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TESTIMONY OF W. HENSON MOORE

PRESIDENT & CEO

AMERICAN FOREST & PAPER ASSOCIATION

ALSO ON BEHALF OF THE AMERICAN CHEMISTRY COUNCIL AND

ELECTRICITY CONSUMERS RESOURCE COUNCIL

COMMITTEE ON ENERGY AND COMMERCE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC

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**Summary of Testimony of W. Henson Moore
On behalf of the American Forest & Paper Association,
American Chemistry Council, and
Electricity Consumers Resource Council**

- Our respective industries are all in the business of making products that require energy for production. An abundant and affordable supply of energy is critical to our ability to make paper, chemicals, steel, plastics and other goods that are mainstays of the U.S. economy.
- The President's National Energy Plan calls for a doubling of energy output from Combined Heat and Power (CHP) units by 2010. Currently, CHP represents 9 percent of total electricity generated nationwide. Almost 60 percent of CHP generation in the forest products industry is from biomass and, thus, is climate friendly. CHP power is also highly efficient power and helps expand the supply of affordable electricity in an environmentally-friendly way.
- To maintain existing CHP, and expand it in the future, facilities must have access to the grid and the ability to purchase back-up power at non-discriminatory rates. Since many states continue to have monopoly electric utilities that own and control both the transmission and generation of electricity, CHP power would not get access and purchase opportunities without PURPA.
- We are concerned that the language of this new draft does not adequately guarantee that CHP plants will have meaningful and continuing access to willing buyers and sellers of power before current PURPA provisions are eliminated.
- Title VII, Subtitle E, Section 7062 of the draft bill encompasses some, but not all of the necessary criteria for FERC to use in determining whether the market is truly competitive. While paragraph (a)(1)(A) sets out indicia of competition upon which FERC can make a finding, paragraph (a)(1)(B) does not. Formation of a Regional Transmission Organizations (RTO) in name only could satisfy paragraph (a)(1)(B).
- Similarly, paragraph (a)(1)(C) provides FERC with unfettered authority to determine a competitive market exists and thus end the purchase and sale obligations. It might be helpful to give FERC guidance as to the criteria they may use in determining a competitive market.
- As currently written, a FERC finding that competition exists in a market will end the utility's obligation to purchase from and sell power to a Qualifying Facility (QF). Because market conditions can change over time, we recommend that this legislation include a provision authorizing FERC to reinstate the purchase and sale obligation if it finds that the conditions of a fully functioning competitive market no longer exist.
- The draft language should also be clarified to ensure the elimination of the obligation to provide back-up and standby power does not affect a local utility's obligation under state law to be the provider of last resort.
- New transmission capacity is needed in some areas of the country, and we believe it should not be held up by local obstructionism. Your language on transmission siting could make a real difference in this regard.
- We support removing those restrictions in PUHCA that limit needed investment by American companies, but believe that reporting and other requirements in PUHCA that protect consumers and investors should remain in place to prevent market abuse and manipulation.

My name is Henson Moore. I am President and CEO of the American Forest & Paper Association. AF&PA represents more than 240 member companies and related associations that engage in or represent the manufacturers of pulp, paper, paperboard and wood products. America's forest and paper industry ranges from state-of-the-art paper mills to small, family-owned sawmills and some 9 million individual woodlot owners.

I am here today also representing the Electricity Consumers Resource Council ("ELCON"), and the American Chemistry Council ("ACC.") ELCON is the national association of large industrial users of electricity. Its membership includes companies from nearly every manufacturing industry. ACC is the national association of companies engaged in the business of chemistry.

As the former Deputy Secretary of Energy involved in developing the last National Energy Strategy in 1991 and the Energy Policy Act of 1992, and as a former member of this subcommittee, I know the severe challenges that confront you. I appreciate the opportunity to share my views, as well as the concerns of industrial energy users and producers, as they relate to decisions you will have to make.

Mr. Chairman and Members of the Committee, our respective industries are all in the business of making products that require energy for production. An abundant and affordable supply of energy is critical to our ability to make paper, chemicals, steel, plastics and other goods that are mainstays of the U.S. economy. We haven't seen a form of energy we didn't like yet – I compliment you on efforts to increase the supply of affordable energy. Our businesses and the international competitiveness of our products are being severely tested by recent energy shortages and rising prices.

The U.S. forest products industry is vital to the nation's economy. We employ 1.5 million people and rank among the top ten manufacturing employers in 42 states with an estimated payroll of \$50 billion. We are the world's largest producer of forest products. Sales of the paper and forest products industry top \$230 billion annually in the U.S. and export markets.

Energy is the third largest cost for the forest products industry, making up more than 8 percent of total operating costs. Paper mills, for example, run their paper machines using electricity largely supplied by mill-operated, on-site cogeneration or Combined Heat and Power (CHP) facilities. Although the industry is nearly 60 percent self-sufficient (using biomass), we also use natural gas, coal, fuel oil and purchased electricity to meet the balance of our energy needs. Forest products companies spent over \$2.1 billion on purchased electricity in 2000. Importantly, the industry also sells more than 12 million megawatt-hours annually of electricity to the transmission grid - the equivalent of a mid-sized utility.

Since 1997, employment at U.S. paper and paperboard mills has gone from 222,400 to 178,000 – a decrease of almost 20 percent. While these losses have been caused by a variety of factors, the additional pressure of the current energy crisis could result in further mill closures and job losses. This situation would be far worse, had it not been for the forest product industry's commitment to fuel efficiency and independence over the past three decades. Since 1972, this industry has reduced its average total energy usage by 17 percent, reduced its fossil fuel and purchased energy consumption by 38 percent, and increased its energy self-sufficiency by 46 percent.

The chemical industry is also a major consumer of virtually all types of energy – fuel, power, steam and feedstocks (raw materials) for its processes. The \$460 billion business of chemistry is a key element of the nation's economy. It is the country's largest exporter, accounting for ten cents out of every dollar in U.S. exports. The industry is also one of the largest and most efficient users of energy in the U.S. economy with energy efficiency improvements of more than 44 percent over the past 30 years. Like the paper industry, the business of chemistry has utilized CHP technologies to become more energy efficient and to significantly reduce emissions.

Energy Policy Legislation and Combined Heat and Power

Any change in energy policy clearly must take into account the needs of consumers and producers. It also needs to address the needs of those who have already taken positive steps to make energy consumption more efficient. The President's National Energy Plan calls for a doubling of energy output from CHP units by 2010. CHP is the cornerstone of the Administration's plan to improve energy efficiency and expand sources of electricity generation in an environmentally-friendly way. This goal of expanded CHP power, increased efficiency and environmentally-friendly power will not be met without the assured access to the grid that is afforded by the Public Utility Regulatory Policies Act of 1978 (PURPA).

The primary function of a CHP unit is to support manufacturing operations that require both electric power and steam or other useful thermal energy. Nonetheless, this electricity represents a critical component of the nation's electricity supply portfolio. Currently, CHP represents 9 percent of total electricity generated nationwide. Forest products, chemicals and oil refining represent 90 percent of the total CHP generation in the

manufacturing sector. Almost 60 percent of CHP generation in the forest products industry is from biomass and, thus, is climate friendly. CHP power is also highly efficient power, reaching efficiency levels of 80 percent, which is at least twice as efficient as conventional power generation. This high level of efficiency occurs because our manufacturing processes use both the heat and the steam, while traditional generation units vent steam into the atmosphere. These efficiencies have also led to significant reductions in air emissions.

Successful development and full implementation of black liquor and biomass gasification programs would make the forest products industry a net exporter of renewable electricity — removing some 18 million tons of carbon emissions from the air and generating nearly 30 gigawatts of CHP-based electricity. Mr. Chairman, this represents enough energy to power two-thirds of California's summertime peak. These initiatives entail substantial risk for an already capital-intensive industry. Much R&D remains to be done to prove the technologies can work without adversely impacting mill operations. Continued cooperation with the federal government is crucial to reducing risk to a level that will allow significant industry participation.

Similar initiatives are underway in the area of coal gasification. These technology development programs are essential to creating new and diverse sources of clean energy. Importantly, without guaranteed access to the grid, these new power sources will not be developed and implemented.

Why PURPA is Important

PURPA was enacted to help reduce U.S. dependence on foreign oil and encourage fuel diversity. It is one of the most successful federal policies in promoting energy efficient

generation and renewable energy. CHP technologies make use of diverse fuel resources, including renewables, thus lessening the nation's dependence on foreign oil. Additionally, CHP units typically are diverse in size and geographically dispersed. Their dispersal throughout the grid means greater efficiency through reduced line losses, and improved system reliability through less dependence upon central generation units. Their smaller size also allows for continual adaptation to, and adoption of, improving technologies. For these reasons, CHP has been a successful addition to the nation's power supply portfolio.

In order to maintain existing CHP, and expand it in the future, facilities must have a market to sell the power they cannot use in their operations. Since many states continue to have monopoly electric utilities that own and control both the transmission and generation of electricity, CHP power would not get meaningful access to the grid without the federal requirement under PURPA. In addition, CHP units must be able to purchase back-up power at non-discriminatory rates. Many industries, such as those I am representing today, responded to PURPA by investing billions of dollars in new on-site CHP generation to provide electricity primarily for their manufacturing processes and, occasionally, to the electrical grid.

Under PURPA, electric utilities are required to interconnect and purchase power from "Qualifying Facilities," or QFs, and they are obligated to sell standby, back-up and maintenance power to such facilities on a non-discriminatory basis. This dual guarantee of a place to sell excess power and to purchase backup power has made it possible for more industries to install the necessary equipment and develop the ability to generate electricity for their own needs, in spite of monopoly utility markets.

The power production facilities of a manufacturing operation are generally sized to meet the optimal demand. When the facility experiences a technical problem it must either divert the excess energy to the grid or shut down the power plant. When the manufacturing production process requires more energy than can be produced on site, then electricity is purchased from the local utility. The seamless integration of these QFs benefits not only the manufacturer, but also the local utility by giving them access to additional power to meet unusually high demand for power. If Congress restricts the current access to the grid that PURPA provides, many of these facilities will be economically harmed.

PURPA's Role in a Transitioning Market

While some regions of the country have moved to a more competitive environment, many have not. Even in those regions where competition has been introduced, it is often limited to a few players that dominate the market, thus depriving small generators of meaningful access to willing buyers and sellers. In the face of monopoly and transitioning markets, there must be an assurance of access to the grid. Without such a requirement, utilities could simply refuse to provide access or make the cost of access either so expensive or so difficult that connection to the grid would be impossible. Thus, the opportunity to fully utilize CHP assets would disappear, and the monopoly utility will dominate the market.

Even with PURPA in place, many QFs, including CHP plants, are still having problems selling power into the electric grid. For example, in the Northwest and California, utilities have put up roadblocks to power being sold to the grid or to transmit power to third parties. In the Southeast, where monopolies control vast transmission and distribution systems stretching over several states, utilities regularly exercise their market power through

unreasonable surcharges, interconnection standards and fees, and “shell game” pricing for backup power sales. QFs frequently face obstacles, such as overly burdensome requirements for interconnection studies and long delays, resulting in projects being cancelled or abandoned because the cost of access is too high.

Obligation for Purchase and Sale of QF Power

FERC has correctly recognized that even in a state that is scheduled to be open to retail competition, there is no guarantee that a fully functioning competitive market for QFs to sell power into will develop. Congressional energy policy legislation should approach PURPA from a similar perspective. Care must be taken to ensure that CHP power is not blocked from the grid as an unintended consequence of reforms to PURPA. The PURPA obligation to purchase is the critical factor that allows manufacturers to contribute to a more diverse energy supply for this nation. If the purchase requirement is eliminated in advance of a truly competitive market place, then many existing CHP assets will become uneconomic, and future CHP development will stall because financing for CHP units is highly dependent on access to the grid.

Similarly, the importance of a federal guarantee for back-up power at just and reasonable rates cannot be over-emphasized in states that remain dominated by monopoly utilities. Without it, QFs would be captive to unregulated monopolies that could charge what they wish. Even in states that have implemented some form of electric restructuring, tariffs and regulations often continue to favor incumbent utilities, and viable options for back-up power often are not offered by competitive suppliers. The QF must be assured of receiving back-up power on a non-discriminatory basis and at just and reasonable rates, especially if the

utility is the “provider of last resort” serving retail load. To the extent that utilities have an obligation to serve retail loads, they also should continue to have the obligation to provide back-up power to QFs on a non-discriminatory basis. Once there is a truly competitive retail market, and QFs can buy back-up power in the open market, then, and only then, will the back-up power guarantee no longer be essential to existing and future CHP power generators.

Assessment of Chairman Barton's Draft PURPA Provisions

Mr. Chairman, I want to compliment you for recognizing in your draft bill that the purchase and sale requirements of PURPA should not be repealed without regard to the conditions in the market where the QF is located. This is a major change from your bill in the last Congress. It appears to be intended to ensure that competitive markets must exist before the purchase and sale requirements of PURPA are repealed. This is a goal we support. We are concerned, however, that the language of this new draft does not adequately guarantee that CHP plants will have meaningful and continuing access to willing buyers and sellers of power before current PURPA provisions are eliminated.

I recognize that legislating the definition of a competitive market is extremely difficult; however, it is essential if CHP power is to survive in this country, and it is essential for meeting this Administration’s objectives on CHP and new power plant construction. Specifically what do we mean by a “fully functioning competitive market?” We mean markets that are comprised of enough willing buyers and sellers that QFs can reasonably expect to have a market for their power and be able to get backup and standby power when they need it. Such markets would include both spot and bilateral transactions offering a wide range of products, not only in terms of duration (short-term, mid-term and long-term,) but also

types of power (capacity and energy; peaking, intermediate and baseload) and allow development of other products and services. Title VII, Subtitle E, Section 7062 of the draft bill encompasses some, but not all of these criteria for FERC to use in determining whether the market is truly competitive.

While paragraph (a)(1)(A) sets out indicia of competition upon which FERC can make a finding, paragraph (a)(1)(B) does not. We strongly support the formation of large, independently managed Regional Transmission Organizations (RTOs) that require separate independent ownership of transmission and generation assets. We believe this is the linchpin of a competitive market for electricity. Those with financial interests in both transmission and generation will always have an economic incentive to favor their own generation over other generators. However, there is no assurance that this will be the outcome of the RTO debate. Legislating in advance of the determination of these rules leaves open the very real possibility that the intent behind your provision (the assurance of competitive markets for QFs to sell and buy power) will not be accomplished. Formation of an RTO in name only could satisfy paragraph (a)(1)(B). Similarly, paragraph (a)(1)(c) provides FERC with unfettered authority to determine a competitive market exists and thus end the purchase and sale obligations. While we may not be concerned about the use of this provision under the philosophy of the current FERC, there is no guarantee that future Commissions will be as committed to bringing about competition in electricity as this one. Therefore, it would be helpful to give FERC guidance as to the criteria they may use in determining a competitive market.

As currently written, a FERC finding that competition exists in a market will end the utility's obligation to purchase from-- and sell power to -- a QF. The legislation must also recognize that market conditions can change over time, and that a competitive market today

may become uncompetitive in the future. For example, a key player may go out of business, or acquire sufficient market share to dominate, or they may control key inputs to the production of electric generation such as natural gas. In these circumstances, FERC should have the authority to reinstate the utility's obligation to purchase and sale requirements of PURPA. We recommend that this legislation include a provision authorizing FERC to reinstate the purchase and sale obligation if it finds that the conditions of a fully functioning competitive market no longer exist.

Finally, with respect to back-up and standby power, the draft language should be clarified to ensure that if the local utility is required by State law to be the provider of last resort, or still has an obligation to serve any and all customers, that obligation should not be affected by a FERC finding that triggers elimination of a requirement to provide back-up and standby power.

Other Issues

There are many other issues worthy of comment in this legislation such as those dealing with the transmission grid, transmission siting, participant funding and market power issues including the repeal of the Public Utilities Holding Company Act (PUHCA).

A transmission grid operated in a fair and non-discriminatory manner is essential to industrial consumers whether they produce their own power, or whether they are simply a purchaser of electricity. Our goal is a transmission system that allows buyers of electricity as much access to sellers of electricity as possible. Industrial customers recognize that until we achieve the open transmission system, the utilities who own monopoly transmission and distribution facilities will still possess and exercise market power. These utilities have often

used their government-granted monopoly power to the detriment of industrial users by favoring their own power generation over other – often lower priced power – produced by others.

We agree with your assessment that new transmission capacity is needed in some areas of the country. Mr. Chairman, I want to commend you for including the language on transmission siting. We support the language you offer and, in fact, we would support stronger language. New transmission, where needed, will produce benefits to many consumers, and it should not be held up by local obstructionism. This is a serious, problem and you have proposed a fair way to deal with the problem.

Your draft also includes a directive for FERC to implement and utilize incentive rates for the construction of new transmission. While your goal is a noble one – to bring more investment to transmission – this directive is unnecessary. FERC currently has the authority to order incentive rates on a case-by-case basis under present law. There are many areas where new transmission is not needed. Incentive rates would be pointless in these areas and would, in fact, do little more than increase costs to consumers. Thus, we believe this provision in the draft has the potential to increase costs to consumers in certain areas without really encouraging additional transmission to be built. If incentive rates were effective, FERC would order those more frequently to help relieve the congestion where it exists on the grid. In my view resolution of the endless delays in transmission siting will do a lot more to bring needed investment than will this provision.

Another transmission issue that we believe is best left to a FERC rulemaking is the issue of participant funding. FERC has – and frequently uses – the authority to order such

funding on a case-by-case basis. While the draft bill's language on participant funding is an improvement over versions that were considered in the Senate last year, we continue to believe this issue is best settled in a regulatory arena, perhaps on a case-by-case basis, rather than legislative arena where it is difficult to craft a one-size-fits-all-rule when each region has a different fact pattern. I would also note that all consumer groups and all non-utility generators believe that mandatory participant funding will hinder, rather than help, the construction of new transmission capacity.

Finally, while my instincts tell me that PUHCA is an outdated and ineffective statute that is no longer useful, energy managers in the forest products industry and elsewhere in the manufacturing community tell me otherwise. There are almost daily stories in the press about utilities allegedly manipulating energy markets. There have been countless instances where utilities have shifted debt from unregulated affiliates to those affiliates subject to state regulations, thus forcing costs to be borne by consumers. While, I support removing those restrictions in PUHCA that limit needed investment by American companies, I believe that reporting and other requirements in PUHCA that protect consumers and investors should remain in place to prevent market abuse and manipulation. Rules are needed to address the operational unbundling of generation, transmission, system control, marketing, and local distribution functions. The need for federal authority to address market power and anti-competitive activities is as essential today for avoiding such abuses as it was 70 years ago.

Conclusion

Industrial users and cogenerators recognize and fully support the need for more electricity generation and transmission. PURPA has been -- and will continue to -- be an

essential law. It encourages the adoption of new technologies. It has produced a broader, more efficient, more environmentally favorable base of electricity generation. Due to PURPA, electricity capacity was added in smaller increments, thus not burdening users with paying for generation that proved to be much larger than necessary. And the cost of building that generation was funded by private capital. The National Energy Plan, including the goal of doubling CHP units by 2010, will be seriously undermined by efforts to repeal PURPA where open markets are not in force and no independent party determines access to the grid.

Any changes to PURPA must be made with a full recognition of their potential impact on existing CHP assets as well as plans for future expansion of CHP. The access to the grid afforded by PURPA and the rights for back-up and standby power, are essential in markets and regions of the country where competitive markets are not yet functioning effectively. In the spirit of moving toward more competitive markets in the future, the Congress should, at a minimum, ensure that this power generation is not disadvantaged by monopolistic markets by making the changes we have suggested.