

**Testimony of
Nora Mead Brownell, Commissioner
before the
Senate Committee on Energy and Natural Resources**

July 26, 2001

Mr. Chairman and Members of the Committee:

Good morning. Thank you for opportunity to testify before you today on the various energy restructuring legislation pending before your Committee. I strongly believe that the goals of any new legislation involving energy restructuring should be to facilitate the development of competitive regional energy markets and the removal of any barriers, regulatory or otherwise, to the development of such markets, while allowing the Commission to perform effective market monitoring. We must also create a regulatory environment which ensures reliability and investment in infrastructure. █

I want to applaud the efforts of this Committee to grapple with the issues of transforming energy markets. Balancing competing agendas and leading the charge for change is neither easy nor neat. Many people wonder why we have to change at all, particularly after events of the past year. We must remind ourselves that this country has enjoyed a standard of living that is unparalleled precisely because it has been willing to take risk, embrace change, and leverage its intellectual assets. It would be a tragedy to ignore the opportunities created by the advances in technology that have transformed so many other industries like communications and transportation. Without a coherent, integrated national energy policy and its associated legislative and administrative changes, we will disadvantage our industries, our environment and our constituents. I

urge us all to share a sense of urgency to do what needs to be done to move forward.

There are many ways to address the issues of transforming markets. I will address some of the most important.

The Public Utility Holding Company Act (PUHCA), enacted during the Depression, and the Public Utility Regulatory Policies Act (PURPA), enacted during the Carter Administration, are impediments to restructuring that, in my opinion, should be repealed. Among other things, PUHCA requires that utility holding companies that are required to register (because they do not meet any one of the exemptions enumerated in the statute) submit to heavy-handed regulation by the Securities and Exchange Commission, including seeking permission for many activities that companies engage in during the ordinary course of their business. PUHCA also subjects holding companies to requirements that they operate an “integrated” and contiguous system and does not adequately address the relatively new phenomenon of "convergence" mergers between gas and electric utilities. While PUHCA was a necessary reaction to abuses that existed a half-century ago, it has outgrown its purposes, and equally important, no longer reflects the utility industry of today, including the rapid rise of non-vertically integrated energy companies.

As just one example of PUHCA's perverse effects, because of the provisions for foreign utilities, the statute causes foreign companies to buy here and U.S. companies to invest overseas. Investment decisions should flow from economics, not from an outdated statute.

PURPA also needs repeal. PURPA requires utilities to buy from alternate energy sources at what are frequently quite high prices. PURPA was enacted in response to a perceived need to reduce dependence on oil for electric generation, and it was thought that this kind of subsidy would help accomplish that result. Now, 22 years later, when a gas-fired generator can be on-line in less than two years, and many advances are being made in distributed generation, PURPA's subsidies for certain types of generation no longer is rational.

Having stated that I believe that PUHCA and PURPA should be repealed, I also believe that we should listen to the concerns of those, like the rural CO-OPs, who are asking us to replace the safeguards, however flawed, that these statutes were intended to provide. It is a change in approach that I have in mind. Instead of relying on heavy regulation, safeguards should be a product of a market oriented approach. We must do everything possible to encourage advances in technologies, particularly renewables, and investment in infrastructure in order to bring them to market as quickly and efficiently as possible. We must also do everything possible to promote transparency and uniform business rules in order to guard against manipulation. We must do everything possible to enhance our market monitoring and enforcement capabilities in order to react and remedy any market abuse. Responses must swift and certain.

There are a number of ways to accomplish this changed approach. I strongly support legislation affirming the Commission's authority to require the formation of RTOs and to shape their configuration according to the characteristics outlined in Order

No. 2000. Large, regional, independent RTOs can improve grid reliability by facilitating transmission planning across a multi-state region, create better pricing mechanisms such as eliminating "pancaking", improve efficiency through better congestion management, and attract investment in infrastructure by facilitating regional consensus on the need for construction. RTOs play an important role in assuring reliability. I recognize that markets do have different characteristics and I do not dismiss those differences. We must work collaboratively with the stakeholders to determine where those differences are real and where they are merely the basis for barriers to entry. Ultimately, however, large regional RTOs must be formed in a timely manner.

I also strongly endorse creating standardized interconnection rules and uniform business rules. Where rules are standardized, there is less room for manipulation. I believe that all interstate transmission facilities should be under one set of open access rules, including the facilities owned and/or operated by municipals, cooperatives, the Tennessee Valley Authority, and the federal power market administrations. These entities, which together control approximately 1/3 of the nation's transmission grid, currently enjoy non-jurisdictional status. Placing all facilities under the same set of rules will eliminate disparities in treatment that operate as disincentives to open access, and better ensure seamless electricity markets.

I must emphasize that it is imperative that we place all transmission, whether related to unbundled wholesale, unbundled retail, or bundled retail transactions, under one set of non-discriminatory open access rules. Our experience since the issuance of

Order No. 888 indicates that it is no longer necessary to segregate the transmission for native load. Having all transmission under one set of rules will eliminate a patchwork of state rules regulating "retail transmission" and better ensure a properly functioning and transparent transmission grid. We must ensure, however, that we do not interfere with state oversight of retail and consumer responsibilities.

I believe that the Commission must be given ultimate authority over the siting of transmission facilities. At the time that the Federal Power Act was enacted, it was appropriate to defer to the individual states for siting transmission facilities within their borders. Times have changed, however, and today, there have been major technological advances in transmission that have created interstate superhighways. State-by-state siting of such transmission superhighways is an anachronism that impedes transmission investment and slows transmission construction. It is possible for one state to veto a desperately needed transmission project. The best solution to this dilemma is through an interstate regional compact or properly functioning RTO, with significant input of the states, to be the first stop for siting approval. However, at some point, it may be necessary for the Commission to make the final determination. Therefore, I would suggest that the Commission act as a backstop. In other words, grant the Commission siting authority over interstate transmission comparable to the interstate natural gas pipeline siting authority in Section 7 of the Natural Gas Act after we have determined "need" on the basis of an evidentiary record. This is one way in which interstate transmission expansion can keep pace with generation.

A final piece to the puzzle is the market monitoring and enforcement capabilities. The Commission's "tool kit" must be strengthened to facilitate the Commission's expanded role in monitoring for, and mitigating, market power abuse. I believe that the Commission needs to develop and expand its market monitoring expertise. The Commission can tap the existing expertise of other federal agencies, and perhaps even private organizations, that are experienced in market monitoring. It can also seek consultants with expertise in electronic trading and market simulation. In either case, it comes down to funding. As the markets we regulate change, we must be prepared to change our regulatory tools. The Commission should be given sufficient funding to ensure that it can hire, train, and retain personnel skilled in market monitoring and market power mitigation or buy expertise on a short-term basis as needed. Legislative solutions must be coupled with the Commission's ability to acquire the necessary talent that can implement its new responsibilities.

I am also of the opinion that market monitoring should not solely be the Commission's responsibility. We should involve the states in a serious discussion of whether combined state and federal action is necessary when market power abuses are occurring in both retail and wholesale markets. It should involve the RTOs. I intend to explore such creative approaches as the development of regional oversight committees, which work with existing regional coordination councils or other similar entities, including state regulators, to better assist the development of workably competitive markets. We should explore the development a coordinated system whereby we share

standardized information thereby reducing both the administrative and cost burden on the respective agencies and stakeholders. We must leverage our resources in concert with the states, particularly with regard to information sharing. Further, we must be certain we are asking the right questions. We must clear about what constitutes market power. We must understand the changing nature of the transactions (e.g., on-line trading). We must use the information effectively.

I believe that the Commission must have timely and reliable data and information to have an effective market monitoring program. There are many different players in the energy markets, many that have not traditionally been subject to our jurisdiction. A significant amount of relevant information about the operation of markets is in the possession of these entities. At times, there has been a reluctance to cooperate and provide the necessary information. It may be appropriate to clarify that the Commission has the authority to seek the information necessary to perform its statutory responsibilities from either jurisdictional or non-jurisdictional sources. Transparency is impossible without the involvement of all market participants.

Naturally, the necessary companion to market monitoring is enforcement. There has historically been a reluctance to apply traditional antitrust doctrine, including penalties, to electric and gas markets, since they were not competitive markets, but were subject to pervasive regulation and sanctioned monopoly structures. That should no longer be the case as we move further and further down the path to de-regulation and restructuring. The enabling statutes the Securities and Exchange Commission and the

Federal Communications Commission provide for a range of enforcement measures, such as civil penalties, which I believe may be appropriate for the Commission. I would suggest consideration of a significant civil penalty to indicate to market participants that we take violations of the Federal Power Act and Natural Gas Act seriously, and are prepared to remedy such violations above and beyond our refund authority, which is statutorily limited. We must also act swiftly and with certainty to respond to market abuses. Markets are fragile and prolonged problems will destroy the market and the confidence of consumers.

The work that you have done is quite extensive and I could probably expound forever, but I believe these are some of the most important. Thank you for asking for my input on these critical issues. I stand ready to assist your Committee in your deliberative process. I again thank the Committee for this opportunity to testify.