

**TESTIMONY OF
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FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE**

**Washington, D.C.
July 26, 2001**

Mr. Chairman and Members of the Committee on Energy and Natural Resources:

Thank you for the opportunity to testify on comprehensive electricity restructuring legislation. Let me state at the outset that I have reviewed Chairman Bingaman's excellent White Paper and agree with all of its recommendations, save one: I would recommend that Congress transfer jurisdiction over the siting of interstate transmission to the Commission, an agency with explicit interstate responsibilities.

With notable exceptions such as PURPA and EPACT, the legal framework that governs the electricity industry is now more than sixty five years old and assumed an old fashioned cost of service regime. Simply stated, the Commission does not have all of the tools it needs both to promote large regional markets and to protect the public interest. I would like to underscore a number of legislative changes that are critical to achieving the goal of well functioning competitive markets that yield substantial consumer benefits.

Transmission Jurisdiction

A. One Set of Rules

Congress should place all interstate transmission under one set of open access rules. That means subjecting the transmission facilities of municipal electric agencies,

rural cooperatives, the Tennessee Valley Authority, and the Power Marketing Administrations to the Commission's open access rules. These entities control 30% of the nation's electricity transmission grid. Their current non-jurisdictional status has resulted in a patchwork of rules that hinder seamless electricity markets. Markets require an open non-discriminatory transmission network in order to flourish.

In addition, all transmission, whether it underlies an unbundled wholesale, unbundled retail, or bundled retail transaction, should be subject to one set of fair and non-discriminatory interstate rules administered by the Commission. This will give market participants confidence in the integrity and fairness of the delivery system, and will facilitate robust trade by eliminating the current balkanized state-by-state rules on essential interstate facilities.

B. Regional Transmission Organizations

While the Commission has made substantial progress in forming the Regional Transmission Organizations that are critical to the competitive market place, our hand would be strengthened by a clear declaration by the Congress that these institutions are in the public interest and should be formed. One appropriate action would be to give the Commission clear authority to order the formation of such institutions in compliance with Commission standards. I firmly believe that large RTOs consistent with FERC's vision in Order No. 2000 are absolutely essential for the smooth functioning of electricity markets. RTOs will eliminate the conflicting incentives vertically integrated firms still have in providing access. RTOs will streamline interconnection standards and help get new

generation into the market. RTOs will improve transmission pricing, regional planning, congestion management, and produce consistent market rules. We know for a fact that resources will trade into the market that is most favorable to them. Trade should be based on true economics, not the idiosyncracies of differing market rules across the region. A clear message from Congress would certainly speed the formation of these critical institutions.

C. Generation Interconnection

I would recommend that Congress direct the Commission to adopt uniform nationwide standards that streamline the process of interconnecting generators to the grid. The Commission has taken some steps in this direction by encouraging utilities to file their interconnection rules, but more must be done. Generation siting decisions should not depend on how easy it is to hook up in a particular region or with a certain transmission provider. Standardized and uniform rules promulgated by the Commission are necessary.

Reliability

We need mandatory reliability standards. Vibrant markets must be based upon a reliable trading platform. Yet, under existing law there are no legally enforceable reliability standards. The North American Electric Reliability Council (NERC) does an excellent job preserving reliability, but compliance with its rules is voluntary. A voluntary system is likely to break down in a competitive electricity industry.

I strongly recommend federal legislation that would lead to the promulgation of mandatory reliability standards. A private standards organization (perhaps a restructured NERC) with an independent board of directors could promulgate mandatory reliability standards applicable to all market participants. These rules would be reviewed by the Commission to ensure that they are fair and not unduly discriminatory. The mandatory rules would then be applied by RTOs, the entities that will be responsible for maintaining short-term reliability in the marketplace. Mandatory reliability rules are critical to evolving competitive markets, and I urge Congress to enact legislation to accomplish this objective.

Rates and Market Power

A. Refunds

I believe the Commission needs additional authority to properly address the issue of refunds for unjust and unreasonable wholesale electricity prices. Section 206 of the Federal Power Act limits a refund effective date to not earlier than 60 days after a complaint is filed or an investigation is started. Whether the Commission can order refunds retroactively from the refund effective date is an issue that is still before the Commission. I note, however, that in an order issued November 1, 2000, the Commission observed that the Federal Power Act and the weight of court precedent strongly suggest that retroactive refunds are impermissible. I recommend clear statutory language that would allow the Commission to order refunds for past periods if the rates

charged are determined to be unjust and unreasonable. Limitations on how far back in time the Commission can order refunds may be appropriate.

B. Civil Penalties

I recommend that the Commission be given authority to assess civil penalties against participants that engage in prohibited behavior in electricity markets, such as anticompetitive acts and violations of tariff terms and conditions. If the Commission is to be the "cop on the beat" of competitive markets, we must have the tools needed to ensure good behavior. Refunds alone are not a sufficient deterrent against bad behavior. Simply giving the money back if you are caught is not enough. The consequences of engaging in prohibited behavior must be severe enough to act as a deterrent.

C. Mergers and Consolidations

To ensure that mergers do not undercut our competitive goals, the Commission's authority over mergers involving participants in electricity markets must be strengthened in a number of ways. Consolidations of market participants can have adverse consequences to the functioning of electricity markets. The Commission's detailed experience with electricity markets and its unique technical expertise can provide critical insights into a merger's competitive effects. The Commission's authority to review mergers should be strengthened to ensure that all significant mergers involving electricity market participants are reviewed.

I recommend that the Commission be given direct authority to review mergers that involve generation facilities. The Commission has interpreted the FPA as excluding

generation facilities *per se* from our direct authority, although that interpretation is currently before the courts. It is important that all significant consolidations in electricity markets be subject to Commission review. For the same reason, the Commission should be given direct authority to review consolidations involving holding companies.

I am also concerned that significant vertical mergers can be outside of our merger review authority. Under the current section 203 of the FPA, our merger jurisdiction is triggered if there is a change in control of jurisdictional assets, such as transmission facilities. Consequently, consolidations can lie outside of the Commission's jurisdiction depending on the way they are structured. For example, a merger of a large fuel supplier and a public utility would not be subject to Commission review if the utility acquires the fuel supplier because there would be no change in control of the jurisdictional assets of the utility. If the merger transaction were structured the other way, i.e., the fuel supplier acquiring the utility, it would be subject to Commission review. Such vertical consolidations can have significant anticompetitive effects on electricity markets. Those potential adverse effects do not depend on how merger transactions are structured, and thus our jurisdiction over those transactions should not depend on how they are structured. Therefore, I recommend that the Commission be given authority to review all consolidations involving electricity market participants.

D. Market Power Mitigation

Market power still exists in the electricity industry. The FERC, with its broad interstate view, must have adequate authority to ensure that market power does not

squelch the very competition we are attempting to facilitate. However, the Commission now has only indirect conditioning authority to remedy market power. This is clearly inadequate. Therefore, I recommend legislation that would give the Commission the direct authority to remedy market power in wholesale markets, and also in retail markets if asked by a state commission that lacks adequate authority. For example, such authority would allow the Commission to order structural remedies directly, such as divestiture, needed to mitigate market power.

E. Demand Responsiveness

Markets need demand responsiveness to price. This is a standard means of moderating prices in well-functioning markets, but it is generally absent from electricity markets. When prices for other commodities get high, consumers can usually respond by buying less, thereby acting as a brake on price run-ups. If the price, say, for a head of cabbage spikes to \$50, consumers simply do not purchase it. Without the ability of end use consumers to respond to price, there is virtually no limit on the price suppliers can fetch in shortage conditions. Consumers see the exorbitant bill only after the fact. This does not make for a well functioning market.

Instilling demand responsiveness into electricity markets requires two conditions: first, significant numbers of customers must be able to see prices *before* they consume, and second, they must have reasonable means to adjust consumption in response to those prices. Accomplishing both of these on a widespread scale will require technical

innovation. A modest demand response, however, can make a significant difference in moderating price where the supply curve is steep.

Once there is a significant degree of demand responsiveness in a market, demand should be allowed to bid demand reductions, or so called "negawatts," into organized markets along with the megawatts of the traditional suppliers. This direct bidding would be the most efficient way to include the demand side in the market. But however it is accomplished, the important point is that market design simply cannot ignore the demand half of the market without suffering painful consequences, especially during shortage periods. There was virtually no demand responsiveness in the California market. Customers had no effective means to reduce demand when prices soared.

It would be helpful for Congress to send a message that instilling a significant measure of demand responsiveness into electricity markets is in the public interest. I would recommend that legislation strongly encourage FERC and state commissions to cooperate in designing markets that include demand responsiveness. This would help to ensure just and reasonable wholesale prices and would be an effective market power mitigation measure.

Transmission Siting

I would recommend that Congress transfer to the Commission the authority to site new interstate electric transmission facilities. The transmission grid is the critical superhighway for electricity commerce, but it is becoming congested due to the increased demands of a strong economy and to new uses for which it was not designed.

Transmission expansion has not kept pace with these changes in the interstate electricity marketplace.

Although the Commission is responsible for well functioning electricity markets, it has no authority to site the electric transmission facilities that are necessary for such markets to thrive and product consumer benefits. Existing law leaves siting to state authorities. This contrasts sharply with section 7 of the Natural Gas Act, which authorizes the Commission to site and grant eminent domain for the construction of interstate gas pipeline facilities. Exercising that authority, the Commission balances local concerns with the need for new pipeline capacity to support evolving markets. We have certificated well over 12,000 miles of new pipeline capacity during the last six years. No comparable expansion of the electric grid has occurred.

I recommend legislation that would transfer siting authority to the Commission. Such authority would make it more likely that transmission facilities necessary to reliably support emerging regional interstate markets would be sited and constructed. A strong argument can be made that the certification of facilities necessary for interstate commerce to thrive should be carried out by a federal agency.

Market Transparency Rules

I agree with the White Paper's recommendations in this area.

Miscellaneous Provisions

I agree with the remainder of the White Paper's recommendations with respect to the repeal of PUHCA and PURPA, and with respect to renewable resources, information to customers, a Public Benefits Fund, and the repeal of tax provisions that inhibit structural changes in the market.

Conclusion

I stand ready to answer questions and to assist the Committee in any way. Thank you for this opportunity to testify.