

**Summary of Testimony of  
Pat Wood, III  
Chairman, Federal Energy Regulatory Commission  
Before the Committee on Energy and Natural Resources  
United States Senate  
March 27, 2003**

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.

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**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 inter-regional 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 legislation 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 212 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.