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"Legislation for Vibrant Competitive Markets"

Remarks by
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I. Introduction

It is both an honor and a pleasure to be here today to address this timely and important conference. The topics being addressed are of great importance to the health of our increasingly digital economy, and the participants here today are among those that will be very influential in making the key decisions on how the issues will eventually be decided on the Hill, whether that is this year or some other time in the near future.

The Congress now has before it significant legislation addressing the restructuring of the electric utility industry. The FERC has a keen interest in the outcome of these legislative debates. We have been nurturing electricity restructuring and emerging markets for several years.

We think competition is the best way to carry out our statutory responsibilities of protecting the public interest and ensuring that rates are just and reasonable and not unduly discriminatory. I am thus delighted that the attention of Congress is now turning to electricity restructuring. There are a few extra tools and clarifications of authority that would enhance FERC's ability to further our pro-market policies for attaining a competitive, efficient and transparent wholesale power market.

Today, I will focus my remarks primarily on H.R. 2944 as reported by the Energy and Power Subcommittee, and I want to commend Chairman Barton for his

leadership in moving a bill out of his subcommittee. I respect all of the hard work that went into this legislation.

H.R. 2944 has some laudable pro-competitive features. It places transmission service offered by public power, rural electric cooperatives, and Federal utilities under FERC open access rules. This is a step toward a seamless web of open access. It endorses the Commission's philosophy that regional transmission organizations will improve interstate transmission service. It establishes electric reliability organizations to develop enforceable reliability standards. This change in the law is of critical importance to emerging competitive markets. I commend the subcommittee for including these provisions. These provisions are pro-market, and aimed at facilitating a seamless and reliable transmission grid. This is in fact the test that I apply in reviewing legislative proposals. My view is that legislation should promote an open, reliable and nondiscriminatory transmission network without seams, and should provide necessary market power mitigation tools.

In many ways, the Administration Bill, H.R. 1828, and the Markey-Largent Bill, H.R. 2050, are more pro-competitive. I want to congratulate all lawmakers who have offered pro-competitive solutions.

II. Transmission Jurisdiction

My first concern with H.R. 2944 is over the Federal-State split of jurisdiction regarding transmission. Order 888 was a quantum leap toward equal access for all. It made wholesale transmission and unbundled retail transmission subject to our tariff, including its strict comparability requirements. In deference to the States, however, our order stopped short of applying the tariff to the transmission that underlies bundled retail transactions.

For those of us who favor large markets built upon open and non-discriminatory grid access, this jurisdictional split over transmission looms as a troubling and balkanizing impediment to vibrant competition. Power markets are regional, whether wholesale or retail, and do not respect state boundaries. It is becoming clear that the historical regulatory practice adopted in Order No. 888 of treating native load uses of transmission differently from all other uses of transmission makes less sense in a competitive wholesale market environment. The same strand of transmission wire should not have competing regulatory masters.

Efficient electricity markets require that all interstate grid users be subject to the same rules. Different transmission rules set by individual states will create seams between states, result in discriminatory access in favor of in-state load, and a sharp balkanization of the markets that are now developing.

Let me paint you a picture of what this means. Imagine you are driving around I-495, the Washington beltway, and a severe constraint develops due to a traffic accident. Only one lane is getting by. That's not too hard to imagine. Let's assume that the State of Virginia has a policy that favors Virginia motorists. Virginia troopers require all vehicles without Virginia tags to exit immediately so that only Virginia-licensed drivers can travel on the beltway. Maryland applies the same policy on its part of the beltway to favor Maryland-licensed motorists. All of us would consider such state specific restrictions on the interstate highway system to be outrageous. Such policies would impede commerce in a disruptive and serious way, and would be completely chaotic and unacceptable on interstate highways.

Imagine the chaos if an interstate natural gas pipeline had to comply with a new set of access rules each time it crossed a state line. The El Paso Interstate Pipeline System, for example, flows through probably 20 or more states, but is subject to one national standard of access and non-discrimination. No one seems to question the obvious pro-competitive impact of this. Gas markets fueled by an open interstate pipeline grid are vibrantly competitive.

H.R. 2944 would write a balkanizing jurisdictional split into law, reserving for Federal jurisdiction only the transmission used in wholesale and unbundled retail sales. Other retail uses of the transmission grid would fall under State jurisdiction. Legislating this split is not a pro-competitive move. Keep in mind, we are talking about the high voltage interstate transmission grid. My strong recommendation would instead be to broaden Federal jurisdiction to include all uses of transmission, whether bundled or unbundled, so as to ensure that the Nation's transmission grid will support efficient electricity commerce. All uses of the transmission grid could then be put under the same tariff with the same terms and conditions. This would facilitate large regional power markets without discrimination.

Now I realize that this would be tough to achieve politically. It requires taking a firm stand favoring markets, but I am convinced it would be in the public interest.

III. RTO Authority

Now let me turn to the issue of regional transmission organizations (RTOs). Order No. 2000, issued by the FERC in December sets as its goal the formation of an RTO in every region of the country by December 15, 2001. RTO formation is absolutely critical to a competitive future for electricity markets. For example, a well-designed RTO can take a real bite out of vertical market power by separating the control of transmission from merchant functions. RTOs also hold promise for resolving a number of grid management problems, such as eliminating balkanization through improved congestion and loop flow management, pricing transmission more efficiently and thereby expanding the scope of power markets, and accurately calculating Available Transmission Capability, thereby improving trade.

RTOs will also make an important contribution to grid reliability. According to the Electric Power Research Institute, electricity will account for nearly 70% of total energy use in the U.S. by 2050, and an upgraded power delivery system capable of supporting a digital economy will be key to our economic growth. Grid reliability is thus of critical importance. Yet there are more and more signs recently that grid reliability is worsening, despite the herculean efforts of reliability managers. For example, a recent DOE report on last summer's power outages in certain regions found a number of factors contributing to those outages. Among the factors, two are noteworthy here.

One factor the report cited is that the transition to competition has left reliability management in the hands of a number of disaggregated institutions. RTOs will definitely help here. A single RTO will be responsible for the reliability of the grid over a large area. A single regional institution will clearly enhance reliability, compared to the current regime, through centralized responsibility for loop flow, redispatch, congestion management, coordination during system emergencies and restorations, coordinating generation and transmission outage schedules, and sharing ancillary service responsibilities.

I believe RTOs will also help to get new transmission facilities sited. Siting is a major problem in getting new facilities in place. Under Order 2000, an RTO must be responsible for planning transmission expansions, and the RTO must coordinate such efforts with the appropriate state authorities. Thus, with an RTO present, there will be a comprehensive regional planning process that will serve as a single point of focus for all participants. It is my hope that this will allow the various state authorities involved in siting approval to find common ground, and approve facilities that are needed for regional commerce.

RTOs will also help reliability by attracting new generation participants. As the sole provider of transmission service, which includes administering an open access tariff and evaluating and approving requests for interconnection, an RTO will provide one-stop shopping for new generators over a broad market area. Perhaps more important, tariff administration and interconnection evaluation by an RTO will be perceived as focused, fair and unbiased. The current scattered administration of the grid, and the perception that the rules of the road are not applied fairly, may be keeping some players, and needed resources, out of the market. RTOs will facilitate their entry.

RTOs are important. My concern is that H.R. 2944 would actually weaken the Commission's ability to ensure that appropriate Regional Transmission Organizations are formed. For example, the bill would leave the decision to form or join an RTO to the discretion of transmission owners. The Commission may need to require RTO membership to remedy market power or undue discrimination. The bill could undermine the Commission's ability to do this.

Leaving the decision to join RTOs entirely to the discretion of transmission owners is not sound policy. Such an approach would allow transmission owners to postpone joining an RTO, to postpone giving up their market power, thereby delaying the competitive as well as the reliability benefits of RTOs. By allowing a "hold out" strategy, transmission owners will also be able to unduly influence the organizational form of an RTO and to insist on a geographic scope and configuration that would result in price or access barriers to competition. Pro-competitive and pro-market RTO configurations won't magically happen. Scope must be driven by regional market and reliability considerations. Small RTOs will perpetuate market balkanization. Gerrymandered RTOs shaped to increase transmission revenues would be anticompetitive. Consumers will not be made

better off. The Commission must not be denied the power to facilitate pro-market RTO configurations.

In addition, H.R. 2944 would set out certain standards for RTOs, including independence standards. I see no reason for Congress to chisel in stone detailed standards for institutions that may need to evolve over time in response to changing market conditions. While the Commission set out standards for RTOs in Order No. 2000, those standards can evolve as needed through our rulemaking process more easily than through additional remedial legislation.

I would recommend that Congress grant the Commission clear authority to form and shape RTOs. This would be pro-competitive and pro-market.

IV. Merger Authority

I am also very concerned that H.R. 2944 will interfere with good decision making regarding mergers. While mergers, particularly those involving wires and pipes assets, can produce efficiencies, mergers must be carefully reviewed to ensure they do not choke off the competition that is just now beginning to take hold in electricity markets. FERC is under increasing pressure to process mergers quickly to allow for timely business decisions. I'm sure most of you can appreciate that. But we must balance that pressure with tough but fair analyses of the competitive effects, both horizontal and vertical, of proposed mergers.

The House subcommittee bill requires the Commission to act on a proposed merger within 180 days. Otherwise, the merger will be deemed approved. The Commission already approves more than 90% of merger applications within 150 days. In some cases, those approvals are subject to conditions to mitigate market power concerns. However, there have been a few cases that presented difficult market power issues that required evidentiary hearings that have taken longer than 150 days. The processing deadline in the bill would prevent the Commission from a thorough pro-market investigation of the tougher cases, those that raise factual issues regarding the competitive effects of a proposed merger. This could have one of two possible undesirable outcomes in particular cases. One is an ill-considered and hasty approval of an anti-competitive merger. The other is a hasty rejection of a merger that otherwise could be approved after more thorough review.

Some want to get FERC out of the merger review process entirely. In my view, this would be unfortunate. The Commission's detailed experience with electricity markets and its unique technical expertise can provide critical insights into a merger's competitive effects. In addition, the Commission's duty to protect the public interest is broader than the strictly competitive focus of the antitrust agencies and thus allows us to better protect consumers from other possible effects of a merger, such as unreasonable costs. As the architect of Orders 888 and the RTO Rule, Order 2000, the Commission must retain the authority to condition a merger to ensure consistency with broader policy goals. And unlike the antitrust agencies, the Commission's merger procedures allow public participation in the restructuring of this vital national industry. Taking any legislative action that could reduce FERC's review of such historic and massive electric industry consolidation just when competition is not in the public interest.

V. Remedying Market Power

Finally, H.R. 2944 fails to provide the Commission with direct authority to remedy market power. As we strive to move toward competitive markets and light-handed regulation (by relying on market-driven solutions), the Commission's ability to remedy market power is increasingly important. Yet the Commission has only indirect conditioning authority to address this crucial issue.

Market power is likely to exist in the electric industry for a while. It is unreasonable to expect a heavily concentrated industry that has operated under a heavily regulated monopoly structure for 100 years to suddenly shed all pockets of market power. If we are to move smoothly and as quickly as possible to a competitive paradigm, the Commission needs explicit authority in this area. I strongly urge that it be included in H.R. 2944, as it is in the Administration and Markey-Largent Bills.

I am aware that some commenters characterize this pejoratively as FERC interference with markets. They opine that FERC should simply get out of the way, let go, and let markets work. But by this same naive logic, the Commission would have never issued Orders 636 and 888, the pro-market gas and electric restructuring orders. Rather than "let go," these rules aggressively facilitated competitive markets. The truth is, markets cannot function without open transportation networks. Markets cannot work where incumbents can dominate the market and

withhold capacity or favor affiliates. Markets must be nourished. Barriers to entry must be removed. Market dominance must be mitigated for markets to flourish. FERC should have the direct authority to mitigate market power and thereby facilitate vibrant markets.

Conclusion

As you can see, I believe the litmus test should be whether legislation promotes markets. I hope that H.R. 2944 can be amended to include the changes I have suggested. I look forward to continuing to contribute to the debate over restructuring legislation.

Thank you.