BEFORE THE
UNITED STATES SENATE

THE COMMITTEE ON ENERGY AND NATURAL RESOURCES

Testimony of
GERALD NORLANDER

For

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Regarding S. 475
Electric Transmission and Reliability Enhancement Act of 2003
and Related Proposals

Washington, DC
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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.

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 <u>all</u> 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

[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.

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

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[2] Staff Draft, Sec. 1211.

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

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

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 strengthening, 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;

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

> 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)

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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 to Ensure FERC Jurisdiction Over the Actions of Such a Board in the Future.*

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

[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.

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

Transmission Investment Incentives

[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 covered 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 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

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[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.

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)

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

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 contracts, 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,

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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.

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:

Click Resolutions.

"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.

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

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.

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

[15] NASUCA Resolution 02-02, *Urging Jurisdictions 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.

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.

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[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 .

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]

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

[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)).

[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).

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.