricity and natural gas utility bills—just as they were in the energy crisis of 2000-2001. Spot market prices for natural gas are over 300 percent higher than they were a year ago. Further, hydroelectric output for the coming year is expected to be not just below normal, but below last year's level, likely causing a further draw on an already tight natural gas market. Many natural gas market analysts are projecting that natural gas prices could reach a permanent plateau of $4.00—$5.00/mmbtu. These fuel price spikes, coupled with a lack of transmission to provide alternative electricity supply, puts consumers in many parts of the West in a position to take it on the chin again unless decisive action is taken now to address transmission grid deficiencies.

Transmission Infrastructure Key To Insulating Consumers

The Western Business Roundtable (Roundtable) participated with the Western Governors' Association (WGA) in the development of the 2001 WGA report entitled "Conceptual Plans for Electricity Transmission in the West." That report concluded that increased transmission infrastructure is an important tool to insulate the West from electricity price volatility due to hydro availability and fuel price volatility, while at the same time enabling remote low-cost coal and renewable resources to be expanded and integrated into the Western fuel mix.

The report went on to note that increased transmission infrastructure will help mitigate market power issues, where one or a few generators can dictate market prices in an area because there is not enough transmission in place to get competing generation into the market area.

II. CURRENT STATE OF PLAY

Though there is wide recognition that the Western region needs significant new investment in regional transmission in order to sustain future growth, little progress has been made toward that goal. With the exception of joint siting protocols developed by the WGA and their federal counterparts, few other concrete steps have been taken towards answering two critical questions:

1. What facilities are needed in the West?
2. How can an environment be created that will allow such projects to be financed and built?

There are many reasons for this, but most boil down to the lack of clarity regarding federal versus state regulatory authority. The political battles surrounding those ambiguities have paralyzed legitimate efforts to make progress on these two questions. Exasperating the political tensions are some operational and institutional characteristics unique to the Western region:

- In many parts of the region, there are long distances between the low cost hydroelectric and coal generating facilities and major load centers. This characteristic promotes unscheduled flows among various loads and generating points, resulting in adverse effects on transmission users.
- Hydropower plays a major role in the region's wholesale electricity market.[2] Most of this generation is provided by federally constituted agencies (Bonneville Power Administration and the Western Area Power Administration) that have other objectives to take into consideration in addition to electricity power pro-

Montana, Nebraska, New Mexico, South Dakota, Texas and Wyoming and all of Arizona, California, Colorado, Idaho, Nevada, Oregon, Utah, Washington and the Canadian providences of British Columbia and Alberta.

[2] For example, in the Northwest Power Pool Area 62 percent of the capacity is supplied by hydropower. In the WECC, as a whole, 39 percent of its generation comes from hydro.

duction. Many such facilities are linked, with multiple dams utilizing the same water to produce electricity. In addition, there are many non-energy constraints on how and when the water may be used, including irrigation, species habitat preservation and recreation.

- Multiple parties jointly own many large nuclear, coal and hydro generating facilities and appurtenant transmission lines and switchyards. Such multi-party ownership presents unique operating and contractual challenges to market participants.
- There is a high concentration of non-jurisdictional utilities, including federal power marketing agencies, municipalities, rural cooperatives and generation and transmission providers. In some cases, such non-jurisdictional utilities completely surround jurisdictional utilities. Imposition of any changes to the Western electricity grid and its operations must include these entities.

There are currently two proposed Regional Transmission Organizations (RTOs) in the West—RTO West, comprised of utilities in the Pacific Northwest, and WestConnect, an RTO located in the Southwest. California's existing Independent System Operator (ISO) also provides independent transmission service to electricity users. Each of these entities has proposed and received conditional Federal Energy Regulatory Commission (FERC) approval for market designs that have critical and fundamental differences. These differences are proposed to be resolved through establishment of the Seams Steering Group-Western Interconnection (SSG-WI).

SSG-WI is intended to serve as the discussion forum for: 1) facilitating creation of a seamless Western market; 2) proposing resolution of issues associated with differences in RTO practices and procedures; and (3) identifying the benefits of important multi-state/regional transmission projects that need to be constructed to support a regional market. However, the SSG-WI process has been painfully slow in developing. There are a number of reasons for this lack of progress. First, the group is a voluntary collaboration by RTO participants. There is no formal staff or budget for this effort and no concrete deadline for delivery of a Westwide plan. Further, the group lacks legal standing and accountability to resolve numerous intractable issues. Finally, several key Western market participants are not currently signatory to any of the RTOs, thus creating gaps that make it very difficult for SSG-WI to achieve its stated goals.

From an infrastructure perspective, this leaves the region in a very bleak position. The SSG-WI process does not have the authority or the tools to develop and implement a sound region-wide transmission plan to adequately strengthen the grid on the timeline that is necessary to protect consumers. Further, no progress has been made in improving the investment climate for the financing of major transmission projects.

Clearly, a regional planning mechanism is needed so that investors can see a path to a reasonable return on investment. The most likely method for doing so would be establishment of a regional tariff mechanism whereby the customers who benefit from these new multi-state/regional projects share in the cost of them. No such multi-state/regional transmission revenue authority for new facilities exists in the West.

III. THE ROUNDTABLE'S VISION FOR THE WEST

The Western Business Roundtable's vision for the West is one in which:

- Consumers across the West have greater access to a balanced and reliable portfolio of low-cost wholesale power sources and are thus better protected from costly and dangerous price spikes attributable to the volatility of a single fuel source;
- Effective incentives successfully encourage the investment necessary to build the thousands of miles of new transmission lines that are needed to ensure the West benefits from a diverse range of affordable generation sources;
- A robust regional transmission system is capable of efficiently moving adequate and affordable power supplies throughout the grid for all users under various the hydro conditions, fuel prices scenarios or system configurations; and
- Fair and balanced market rules prevent market participants from exercising market power and gaming the wholesale electricity system to the detriment of consumers.

To accomplish this vision, we believe that the jurisdictional ambiguities and market distortions that currently plague the wholesale electricity markets must be resolved and resolved quickly. The West's long-term economic viability depends on it.

IV. THE ROUNDTABLE'S PROPOSAL: WESTERN MARKET DESIGN

A. The Framework

The Roundtable[3] urges state and federal policymakers to consider a Western regional market concept structured around a "delegation of authority" model. Under this approach, Congress would statutorily authorize a Western regional entity with authority to establish and govern a number of critical elements of market design and function, including, at a minimum: 1) regional planning; 2) regional transmission tariff development and administration, and; 3) siting of critical interstate transmission facilities.

Governors of the Western states would take the lead in proposing the specific structure and composition of such a regional entity. The Federal Government would provide sufficient funding to establish the Western regional entity. Once established and functioning, funding for its operations would be provided through a fee on electricity consumption.

We believe this approach could provide a win-win opportunity for both Western States and the Federal Government.

From the States' perspective:

- It would enhance the power of states. Rather than simply being relegated to an advisory role in a FERC-run process, the states, through the regional body, would enjoy real authority to shape and monitor the interstate wholesale electricity market in the region;
- It would provide a framework to achieve what policymakers seek—a regional planning approach developed and carried out by regional stakeholders;
- It would provide an efficient mechanism to truly deal with the range of issues that currently plague the regional market, but which no one state has authority to resolve;
- It would assure that the proper legal and administrative remedies will be available to assure that any state-versus-state conflicts that may emerge can be resolved;
- It would allow a mechanism to adequately fund the planning process, thus solving one of the impediments which currently is hampering progress of the SSG-WI process; and
- It would leave the decision of how and where critical infrastructure projects will be sited and paid for with those policymakers who directly represent impacted consumers.

From the Feds' perspective:

- It would provide an efficient, streamlined mechanism for dealing with unique regional attributes and challenges;
- Because it would require accountability by state and regional entities, it should reduce the amount of needless friction and delay that currently plagues federal officials as they try to work through these jurisdictional issues; and
- Under a delegation regime, Congress and the Federal government would retain overarching authority to make sure that the regional approach being developed by the regional entity does not violate the overall objectives of the Federal Power Act.

B. Critical Organizing Principles

1. All transmission entities within the region—including FERC non-jurisdictional entities, WAPA and BPA—must be involved and treated equitably. In the West particularly, a significant portion of the transmission system is owned by federal power agencies, municipal utilities and rural electric cooperatives. It is critically important that all such entities play by the same rules and be treated equitably. Otherwise, the goal of ending balkanization of the system will be frustrated and regional bottlenecks will continue to exist.

2. The regional planning involved must include the entire West. The regional body should be tasked with identifying: 1) coordination issues needed to be resolved between functioning RTOs; 2) what facilities are needed; 3) when those facilities need to come on-line; 4) cost justifications for each; and 5) what is required to ensure that reliable and affordable service is provided to all consumers in the West.

3. When such projects identified are multi-state in nature, the regional body must have tariff authority and use it to assure that costs are properly allocated among all regional beneficiaries of the project. The costs of multi-state transmission projects should be spread across regional beneficiaries via regional transmission tar-

[3] The Edison Electric Institute, a member of the Roundtable, was not able to endorse all of the elements of this proposal.

iffs, thereby eliminating the pancaking of rates that now occurs. Absent this approach, transmission for low-cost, remote projects will not be built, thereby causing a continued reliance on price-volatile sources built close to load centers.

4. The regional entity needs to be vested with adequate authority for planning, siting and issuance of Certificates of Need. The grant of such authorities is important to assure that critical multi-state facilities can be constructed on the timeline dictated by the regional planning process. It is important to recognize that, in the case of most transmission upgrade projects, only the widening of existing transmission corridors are involved.

5. State regulatory commissions must be assured meaningful roles in governance and operation of the process. This approach should enhance the power of states and state commissions by giving them real authority, via a regional mechanism, to shape and monitor the interstate wholesale electricity market in the region;

6. A clear mechanism to govern operation of the entire interstate grid must be established. We believe that independent entities must be a key component of that system and will go far in mitigating the conflicts of interest that currently occur where wholesale market participants also control transmission planning, rights availability and allocations.

7. Full and open transmission access is critically important. Open and non-discriminatory access is the key to eliminating market power abuses that result from exploitation of imperfections and bottlenecks in the regional transmission grid.

The Roundtable believes that consumers across the West deserve and will demand a transmission system that delivers low-cost and reliable power when and where it is needed. We look forward to rolling up our sleeves and continuing to work with Western Governors, State Public Utility Commissions, Congress, FERC and other stakeholders to achieve this and other important goals.

NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION,
Rosslyn, VA, March 27, 2003.

Hon. PETE DOMENICI,
Chairman, Energy and Natural Resources Committee, U.S. Senate, Washington, DC.

Hon. JEFF BINGAMAN,
Ranking Member, Energy and Natural Resources Committee, U.S. Senate, Washington, DC.

DEAR SENATORS DOMENICI AND BINGAMAN: We understand that the matter of reliable electrical energy has many stakeholders and regret that NEMA was unable to testify at today's hearing on electricity provisions of the draft Senate electricity bill (S. 475). We believe that the 400 manufacturers of electrical equipment that NEMA represents are important players in the electricity enterprise as we make the electricity infrastructure that needs to be improved for the demands of today and the future.

We note that several witnesses pointed out the essential nature of transmission, without which the generation cannot be connected to the customer. We also note that transmission reliability is defined as including adequacy and security. While we support the efforts underway to move to mandatory and enforceable standards under a self-regulated regime, at the same time we note that this helps principally with the security aspect, while investments in infrastructure are needed for adequacy. The decreasing annual investment in transmission infrastructure shows that inadequate incentives exist.

We have attached our written testimony for your consideration. In it we propose the incentives in rates and taxes that we believe are needed for transmission infrastructure improvements to occur. We have made specific comments keyed to the draft bill.

We look forward to working with you and your staff on the legislation needed for all of us to enjoy the economic prosperity that is so dependent on reliable electricity.

Sincerely yours,

EDWARD GRAY,
Director, Energy Policy.

STATEMENT OF DR. GREGORY REED, VICE PRESIDENT, MARKETING AND TECHNOLOGY MITSUBISHI ELECTRIC POWER PRODUCTS, INC., FOR THE NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION

INTRODUCTION

Good morning, Senator Domenici, Senator Bingaman, and members of the Committee on Energy and Natural Resources. I am Dr. Gregory Reed of Mitsubishi Electric Power Products, a U.S. based manufacturer of electric power industry products and systems, and today I am representing the National Electrical Manufacturers Association (NEMA). These remarks are the result of a consensus of a number of NEMA members. The remarks are presented in the format requested in the template for witness testimony.

NEMA is the leading trade association in the United States representing the interests of electro-industry manufacturers. Founded in 1926 and headquartered near Washington, D.C., its 400 member companies manufacture products used in the generation, transmission and distribution, control, and end-use of electricity. Domestic shipments of electrical products within the NEMA scope exceed $100 billion.

NEMA's members have unparalleled expertise in the manufacture of generation, transmission and distribution equipment and systems. As such, NEMA brings important expertise and unique policy perspectives to the issues involved in the ongoing restructuring of the electric utility industry.

My testimony today will address NEMA's perspective regarding issues related to improving electrical transmission system reliability. Specifically, we will comment on the applicable provisions in the draft Electric Transmission and Reliability Enhancement Act of 2003. We also have commented on the March 20, 2003 "STAFF DISCUSSION DRAFT" where an issue in the template is not addressed in the draft Electric Transmission and Reliability Enhancement Act (S. 475).

We applaud the development of a draft electricity bill, and encourage the Committee to assure that electricity provisions are part of any comprehensive energy measure ultimately sent to the Senate floor. Even before the recent meltdown of energy markets, electric transmission system investments were decreasing at 15% per year. With the situation now, with credit ratings and stock values of industry participants far lower than they have been traditionally, it is more difficult than ever for them to make the needed transmission investments and Congressional action is essential.

RELIABILITY STANDARDS

Section 215 of the draft Electric Transmission and Reliability Enhancement Act would establish mandatory and enforceable transmission reliability standards. We support this provision.

NEMA supports policies that create enforceable and mandatory reliability standards to ensure that the interstate transmission grid is not operated in a manner that adversely affects system reliability. Currently, the utility industry operates under voluntary standards established by the National Electric Reliability Council (NERC) with regard to the planning, engineering, and operation of electric systems. Utilities have generally adhered to NERC's guidelines based on a collective concern for the reliable operation of the interstate transmission grid. NERC has no enforcement capability, however, and their guidelines have sometimes been ignored by some market participants.

The term transmission reliability of the interconnected bulk electric system represents both the adequacy and security of the electric system. NEMA is concerned with ensuring reliability through more adequate transmission infrastructure. To date, the operational action typically taken to ensure security has been to reduce load. Improving the infrastructure will decrease the frequency of load reductions.

TRANSMISSION SITING

Section 1221 of the staff discussion draft legislation calls for studies of transmission congestion and designation of "Congestion Zones". These areas would be eligible for special treatment in transmission facility siting. We prefer the approach in the draft House Energy Policy Act of 2003.

A major impediment to the construction of new transmission facilities, especially in the form of new transmission lines, remains the siting and permitting process. In the past, transmission lines were built primarily to meet state requirements to serve a utility's native loads. However, new transmission facilities, in some locations, are no longer likely to be used to provide service to a particular utility's customers or a regulator's constituents, but for other purposes (such as the support of regional, multi-state, power markets).

Some state commissions and local authorities may be less likely to authorize the development and construction of new transmission facilities if they are used for purposes that do not directly benefit a particular utility's customers or regulator's constituents. Therefore, we support the provision in the draft House Energy Policy Act of 2003 to provide Federal backstop transmission line siting authority for lines vital to wholesale interstate electricity commerce where states have failed to act.

It is clear that additional transmission capacity is required to meet growing electricity demand. However, the current infrastructure can and should be enhanced as well. Deploying the technologies to do so creates fewer siting issues. There are technologies available today that can increase power flow capacity and enhance the controllability of the existing transmission infrastructure. These technologies will assist operators of the transmission system in meeting consumer demand in the most efficient way.

Transmission voltage, capacity, and control enhancements require significant investment in new equipment, but do not necessarily require new rights-of-way. Addition of multiple conductors per phase and transmission of power at a higher voltage (i.e., 765kV) may be options under the right circumstances. In addition, other low environmental-impact technologies are proven alternatives to the protracted process of power line construction and avoid many of the contentious issues associated with siting. These technologies can be implemented rapidly and efficiently and include the following:

- Increasing the transmission and distribution line capacity through the use of higher voltages and/or larger conductor size.
- Utilizing high voltage direct current (HVDC) transmission to nearly double capacity, better control of power transfer, and improve overall system stability. Such technology is already in use in the northwest, southwest and northeast.
- Adding peaking power units at substations, where power goes from sub-transmission to primary distribution, can enhance system efficiency and reliability.
- Improving power factor through the use of, for example, capacitors or synchronous condensers. This has been successfully done throughout many areas of the nation.
- Undergrounding of transmission and distribution cables is an alternative in places where the right of way is not available.
- Building intelligence into the grid through the installation of Flexible AC Transmission System (FACTS) technologies and wide area controls capable of increasing the power on stability-limited lines by as much as 40%, as well as enhancing system reliability, ensuring higher levels of security, and dynamically improving system controllability.
- Using real-time dynamic rating systems of transmission lines based on actual weather conditions and line currents, which can increase the power of thermally limited lines by up to 15%.
- Applying new analytical software models to better calculate stability and thermal limits in real-time, which can provide increased power transfers by up to 10%.

Our national transmission policy should encourage investments in and deployment of these low environmental impact technologies.

TRANSMISSION INVESTMENT INCENTIVES

Section ____32 of the staff discussion draft legislation calls for a Federal Energy Regulatory Commission ("FERC" or "the Commission") rulemaking on transmission infrastructure improvement. We support this provision.

The draft calls for FERC to provide a rate of return that attracts new investment. The allowed rate of return for regulated transmission system assets investment is typically 3-4 points over prime. The rate of return for a deregulated market would need to be approximately 6-8 points over prime. We are pleased to see that the Federal Energy Regulatory Commission has awarded higher rates of return for transmission for entities that join Regional Transmission Organizations (RTOs) and has asked for public comment on this matter.

The proposal calls for FERC to consider performance and incentive based rates. Incentive or performance-based rates should be used to encourage transmission investments. Performance based rates have reduced congestion costs where implemented and resulted in lower rates for consumers. These incentives should encourage technology investments to: improve reliability; increase availability; enhance controlability; reduce congestion; improve power factors; increase energy efficiency; and improve customer service.

TRANSMISSION ORGANIZATIONS/RTOS

Section 407 of the staff discussion draft addresses Regional Transmission Organizations (RTOs). We prefer the approach in the draft House Energy Policy Act of 2003.

In part to encourage the efficient expansion of the transmission system, and to ensure regulatory certainty, FERC issued a series of regulations designed to facilitate the development of Regional Transmission Organizations ("RTOs"). Under FERC Order 2000, RTOs would be responsible for, among other things, transmission planning and expansion consistent with applicable state and local siting regulations. This is particularly important to bring regional perspectives to transmission planning and siting decisions. The Commission requires RTOs to accommodate state efforts to create multistate agreements to review and approve new transmission facilities. The regulations also include transmission rate incentives designed to facilitate the development of new transmission facilities. FERC has been implementing such rates on a case-by-case basis. FERC-approved RTOs also should focus on the deployment of new transmission technologies.

NET METERING AND REAL-TIME PRICING

Section ____72 of the staff discussion draft addresses net metering and Section ____73 of the staff discussion draft addresses real-time pricing and time of use metering. We support these provisions.

NEMA supports net metering to encourage small distributed generation including renewables.

Real time pricing and the associated time of use meters are needed to increase demand responsiveness. A market cannot function well without demand response. Current electricity markets behave with a "hockey stick" shaped curve of price versus demand, where the costs increase modestly for most demand ranges, but rapidly for the highest demands as less efficient generation is brought online. Studies show that modest demand reductions would result in significant cost reductions that could be shared broadly across customers.

CONCLUSION

Congress must take decisive action to ensure that the interstate transmission grid will continue to reliably serve consumers of electric energy, and that adequate capacity is ensured. To achieve this goal, the nation should adopt a holistic approach to transmission policy that not only facilitates the development of new transmission facilities, but also recognizes and encourages the role of technology in expanding transmission capacity from existing facilities. Accordingly, NEMA recommends that the foundation of any new transmission policy should rest upon the creation of a regulatory structure that: (1) promotes the use of technology to protect and enhance the integrity and reliability of the existing interstate transmission grid in the near-term; (2) removes siting and permitting impediments that currently serve as a barrier to the construction of new facilities; and (3) ensures, through the use of rate incentives and tax policy that investments in new transmission facilities generate a competitive return for the investment made.

UTILITY WORKERS UNION OF AMERICA,
Washington, DC, April 15, 2003.

Hon. PETE V. DOMENICI,
U.S. Senate, Washington, DC.

Re: Senate Energy Bill

DEAR SENATOR DOMENICI: The Senate Energy and Natural Resources Committee is considering major energy legislation that will revise the very structure of electricity markets. The Utility Workers Union of America (UWUA) is very worried that the Electricity title (Title XII, in the initial draft) presents grave risks for consumers. Should this legislation pass, there is the real likelihood that rates will rise higher than they otherwise would, especially for residential and small business customers. The reliability of supply may also be in jeopardy.

For close to 100 years, investor-owned distribution companies that directly serve customers have primarily been under state jurisdiction. State commissions not only set rates, but they (or companion state agencies) insure that there is adequate generation supply and oversee siting of transmission facilities. The system has worked remarkably well. Throughout the 20th century, the United States enjoyed some of the lowest-priced and most reliable electricity in the world. This was true not only

in comparison with other industrial countries, but even less-developed countries with very low labor costs and cheap hydroelectric supplies.

At the state level, restructuring efforts reached a high-water mark about two years ago. The meltdown of the California market caused a number of states to repeal or back track on their restructuring plans. Restructuring has also not succeeded in other states that haven't had such spectacular failures and press coverage as California. In most restructured states, small consumers have been unable to find competitive suppliers willing to sell to them. Rates have jumped significantly in Texas; in Massachusetts (where one company just received a 410% increase in its default service rates); and other states where markets are open to competition. Consumers are not gaining anything but confusion and uncertainty. Prices have also become far more volatile.

Restructuring places supply at the risk of unregulated players who respond solely to the interests of stockholders, not to regulatory mandates or the needs of consumers.

In this context, UWUA urges the Senate not to pass the Electricity title. In particular:

- Repeal of PUHCA will eliminate essential public protection: The Public Utilities Holding Company Act was adopted in the 1930's, the last time this country experienced the types of accounting tricks and market manipulations recently seen with the Enron crisis. This is not the time to remove existing restrictions that limit the ability of holding companies to use the assets of regulated distribution companies to launch risky new ventures. As recent experience proves, unregulated power marketers and brokers can cost consumers billions, as well as putting the livelihoods and pension plans of their own employees at great risk.
- FERC should not be given enhanced jurisdiction, particularly not at the expense of state regulatory authority: Provisions of the energy act that would give FERC any additional authority over entities not currently regulated at the federal level (municipally owned utilities, power marketing authorities, federal entities, etc.); that would force open access to transmission lines and assets currently reserved for native load; or that would allow FERC to grant "incentive" rates of return to transmission owners are ill-advised. The latter "incentive" proposal would simply shift billions of dollars from consumers to owners of transmission. Given FERC's extraordinary failure to protect California consumers from flagrant market manipulation, despite the pleas of a broad range of elected and appointed officials, expanding FERC's jurisdiction puts consumers at needless risk. States have proved to be far more effective in insuring just and reasonable rates, and insuring reliable supply.

FERC strongly believes that the market is the best protector of consumer interests. But one hundred years of state regulation proves that states do a better job of protecting consumer. FERC's policies of the past few years prove it is more interested in vindicating its procompetition views than actually keeping rates down.

On behalf of the 50,000 men and women of UWUA who fully understand the value of inexpensive and reliable electric supply, I urge you not to adopt the Electricity title.

Sincerely,

DONALD E. WIGHTMAN,
National President.

AMERICAN PUBLIC POWER ASSOCIATION,
AMERICAN PUBLIC GAS ASSOCIATION,
April 16, 2003.

Hon. PETE DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Our associations represent the locally-owned gas and electric distribution utilities that serve more than 80 million residential and commercial customers. We recognize and appreciate your leadership and strongly support your committee colleagues as you move forward to pass energy legislation that is vital for our nation's economic success. We have every confidence that the Senate's final product will be a balanced one that treats consumers of both natural gas and electricity in a fair and equitable manner.

Given the ongoing revelations of manipulation and abuse that have taken place in electricity markets, we believe it is essential to provide natural gas consumers

with protections from similar abuses. Specifically, we urge you to support limited amendments to the Natural Gas Act that would extend and strengthen consumer protections in these areas: penalties, manipulative trading practices, market transparency, and refunds. While the reasons are obvious why APGA strongly supports this change, it is also becoming more important for NRECA and APPA members who increasingly rely on natural gas to generate electricity. As pipeline customers, all of our members should be entitled to consumer protections under the NGA that are similar to those afforded consumers under the FPA.

We understand that some interests have already weighed-in against such consumer protection provisions, arguing that the fundamental structure of the NGA should remain unchanged. We agree about the need to keep the fundamental provisions of the NGA intact. Making the four above-referenced changes to the NGA to bring about parity and consistency between the two acts, however, does not constitute a "fundamental" change of the NGA structure. Rather such changes simply further the overriding purpose of the NGA to protect natural gas consumers from paying excessive rates.

Absent the same upgrades for the NGA that the Senate now proposes for the FPA, the Federal Energy Regulatory Commission (FERC) will continue to be handicapped in its ability to protect natural gas consumers. This fact was recognized by FERC Chairman Pat Wood in testimony before your committee last month when he specifically supported these changes to the NGA. FERC Commissioner Bill Massey reinforced this support at that same hearing.

After all is said on the matter, the primary purpose for both acts is still to protect consumers. On behalf of more than 3,400 cities and towns and the many communities served by consumer- and municipally-owned utilities, we request that you support these common sense and much-needed protections for the customers of both natural gas and electricity.

Sincerely,

ALAN RICHARDSON, *President.*

GLENN ENGLISH, *Chief Executive Officer, National Rural Electric Cooperative Association.*

BOB CAVE, *President, American Public Gas Association.*

STATEMENT OF HON. BILL RICHARDSON, GOVERNOR OF NEW MEXICO, ON BEHALF OF THE WESTERN GOVERNORS' ASSOCIATION

Thank you, Mr. Chairman and Senator Thomas, for your thoughtful proposals to amend federal law governing electric power regulation.

This is an issue of intense interest to Western governors. The region is still recovering from the 2000-2001 Western electricity crisis and there is significant concern about the intended and unintended consequences of the Standard Market Design proposed by the Federal Energy Regulatory Commission (FERC).

In our testimony to this Committee in 2001, we related three areas of agreement among Western governors on federal electricity legislation.

1. Federal electric system reliability legislation needs to be enacted to ensure that present voluntary regional reliability standards can be enforced. Such legislation should recognize and defer to standards developed and enforced in the Western Interconnection. States should have a primary role in overseeing the standards setting and enforcement processes.

2. FERC should not be granted the power of eminent domain for electric transmission line siting, even in a backstop mode. There is no evidence in the West that states have ever blocked the permitting of an interstate transmission project. There is no evidence nationwide that states have systematically abused their responsibilities to balance transmission needs with other public needs in decisions on the siting of transmission facilities.

3. The federal government should not intrude into the retail electric decisions of states. In our testimony to you in June 2001, Western governors opposed federal legislation that would expand FERC's authority into retail electricity decisions. With FERC's release of its proposed Standard Market Design rule in July, our concerns about FERC intrusion into retail electricity decisions have been greatly amplified.

We continue to maintain these positions.

In the following testimony, we provide important background on the unique elements of the Western Interconnection and then offer observations on the 13 topics on which you requested comment.

UNDUE ELEMENTS OF THE WESTERN INTERCONNECTION

In crafting legislation, the Committee should keep in mind that North America is served by three essentially electrically-separate power grids. Within the Western Interconnection, the western states, western Canadian provinces and northwest Mexico are fully integrated. However, there are few ties between the Western Interconnection and the other interconnections. Generators are synchronized within interconnections but not between interconnections.

The geography of the system is important, because it defines the practical maximum extent of power markets and impacts of power outages. An event in British Columbia can cause blackouts in Arizona, but an outage in Arizona cannot impact states in the Eastern Interconnection.

The Eastern and Western grids have developed different features. The Western grid is defined by long distances between generators and customers (load centers). The Eastern grid more resembles a tight-knit network of transmission. As a result, the maintenance of stable system voltage is often the constraining factor in the operation of the Western grid, while the thermal limits of lines is typically the constraining factor in the Eastern grid.

Another reality differentiating the East and the West is the vast ownership of land in the West by federal agencies. This land ownership pattern often creates different transmission facility siting challenges than in the East.

As a result of these differences, institutions and practices[1] to address electric power issues have evolved differently in the West than in the East.

We recommend that federal legislation recognize these electrical, geographic and institutional differences and resist the temptation to adopt federal government-centric, one-size-fits-all solutions. We believe the experience in Western power markets over the past several years has illustrated the limitations of policy made in Washington, D.C. for the West.

REGIONAL ENERGY SERVICES COMMISSIONS

The Staff Discussion Draft includes a Subtitle B—"State Coordination" and proposes that states be provided authority to ". . . enter into agreements to establish Regional Energy Services Commissions (RESC)". This provision would potentially confer upon RESCs: 1) authority currently held by states, like transmission siting; and 2) Federal Energy Regulatory Commission authority related to regulation of the wholesale trade of electricity. FERC would have jurisdiction for resolving disputes among RESCs and participating and non-participating states, as well as between RESCs.

The Western Governors commend the Committee for moving from the top down, centralized model proposed by FERC in its Standard Market Design NOPR, to a more regional model. While the Western states have just begun to analyze the pros and cons of the RESC provisions, this change of direction from Washington, D.C., is welcome.

To fully understand the implications of the RESC concept, it would be desirable for Congress to first clarify state and FERC jurisdiction over such issues as the transmission component of bundled retail sales and transmission to serve native load. Such clarification is critical to understanding the scope of Section 404(b) which allows the Commission to "affirm, modify, or set aside such State regulatory order or ruling in whole or in part if the Commission finds that the State regulatory authority's order or ruling would result in undue discrimination in the provision of the transmission of electric energy and/or sale of such energy at wholesale . . . or results in unjust or unreasonable rates, charges or classifications . . ."

Our initial review of the Staff Discussion Draft raises numerous questions that need to be addressed before proceeding. For example:

- Why is five percent of U.S. electricity load the minimum threshold for establishing a RESC?
- Can there be one-state RESCs?
- Will multiple RESCs be allowed in the Western Interconnection?

[1] For example, the Western industry has relied on rating the capacity of transmission paths under different system conditions and limiting the use of paths to their rated capacities. Because paths are not similarly rated in the Eastern Interconnection, the industry relies on Transmission Loading Relief (TLRs) in the East to force users to cut back power transfers when reliability is threatened.

- How are the RESCs to be funded?
- Why would states, which have territory in two regions, be prohibited from participating in RESCs in both regions?
- What are the specific grounds for the Secretary of Energy to disapprove an RESC?
- In Section 403(a), what does "primary jurisdiction" mean?
- Market power review and monitoring functions could reside with the RESC. Where does the responsibility for market mitigation actions reside?
- Section 403(b) provides for the RESC to develop enforcement mechanisms. Where does the authority to implement such enforcement mechanisms reside?
- Is the intent of the Staff Discussion Draft to leave FERC with authority over electricity decisions whenever any state objects to a decision of a RESC or does not agree to join an RESC?
- If an RESC does not address any of the items listed in Section 402(a), would FERC assert jurisdiction under Section 406 regardless of whether or not such functions would otherwise be under FERC jurisdiction? For example, if an RESC elects not to take one type of action (e.g., recommend preemption of state jurisdiction over bundled transmission service), does Section 406 grant FERC the authority to preempt state law? Or, if an RESC finds that the costs of an RTO exceeds the benefits, can it disapprove an RTO under Section 407? If it disapproves an RTO that is not cost-effective, can FERC assert jurisdiction over the RTO proposal under Section 406?
- What is the role of the RESC in overseeing the operation of an RTO after it has been approved?

Certain features of the RESC proposal, when combined with other provisions in the Staff Discussion Draft, are clearly not acceptable. For example, granting FERC the power to preempt state siting laws unless the RESC assumes the power to preempt state siting laws is a non-starter.

As noted previously, the Western Governors are encouraged by the shift in policy direction represented by the discussion draft. In fact, WGA's existing policy calls on Congress to "allow states to create regional mechanisms to decide regional power issues, including but not limited to, the creation and operation of regional transmission organizations, reliability of the western power grid, transmission system planning and expansion, maintenance requirements and market monitoring". Before proceeding with any provision on regional governance, however, it is important for the Committee to understand how Western states interact today on electricity issues and what steps they have taken to address future regional issues since the 2000-01 electricity crisis.

Interstate cooperation on electricity issues occurs in the West at three levels: among the governors; among the state commissions established to regulate the electricity industry; and among the state energy siting agencies and programs. At the level of the governors, the Western Governors' Association and its energy arm, the Western Interstate Energy Board, address policy issues as directed. This interaction and analysis has included extensive public and private participation and led to a series of policy resolutions and reports on the Western Electricity Interconnection (see "Conceptual Plains for Electricity Transmission in the West" and "Financing Electricity Transmission Expansion in the West: A Report to the Western Governors").

In 1983, the Committee on Regional Electricity Cooperation (CREPC) was formed to facilitate voluntary cooperation among Western state and Western Canadian provincial utility regulatory commissions and energy agencies on issues of common interest. This group has met regularly since that time to address issues and interact with the Federal Energy Regulatory Commission. CREPC has kept the region's commissions and energy agencies abreast of policy, regulatory and technical issues and serves as the primary forum for interstate cooperation on electricity policy issues in the West.

In 2002, the Western Governors and concerned federal agencies entered into a "Protocol Governing the Siting of lnterstate Transmission Lines in the West". Under the Protocol, the states and federal agencies agree to collaborate in the review of siting proposals and permit requests from the time of their submission in order to identify and resolve siting issues as quickly as possible. To date, no new transmission proposals have been offered so we have not yet had an occasion to use the process. We are confident that the West's long record of cooperation will help ensure that any future use of the process provided in the Protocol will be successful. It has been the West's experience that federal agency delays are the most significant impediment to siting of transmission lines in the West. The governors believe the Protocol will result in a marked improvement in future siting activities.

Western governors have recognized that additional regional cooperation may be necessary to address increasing demand for electricity, prevent recurrences of the 2000-2001 crisis, and capitalize on the region's vast fossil and renewable energy resources. The governors submitted a proposal for a regional information and planning mechanism with the U.S. Department of Energy in May 2002. Secretary of Energy Spencer Abraham responded positively to the proposal in June 2002 and indicated his willingness to fund the development of such a system, appropriations permitting, in FY 2003. The purpose of this initiative is to ensure that public and private decisionmakers are fully informed about the Western electricity market in order to enhance public interest monitoring and regulation of market activities and to help producers and consumers deal with market fluctuations more effectively than they were able to in the Western electricity crisis.

Furthermore, in December 2002, the governors asked WGA (WIEB) and CREPC to explore and propose a regional decision-making mechanism for their consideration. The Department of Energy has agreed to support this project as well. The purpose of this initiative is to explore how the states might address future interstate policy issues that affect the operation of the Western Interconnection in a more formal manner than the informal, voluntary collaboration provided by CREPC. This initiative is just getting underway.

The Western Governors commend the Committee for recognizing the regional and state nature of the nation's electricity markets. We hope to work closely with you, Chairman Domenici, Senator Bingaman, Senator Thomas and others to reach consensus about this proposal. Given the complexity of the proposal, and the unique aspects of different regions of the nation we find it difficult to express optimism that this proposal could be fully vetted in the apparently very short timeframe before your Committee must act on energy legislation. In the interim, we suggest that Congress should clarify state and FERC jurisdiction over such issues as the transmission component of bundled retail sales and transmission to serve native load, and the Committee should instruct the U.S. Department of Energy and FERC to cooperate with states within the nation's regional electricity markets on the development of appropriate regional governance models, which may vary according to the needs of each region. Through such a program of cooperation and assistance, reliable and economical regional governance mechanisms are much more likely to emerge. As noted, the Western Governors have already directed that a Western model be explored.

RELIABILITY STANDARDS

We are pleased that Senator Thomas' bill includes reliability provisions that will meet the needs of the West and the nation. On behalf of the Western Governors, I would like to thank Senator Thomas, and his staff, again for their leadership and support on this issue. If the Congress takes no other action this year on electricity issues, we urge you to enact these reliability provisions. The proposal in the Staff Discussion Draft to make a Regional Energy Services Commission the regional reliability organization, as opposed to playing an oversight role in the setting and enforcement of reliability standards, is particularly problematic.

Since 1997, Western Governors have urged the enactment of federal reliability legislation to provide a legal underpinning for enforcing reliability standards. As a stop-gap measure, the West has implemented a system of contracts to make standards enforceable. Most control areas in the West have executed the contracts, a few have not. However, such a contract enforcement system is not a long-term substitute for federal legislation.

In 1997, 2001, and again last year, Western Governors called for a new approach to setting and enforcing reliability standards that includes a public process for setting standards, review of standards by states, application of standards to all users of the grid, enforcement of sanctions for non-compliance with the standards, mandatory membership by operators of the grid in regional reliability councils, and joint state/federal oversight of establishing and enforcing reliability standards. In 2000, the governors urged the "organization of regional advisory bodies of affected states and Canadian provinces to advise regional and North American organizations and the Federal Energy Regulatory Commission and appropriate Canadian and Mexican regulatory authorities . . . FERC should defer to the advice of such regional advisory bodies when advisory bodies cover an entire interconnection."

Through extensive on-going collaborative efforts between the Western states/provinces and the Western electric power industry, three principles have been developed that guide our views of federal reliability legislation.

(1) Deference must be given to standards adopted within and for the Western Interconnection.

(2) The implementation and enforcement of standards must be delegated to the West.

(3) States must have a role in the process.

Over a three-year period, Western states, provinces and industry worked to streamline and consolidate existing industry grid management institutions into one new entity, the Western Electricity Coordinating Council. Western Governors called for the expeditious establishment of the new institution. Last April, the new institution was formed. WECC was designed to rapidly implement the provisions of federal reliability legislation and is prepared to do so as soon as such legislation is enacted.

Through extensive work with the North American Electric Reliability Council (NERC), the central elements of what the West needs are included in the NERC consensus legislation that the Senate passed last year, thanks to Senator Thomas' leadership. The NERC language provides for deference to standards that cover an entire interconnection. It provides for delegation of implementation and enforcement functions to a regional entity, such as the WECC, that is much closer to the issues than a North American body or FERC. It provides for a state advisory role and enables FERC to defer to such advice when given on an interconnection-wide basis. This approach builds on existing technical expertise in the industry and states and does not require the establishment of a large new federal bureaucracy.

The reliability provisions of the Thomas bill meet the needs of the West and we urge their adoption. Given the uncertain future of the Regional Energy Services Commission concept, we recommend that the Committee keep the language in the Thomas bill related to the creation of Regional Advisory Bodies.

OPEN ACCESS

Western governors believe that all segments of the Western industry, including investor-owned utilities, public power, federal power marketing administrations, power marketers and brokers, and independent power producers, should participate in the competitive wholesale electricity market. Congress should ensure that federal institutions, such as the power marketing administrations, participate in regional efforts to promote wholesale competition. This may include participation in cost-effective Regional Transmission Organizations.

TRANSMISSION SITING AND PREEMPTION OF STATE SITING LAW

We are disappointed that the staff draft proposes to take the Committee down the unproductive path of federal preemption of state electric transmission siting laws. The proposed transfer of these powers from states to RESC's is likewise problematic unless it is truly voluntary and not compelled by threat of federal preemption. The continued emphasis on preempting state siting authority is particularly discouraging given the fact that no evidence has been presented in any forum that we are aware of that justifies granting FERC such preemptive powers, even in a backstop role. Senator Thomas' approach, which focuses on getting the federal government's house in order on transmission permitting, is much more appropriate.

Western governors have a long record of proactively addressing the transmission needs in the Western Interconnection. We recognize that an adequate transmission system is necessary to maintain the reliability of the grid and enable competitive wholesale electricity markets.

The record in the West provides no evidence supporting the need for new centralization of land use decisions that are more properly made in the West based on intelligent tradeoffs of needs and values. We urge the Committee to keep in mind that no western state has ever denied a permit for an interstate transmission line. The idea of federal eminent domain for electric transmission is a solution looking for a problem.

The major challenge to siting of transmission in the West rests with federal land management agencies. The federal government owns vast tracts of land in the West (e.g., approximately 83% of the land in Nevada, 65% of Utah, 63% of Idaho, 53% of Oregon, 50% of Wyoming, 46% of Arizona, 45% of California, 36% of Colorado, 34% of New Mexico, 29% of Washington, and 28% of Montana.) If it accomplishes its goals, the preemption language, in fact, may provide a perverse incentive to site more transmission on private lands, further exacerbating the decrease in private lands in the West.

Few new transmission lines have been proposed in the West over the past decade due to increased reliance on natural gas fired generation near load centers and uncertainty created by FERC policies. The President's Executive Order 13212 directing federal agencies to expedite energy-related projects provides needed direction. However, agencies need adequate resources to execute their responsibilities. States also

recognize that timely action is essential in the modern competitive electricity market.

The 2001 WGA "Conceptual Transmission Plan" recommended that all siting review processes be streamlined and coordinated to enable timely construction of transmission lines. State review processes should address both local and Western Interconnection needs, and federal agency review processes should be coordinated internally as well as with State and Tribal authorities. The 2002 report, "Financing Electricity Transmission Expansion in the West", reinforced the need for pro-active transmission planning and collaborative action on transmission permitting as important ingredients for project financing.

We have acted on these recommendations. Last summer, 12 Western governors, including all governors in the Western Interconnection, signed the *Protocol Governing the Siting of Interstate Transmission Lines in the West* to coordinate and collaborate on the review of proposed interstate transmission lines. We are pleased to report that the Secretaries of the Interior, Agriculture, and Energy and the Chairman of the White House Council on Environmental Quality also signed the protocol.

The protocol is a constructive step in recognizing the regional impacts of major transmission additions. When coupled with appropriate direction and funding of federal land management agencies, we believe the Protocol will get the job done. Unlike the approach in the Staff Discussion Draft, our approach does not create new centralized bureaucracy at DOE or FERC. Our approach is to make existing government agencies work, not add new layers of government review. We would be pleased to report to you in a year on the progress made under the protocol.

We urge the Committee to not include eminent domain provisions in its energy bill.

TRANSMISSION INVESTMENT AND TRANSMISSION COST ALLOCATION

Western Governors have not adopted a collective position on transmission investment incentives or transmission cost allocation. However, we would caution that such incentives are not free. The costs of such incentives will be borne by our citizens and businesses.

Western Governors have worked on transmission financing for several years. Beginning with the WGA Transmission Roundtable in May 2001, Western governors have been concerned about the issue of financing new transmission. At our request, in February 2002, Western stakeholders delivered a report to governors on transmission financing titled *Financing Electricity Transmission Expansion in the West.* The report reached consensus on several points, including:

- Confidence in cost recovery, including a reasonable return on investment, is the key to financing transmission expansion.
- Uncertainty over the future structure of the industry and recovery of transmission investment costs have contributed to a lack of investment in recent years.
- Due to the long lead-time required for transmission construction, further investment to expand the transmission infrastructure in the western states may be needed now to bring economic and strategic benefits to customers in the future.
- There are two distinct models for identifying transmission expansion projects, securing the necessary capital investment and providing for the recovery of the investment costs. These are the market-driven model and the total system cost model.
- The two models could co-exist and transmission projects could be financed through a combination of both models. The approach used should be determined on a project-specific basis.

Since the report, each of the nascent RTOs in the West has developed transmission financing approaches. These efforts continue to be refined.

PUHCA

Western governors have not taken a collective position on amendments or repeal of the Public Utilities Holding Company Act.

PURPA

Western governors have not taken a collective position on amendments to the Public Utility Regulatory Policies Act. However, we do note that it seems inappropriate to condition the elimination of the "must purchase" provisions of PURPA on the existence of "competitive wholesale markets" or the existence of retail competition. The existence of competitive wholesale markets remains an issue of much dis-

pute and few states in the West have or are likely to endorse retail competition in the near term.

NET METERING AND REAL-TIME PRICING

Net metering is an appropriate electricity policy. Every state in the West already has some form of net metering. If the Committee retains the provision, it should allow each state PUC to decide the nature of such policy in the context of state law.

Western governors have identified demand response as a critical element for well-functioning electricity markets. During the 2000-2001 Western electricity crisis, many novel demand response programs were put in place. The evaluation of the efficacy of specific programs continues. If the Committee retains the provision, it should allow each state PUC to decide the appropriateness of such policy in the context of state law.

RENEWABLE ENERGY

Significant progress is being made in the West to expand the generation of electricity from renewable resources. Several states have adopted aggressive Renewable Portfolio Standards. Other states have additional programs in place to increase renewable energy generation like financial incentives and generation disclosure requirements.

Western governors agree on the need to extend and expand the existing renewable energy production tax credit. The credit has been particularly helpful in expanding the development of wind resources in the West. As additional wind generation is deployed, the cost of wind generation decreases. Similar improvements can be expected if the deployment of solar, geothermal and biomass generation technologies accelerates. Although not within the purview of this Committee, we would urge you to work with the Senate Finance Committee to include a production tax credit in final energy legislation.

Although not part of the electricity provisions of pending bills, the governors also support the development of new advanced clean coal technologies.

MARKET TRANSPARENCY, ANTI-MANIPULATION, ENFORCEMENT

Much has been learned from the Western electricity crisis of 2000-2001. The Committee is to be complimented for focusing on the core FERC functions of market monitoring and enforcement. FERC's performance in these critical areas needs to be improved and should be a higher priority than seeking to expand jurisdiction into areas of state responsibility.

In addition to the reforms proposed thus far, Western governors believe that a robust information and planning system is necessary to ensure that adequate infrastructure is in place to avoid future crises. Comprehensive and up-to-date data are critical to assure resource adequacy. We would encourage the Committee to direct the Department of Energy and FERC to assist the West in developing such an information and planning system.

STATEMENT OF MICHEHL R. GENT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL

My name is Michehl Gent and I am president and chief executive officer of the North American Electric Reliability Council (NERC).

NERC is a not-for-profit organization formed after the Northeast blackout in 1965. NERC's mission is to ensure that the bulk electric system in North America is reliable, adequate, and secure. NERC works with all segments of the electric industry as well as customers and regulators to "keep the lights on" by developing and encouraging compliance with rules for the reliable operation and planning of these systems. NERC comprises ten Regional Reliability Councils that account for virtually all the electricity supplied in the United States, Canada, and a portion of Baja California Norte, Mexico.

NERC supports the reliability provisions (Section 104) of S. 475, the "Electric Transmission and Reliability Enhancement Act of 2003," with minor technical changes. The reliability provisions of S. 475 are similar to the reliability provisions that the Senate adopted last year as part of H.R. 4. They are also largely the same as the reliability provisions included in Subtitle C of the legislation approved last week by the House Energy and Air Quality Subcommittee, the "Energy Policy Act of 2003."

With or without Congressional guidance, the electricity industry is changing in fundamental ways. These changes are disrupting the mechanisms, relationships and

incentives that have long ensured the reliability of the North American electricity grid. To ensure that these changes do not jeopardize the reliability of our interconnected electric transmission system, we must shift from a system of voluntary compliance with reliability standards to a system of mandatory compliance. NERC and a substantial majority of other industry participants believe that the best way to do this is through an independent, industry self-regulatory organization to set and enforce mandatory reliability rules, subject to oversight within the United States by the Federal Energy Regulatory Commission.

Section 104 of S. 475 embraces this concept and contains largely the same language that we understand the House and Senate conferees agreed to during the conference on H.R. 4 in the last Congress. NERC requests that you make minor changes to the language in Section 104, to track the language on governance of regional entities that is contained in Section 7031 of the bill the House Subcommittee approved last week. I have attached specific suggested language for the revision to this testimony (Attachment 1).* NERC will be pleased to work with Committee members and Committee staff on the language.

NERC has appeared before Committee on a number of occasions, testifying in support of reliability legislation. The Senate adopted NERC-supported reliability language in 2000 (S. 2071) and again in 2002 (as part of H.R. 4). Today I will focus on two questions: (1) why reliability legislation is needed now; and (2) how Section 104 of S. 475 meets this need. I will also provide NERC's views on the reliability provisions (Title XII, Subtitle D) contained in the staff draft dated March 25, 2003.

WHY IS RELIABILITY LEGISLATION NEEDED NOW?

NERC sets the reliability standards by which the grid is operated from moment to moment, as well as the standards for what must be taken into account by those that plan, design, and construct an integrated system that is capable of being operated reliably. The NERC standards do not specify how many generators or transmission lines to build, or where to build them. They do indicate what planned and unplanned contingencies the system must be able to meet to ensure that it can retain its integrity under a broad range of actual supply, demand and equipment outage conditions. We attribute the reliability of the present system to these standards, which have been in practice for decades.

The interconnected bulk electric system is subject to any number of unexpected and uncontrollable events, as a matter of course. Severe weather may knock down transmission lines, lightning strikes may cause short circuits, mechanical equipment may fail due to fatigue or overloading, generating plants may suffer breakdowns, fuel supplies can be disrupted, human error can lead to the outage of equipment, or we may inadvertently operate in an unstudied state. To that list of everyday occurrences, we now have added the threat of terrorist activity directed at the bulk electric system. The bulk electric system is designed and operated generally in what we refer to as a "first contingency" status, that is, the system must be able to withstand the loss of the single largest element (generator, transmission line, transformer, etc.) and still remain stable and secure. Otherwise, because of the instantaneous nature of electricity, we would risk cascading outages with severe economic and public safety consequences that could occur in a matter of seconds.

I have attached to my testimony a table describing five notable occasions when we did have such a cascading outage: November 9, 1965 in the Northeastern United States and Eastern Canada; July 13, 1977 in New York City; July 2, 1996 in the West; August 10, 1996 in the West; and June 25, 1998 in the Upper Mid-West and western Ontario (Attachment 2). The scope and duration of these outages underscore why we must take all reasonable steps to prevent such widespread cascading outages where possible, and why we must have solid restoration plans when outages do occur. Mandatory reliability rules and an effective means to monitor and enforce compliance with them are the major component of those reasonable steps.

NERC's rules, which are not now enforceable, have generally been followed by participants in the electricity industry, but that is starting to change. As competitive, economic and political pressures on electricity suppliers increase and as the traditional mechanisms, relationships, and incentives for ensuring reliability are altered, NERC is seeing an increase in the number and severity of rules violations. Moreover, new issues are arising that demand an institution focused on reliability that can act fairly, but decisively, and in a timely manner.

Let me give you an example. Traditionally, integrated utilities operated their generators to supply both the "real" (MW) and "reactive" (MVar) power necessary to maintain reliable operation of the transmission system, and charged for these serv-

* Attachments 1 and 2 have been retained in committee files.

ices as part of the regulated cost of service. (It's worth noting here that control of flows and voltages on an electric system is not accomplished by valves and switches, as in gas or telecommunications systems, but by controlling the real and reactive power outputs of generators.) These "services" provided by generators included such things as spinning and non-spinning reserves and system voltage support. Now, with the generation function separated from the transmission function in many cases, these "services" are no longer provided by a single, integrated entity, but must be arranged and paid for separately through tariffs and contracts with generators. To assure that this is done, we need enforceable standards that require transmission operators (including RTOs) to make adequate provision in their tariffs and contracts for these essential reliability services. How these arrangements are made can be the subject of filings with FERC or other regulators, but they must be made. Absent such enforceable standards, the reliability of our interconnected grids will be at serious risk.

To accommodate the changes taking place in the industry, NERC is rewriting all of its reliability standards according to a new "functional" reliability model that sets out measurable and, under Section 104 of S. 475, enforceable requirements for entities that are responsible for performing critical reliability functions. These new standards will place uniform requirements on those that have the responsibility for maintaining the minute-to-minute balance between supply and demand, for seeing that power flows remain within the physical limits of the system, and that grid voltages stay within tolerance.

Let me give you another, very different example of why this legislation is needed. NERC plays a critical role in protecting our industry's critical infrastructure from both physical and cyber attacks. Since the early 1980s, NERC has been involved with the electromagnetic pulse phenomenon, vulnerability of electric systems to state-sponsored, multi-site sabotage and terrorism, Year 2000 rollover impacts, and most recently the threat of cyber terrorism. At the heart of NERC's efforts has been its ability to marshal] the industry's best experts on the design and operation of electricity systems in North America, and serve as the industry's point of contact with various federal government agencies, including the National Security Council, the Department of Energy, the Nuclear Regulatory Commission, the Federal Bureau of Investigation, and now the new Department of Homeland Security, to reduce the vulnerability of interconnected electric systems to such threats.

I know that this Committee understands how vitally important this function is. Yet, NERC's continuing ability to serve this function cannot be taken for granted. NERC traditionally has been funded by contributions from its member Regional Councils, which are in turn funded by their member organizations. New entrants and the pressure of competitive markets have made this funding mechanism increasingly unsatisfactory. A new funding mechanism is needed that properly and fairly supports NERC's activities, including its activities related to critical infrastructure protection. Section 104 of S. 475 would address this issue by authorizing FERC to certify an electric reliability organization that, among other things, has established rules that "allocate equitably reasonable dues, fees and other charges among end users for all activities under this section." See proposed new Federal Power Act section 215(c)(2)(B).

SECTION 104 OF S. 475 WOULD PROVIDE FOR AN ORGANIZATION CAPABLE OF PROTECTING THE RELIABILITY AND THE SECURITY OF THE NORTH AMERICAN ELECTRICITY GRID

We need legislation to change from a system of voluntary transmission system reliability rules to one that has an industry-led organization promulgating and enforcing mandatory rules, backed by FERC in the United States and by the appropriate regulators in Canada and Mexico. Section 104 of S. 475 would do this. Under its provisions:

- Reliability rules would be mandatory and enforceable.
- Rules would apply to all owners, operators and users of the bulk power system.
- Rules would be fairly developed and fairly applied by an independent, industry self-regulatory organization drawing on the technical expertise of industry stakeholders.
- FERC would oversee that process within the United States.
- This approach would respect the international character of the interconnected North American electric transmission system.
- Regional entities would have a significant role in implementing and enforcing compliance with these reliability standards, with delegated authority to propose appropriate regional reliability standards.

A broad coalition joins NERC in supporting this approach to legislation, including the Western Governors Association, the National Association of Regulatory Utility

Commissioners, the National Association of State Utility Consumer Advocates, the American Public Power Association, the Canadian Electricity Association, the Edison Electric Institute, the National Rural Electric Cooperative Association, the Institute of Electrical and Electronics Engineers, and the Western Electricity Coordinating Council.

Right now a hole exists in the Federal Power Act, because FERC does not have direct authority over reliability matters and does not have jurisdiction over the entities that own almost one-third of the bulk power system. Having an industry self-regulatory organization develop and enforce reliability rules applicable to all owners, operators and users of the bulk power system under government oversight, as Section 104 of S. 475 would do, takes advantage of the huge pool of technical expertise that the industry has been able to bring to bear on this subject over the last 35 years. Having FERC itself set the reliability standards through its rulemaking proceedings, even if based on advice from outside organizations, would require FERC to develop or acquire technical expertise and experience that it does not now have, and would dramatically expand FERC's workload at perhaps the worst possible time.

The electric industry is in a great state of flux, as regional transmission organizations are forming and reforming, and vertically integrated companies are separating and selling off various portions of their business. Change is happening at different paces in different places. With all the uncertainty as to who will ultimately operate and plan the interconnected transmission system, it is more important than ever that an industry-led self-regulatory organization be created to establish and enforce reliability standards applicable to the entire North American grid, regardless of who owns or manages which portions of the grid, and regardless of whether the grid is being used for the new markets that are emerging or in more traditional ways. Both market models are likely to exist side by side for a considerable period of time. The self-regulatory reliability system authorized in Section 104 of S. 475 is indifferent to industry structure and can help ensure that grid reliability is maintained, even while new market structures and new RTOs are being formed. Because FERC will provide oversight of the electric reliability organization in the U.S., FERC can ensure that the organization's actions are fair and balanced and closely coordinated with FERC's evolving market policies.

The industry self-regulatory organization authorized in Section 104 of S. 475 also addresses the international character of the interconnected grid. There is strong Canadian participation within NERC now. Having reliability rules developed and enforced by a private organization in which varied interests from both countries participate, with oversight in the United States by FERC and with equivalent activity by provincial regulators in Canada, is a practical and effective way to develop the common set of rules needed for the reliability of the international grid. Otherwise, U.S. regulators would be dictating the rules that Canadian interests must follow—a prospect that would be unacceptable to Canadian industry and government alike. Or, regulators on either side of the border might decide to set their own rules, which would be a recipe for chaos. Efforts are also under way to interconnect more fully the electric systems in Mexico with those in the United States, primarily to expand electricity trade between the two countries. With that increased trade, the international nature of the North American electricity market will take on even more importance, further underscoring the necessity of having an industry self-regulatory organization, rather than FERC itself, set and enforce compliance with grid reliability standards.

THE RELIABILITY PROVISIONS IN THE STAFF DRAFT ARE NOT ADEQUATE

NERC does not support the reliability provisions contained in the staff discussion draft dated March 25, 2003. Although much of the reliability language in the staff draft is the same as that in S. 475, the staff draft's introduction of the concept of regional energy services commissions (RESCs) substantially changes and muddles the reliability provisions. Assigning reliability enforcement authority to RESCs, as the March 25 draft does, substitutes a brand new governmental entity, with no technical competence or experience whatsoever, for the industry-led enforcement, subject to government oversight, that is the essence of the S. 475 reliability provisions. The RESCs apparently would not need to meet any of the requirements for receiving delegated enforcement authority that other regional entities would need to meet. Introducing RESCs into the reliability context also raises a host of unanswered questions concerning the intended relationships among FERC, the electric reliability organization, and the RESCs. It appears that public utilities in States with RESCs are exempted from the coverage of the reliability provisions (which will be in Part II of the Federal Power Act). It is not clear whether the ERO would need to submit its

funding requirements to the RESCs, since the RESCs are intended to have rate responsibility within their regions. The staff draft also eliminates the regional advisory body, putting in its place the RESC.

NERC urges that the necessary exploration and development of the RESC concept for use in other areas to which it may be more suited not delay prompt approval by Congress of urgently-needed reliability legislation..

CONCLUSION

NERC commends Senator Thomas for the leadership he continues to provide on attending to the critical issue of ensuring the reliability of the interconnected bulk power system as the electric industry undergoes restructuring. A new electric reliability oversight system is needed now. The continued reliability of North America's high voltage electricity grid and the security of the consumers whose electricity supplies depend on that grid are at stake. An industry self-regulatory system is superior to a system of direct government regulation for setting and enforcing compliance with grid reliability rules. The language of Section 104 of S. 475, with the clarification of the regional governance issue, presents a sound approach for ensuring the continued reliability of the North American electricity grid. It is also an approach that has widespread support among industry, state, and consumer interests. The reliability of North America's interconnected transmission grid need not be compromised by changes taking place in the industry, provided reliability legislation is enacted now.

STATEMENT ON BEHALF OF THE UTILITY COALITION ADVOCATING RENEWABLE ENERGY

The Utility Coalition Advocating Renewable Energy (UCARE)[1] submits this testimony supporting the inclusion of a national renewable energy portfolio standard (RPS) in any energy legislation to be passed by the Senate. A RPS will help diversify America's energy sources while creating jobs, promoting economic development, enhancing the development of domestic energy sources and reducing air pollution emissions. Because renewable energy can help meet many of our critical national needs, we believe a meaningful RPS should be part of our national energy policy and adopted by the 108th Congress. During the 107th Congress, the Senate passed an energy bill that included a RPS, however, Congress adjourned without resolving the differences between the House and Senate. We encourage the Senate to again include a RPS in its comprehensive energy legislation.

Thirteen states have enacted some form of minimum renewable energy requirements. The Department of Energy's Energy Information Administration (EIA) projects in their Annual Energy Outlook 2003 that 5.2 gigawatts of new renewable electric generating capacity through 2025 will be added as a result of these State mandates. According to EIA, a number of States with renewable energy portfolio standards in place are projected to add significant amounts of renewable capacity, including Massachusetts (1,112 megawatts), Texas (1,001 megawatts), Nevada (778 megawatts), California (623 megawatts), Minnesota (399 megawatts), New Jersey (340 megawatts), and New York (335 megawatts). Other States with smaller mandate requirements include Arizona, Hawaii, Iowa, Illinois, Montana, Oregon, West Virginia, and Wisconsin. Most of the new capacity is expected to be constructed in the near term—47 percent by 2003 and more than 60 percent by 2005.

A federal program is needed to build on these State efforts to assist in mitigating a number of our national energy problems including energy supply shortages, fossil fuel price increases and price volatility, air pollution and climate change. While states are demonstrating that renewable energy standards can work, a patchwork of state programs with different requirements can create inefficiencies and will not provide the benefits associated with a national program. For example: utilities operating in more than one state will be subject to different renewable energy targets, different enforcement mechanisms and trading systems. It would be much more efficient and less costly to implement if national rules with common trading market mechanisms were in place.

A RPS will help stabilize electricity prices, reduce natural gas prices, reduce emissions of carbon dioxide and other harmful pollutants, create jobs and promote economic development.

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[1] UCARE is a coalition of utilities consisting of PacifiCorp, WE Energies, Minnesota Power and PG&E Corp. that supports the enactment of a federal renewable portfolio standard.

- Improve energy diversity: According to the EIA, over 70 percent of our electricity was generated from fossil fuels (coal, gas and petroleum) in 2000 with only 2 percent from non-hydro-electric renewable energy sources (7 percent currently is provided from hydro-electric generation). A federal RPS, by adding to the percentage electricity that all states would receive from renewable energy sources, will diversify our fuel mix for the future enhancing the reliability of energy supplies for our nation.
- Reduce price volatility: By encouraging a greater share of the nation's electricity to come from renewable energy sources, a nationally-implemented RPS will create competition with other energy sources keeping prices down. Most new electricity generation in the future is expected to be fueled by natural gas. By 2020 EIA projects natural gas to increase to 32% (double its current level) of total electricity generation. The uncertainties surrounding our country's ability to meet this demand can lead to shortages and price volatility.
- Improve our environment: A federal RPS would significantly reduce the emissions of carbon dioxide, nitrogen oxides, and sulfur dioxide. Electricity generation is a leading source of U.S. carbon emissions, accounting for over 40% of the total emitted in the United States. According to the Union of Concerned Scientists (UCS), a federal RPS could reduce 27 million metric tons of carbon emissions a year by 2020.
- Promote economic development: A RPS would have significant economic benefits by creating a local market for renewable energy technologies adding to new capital investment and creating jobs.

The Senate should adopt a market-based renewable energy portfolio standard (RPS) requiring all retail utilities to gradually increase the portion of electricity produced from renewable energy resources such as wind, biomass, geothermal, and solar energy by a certain percentage over a period of time. Utilities should meet the RPS requirement either by generating sufficient renewable energy electricity to meet the ratio or by purchasing tradable renewable electricity credits that would be created and tracked. The RPS should employ market prices through credit trading and spread the cost of supporting renewable generation more evenly across the retail electricity market.

There are a number of principles that should be addressed in a RPS:

- The requirements of a RPS need to apply across the board to all electricity providers. The standard should apply to all retail electricity suppliers, including all public and cooperatively owned utilities;
- The RPS should include tradable renewable credits with a mechanism that limits the cost of a credit;
- There must be an enforcement mechanism;
- The RPS has to be meaningful, the "requirements" need to be high enough to trigger market growth;
- Renewable energy resources should at the very least include solar, wind, ocean, geothermal, biomass, landfill gas and incremental hydro.

In conclusion, a national RPS would make the U.S. energy supply more reliable and more secure. The Senate last year took a good first step and we encourage you to expand on our efforts and enact a RPS in energy legislation in the 108th Congress.

STATEMENT OF THE AMERICAN FOREST & PAPER ASSOCIATION

SUMMARY OF THE AMERICAN FOREST & PAPER ASSOCIATION'S STATEMENT

- The Administration's National Energy Policy calls for doubling energy output from Combined Heat and Power (CHP) units by 2010.
- Existing and future CHP facilities will be in jeopardy if the Public Utilities Regulatory Policy Act (PURPA) is repealed prior to the development of open markets where an independent party determines access to the grid.
- Currently, CHP represents 7 percent of total electricity capacity and 9 percent of generation. Almost 60 percent of CHP generation in the forest products industry is from biomass and, thus, is climate friendly. CHP power is also highly efficient power and helps expand the supply of affordable electricity in an environmentally-friendly way.
- On-site CHP power generation is critical to the profitability and competitiveness of manufacturing facilities. The increased efficiency that occurs to the manufacturing process as a result of on-site generation frequently means the difference between profitability or not.

- To maintain existing CHP, and expand it in the future, facilities must have access to the grid and the ability to purchase back-up power at non-discriminatory rates. Since many states continue to have monopoly electric utilities that own and control both the transmission and generation of electricity, CHP power would not get access and purchase opportunities without PURPA.
- We strongly recommend inclusion of the Carper-Collins/CHP amendment language that passed the Senate on a voice vote in the 107th Congress. The language establishes market conditions by which utility obligations under PURPA would end and provides certainty for both utilities and CHP operators.
- In addition, the House Energy and Commerce Subcommittee on Energy and Air Quality approved PURPA language that refines the Carper-Collins amendment and accommodates the concerns of CHP producers, and we urge the Senate Committee to consider this language as an appropriate balance between the needs of utilities and industrial generators of electricity.
- Finally, we support removing those restrictions in PUHCA that limit needed investment by American companies, but believe that reporting and other requirements in PUHCA that protect consumers and investors should remain in place to prevent market abuse and manipulation.

The American Forest & Paper Association (AF&PA) appreciates the opportunity to provide comments on the proposed electricity legislation under consideration by the Senate Committee on Energy and Natural Resources. AF&PA is the national trade association of the forest and paper industry and represents more than 240 member companies and related associations that engage in or represent the manufacturers of pulp, paper, paperboard and wood products. America's forest and paper industry ranges from state-of-the-art paper mills to small, family-owned sawmills and some 9 million individual woodlot owners.

The U.S. forest products industry is vital to the nation's economy. We employ 1.5 million people and rank among the top ten manufacturing employers in 42 states with an estimated payroll of $50 billion. We are the world's largest producer of forest products. Sales of the paper and forest products industry top $230 billion annually in the U.S. and export markets.

Energy is the third largest cost for the forest products industry, making up more than 8 percent of total operating costs. Recent energy price increases are severely impacting our competitiveness. One of the ways we address this huge cost issue is to produce as much of our electricity as possible through on-site cogeneration or Combined Heat and Power (CHP). Although the industry is nearly 60 percent self-sufficient using biomass, natural gas, coal, fuel oil and purchased electricity to balance our energy needs. Forest products companies spent over $2.1 billion on purchased electricity in 2000. Importantly, the industry also sells more than 12 million megawatt-hours annually of electricity to the transmission grid—the equivalent of a mid-sized utility.

Since 1997, employment at U.S. paper and paperboard mills has gone from 222,400 to 178,000—a decrease of almost 20 percent. While these losses have been caused by a variety of factors, the additional pressure of the current energy crisis could result in further mill closures and job losses. This situation would be far worse, had it not been for the forest product industry's commitment to fuel efficiency and independence over the past three decades. Since 1972, this industry has reduced its average total energy usage by 17 percent, reduced its fossil fuel and purchased energy consumption by 38 percent, and increased its energy self-sufficiency by 46 percent.

ENERGY POLICY LEGISLATION AND COMBINED HEAT AND POWER

Any change in energy policy clearly must take into account the needs of consumers and producers. It also needs to address the needs of those who have already taken positive steps to make energy consumption more efficient. The President's National Energy Plan calls for a doubling of energy output from CHP units by 2010. CHP is the cornerstone of the Administration's plan to improve energy efficiency and expand sources of electricity generation in an environmentally-friendly way. This goal of expanded CHP power, increased efficiency and environmentally-friendly power will not be met without the assured access to the grid that is afforded by the Public Utility Regulatory Policies Act of 1978 (PURPA).

The primary function of a CHP unit is to support manufacturing operations that require both electric power and steam or other useful thermal energy. Nonetheless, this electricity represents a critical component of the nation's electricity supply portfolio. Currently, CHP represents 9 percent of total electricity generated nationwide. Almost 60 percent of CHP generation in the forest products industry is from biomass and, thus, is climate friendly. CHP power is also highly efficient power, reach-

ing efficiency levels of 80 percent, which is at least twice as efficient as conventional power generation. This high level of efficiency occurs because our manufacturing processes use both the heat and the steam, while traditional generation units vent steam into the atmosphere. These efficiencies have also led to significant reductions in air emissions.

Successful development and full implementation of black liquor and biomass gasification programs would make the forest products industry a net exporter of renewable electricity—removing some 18 million tons of carbon emissions from the air and generating nearly 30 gigawatts of CHP-based electricity. This represents enough energy to power two-thirds of California's summertime peak. These initiatives entail substantial risk for an already capital-intensive industry. Much R&D remains to be done to prove the technologies can work without adversely impacting mill operations. Continued cooperation with the federal government is crucial to reducing risk to a level that will allow significant industry participation.

WHY PURPA IS IMPORTANT

PURPA was enacted to help reduce U.S. dependence on foreign oil and encourage fuel diversity. It is one of the most successful federal policies in promoting energy efficient generation and renewable energy. CHP technologies make use of diverse fuel resources, including renewables, thus lessening the nation's dependence on foreign oil. Additionally, CHP units typically are diverse in size and geographically dispersed. Their dispersal throughout the grid means greater efficiency through reduced line losses, and improved system reliability through less dependence upon central generation units. Their smaller size also allows for continual adaptation to, and adoption of, improving technologies. For these reasons, CHP has been a successful addition to the nation's power supply portfolio.

In order to maintain existing CHP, and expand it in the future, facilities must have a market to sell the power they cannot use in their operations. Since many states continue to have monopoly electric utilities that own and control both the transmission and generation of electricity, CHP power would not get meaningful access to the grid without the federal requirement under PURPA. In addition, CHP units must be able to purchase back-up power at non-discriminatory rates. Many industries responded to PURPA by investing billions of dollars in new on-site CHP generation to provide electricity primarily for their manufacturing processes and, occasionally, to the electrical grid.

Under PURPA, electric utilities are required to interconnect and purchase power from "Qualifying Facilities," or QFs, and they are obligated to sell standby, back-up and maintenance power to such facilities on a non-discriminatory basis. This dual guarantee of a place to sell excess power and to purchase backup power has made it possible for more industries to install the necessary equipment and develop the ability to generate electricity for their own needs, in spite of monopoly utility markets.

The power production facilities of a manufacturing operation are generally sized to meet the optimal demand. When the facility experiences a technical problem it must either divert the excess energy to the grid or shut down the power plant. When the manufacturing production process requires more energy than can be produced on site, then electricity is purchased from the local utility. The seamless integration of these QFs benefits not only the manufacturer, but also the local utility by giving them access to additional power to meet unusually high demand for power. If Congress restricts the current access to the grid that PURPA provides, many of these facilities will be economically harmed.

PURPA'S ROLE IN A TRANSITIONING MARKET

While some regions of the country have moved to a more competitive environment, many have not. Even in those regions where competition has been introduced, it is often limited to a few players that dominate the market, thus depriving small generators of meaningful access to willing buyers and sellers. In the face of monopoly and transitioning markets, there must be an assurance of access to the grid. Without such a requirement, utilities could simply refuse to provide access or make the cost of access either so expensive or so difficult that connection to the grid would be impossible. Thus, the opportunity to fully utilize CHP assets would disappear, and the monopoly utility will dominate the market.

Even with PURPA in place, many QFs, including CHP plants, are still having problems selling power into the electric grid. For example, in the Northwest and California, utilities have put up roadblocks to power being sold to the grid or to power transmission to third parties. In the Southeast, where monopolies control vast transmission and distribution systems stretching over several states, utilities

regularly exercise their market power through unreasonable surcharges, interconnection standards and fees, and "shell game" pricing for backup power sales. QFs frequently face obstacles, such as overly burdensome requirements for interconnection studies and long delays, resulting in projects being cancelled or abandoned because the cost of access is too high.

OBLIGATION FOR PURCHASE AND SALE OF QF POWER

FERC has correctly recognized that even in a state that is scheduled to be open to retail competition, there is no guarantee that a fully functioning competitive market for QFs to sell power into will develop. Congressional energy policy legislation should approach PURPA from a similar perspective. Care must be taken to ensure that CHP power is not blocked from the grid as an unintended consequence of reforms to PURPA. The PURPA obligation to purchase is the critical factor that allows manufacturers to contribute to a more diverse energy supply for this nation. If the purchase requirement is eliminated in advance of a truly competitive market place, then many existing CHP assets will become uneconomic, and future CHP development will stall because financing for CHP units is highly dependent on access to the grid.

Similarly, the importance of a federal guarantee for back-up power at just and reasonable rates cannot be over-emphasized in states that remain dominated by monopoly utilities. Without it, QFs would be captive to unregulated monopolies that could charge what they wish. Even in states that have implemented some form of electric restructuring, tariffs and regulations often continue to favor incumbent utilities, and viable options for back-up power often are not offered by competitive suppliers. The QF must be assured of receiving back-up power on a nondiscriminatory basis and at just and reasonable rates, especially if the utility is the "provider of last resort" serving retail load. To the extent that utilities have an obligation to serve retail loads, they also should continue to have the obligation to provide back-up power to QFs on a nondiscriminatory basis. Once there is a truly competitive retail market, and QFs can buy back-up power in the open market, then, and only then, will the back-up power guarantee no longer be essential to existing and future CHP power generators.

ASSESSMENT OF SENATE LEGISLATIVE PROPOSALS

The purchase and sale requirements of PURPA should not be repealed without consideration of the conditions in the market where the QF is located. The draft Senate Committee language and S. 475 both reflect major changes from the Senate passed energy bill in the 107th Congress, which contained the language offered by Senators Carper and Collins. The Carper-Collins amendment ensured that CHP technology would remain viable in transitioning electricity markets. Specifically, the language established an appropriate transition from current laws protecting CHP and other small generation plants from abuses of monopoly market power by utilities. PURPA has been critical in allowing CHP plants that serve industrial and commercial facilities to exist in an otherwise monopoly market. As retail and wholesale electricity markets become open to competition these provisions become unnecessary.

The Carper-Collins/CHP amendment passed the Senate on a voice-vote after a motion to table was rejected by a 60-37 vote. It recognized that not all of the nation's electricity markets are the same and rejected draconian, one-size-fits-all approaches to ending PURPA's obligations that run be counter-productive to maintaining and increasing CHP usage. By establishing market conditions under which PURPA obligations would end, the amendment provided certainty for both utilities and CHP operators.

Further, we have significant concerns about the newly proposed Regional Energy Services Commission (RESC). While we understand that the genesis of this proposal emerges from frustrations with recent actions of the FERC, we believe the approach will be counter productive to the creation of competitive electricity markets and will make interconnection between different regions of the country more rather than less difficult. It threatens to increase the energy costs of American manufacturers and make them less competitive. More specifically, giving a new untested regional authority the ability to terminate the Federal obligation to purchase and sell electricity under PURPA is completely counter to the intent of the Carper-Collins amendment that was overwhelmingly support by the Senate last year.

We strongly recommend inclusion of the Carper-Collins/CHP amendment in this legislation to guarantee that CHP plants will have meaningful and continuing access to willing buyers and sellers of power before current PURPA provisions are eliminated. In addition, the House Energy and Commerce Subcommittee has adopt-

ed refinements to the Carper-Collins language to the legislation it approved on March 19th. Industrial users and generators of electricity support the House subcommittee passed provisions relating to PURPA and urge the Senate Committee to consider this language as an appropriate balance between the needs of utilities and industrial generators of electricity.

OTHER ISSUES

A transmission grid operated in a fair and non-discriminatory manner is essential to industrial consumers whether they produce their own power, or whether they are simply a purchaser of electricity. Our goal is a transmission system that allows buyers of electricity as much access to sellers of electricity as possible. Industrial customers recognize that until we achieve the open transmission system, the utilities who own monopoly transmission and distribution facilities will still possess and exercise market power. These utilities have often used their government-granted monopoly power to the detriment of industrial users by favoring their own power generation over other—often lower priced power—produced by others.

Generally speaking, AF&PA supports the idea that new transmission capacity is needed in some, but not all, areas of the country, and there needs to be a reasonable and timely approach for siting and building of new transmission lines. The House Subcommittee bill has a modest approach for transmission siting and should be considered going forward to ensure that consumers' capacity needs are met as quickly as possible. However, we oppose efforts to require transmission investment incentives. We believe FERC currently has the authority to use incentives where they are needed. We are concerned that efforts that essentially require incentives for new transmission will unnecessarily increase prices to consumers.

Finally, we find almost daily stories in the press about utilities allegedly manipulating energy markets. There have been countless instances where utilities have shifted debt from unregulated affiliates to those affiliates subject to state regulations, thus forcing costs to be borne by consumers. While we support removing those restrictions in PUHCA that limit needed investment by American companies, we also believe that reporting and other requirements in PUHCA that protect consumers and investors should remain in place to prevent market abuse and manipulation. Rules are needed to address the operational unbundling of generation, transmission, system control, marketing, and local distribution functions. The need for federal authority to address market power and anti-competitive activities is as essential today for avoiding such abuses as it was 70 years ago.

CONCLUSION

Industrial users and congenerators recognize and fully support the need for more electricity generation and transmission. PURPA has been—and will continue to—be an essential law. It encourages the adoption of new technologies. It has produced a broader, more efficient, more environmentally favorable base of electricity generation. Because of PURPA, electricity has been added in smaller increments, thus not burdening users with paying for generation that proved to be much larger than necessary. And the cost of building that generation was funded by private capital. The National Energy Plan, including the goal of doubling CHP units by 2010, will be seriously undermined by efforts to repeal PURPA where open markets are not in force and no independent party determines access to the grid.

Any changes to PURPA must be made with a full recognition of their potential impact on existing CHP assets as well as plans for future expansion of CHP. The access to the grid afforded by PURPA and the rights for back-up and standby power, are essential in markets and regions of the country where competitive markets are not yet functioning effectively. In the spirit of moving toward more competitive markets in the future, the Congress should, at a minimum, ensure that this power generation is not disadvantaged by monopolistic markets by making the changes we have suggested.

SUMMARY OF TESTIMONY OF ALDEN MEYER, DIRECTOR OF GOVERNMENT RELATIONS, UNION OF CONCERNED SCIENTISTS

Investments in domestic renewable energy sources, together with continued efficiency improvements, can:

- reduce the vulnerability of our energy system to disruption of supplies and price shocks;
- create skilled jobs for American workers, and export opportunities for U.S. companies;

- reduce emissions of harmful air pollutants;
- provide fuel diversity and price stability benefits for electricity consumers.

In spite of these compelling environmental, economic, and security benefits, renewable energy technologies continue to face many market barriers, which unnecessarily keep them from reaching their full potential. A national Renewable Electricity Standard for electricity that requires utilities to gradually increase the portion of electricity produced from renewable resources such as wind, biomass, geothermal, and solar energy is needed to overcome these barriers.

Recent analyses by UCS and the Energy Information Administration demonstrate that the United States could affordably generate at least 20 percent of our electricity from non-hydro renewable energy by 2020. Even using very conservative assumptions on renewable energy costs, EIA found that a 10 percent RPS would result in net savings for consumers on their electricity and natural gas bills throughout the 2002-2020 period. Increasing the renewable energy standard to 20 percent by 2020 would result in greater fuel diversity and environmental benefits compared to the 10 percent standard, and would still provide savings to energy consumers.

The public overwhelmingly supports this policy. A survey conducted last year by Mellman Associates found that when presented with arguments for and against a 20 percent renewable energy standard, 70 percent of voters support it, while only 21 percent oppose it.

With appropriate policies, renewable energy technologies can provide Americans with the clean and reliable electricity they desire, while also saving them money, contributing to our nation's energy security and achieving significant reductions in harmful emissions.

The net metering and renewable energy production incentive provisions included in the current draft bill before the committee are laudable and deserving of support. But by themselves, these provisions will not get the job done. A strong, market-friendly renewable electricity standard is required to realize the full potential of America's renewable energy resources. Such a standard should be included in any bill this committee reports to the full Senate.

STATEMENT OF ALDEN MEYER, DIRECTOR OF GOVERNMENT RELATIONS, UNION OF CONCERNED SCIENTISTS

I. INTRODUCTION

The Union of Concerned Scientists (UCS) is a nonprofit organization of more than 60,000 citizens and scientists working for practical environmental solutions. For more than two decades, UCS has combined rigorous analysis with committed advocacy to reduce the environmental impacts and risks of energy production and use. Our clean energy program focuses on encouraging the development of clean and renewable energy resources, such as solar, wind, geothermal and biomass energy, and on improving energy efficiency.

We favor the adoption of policies to increase; the use of renewable energy resources in our nation's electricity generation mix. Such policies are needed to meet our future electricity needs, diversify our electricity supply, reduce the vulnerability of our energy system, stabilize electricity prices, and protect the environment. Specifically, we endorse a renewable electricity standard, sometimes also known as a renewable portfolio standard—a market-based mechanism that requires utilities to gradually increase: the portion of electricity produced from renewable resources.

The electricity industry penetrates every sector of the economy and our lives. It keeps our food fresh. It lights up the darkness. It powers the manufacturing process. It runs life-giving medical systems and mind-enriching information systems. It helps warm us in the winter and cools us in the summer.

As important as electricity is to the economy, the tragic events of September 11 have brought renewed attention to how vital and connected our energy system is to national security. The vulnerability of the energy infrastructure to attack has been increasingly recognized as a significant issue, with terrorist threats reported to nuclear power plants and natural gas pipelines, and heightened security implemented at dams, power plants, refineries, liquefied natural gas tankers and terminals, and the electrical grid.

Electricity use also has a significant impact on the environment. Electricity accounts for less than three percent of U.S. economic activity. Yet, it accounts for more than 26 percent of smog producing nitrogen oxide emissions, one-third of toxic mercury emissions, some 40 percent of climate-changing carbon dioxide emissions, and 64 percent of acid rain-causing sulfur-dioxide emissions.

Unfortunately, there are no quick fixes to make the United States energy independent, ensure price stability, or clean up the air we breathe. However, invest-

ments in domestic renewable energy sources, together with continued efficiency improvements, can gradually reduce our dependence on imports and reduce the vulnerability of the U.S. energy system to disruption of supplies or to attack. Investments that increase fuel diversity strengthen the ability of our economy to withstand supply interruptions or price shocks from any one fuel source. Investments in indigenous renewable energy sources keep money circulating and creating jobs in regional economies, and create export opportunities. And of course, investments in clean air benefit everyone that breathes the air.

By investing in renewable energy, our nation promotes a host of important public goods: national security, fuel diversity, price stability, universal and reliable electric service, economic development, and a healthier environment. Most importantly, investing in renewable energy can provide all these benefits and reduce electricity costs.

In this testimony, we review the potential for renewable energy and how it can help promote these public goods. We then present the renewable energy standard for electricity as the best policy mechanism for reducing market barriers and stimulating the development of renewable energy resources. Finally, we review three recent studies that show we can significantly improve our efficiency and increase the contribution of renewable energy to our electricity mix, while lowering consumer energy bills.

II. RENEWABLE ENERGY POTENTIAL, BENEFITS, AND BARRIERS

The United States is blessed by an abundance of renewable energy resources from the sun, wind, and earth. The technical potential of good wind areas, covering only 6 percent of the lower 48 state land area, could theoretically supply more than one and a third times the total current national demand for electricity. An area just over one hundred miles by one hundreds miles in Nevada could produce enough electricity from the sun to meet annual national demand. We have large untapped geothermal and biomass (energy crops and plant waste) resources. Of course, there are limits to how much of this potential can be used economically, because of competing lard uses, competing costs from other energy sources, and limits to the transmission system. The important question is how much it would cost to supply a specific percentage of our electricity from non-hydroelectric renewable energy sources. As this testimony will later show, recent analyses demonstrate we could affordably generate at least 20 percent of our electricity from non-hydro renewable energy by 2020.

The benefits of renewable energy are as plentiful as the resource itself—environmental improvement, economic development, and increased fuel diversity and national security.

Harnessing renewable energy conserves natural resources for future generations, and reduces the environmental and public health impacts of mining, refining, transporting. burning, and disposing of wastes from fossil fuels, as well as reducing air emissions. Renewable resources also provide insurance against increased costs from stricter environmental regulations in the future.

Renewable energy provides new economic development opportunities, especially in rural areas that are rich in wind and biomass resources. According to the U.S. Department of Energy, generating 5 percent of the country's electricity with wind power by 2020 would add $60 billion in capital investment in rural America, and create 80,000 new jobs. Renewable energy technologies also offer the potential for a very large export market, as many countries around the world are increasing their use of renewable resources.

Renewable energy technologies diversify our energy resource portfolio, reducing exposure to energy supply interruptions and price volatility, which can affect the entire economy. Indeed, Stephen Brown, director of energy economics at the Dallas Federal Reserve Bank, notes that "nine of the 10 last recessions have been preceded by sharply higher energy prices." Two years ago, soaring natural gas prices was one key factor in the California energy crisis that caused rolling blackouts and cost energy consumers billions of dollars. There are now significant indications that the natural gas price volatility experienced during 2001 was not an isolated event. Just last week, as the composite price of March natural gas on the New York Mercantile Exchange,jumped 65 percent in one clay, the Wall Street Journal reported industry observers as saying that "the U.S. is entering a prolonged period of higher natural gas prices, and the days of $3 natural gas, which lasted from the mid-1980s until about 2000, may be gone."

There is also a growing recognition that renewable energy and efficiency can enhance energy security. An official banner at the Administration's Renewable Energy Summit in the fall of 2001 read: "Expand Renewable Energy For National Security." James Woolsey, former head of the Central Intelligence Agency, Robert McFarlane,

President Reagan's former national security advisor, and Admiral Thomas Moorer. former chair of the Joint Chiefs of Staff, together wrote Congressional leader September 2001 urging enactment of minimum standards for renewable fuels and electricity, along with an increase in energy efficiency funding, in order to increase national security.

In spite of these compelling environmental, economic, and security benefits, renewable energy technologies continue to face many market barriers, which unnecessarily keep them from reaching their full potential.

Renewable energy has made great strides in reducing costs, thanks to research and development and growth in domestic and global capacity. The cost for wind and solar electricity has come down by 80-90 percent over the past two decades. However, like all emerging technologies, renewable resources face commercialization barriers. They must compete at a disadvantage against the entrenched industries. They lack infrastructure, and their costs are high because of a lack of economies of scale.

Renewable energy technologies face distortions in tax and spending policy. Studies have established that federal and state tax and spending policies tend to favor fossil-fuel technologies over renewable energy. A recent study by the Renewable Energy Policy Project showed that between 1943 and 1999, the nuclear industry received over $145 billion in federal subsidies vs. $4.4 billion for solar energy and $1.3 billion for wind energy. Another study by the non-partisan Congressional Joint Committee on Taxation projected that the oil and gas industries would receive an estimated $11 billion in tax incentives for exploration and production activities between 1999 and 2003. In addition to these subsidies, conventional generating technologies enjoy a lower tax burden. Fuel expenditures can be deducted from taxable income, but few renewable technologies benefit from this deduction, since most do not use market-supplied fuels. Income and property taxes are higher for renewable energy, which require large capital investments but have low fuel and operating expenses.

Many of the benefits of renewable resources, such as reduced pollution and greater energy diversity, are not reflected in market prices, thus eliminating much of the incentive for consumers to switch to these technologies. Other important market barriers to renewable resources include: lack of information by customers, institutional barriers, the small size and high transaction costs of many renewable technologies, high financing costs, split incentives among those who make energy decisions and those who bear the costs, and high transmission costs.

Some have called for future support of renewable energy through "green marketing," selling portfolios with a higher renewable energy content (and lower emissions) to customers who are willing to pay more for them. We strongly support green marketing as a means to increase the use of renewable energy and reduce the environmental impacts of energy use. Surveys show that many customers are willing to pay more for renewable energy, and pilot programs have shown promising, but not overwhelming results.

Green marketing is not a substitute for sound public policy, however. There are many barriers to customers switching to green power, not the least of which is inertia. More than fifteen years after deregulation of long-distance telephone service, half of telephone customers still had not switched suppliers, even though they could get much lower prices by doing so. A recent study by the National Renewable Energy Laboratory projects that in an optimistic scenario, green marketing could increase the percentage of renewable energy in our electricity mix from about 2 percent today to only about 3 percent in ten years.

With green electricity, the benefits of any individual customer's choice accrue to everyone, not the individual customer. Green customers gets the same undifferentiated electrons and breathe the same air as their neighbors choosing to buy power from cheap, dirty coal plants, creating a strong incentive for people to be "free riders" rather than pay higher costs for renewable resources. People recognize this public benefits aspect of green power. While they consistently say they are willing to pay more for electricity that is cleaner and includes more renewable energy, they overwhelmingly prefer that everyone pay for these benefits to relying on volunteers. A deliberative poll by Texas utilities found that 79 percent of participants favored everyone paying a small amount to support renewable energy, versus 17 percent favoring relying only on green marketing.

III. THE RENEWABLE ENERGY STANDARD

A number of complementary policies should be enacted to reduce market barriers to renewable energy development:

- Extending production tax credits of 1.7 cents per kWh and expanding them to cover all clean, renewable resources (excluding hydropower);

- Enacting a federal public benefit fund to match state programs for energy efficiency, renewable energy, research and development, and protecting low-income customers;
- Adopting national net metering standards, allowing consumers who generate their own electricity with renewable energy systems to feed surplus electricity back to the grid and spin their meters backward, thus receiving retail prices for their surplus power production;
- Increasing spending on renewable energy research and development.

The deployment of all these policy solutions will be required to truly level the playing field for renewable energy. However, we believe that a national Renewable Electricity Standard for electricity—also known as a Renewable Portfolio Standard (RPS) is the cornerstone of any comprehensive policy approach to stimulate renewable energy development. A national RPS can diversify our energy supply with clean, domestic resources, It will help improve our national security, stabilize electricity prices, reduce natural gas prices, reduce emissions of carbon dioxide which are heating up the earth and threaten to destabilize the climate—and other harmful air pollutants, and create jobs—especially in rural areas—and new income for farmers and ranchers.

For these reasons, we believe a national RPS should be included in any electricity bill reported by this Committee.

The RPS is a market-based mechanism that requires utilities to gradually increase the portion of electricity produced from renewable resources such as wind, biomass, geothermal, and solar energy. It is akin to building codes, or efficiency standards for buildings, appliances, or vehicles, and is designed to integrate renewable resources into the marketplace in the most cost-effective fashion.

By using tradable "renewable energy credits" to achieve compliance at the lowest cost, the RPS would function much like the Clean Air Act credit-trading system, which permits lower-cost, market-based compliance with air pollution regulations. Electricity suppliers can generate renewable electricity themselves, purchase renewable electricity and credits from generators, or buy credits in a secondary trading market. This market-based approach creates competition among renewable generators, providing the greatest amount of clean power for the lowest price, and creates an ongoing incentive to drive down costs.

Thirteen states—Arizona, California, Connecticut, Iowa, Maine, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico. Pennsylvania, Texas, and Wisconsin—have enacted minimum renewable energy requirements. But energy production creates national economic and environmental problems that need national solutions. The U.S. Senate recognized this need last year when they passed the first-ever national renewable energy standard with strong bi-partisan support. As part of comprehensive energy legislation (H.R. 4), the Senate passed a 10 percent by 2020 renewable energy standard that, if signed into law, would have saved consumers money on their energy bills and resulted in the U.S. increasing its total home-grown renewable power to over 74,000 megawatts (MW). This level of renewable development would produce enough electricity to meet the needs of 53 million typical homes.

The RPS is the surest mechanism for securing the public benefits of renewable energy sources and for reducing their cost to enable them to become more competitive. It is a market mechanism, setting a uniform standard and allowing companies to determine the best way to meet it. The market picks the winning and losing technologies and projects, not administrators. The RPS will reduce renewable energy costs by:

- Providing a revenue stream that will enable manufacturers and developers to obtain project financing at a reasonable cost and make investments in expanding capacity to meet an expanding renewable energy market.
- Allowing economies of scale in manufacturing, installation, operation and maintenance of renewable energy facilities.
- Promoting vigorous competition among renewable energy developers and technologies to meet the standard at the lowest cost.
- Inducing development of renewables in the regions of the country where they are the most cost-effective, while avoiding expensive long-distance transmission, by allowing national renewable energy credit trading.
- Reducing transaction costs, by enabling suppliers to buy credits and avoid having to negotiate many small contracts with individual renewable energy projects.

Some people have asked why hydropower is not eligible to earn renewable energy credits in most RPS proposals. The primary reason for not including hydro is that it is a mature resource and technology. In most cases, it is already highly competi-

tive. It will not benefit appreciably from the cost-reduction mechanisms outlined above, and an RPS that included hydro would produce negligible, if any, increases in hydro generation.

Some people have also expressed concerns about the variable output of renewable sources like solar and wind, and believe that an RPS would affect the reliability of our energy system. However, the electric system is designed to handle unexpected swings in energy supply and demand, such as significant changes in consumer demand or even the failure of a large power plant or transmission line. Solar energy is also generally most plentiful when it is most needed-when air-conditioners are causing high electricity demand. There are several areas in Europe, including parts of Spain, Germany, and Denmark, where wind power already supplies over 20 percent of the electricity with no adverse effects on the reliability of the system. In addition, several important renewable energy sources, such as geothermal, biomass, and landfill gas systems can operate around the clock. Studies by the EIA and the Union of Concerned Scientists show these nonintermittent, dispatchable renewable plants would generate about half of the nation's non-hydro renewable energy under a 10 percent RPS in 2020. Renewable energy can increase the reliability of the overall system, by diversifying our resource base and using supplies that are not vulnerable to periodic shortages or other supply interruptions.

IV. BENEFITS OF A RENEWABLE PORTFOLIO STANDARD

Three recent studies, one by the U.S. Energy Information Administration (EIA) and two by the Union of Concerned Scientists, show that a 10 percent RPS by 2020 is easily achievable and can stimulate economic development and increase energy security, while reducing consumer energy bills as well as local and global environmental hazards. Increasing the RPS to 20 percent by 2025 would result in greater diversity, environmental, and economic development benefits compared to the 10 percent standard, and would still provide savings to energy consumers. When combined with energy efficiency measures and additional renewable energy policies, the RPS can significantly lower consumer energy bills.

EIA Analysis: The EIA study was conducted at the request of Senator Frank Murkowski, as the Senate considered inclusion of the RPS as part of comprehensive national energy legislation (S. 1766). As part of their analysis, the EIA examined the costs of using the RPS to achieve levels of 10 percent (both with and without the sunset provision in S. 1766) and 20 percent renewable electricity supplies by the year 2020.

The EIA scenarios found benefits to consumers from increasing renewable energy use despite including a number of assumptions that are extremely unfavorable to renewable energy. Many of these assumptions were examined and rejected by the Interlaboratory Working Group—made up of experts from the National Renewable Energy Lab, Oak Ridge National Lab, Pacific Northwest Lab, Battelle Memorial Institute, and Lawrence Berkeley National Lab—in their *Scenarios for a Clean Energy Future* (IWG, 2000). In some of the most important such assumptions, EIA

- Used higher cost and worse performance assumptions for most renewable technologies than recent experience or projections by the Electric Power Research Institute and DOE;
- Arbitrarily increased the capital cost of wind, biomass, and geothermal technologies by up to 200 percent in a given region after a fairly small amount of the regional potential is met; more than 90 percent of the highest value wind resources in the US, for example, are assigned a capital cost multiplier of 200 percent; and
- Limited the penetration of variable output resources like wind and solar power to 15 percent of a region's electricity generation; in parts of Germany, Denmark and Spain, wind power is already providing more than 20 percent of total electricity generation.

These assumptions, and others, led to projections of very high renewable energy prices in high renewable energy penetration scenarios. With the availability and penetration of the lowest cost wind and biomass resources assumed to be sharply limited, higher RPS levels in ETA's version of the model require deploying more expensive renewable resources.

Despite these overly conservative assumptions for renewable energy cost and availability, EIA still found that the 10 percent RPS would have virtually no impact on retail electricity prices. Figure 1* shows that, in 2020, electricity prices would

*Figures 1-7 have been retained in committee files.

be only one-tenth of one cent per kilowatt-hour higher than business as usual under a 10 percent FPS.

Even these small increases in electricity prices are largely offset, however, by lower natural gas prices. Diversifying the electricity mix with renewable energy helps stabilize electricity prices by easing pressure on natural gas prices and supplies. Under a 10 percent RPS, ETA found that average consumer natural gas prices are 2.2 percent lower than business as usual in 2010, and 1.9 percent lower in 2020. These lower prices would save gas consumers $1.7 billion per year by 2020 (2000 dollars, 8 percent discount rate).

In the key results section of its report, EIA recognizes this benefit of increased renewable energy use by noting that "the retail electricity price impacts of the RPS are projected to be small because the price impact of buying renewable credits and building the required renewable energy is projected to be relatively small when compared with total electricity costs and to be mostly offset by lower gas prices that result from reduced gas use."

However, EIA did not report on the extent to which these lower natural gas prices offset higher electricity costs. By adding total residential, commercial and industrial energy expenditures, it can be seen that total non-transportation energy costs would actually be $2.7 billion lower in 2010 and only $1.5 billion or 0.3 percent higher in 2020 under the 10 percent RPS than under business as usual (Figure 2).[1] The net present value savings of the RPS scenario would be $6.7 billion compared to the business as usual case (2000 dollars, 8 percent discount rate).

A 10 percent RPS would also help reduce emissions from power plants. Under an RPS, carbon emissions from power plants would be 23 million metric tons or 3 percent lower than business as usual in 2010 and 53 million metric tons or 7 percent lower in 2020, according to EIA.

"No Sunset" Case: The EIA report also examined a 10 percent RPS by 2020 without a key provision included in the original RPS proposed in S. 1766—a 2020 sunset date. ETA found that this sunset provision would cause electric generators to chose an alternative compliance mechanism rather than develop additional renewable energy sources in the later years of the requirement. If the sunset provision was removed from S. 1766—as was effectively the case in the RPS passed by the Senate—EIA found that there would be a significant impact on the costs and benefits of the RPS.[2] EIA results show that under a 10 percent RPS with no sunset, average retail electricity prices would be unchanged through 2020 compared to business as usual. Average consumer natural gas prices would be 2.3 percent lower than business as usual in 2020. With no change to consumer electricity prices, lower natural prices result in savings for consumers on their electricity and natural gas bills throughout the 2002-2020 period (Figure 3). Total non-transportation energy costs would be $3.1 billion lower in 2010 and $3 billion lower in 2020 under the 10 percent RPS than under business as usual (Figure 2). Removing the sunset provision from the 10 percent national standard would also nearly double total energy consumer savings to $13.2 billion through 2020.

EIA 20 percent analysis: Results from the ETA analysis also show that increasing the renewable energy standard to 20 percent by 2020 would result in greater diversity and environmental benefits compared to the 10 percent standard, and would still provide savings to energy consumers.

Under a 20 percent RPS, ETA results show virtually no impact on retail electricity prices compared to business as usual through 2015. In 2020, electricity prices would be just two-tenths of one cent per kilowatt-hour higher than business as usual.

By diversifying the energy mix even further with a 20 percent RPS, EIA results show an even greater impact on natural gas prices and supplies. Average consumer natural gas prices are 3 percent lower than business as usual in 2010 and 3.6 percent lower in 2020. These lower prices would save gas consumers $3.3 billion per year by 2020.

Similarly to the 10 percent RPS case, EIA results show that lower natural gas prices more than offset the very small increases in electricity prices caused by add-

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[1] Results obtained through personal communication with Laura Martin at EIA, on March 7, 2002. Tables available upon request.

[2] The sunset does not actually have to be removed, but it must be at least ten years after the date at which the renewable energy ramp-up ends, in order to allow generators that come on-line late in the RPS ramp-up enough time to recover their costs. Otherwise, no renewable energy generation would be added in the last few years of the RPS, and suppliers would instead buy proxy credits from or pay penalties to DOE. The early sunset thus produces less renewable generation and higher costs.

ing more renewable energy sources to the generation mix. Total consumer energy savings would be $5.7 billion over the next 18 years.

According to EIA, a 20 percent by 2020 RPS would also result in greater carbon emissions savings from power plants. Carbon emissions would be 43 million metric tons or 6 percent lower than business as usual in 2010 and 76 million metric tons or 10 percent lower in 2020.

UCS Analysis: The Union of Concerned Scientists. in *Renewing Where We Live: A National Renewable Energy Standard Will Benefit Americas Economy*, investigated the costs and benefits of a 10 percent RPS by 2020 RPS combined with an extension of the Federal renewable energy production tax credit as passed by the Senate in March 2002.

Our analysis used the U.S. Energy Information Administration's NEMS computer model, with scenarios run for UCS by the Tellus Institute. We based our business-as-usual scenario on Annual Energy Outlook 2002 (EIA, 2001), the EIA's long-term forecast of U.S. energy supply, demand, and prices. The year 2000 is the last year of history in the model, which makes projections through 2020. We modified several NEMS assumptions for renewable energy, generally in line with the IWG Clean Energy Future analysis, in order to model these technologies more accurately.

We found that the national portfolio standard and renewable energy tax credits passed by the Senate would reduce long run energy costs to consumers. Total annual consumer energy bills (not including transportation) would be $100 million lower than business as usual in 2010, and $3.8 billion or 1 percent lower in 2020 (Figure 4). The present value of total consumer savings would be $7.8 billion between 2002 and 2020. if taxpayer costs from the tax credits and increased federal research and development funding for renewable energy are included, total consumer savings would be $2.8 billion.[3] Increased competition from renewable energy leads to lower natural gas prices, which more than offset the slightly higher costs of generating renewable electricity in the United States.

UCS analysis found that under a 10 percent RPS, the United States would increase its total home-grown renewable power to over 74,000 megawatts (MW) by 2020. The majority of this development would be powered by America's strong winds, with significant contributions from biomass and geothermal. This level of renewable development would produce enough electricity to meet the needs of 53 million typical homes.

Renewable energy development resulting from the Senate-passed RPS would bring significant economic benefits to the United States. Through 2020, the national standard would produce

- $17 billion in new capital investment;
- S1.2 billion in new property tax revenues for local communities;
- $410 million in lease payments to farmers and rural landowners from wind power.

UCS also found that the increased use of renewable energy in the United States would reduce air pollution from power plants, Nationally, the renewable energy standard will reduce about 27 million metric tons of carbon emissions a year by 2020. The renewable standard will also reduce harmful water and land impacts from extracting, transporting, and using fossil fuels.

In the future, natural gas is projected to fuel much of the new electricity generation built in the United States without additional policies for renewable energy. This increase in demand for natural gas may lead to natural gas prices that are higher and more volatile than those used in our base case analysis. Based on these assumptions, UCS also examined the effects of a 10 percent RPS on an alternative scenario where wholesale natural gas prices are 35 percent higher by 2020.

UCS found that the more expensive natural gas is, the greater the savings will be from reducing natural gas use through a renewable energy standard. In the scenario that we analyzed, total consumer energy bill savings through 2020 from the renewable standard would more than double to $17.6 billion. Renewable energy generation and related economic development benefits would also increase significantly if gas prices were higher.

In *Clean Energy Blueprint: A Smarter National Energy Policy for Today and the Future*, the Union of Concerned Scientists investigated the costs and benefits of two energy efficiency and renewable energy scenarios, compared to business as usual.

[3] Last year's House and Senate energy bills included renewable energy tax credits worth between $2.6 billion (Congress' estimate) and $5.2 billion (UCS' estimate) over the next 10 years. The bills also included 10 years' worth of subsidies for fossil fuel and nuclear power totaling about $9.1 billion in the Senate bill and $28 billion in the House bill. (Note: these dollar figures are not discounted.)

We did not examine RPS-only scenarios, as in *Renewing Where We Live* or as EIA did, but looked at a 20 percent RPS in combination with other renewable energy and energy efficiency policies.

We examined a scenario consisting primarily of the policies in the Renewable Energy and Energy Efficiency Investment Act of 2001 (S. 1333), sponsored by Senator Jeffords. 1n addition to a 20 percent RPS, S. 1333 would have established a federal public benefit fund and net metering. We also assumed that research and development spending on renewable energy and efficiency would increase 60 percent over three years to levels recommended by the President's Committee of Advisors on Science and Technology.

We also investigated the costs and benefits of the RPS with an expanded suite of renewable energy and energy efficiency policies. In addition to the above policies, these included:

- Production tax credits of 1.7 cents per kWh for renewable energy would be extended and expanded to cover all clean, non-hydro renewable resources, helping to level the playing field with fossil fuel and nuclear generation subsidies.
- Combined heat and power: Incentives would be provided and regulatory barriers removed for power plants that produce both electricity and useful heat at high efficiencies.
- Improved efficiency standards: National minimum efficiency standards would be established for a dozen products; generally to the level of good practices today. In addition, existing national standards would be revised to levels that are technically feasible and economically justified.
- Enhanced building codes: States would adopt model building codes established in 1999/2000, as well as new more advanced codes established by 2010.
- Tax incentives would promote efficiency improvements for buildings and equipment beyond minimum standards.
- Industrial energy efficiency measures. Industry would improve its efficiency by 1 to 2 percent per year through voluntary agreements, incentives, or national standards.

Like Renewing Where We Live, this analysis used the U.S. Energy Information Administration's HEMS computer model, with scenarios run for UCS by the Tellus Institute. For this report, we based our business-as-usual scenario on Annual Energy Outlook 2001 (EIA, 2000). The year 1999 is the last year of history in the model, which makes projections through 2020. The efficiency policies were developed by and modeled by the American Council for an Energy Efficient Economy. The calculated energy savings were used to adjust the AEO forecasts. The energy efficiency costs were annualized and added to the results. Once again, we modified several NEVIS assumptions for renewable energy, generally in line with the IWG Clean Energy Future analysis, in order to model these technologies more accurately and applied these modifications to both the business-as-usual scenario and the Clean Energy Blueprint.

Combined with increased research and development, S. 1333 would save consumers a total of $70 billion between 2002 and 2020, with savings reaching $35 billion per year by 2020. Under a higher-gas-price scenario, cumulative savings would reach $130 billion between 2002 and 2020. In 2020, monthly bills for a typical household would be $34 per month under S. 1333, compared to $38 per month under business as usual and $25 per month under the Clean Energy Blueprint,

Carbon dioxide emissions from power plants would be nearly one-third lower than under business as usual by 2020, while sulfur dioxide emission levels would be 8 percent lower and nitrogen oxide emissions 15 percent lower.

When combined with the energy efficiency and additional renewable energy policies included in the Clean Energy Blueprint, the economic and environmental benefits of the RPS are even greater. Under the Blueprint, total energy use would be 19 percent lower than business as usual by 2020 and only 5 percent higher than 2000 levels, due to increased energy efficiency in homes, offices, and factories. Natural gas use would grow by 8 percent from today's level, but be 31 percent less than business as usually 2020. Coal-tired electricity generation is 61 percent below business as usual in 2020 and 53 percent lower than today's levels.

Oil use would be reduced by 5 percent, saving over 400 million barrels per year by 2020. More oil Would be saved over the next 18 years than is projected to be economically recoverable from the Arctic National Wildlife Refuge over 60 years. The Clean Energy Blueprint did not include oil savings from increased energy efficiency and renewable energy use in the transportation sector. Another recent UCS study, *Drilling in Detroit: Tapping Automaker Ingenuity to Build Safe and Efficient Automobiles*, has shown that fuel economy improvements in cars and light trucks would provide significant oil savings (UCS, 2001). If these savings were combined

with the savings from the Clean Energy Blueprint, the United States would save more than 15 times the oil available in the Arctic Refuge at 2001 oil prices (Figure 5) and total oil use would be 9 percent lower in 2010 and 23 percent lower in 2020 than under business as usual. The combined net savings to consumers would increase to over $150 billion per year by 2020 and $645 billion between 2002 and 2020.

Non-hydro renewable energy sources (wind, biomass, geothermal, and solar) would produce 20 percent of the nation's electricity by 2020. Energy efficiency measures would offset projected growth in electricity use. Combined heat and power plants would meet 39 percent of commercial and industrial electricity needs. Thus, the Clean Energy Blueprint would eliminate the need for 975 of the 1,300 new power plants the administration's *National Energy Policy* says we need by 2020, and retire 180 existing coal plants and 14 nuclear plants, reducing the number of vulnerable energy facilities.

By 2020, because of lower electricity demand and because natural gas is used both to generate electricity and to produce useful heat, overall natural gas generation is 33 percent lower than business as usual in 2020. The Blueprint's efficiency and renewable energy policies reduce natural ;as prices by 27 percent by 2020, saving businesses and homes that use natural gas nearly $30 billion per year.

Under the Clean Energy Blueprint, net energy savings would grow to $105 billion per year by 2020, totaling $440 billion between 2002 and 2020 (total savings between 2002 and 2020 are in 1999 dollars using a 5 percent real discount rate.) A typical family would save $350 per year in lower energy bills by 2020 (Figure 6).

The Clean Energy Blueprint would reduce power plant carbon emissions two-thirds by 2020 compared to business-as-usual projections (Figure 7). Sulfur dioxide emissions, which are the primary cause of acid rain, and nitrogen oxide emissions, a major cause of smog, would both be reduced more than 55 percent.

The Clean Energy Blueprint would reduce the need to drill for natural gas and to build some significant portion of the over 300,000 miles of new pipelines called for in the administration's National Energy Policy. It would also reduce the need to mine, transport, and burn 750 million tons of coal per year by 2020 compared to business-as-usual projections. Moreover, energy efficiency measures and renewable energy facilities can be deployed faster than new fossil and nuclear energy supplies could be developed.

VI. CONCLUSION

Survey after survey has shown that Americans want cleaner and renewable energy sources, and that they are willing to pay more for them. A survey conducted last year by Melhrnan Associates found that when presented with arguments for and against a 20 percent RPS requirement, 70 percent of voters support an RPS, while only 21 percent oppose it.

The combination of EIA and UCS studies demonstrate that with appropriate policies, renewable energy technologies can provide Americans with the clean and reliable electricity they desire, while also saving them money, contributing to our nation's energy security and achieving significant reductions in harmful emissions.

The net metering and renewable energy production incentive provisions included in the current drag bill before the committee are laudable and deserving of support. But by themselves, these provisions will not get the job done. A strong, market-friendly renewable energy standard is required to realize the full potential of America's renewable energy resources.

For all of these reasons, we respectfully urge that as the Committee moves forward with its development of national energy legislation, you support inclusion of a renewable portfolio standard. Thank you.

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