

STATEMENT OF JAMES B. ROUSE

ON BEHALF OF

THE ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON)

BEFORE THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

JULY 25, 2001

A HEARING ON LEGISLATIVE PROPOSALS

FOR ELECTRICITY RESTRUCTURING

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ASSOCIATE DIRECTOR, ENERGY POLICY, PRAXAIR, INC.
AND CHAIRMAN, THE ELECTRICITY CONSUMERS RESOURCE COUNCIL
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Good morning, my name is James B. Rouse, associate director, energy policy for Praxair, Inc. Praxair is a large industrial gases company, producing atmospheric gases: oxygen, nitrogen, argon and rare gases; our process gases include hydrogen, helium and carbon dioxide. For us, electricity is a raw material, constituting up to 70% of our operating costs. We operate in some 44 countries and are the largest industrial gases producer in North and South America. I am here today as chairman of the Electricity Consumers Resource Council, or ELCON. ELCON, established in 1976, is the national association representing large industrial users of electricity. ELCON's member companies come from virtually every segment of the manufacturing community.

ELCON's members operate in a competitive, international environment and require an adequate and reliable supply of electricity at competitive prices in a vibrant interstate marketplace. Large users of electricity know very well that the decisions made in this Committee and by Congress will have a direct impact on their businesses' well being as well as business decisions. ELCON greatly appreciates the opportunity to testify.

ELCON and its member companies favor competition over regulation and have long advocated truly open and fully competitive electricity markets, including retail access guaranteeing that all consumers have the right to choose their supplier of electricity and electricity services. We also believe that, just as is true for other energy products, a large national or even international market with consistent rules and standards is optimal for the sale and purchase of electricity. When it comes to electricity, we are dealing with a commodity sold in interstate commerce. Our existing electricity system clearly transcends state lines. We need a national framework and a strong federal bill. Consumers should benefit from a large, seamless interstate electricity market.

ELCON members continue to support competition. However, we would assert that we do not have true competition anywhere. Several states, in attempting to restructure, has simply deregulated, or in some cases reregulated, existing monopolies. The failures to date, and California is perhaps the most egregious but there are others, represent failures of reregulation and failures of state legislative plans that included too many political compromises. The experiences in California and elsewhere cannot and should not be described as failures of competition.

The major concerns of ELCON members are nearly identical to those set forth in the chairman's "White Paper on Electricity Legislation" issued July 20, 2001. As we identified those issues in testimony before this committee on April 20, 2000, they are the linked issues of Market Power, Repeal of the Public Utility Holding Company Act (PUHCA), Reliability, and Transmission and Grid Governance. The White Paper adds two other categories: (1) Regional Planning and Siting; and (2) Market

Transparency Rules. Customer choice and retail access are wonderful goals, but they are worthless if the transmission system, which will remain monopolistic for many years, does not allow for the free and non-discriminatory movement of electricity from seller to buyer. Given that owners of monopoly transmission facilities will still exercise market power -- that is monopoly power -- I cannot emphasize too strongly that regulation is needed to ensure that the owners of the transmission system do not use their position to the detriment of real competition.

We concur with the White Paper that FERC must have the authority and be required both to (1) promulgate rules for the independent operation of the grid and (2) compel utilities to turn over control of their transmission facilities to independent Regional Transmission Organizations, or RTOs. Such rules should preserve the reliability of the grid and encourage the sale and transportation of electricity from any seller to any buyer in an open, competitively neutral, and nondiscriminatory manner.

FERC's recent order of July 12 on the RTO issue is a major FERC initiative. FERC, for the first time, has clearly set forth its policy that there should be large, regional RTOs: One to comprise what is now the Western Interconnect; and three that comprise the Eastern Interconnect. FERC has established mediation dockets to bring the utilities together to establish RTOs for the Northeast and Southeast. But we believe that utility membership in an appropriate RTO should not be voluntary as provided for in Order 2000, but mandatory, and that legislation should affirm FERC's authority to order utilities to join regional transmission organizations. As an aside, in the last Congress, the provisions of S 1273, offered by Chairman Bingaman, best addressed the question of RTOs. It granted FERC the authority to oversee the creation of an RTO and compel utilities to turn over control of their transmission facilities. Senator Bingaman deserves special praise for being the first to introduce this concept in his earlier legislation, and we are pleased he has reintroduced that same idea in this Congress.

ELCON has been an active participant in the NERC process and supported the consensus language on reliability contained in S. 2071 last year on the condition that it be considered as part of a comprehensive bill and not on a stand-alone basis. This position is based on sound policy. While we recognize the need to establish a new, statutorily authorized self-regulating reliability organization, such action will barely begin to address reliability. Legislation to reduce the potential for reliability problems must do more than simply provide accreditation to a new oversight body. It must establish a framework for appropriately-sized regional transmission organizations, it must guarantee non-discriminatory access to the grid, and it must clarify the current uncertainty about federal and state jurisdiction over transmission. Moreover, it cannot give new market regulating authority to those who now have, directly or indirectly, substantial market power. We concur that legislation should require sanctions and penalties for failure to comply with rules developed by a new electric reliability organization and that the entire framework is subject to federal oversight. ELCON is continuing to work with various stakeholders in an effort to develop new language. It is becoming increasingly clear that the "consensus" language approved in February 1999 is too complicated, too prescriptive, and too long. There have been several new proposals put forth even in the last few weeks that offer improved ways to establish a new electric reliability organization.

Market power is a subject of intense recent interest, growing out of the wildly fluctuating rates and volatile supply situation in the West. Market power arises from several sources. Where there is an

imbalance in supply and demand, market power is often held by a few producers who can demand higher rates during periods of shortage. Where there is transmission congestion, the owner and operator of the grid can favor his own generation affiliate in denying access to competitive sources. Where the integrated system favors the native load utility over competing generators, new entrants are discouraged. Where an artificial power exchange is created for non-market purposes, true competition is thwarted.

Markets will eventually be workably competitive when there is an adequate generation supply in all sections of the country and where that supply can move freely over a transmission system under control and supervision of large RTOs. Transmission rates, terms and conditions will be set by the RTOs and administered by the RTOs, subject to FERC oversight. Any market operated by an RTO or on behalf of an RTO should be subject to an independent market surveillance function to monitor such markets for potential design flaws, gaming behavior and the exercise of vertical, horizontal or localized market power. This includes markets for transmission services, ancillary services and power exchanges

The White Paper posits that legislation should require the Commission to take into account the impact of “demand response mechanisms” on rates. ELCON has proposed that FERC add a Ninth Function for Customer Load Response (CLR) curtailment service (in addition to the Eight Functions set forth in Order 2000). This would require that markets for CLR be integrated with other FERC real-time markets. This would also ensure that such markets are reasonably standardized in each RTO. Participation in the CLR market should be voluntary and open to any customer.

Regional Planning and Siting for new transmission capacity poses a challenge for policymakers. ELCON believes that Congress should delegate to FERC the same authorities under the Federal Power Act with respect to the siting of interstate transmission facilities as FERC is currently authorized under the Natural Gas Act with respect to interstate natural gas pipelines. ELCON agrees that a regionally based approach to transmission planning, planning and siting is desirable. However, the RTOs, rather than some new regional regulatory compact, should be delegated with that responsibility, or as the White Paper states, FERC should “cede such authority to appropriately constituted regional entities,” which should be RTOs. They would also establish and monitor regional reserve requirements, maintenance and market monitoring functions noted above.

Besides the ongoing operation of the grid, RTOs should play a major role in the planning of new and upgraded transmission facilities, as required under Order 2000, but which authority would need be augmented and reaffirmed in legislation. Regulated transmission providers are entitled to a reasonable opportunity to recover all costs associated with their prudently incurred investments, plus a return on those investments that are deemed used and useful. Working through RTO processes, transmission providers will be assured that all needed expansions and upgrades will be fully compensated according to FERC rules.

Market Transparency Rules are integral to the successful operation of a workably competitive market. While proprietary information on commodity pricing will continue to receive the protection it deserves, market participants need real-time information on the regulated services, including transmission capacity, ancillary services and line loading. This will be necessary for buyers, sellers, grid operators and regulators to assure that markets are indeed workably competitive on a continuing basis. Short-term

operational planning and long-term capacity planning are both well-served by adequate information, furnished by both the Energy Information Administration and also by an expected plethora of commercial entities who are already vying for customers in anticipating of the opening of markets.

The White Paper also addresses other “Other Provisions.” Regarding the repeal of PUHCA, we first emphasize that PUHCA is the only federal consumer protection statute for electric utility customers. We believe that, if PUHCA is repealed, we need clear authority vested in FERC to prohibit any potential anti-competitive practices involving regulated utilities and unregulated affiliates. Rules are needed to address the operational unbundling of generation, transmission, system control, marketing and local distribution functions. State and Federal regulators must have complete access to all books and records of all regulated entities and entities owned or controlled by regulated entities. In addition, we argue that, optimally, PUHCA repeal not be effective until all states have retail access or until competition on a nation-wide basis is otherwise achieved.

The White Paper calls for repeal of the mandatory purchase requirements of the Public Utility Regulatory Policies Act (or PURPA) of 1978. Many ELCON members cogenerate and sell electricity to utilities as Qualifying Facilities (or QFs) pursuant to PURPA. Despite its bad press, as long as consumers are held captive to monopoly utilities, PURPA is an essential law. It has produced a broader, more efficient base of electricity generation. Due to PURPA, electricity capacity was added in smaller increments, thus not burdening users with paying for generators that proved to be much larger than necessary. And entrepreneurs with private non-regulated capital funded generation.

That having been said, the “mandatory purchase” provisions of PURPA are an anachronism in a truly competitive market and should be recognized as such. With regard to existing PURPA contracts, be they at market or above today’s market, no one is suggesting that such contracts be rescinded. Existing PURPA contracts are and should be a non-issue. The impact of repealing the mandatory purchase provisions of PURPA on a prospective basis is virtually non-existent. The number of new, uneconomic PURPA-based contracts being signed today based on the often above market “avoided cost” formula is close to nil. In addition, the much-maligned avoided cost principle is not to blame. If properly implemented, it harms no one. Some states, for their own reasons, set avoided cost at artificially high levels. Again, this is no longer the case.

I hasten to add, however, that even without the use of these mandatory purchase requirements, the majority of new capacity being brought on line is from non-utility generation and that has been the case over several years. PURPA has succeeded in demonstrating that electricity can be generated by non-utility sources in an efficient, reliable, and environmentally favorable manner. Some 25 years ago utilities vehemently disputed what is now fact.

While the mandatory purchase provisions are no longer necessary in a truly competitive electricity market, it is important to note that PURPA and Section 210 are much more than simply mandatory purchase requirements, including its requirements that utilities interconnect with cogenerators. However, I cannot overemphasize the importance of a federal guarantee for back-up power at just and reasonable rates in states that remain non-competitive. Without such a guarantee, cogenerators would be captive to unregulated monopolies that could charge what they wish, and the cogenerators would have no

alternative. In states without real customer choice, retaining the federal guarantee for back-up power now in PURPA is essential if there is to be any investment in cogeneration capacity.

Over the past three decades, the growth of electricity-dependent businesses and industry has been remarkable. In just the past five years, we have seen demand far outstrip supply in many regions. While the economy has become ever more electricity dependent, our infrastructure, market mechanisms and regulations have not kept pace. We need strong, but not excessive, federal regulatory authority to guarantee that electricity is available throughout the nation on a non-discriminatory basis. It is up to this Committee and other oversight bodies to ensure that such regulation is not over-reaching, that it is encouraging and not hindering true competition.

In conclusion, ELCON and its member companies favor a strong federal bill so that all electricity consumers can enjoy the benefits of competition. California notwithstanding, competition is coming. But the reality is that we face a long transition period before we get there. Truly comprehensive Federal legislation is needed to achieve workably competitive electricity markets. States will continue to have an important role, but that role does not extend to the regulation of interstate commerce. And electricity is clearly interstate commerce. That is why this Committee and this Congress must enact strong, comprehensive federal legislation. ELCON stands ready as it has for a quarter century to represent its members, to engage the debate, to propose policy alternatives and to participate in a momentous shift in the provision of an essential service, electricity.