

**Testimony of
William L. Massey, Commissioner
Federal Energy Regulatory Commission
Before the Committee on Energy and Natural Resources
United States Senate
Washington, DC
March 27, 2003**

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.