

Testimony of Representative Peter DeFazio  
Senate Committee on Energy and Natural Resources  
Hearing on FERC's Standard Market Design Notice of Proposed Rulemaking  
September 17, 2002

Chairman Bingaman and Members of this Committee, I applaud you for conducting an oversight hearing on FERC's Standard Market Design Notice of Proposed Rulemaking (SMD NOPR).

The SMD NOPR is a 600-plus page, virtually unintelligible academic exercise that fails to recognize how electricity is actually delivered in the Pacific Northwest. Policymakers should keep in mind that the last time a similar academic exercise was imposed on consumers, the California energy system imploded.

The SMD NOPR also represents an extraordinary assertion of authority by federal regulators to scrap the current regulatory framework that works well, at least in my region of the country, and replace it with a radical nationwide experiment that has not been authorized by Congress.

In short, FERC's SMD NOPR assumes that all markets operate efficiently, all utilities own generation and transmission and can respond immediately to price signals, all regulation of the electricity grid ought to reside in Washington, D.C., all utilities have the desire and the capability to participate fully in complex new markets, and that all regions of the country have a similar geography, generation and load distribution as the Northeastern United States. None of these assumptions is applicable to the Pacific Northwest.

I am hopeful that this hearing will lead the Committee to exert its right to limit FERC's unauthorized experiment.

**FERC Asserts Authority Where It Has None**

Congress has not authorized FERC to pursue SMD. Let me stay that again, because it's an important point. Congress has not authorized FERC to pursue SMD. Therefore, it is incumbent upon Congress to exert our authority and limit the scope of FERC's experiment.

FERC considers the SMD NOPR a continuation of the work begun with Orders 888 and 2000, which were issued in response to the 1992 Energy Policy Act and FERC's statutory responsibility to ensure adequate supplies of electricity at just and reasonable rates.

However, the SMD NOPR goes far beyond FERC's statutory authorization.

Indeed, a July 12, 2002, ruling by the U.S. Court of Appeals for the District of Columbia Circuit (*Atlantic City Electric Company et.al. v. FERC*) ruled that FERC overstepped its

regulatory authority with Order 888 and subsequent rulings. While not a perfect parallel for the issues raised by the SMD NOPR, I believe the ruling is instructive.

The ruling stated that FERC can't force modifications to contracts unless in the public interest, can't limit the ability of utilities to change their rate design, and can't force utilities to participate in a regional transmission organization (RTO). The Court stated, "As a federal agency, FERC is a 'creature of statute,' having 'no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress.' Thus, if there is no statute conferring authority, FERC has none."

The Court concluded "Section 205 of the Federal Power Act gives a utility the right to file rate and terms for services rendered with its assets...FERC cannot point to any statute giving it authority for its unprecedented decision to require the utility petitioners to cede rights expressly given to them in section 205 of the Federal Power Act."

The Court went on to explain, "Section 205(d) [of the Federal Power Act] provides that a public utility may file changes to rates, charges, classification, or service at any time upon 60 days notice...FERC can then review those changes under section 205 and suspend them for a period of five months, *but it can reject them only if it finds that the changes proposed by the public utility are not 'just and reasonable.'*" [emphasis added]

FERC has made no such finding with respect to utilities in the Northwest.

The Court also shot down FERC's attempt to use Section 206 of the Federal Power to justify its extraordinary assertion of authority. The Court said, "Similarly, nothing in Section 206 sanctions denying petitioners the right to unilaterally file rate and term changes. Section 206 merely permits the Commission – acting either on its own initiative or after a complaint – to initiate changes to existing utility rates and practices. In order to make any change in an existing rate or practice, FERC must first prove that the existing rates or practices are 'unjust, unreasonable, unduly discriminatory or preferential.' Then, FERC must show that its proposed changes are just and reasonable."

FERC has made no such finding with respect to the Northwest, and FERC has made no showing that its proposed changes are just and reasonable.

In a particularly devastating passage to FERC, the Court ruled, "FERC cannot rely on one of its own regulations to trump the plain meaning of a statute...No matter how 'bedrock' the principle of ISO independence may be, Order 888 is merely a regulation. It cannot be the basis for denying the petitioners their rights provided by a statute enacted by both houses of Congress and signed into law by the President."

As will be discussed in greater detail below, the SMD NOPR would abrogate existing transmission rights and contracts. However, the Court of Appeals noted, "Under the Mobile-Sierra doctrine, FERC may abrogate or modify freely negotiated private contracts that set firm rates or establish a specific methodology for setting the rates for service, and

deny either party the right to unilaterally change those rates, *only if required by the public interest.*” [emphasis added]

FERC has not made a case for why abrogating existing transmission rights and contracts would be in the public interest in the Northwest.

The Court concluded, "FERC has attempted to assert authority where it has none." I think a Court would conclude the same thing about the SMD NOPR.

### **FERC Is Trying To Solve Problems That Don't Exist in the Pacific Northwest**

The problems identified by FERC that the SMD NOPR is theoretically supposed to address – such as discriminatory access to and pricing of transmission, inadequate investment in infrastructure – either do not exist in the Pacific Northwest, or, to the extent they do, can be resolved through existing institutions like the Bonneville Power Administration (BPA), the Northwest Power Planning Council, and state public utility commissions (PUCs).

While FERC made a number of findings of fact regarding discrimination and other problems that exist at least somewhere in the country, FERC made no attempt in the SMD NOPR to make findings of fact on a regional basis. In other words, there is nothing in the Order that FERC can point to documenting problems in the Northwest. Instead, FERC just asserts without evidence that problems exist nationwide and, therefore, require a uniform, nationwide solution.

Even FERC Chairman Pat Wood, III, in a meeting with several Northwest House Members a week prior to the release of the NOPR, acknowledged that he couldn't think of a single docket involving allegations of discrimination or similar problems in the Northwest. Indeed, none of the cases cited in the footnotes in the NOPR are cases involving the Northwest. Therefore, FERC's one-size fits all vision will, by definition, increase costs in the Northwest by adding unnecessary and burdensome rules, markets and institutions. A region can't comply for free.

On Page 19, Paragraph 19, FERC quotes Order 2000, which says, “perceptions of discrimination are significant impediments to competitive markets. Efficient and competitive markets will develop only if market participants have confidence the system is administered fairly.” FERC fails to recognize that the perception in the Northwest is that the SMD NOPR will not lead to a fair and transparent system, so how does that represent progress toward eliminating “perceptions of discrimination” as “significant impediments to competitive markets”? The general perception among stakeholders in my region is that the current system works fine, thank you, so why scrap it?

On Page 20, Paragraph 33, FERC alleges seams problems within and between regional markets. What FERC doesn't acknowledge is that, despite a lack of standardization of rules, the Northwest has long enjoyed a mutually beneficial seasonal exchange with California. In addition, trading along the California-Oregon border has generally been

robust. Clearly, any seams issues that exist with respect to varying market rules and practices in the West can be resolved without SMD.

On Page 156, Paragraph 336, FERC complains that transmission planning and expansion have generally been performed in a single control area rather than on a regional basis. Again, that is not the case in the Northwest where BPA, regional utilities, the Northwest Power Pool and the Northwest Power Planning Council (established by Congress in the Pacific Northwest Electric Power Planning and Conservation Act of 1980) are responsible for significant transmission and generation forecasts, planning and expansion.

Further, BPA, which owns and operates 75 percent of the transmission in the Northwest, is already voluntarily complying with FERC's open access Order 888. This means that the discrimination concerns of FERC are essentially non-existent in the Northwest. To the extent problems do exist, the SMD NOPR represents a nuclear bomb designed to kill a mosquito.

BPA's power business line (PBL) and transmission business line (TBL) are functionally separate entities. BPA provides access to its transmission system to others at rates, terms, and conditions comparable with BPA PBL's own use of the transmission grid. The terms and conditions must also be comparable to those that the Commission imposes on jurisdictional utilities. BPA is also able to negotiate general transfer agreements (GTAs) with investor utilities that provide BPA's consumer-owned utilities access to other's transmission. Any concerns about pricing and access can be resolved within the region.

### **FERC Fails To Understand the Distinct Nature of the Northwest Energy Grid**

Not only does the SMD NOPR represent a solution in search of a problem in the Northwest, it proposes a "solution" that does not work with the unique features of the Northwest electric system.

Generation in the Northwest is dominated by the Federal Columbia River Power System (FCRPS). There are 31 hydro projects, one nuclear power plant, and several smaller renewable contract resources. Hydro represents nearly 50 percent of the Pacific Northwest's power supply.

The hydro projects are owned by the Army Corps of Engineers, the Bureau of Reclamation, public utilities, and private utilities. BPA markets the power generated by the federal dams.

BPA transmission system is made up of 15,000 miles of high voltage lines, 300 substations providing service to about 160 customers. As I previously mentioned, 75 percent of the transmission in the Northwest is owned by BPA. While BPA is not currently FERC-jurisdictional, FERC could force BPA to comply with SMD through the reciprocity provisions and, if the Senate electricity title makes it through the energy conference "as is," BPA transmission would be FERC jurisdictional. Therefore, the SMD NOPR is of great concern to the Northwest congressional delegation.

Major load centers in the Northwest are west of the Cascade Mountain range along the Seattle-Portland corridor. Other major load centers are Spokane and Boise. There are many sparsely populated rural areas as well. Major generation is often located hundreds of miles away, and on the other side of the mountains, thus necessitating long-distance transmission of electricity.

To provide a sense of the large scale of the Northwest system, I would note that the Pennsylvania-New Jersey-Maryland (PJM) Interconnection, which is the model for FERC's SMD, serves more than twice as many people in an area 1/6<sup>th</sup> the size of the Pacific Northwest grid.

Further, the river system in the Northwest has a number of non-power obligations, including flood control, navigation, irrigation, municipal and industrial water supply, recreation, and fish and wildlife protection.

The major drivers of the system are flood control and the Endangered Species Act. Power generation can be forced to take a back seat.

In addition, there is limited storage capability in the Northwest. When the FCRPS is empty, it can store around 25 percent of the annual run-off. By contrast, the Colorado or Missouri systems can store 400 percent of the annual run-off.

There are a number of physical characteristics, as well as legal obligations, that prohibit the river from being run to optimize power production or to respond to market signals.

Some hydro projects include multiple participants in addition to the project owner/operator. For example, the Mid-Columbia projects (Chelan, Douglas, and Grant County PUDs) have many FERC jurisdictional and non-jurisdictional purchasers.

In addition, power downstream depends on water released upstream. And, as the water moves downstream, project owners either have to use it or lose it. That means project owners are often responding to the physics of the system and their own load needs, not market signals.

There is also wide variation of generation in a hydro-based system. Between day-ahead and real-time, there are deviations in load, stream flows, the timing of planned operations and the occurrence of unplanned power constraints.

Among the causes: volatility in weather conditions, the biological opinion to protect endangered fish, safety concerns, and river navigation.

The Northwest grid is already subject to cooperative treaty, operational and control agreements. All of the hydropower on the Columbia and Snake rivers is hydraulically linked. In other words, no dam can be operated in isolation of another. As I previously mentioned hydro operations in the Northwest are also subject to substantial non-power

obligations such as court-ordered recovery of endangered fish, flood control, irrigation, recreation, river navigation, and the federal government's own international treaty obligations with Canada and Native American nations of the Pacific Northwest. These characteristics necessitate a degree of cooperation that is not present in other regions of the country, and is reflected in agreements like the Pacific Northwest Coordinating Agreement, the Mid-Columbia Hourly Coordination Agreement, the Columbia River Treaty, the Non-Treaty Storage Agreement, among others. Congress has previously recognized the uniqueness of the Northwest energy grid through passage of the Northwest Power Act and other Northwest-specific energy legislation.

These aforementioned characteristics highlight the inappropriateness of imposing a standardized market on a region that has anything but a standard electricity system.

The next several sections of my testimony will explain how the SMD NOPR will harm Northwest consumers by failing to take into account the distinct characteristics of the Northwest energy system.

### **The SMD NOPR Vastly Increases Complexity Without Any Clear Benefit**

The SMD NOPR vastly increases the complexity of energy markets, which are already subject to manipulation. As lead Enron trader Timothy Belden told the *Los Angeles Times*, "If you want to trade power in California for Enron, the minimum requirements are, you need to have a law degree and a Ph.D. in engineering. You need to have done significant research in market theory and game theory."

With markets that complex, it's no wonder manipulation was rampant. The SMD NOPR will only make problem worse. Particularly for small, rural public utilities that don't have a Ph.D. on staff with a lengthy resume and experience in market and game theory.

The Northwest has traditionally relied on long-term bilateral contracts for power and transmission. Although the SMD pays lip-service to bilateral contracting, it also requires the Independent Transmission Provider (ITP), which is essentially identical to a Regional Transmission Organization (RTO), to operate a number of day-ahead and real-time markets, or auctions. The ITP would operate markets for energy, transmission, ancillary services, regulation, and operating reserves.

In these bid-based auctions envisioned by FERC, all sellers would receive the market clearing price, regardless of what they bid. This could drive up prices if bidding manipulation occurs and all sellers receive the manipulated price rather than the price at which they bid.

The SMD NOPR creates a congestion management scheme that relies on locational marginal pricing (LMP). Under LMP, the ITP will establish separate energy prices at each node on the transmission grid and separate prices to transmit energy between any two nodes on the grid. In theory, this would help identify congestion points and the entities responsible for it.

The previously mentioned characteristics of the Northwest energy system, particularly the coordinated operation of the system and the non-power obligations of the river, make it incompatible with the LMP scheme. On pages 100-104, FERC acknowledges the various concerns raised by Northwest parties about the incompatibility of LMP with a hydro-based federal system, but then proceeds to dismiss all of the concerns and insist LMP will work in the Northwest. Utilities and regulators in the Northwest, those who know the coordinated hydro system the best, insist it won't work. As the WUTC mentioned in a series of questions to FERC, hydropower accounts for 60 percent of the energy and 70 percent of the capacity in the NW. Would the balance actually produce meaningful price discovery under LMP? Not likely.

It is telling that FERC acknowledges "price signals alone may not guarantee sufficient investment" (Page 55, Paragraph 112). Therefore, FERC proposes a regional planning and expansion backstop authority. Apparently FERC doesn't have confidence the "market" will produce its desired result.

The SMD NOPR proposes that Congestion Revenue Rights (CRRs), which are *financial* rights not guarantees of *physical* capacity, would be provided to existing contract holders to theoretically protect them from paying congestion charges. Entities with current transmission rights could receive an allocation of rights initially comparable to what they receive under current contracts, but after four years, all CRRs would be auctioned under SMD, with the rights going to the highest bidder.

CRRs are a poor substitute for actual, physical transmission rights. A right to avoid congestion is not the same as a right to receive firm transmission service. Nor does a right to receive revenue from CRR auctions necessarily translate into the ability to serve native load (i.e. keep the lights on).

The SMD NOPR creates a secondary market where CRRs can be traded. This will further increase the cost of transmission as its price is continually bid upward. There does not appear to be any sort of price cap for this secondary market in CRRs as FERC proposes (\$1,000 a MW) for generation. That opens the market to significant gaming opportunities.

On page 48, Paragraph 96, FERC frets about the "unprecedented uncertainty about, and lack of confidence in, today's electric markets." It's hard to see how this will change under SMD. Load-serving entities will always have uncertainty about whether they can out-bid other entities in order to get the transmission necessary to keep the lights on.

Further questions are raised by the creditworthiness requirements. Obviously market participants want those they are making deals with to be credit worthy. However, it's not clear who could meet adequate credit standards in today's depressed energy sector. There has been an 86 percent drop over the last 14 months for the top dozen independent power producers. Over 50 percent of the peak load in California and New York is being

met by owners in junk bond status or worse. A number of public and private utilities in the Northwest have seen their bond status downgraded, often significantly.

The resource adequacy requirement could further complicate the ability for energy companies to maintain decent credit since investors could not be sure whether the company would recover its investment.

The credit standards would also limit participation in auctions. Participants would have a pre-approved credit limit. But, if the auction bidding went above your limit, you're out of luck. This would be particularly problematic for the dozens of small, rural utilities in the Northwest.

Many small utilities, such as the transmission dependent utilities in the Northwest, would face significant "start-up" costs in order to participate in the complex markets envisioned in the NOPR. The costs would include hiring staff, developing software, developing new risk management strategies etc. Further, the lack of ownership of transmission by these utilities would prevent them from participating meaningfully in a bid-based market.

In short, many small, rural utilities will be at a competitive disadvantage in these markets.

On Page 130, Paragraph 274, in describing the day-ahead power auctions, FERC claims energy limited resources like hydro would be given flexibility to schedule by specifying the amount or the number of hours available for the next day. The supplier could then request that the RTO/ITP schedule that available energy when the energy price is the highest. However, in a footnote, FERC notes that "While this scheduling feature is intended mainly for energy-limited resources, it would be available to all generators and would not restricted to energy-limited resources, unless such restrictions are necessary to mitigate market power." It's hard to see how such a scheme will lead to lower prices or more efficient usage of the system.

On Page 142, Paragraph 299, FERC says that the Independent Transmission Provider may need to procure additional reserves to the extent that forecasted loads exceed the amount of energy scheduled to be delivered to load. Why should an RTO-like entity have the responsibility for ensuring adequate generation to keep the lights on. Isn't this akin to creating a giant vertically-integrated utility? If so, why not just re-regulate power and go back to cost-based rates?

On page 143, Paragraph 304, FERC says, "Conversely, participants that reduce transmission service in real-time (compared to the day-ahead schedule) would be paid the applicable hourly real-time transmission usage price for the applicable receipt and delivery points, to compensate them for the additional transmission capacity they have made available in real time." That seems to lend itself to the Enron strategy of scheduling energy and transmission usage they have no intention of using in order to get payments for relieving congestion when they voluntarily cut back.

## **The SMD NOPR Does Not Protect Existing Transmission Rights and Contracts**

Despite statements to the contrary, the SMD NOPR does not protect existing transmission rights. Therefore, FERC is proposing to unilaterally abrogate the contracts and resource decisions of utilities – including some non-jurisdictional utilities - and force them into auction to secure the rights for which they previously planned and depended.

Under the existing system, utilities in the Northwest sign lengthy contracts (terms of 10-30 years are common) with BPA for transmission service. BPA owns and operates 75-80 percent of the transmission in the Northwest. BPA contracts generally grant utilities the right to obtain additional capacity to serve load growth, change pre-schedules and points of delivery, and vary resource options all without facing financial penalties. The flexibility of the transmission rights guaranteed to BPA customers under existing contracts, which is essential in a hydro-based system, would be lost under SMD.

On Page 67, Paragraph 140, FERC acknowledges its goal: to ensure that “customers that value the transmission service the most will get it.” Nowhere is there a recognition that those who “value” the transmission service the most may not be the same as those with an obligation to keep the lights on. In short, the ratepayers who have paid for the system will no longer have guaranteed access to it.

FERC specifically notes its preference for auctioning all transmission rights (Page 177, Paragraph 382). FERC does allow regionally flexibility for a four-year transition period, but after that point, load-serving entities in the Northwest (including small, rural public utilities) will have to compete with deep-pocketed entities in an auction in order to get the transmission rights they previously had. As FERC itself notes, the only way "to achieve certainty with respect to price and avoid congestion costs" is "to acquire the Congestion Revenue Rights associated with its specific receipt point-delivery point combination(s)" (Page 69, Paragraph 144).

FERC doesn't even require those bidding to have any intention of delivering power (Page 78, Paragraph 162, transmission rights can be traded to another entity “whether or not that entity intends to transmit power.”). Apparently FERC believes companies should be able to bid up the price of transmission for no reason other than profit, as was done with generation during the Western energy crisis.

FERC claims to protect pre-Order 888 contracts (Page 171, Paragraph 373 "we propose not to abrogate existing pre-Order 888 contracts"). However, nearly all of BPA's public power transmission customers are served over post-Order 888 contracts. Therefore, these contracts would essentially be voided or the rights made so worthless that the economic consequences would be devastating.

This is not the way to run a reliable, affordable grid.

On Page 48, Paragraph 97, FERC expresses concern about "the risk of making long-term commitments when market rules are subject to frequent experiment and change." Yet,

FERC apparently has no problem upending years of resource planning as represented by the long-term contracts for transmission and power held by utilities in the NW. FERC is more than willing to punish these utilities for their foresight.

The NOPR envisions a cataloguing process during which current transmission rights would essentially be added up to see whether any additional capacity is available for auction. If the system is already oversubscribed, then the RTO/ITP could reduce the rights of existing contract holders in order to bring the system into balance (Page 174, Paragraph 377). This is another example of current rights be eliminated or, at a minimum, re-priced in such a way as to make the economically useless.

Congestion Revenue Rights (CRRs) could be allocated to current holders of transmission contracts (though, only for the four year transition period). However, Page 173, Paragraph 376 provides little detail on the cataloguing process that would be used to determine who gets what CRRs based on historical usage. It doesn't even say who is at the table when determining the allocation. These rights are supposed to approximate the rights they currently hold and protect the utility against paying congestion charges "when specific receipt and delivery points are used" (Page 55, Paragraph 111). This latter limitation would violate existing BPA contracts, which allow utilities to change schedules and points of delivery.

Further, FERC undermines current transmission rights by prohibiting preference for utilities with native load or for protecting transmission rights to serve load growth.

Despite FERC's rhetoric in the refund proceedings and other dockets about the sanctity of contracts ("we propose in this order to promote the contract certainty necessary to support competitive wholesale power markets" [PL02-7]), in the SMD NOPR, FERC is proposing a wholesale abrogation of existing contracts.

As I mentioned at the outset, FERC's disregard for existing transmission rights and contracts appears to violate the *Atlantic City Electric Co. v. FERC* ruling.

### **The SMD NOPR Will Result in Unjustified Cost Shifts**

The SMD NOPR will lead to massive cost shifts away from generators and independent marketers, and onto load-serving entities, which means retail customers will suffer massive rate hikes.

A charge is imposed to recover the embedded costs of the transmission system. However, the charge only applies to load-serving entities, not marketers or independent generators (Page 68, Paragraph 142, "...only customers taking power off the grid would pay the access charge.").

FERC justifies this cost shift by claiming that generators would merely pass the cost through to customers (i.e. load-serving entities) anyway, so why charge the generators? That strikes me as unfair. In a so-called market based system, why shouldn't generators

have to compete based on cost too? In other words, for true competition to develop, why shouldn't generators decide whether to pass the cost through and let customers determine whether to buy from a generator that does pass the cost through?

I also believe it is unfair to exempt shareholders of publicly-traded companies and investors in privately-held companies, who have supposedly volunteered to take on market risk, from paying the embedded costs of the system from which they generate their profits. Under the SMD NOPR, it is only retail consumers, who generally didn't ask to have their electricity subject to market whims, who pay.

FERC proposes to require regional "reserve margins." FERC suggests a minimum 12 percent excess capacity over forecasted peaks. However, this mandate applies only to load-serving entities. Marketers and independent generators would be exempt, which means, yet again, more costs imposed on load-serving entities and, ultimately, their ratepayers.

The reserve margin will exacerbate the cost shifts because it strips load-serving entities from having control over their resource needs. Since the RTOs envisioned by the NOPR would have responsibility for reliability, they will likely have a bias toward more resources than necessary at more expense. It is also not clear how a variable resource like hydro power would be treated under this requirement.

An additional problem with the NOPR that results in costs being unfairly imposed solely on load-serving entities is that export fees for moving power out of one region and into another are prohibited (Page 85, Paragraph 180). This further discriminates in favor of independent generators and marketers like Enron, Dynegy and Duke.

This prohibition on export fees also contributes to the second group unfairly penalized by cost shifts resulting from the SMD NOPR. There would be significant cost shifts from importing regions onto consumers in exporting regions because access charges would only be applied for the transmission system "where power is ultimately delivered to load." (Page 86, Paragraph 180). In other words, Canadian marketers like B.C. Hydro would not have to pay a dime toward the embedded costs of the Pacific Northwest grid while transmitting power through for sale in California. How does that send the proper "price signals" to build infrastructure where it's needed?

Page 88-89 of the SMD NOPR proposes two ways in which inter-regional transfers of money could be made, but who knows if adequate revenue would actually be collected. These transactions are not as easily reconciled as the NOPR suggests. As this Committee knows, a number of out-of-state entities that sold into California are still awaiting payment, and there are at least two refund cases (a California and a Pacific Northwest docket) that FERC has yet to resolve more than two years after the fact.

### **The SMD NOPR Threatens Multiple BPA Statutory Obligations**

I am also concerned the SMD NOPR – particularly the premise that transmission should go to those who value it the most - puts at risk numerous BPA statutory obligations, particularly public power preference, Northwest regional preference, and the balancing of non-power obligations like river navigation and court-ordered recovery of endangered fish.

Any BPA revenues flowing through the ITP would compromise the tax status of BPA revenues and the security of BPA bonds. If BPA’s transmission system became taxable, it would impose a cost of hundreds of millions of dollars on Northwest consumers.

Under the Transmission System Act, BPA is responsible for planning and expanding the federal transmission system. However, the SMD NOPR proposes that the Western Electricity Coordinating Council take over that responsibility. This could lead to increased costs in the Northwest if the WECC believes more infrastructure is need on a West-wide basis regardless of the adequacy in the Northwest.

BPA cannot submit to binding arbitration in disputes with the ITP if, in the Administrator’s opinion, the outcome would threaten BPA’s statutory obligations. The SMD NOPR requires binding arbitration.

### **The SMD NOPR Strips Authority from State Public Utility Commissions**

There are other members testifying today who will talk in more detail about the SMD NOPR’s unprecedented preemption of the authority of state utility regulators. I concur with their concerns.

The SMD NOPR inappropriately extends FERC jurisdiction to bundled retail customers, which has traditionally been within the sole jurisdiction of state regulators. This will complicate efforts by state regulators to protect retail customers, particularly in states that have had the wisdom not to deregulate.

Paragraph 69 of the SMD NOPR lists “four prominent examples” of why bundled retail customers have unfair advantages over wholesale customers of unbundled retail customers. This implies that deregulation and unbundling as mandated by the federal government should be universal at the retail level. This would be an insane policy to promote given the overwhelming evidence in the U.S. and around the world of the failure of electricity deregulation. Such a policy would strip away virtually any local control over electricity policy.

FERC’s response to the concerns of state officials is that the SMD NOPR provides state officials with a role in the decisions of RTOs. FERC does propose creating Regional

State *Advisory* Committees to the RTOs, but there is no requirement that state concerns be considered. As the name implies, the states would have an advisory role without any decision-making authority (Page 297, “Stakeholder committees must be used to advise the Board of Directors rather than function as a decision-making body.” Page 291, State Advisory Boards will be designed only to “provide the [RTO] Board...with a consensus view from states in the area.”). Indeed, there is no expectation the independent transmission entity would heed state concerns when FERC itself ignores them.

## **Conclusion**

The bottom line is that the SMD NOPR is intellectually inconsistent mush. FERC argues in much of the document in favor of the standard economic theory that market-based pricing in power markets will send the proper “price signals” to consumers, utilities, and developers, which will result in more efficiency, lower prices, etc. But at the same time, the SMD NOPR is filled with hundreds of pages of regulation to ensure the market doesn’t do what it would naturally do.

For instance, FERC proposes price caps to protect the market from manipulation, but some economists argue that price caps prevent proper price signals from being sent to the market. Therefore, FERC also proposes planning and resource adequacy mandates to make-up for the shortfalls potentially caused by price caps.

Similarly, the congestion revenues envisioned by FERC can send a perverse price signal to utilities, thus encouraging utilities that hold such rights to collect the congestion revenue rather than build transmission to alleviate the congestion.

In other words, the SMD NOPR proves that so-called “markets” cannot be trusted to reliably and affordably deliver electricity. Rather than moving toward re-regulation of electricity through a federal power grab, I would prefer re-imposing cost-based pricing at the wholesale level and leaving state and local authorities free to regulate at the retail level. The “federalization” of regulation envisioned by FERC will be a disaster.

FERC and Members of Congress should keep in mind that many of the problems we’re seeing today with inadequate transmission infrastructure exist only because a system that was built to serve load under a cost-based system is now expected to support millions of additional wholesale transactions that are solely intended to generate profit for marketers. We would not have the problems with congestion and inadequate infrastructure without wholesale deregulation.

The one-size fits all vision for market-driven transmission reflected in the SMD NOPR, which intentionally or ignorantly dismisses the very real and fundamental differences between energy grids around the country, will not lead to efficient building of transmission, will not lead to more efficient operation of the grid, and will not lead to lower prices for consumers. Congress should not continue under the illusion that it will.