



TESTIMONY OF JAMES ROUSE
CHAIRMAN OF
THE ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON)
BEFORE THE HOUSE SUBCOMMITTEE ON ENERGY AND AIR QUALITY
ON HR 3406
DECEMBER 13, 2001

Summary to Testimony of James Rouse, December 13, 2001

Regional Transmission Organizations (RTOs)

- Governance must be truly independent
- Scope and configuration are essential
 - Two tests (cost-benefit study and generation sufficiency) are flawed
 - Cost-benefit studies will lead to litigation
- Generation sufficiency not relevant to competition
- FERC should be allowed flexibility in designating best practices for market design

RTOs SHOULD BE LARGE AND SEAMLESS AND OPERATE TO FACILITATE THE FLOW OF POWER AS EFFICIENTLY AS POSSIBLE

Incentive Rates

- Transmission is a low-risk investment, traditional rate of return sufficient
- NERC's Winter Assessment states transmission grid adequate
- FERC has authority to authorize incentive rates when and where necessary

ELCON DOES NOT SUPPORT INCENTIVES BEYOND COST OF SERVICE FOR MONOPOLY TRANSMISSION EXPANSION AND IMPROVEMENT

PUHCA

- No bona fide consumer group supports PUHCA repeal
- FERC needs authority to address relationships between regulated and unregulated entities

PUHCA REPEAL ABSENT SUFFICIENT REPLACEMENT PROVISIONS COULD LEAD TO MARKET POWER ABUSE

PURPA

- PURPA cannot result in higher prices if implemented correctly
- Only utilities, not consumers, are pressing for PURPA repeal

PURPA IS ONE OF THE FEW FEDERAL STATUTES RESULTING IN MORE COMPETITION IN THE ELECTRICITY INDUSTRY

Price-Responsive Demand Program

- There is no need to set 5 percent target
- Legislation should encourage a market-based response

CONSUMERS WILL ADJUST THEIR CONSUMPTION IF GIVEN SUFFICIENT INFORMATION AND APPROPRIATE MARKET-BASED INCENTIVES

Reliability

- There should be one organization setting standards for both reliability and commercial practices
- That one organization must be open, balanced, and inclusive

LEGISLATIVE LANGUAGE SHOULD NOT BE OVERLY PRESCRIPTIVE IN DETERMINING "RELIABILITY" ISSUE

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Mr. Chairman, members of the Subcommittee, I am James Rouse from Praxair, Inc., an industrial gases company headquartered in Danbury, Connecticut. I am Chairman of, and today represent, the Electricity Consumers Resource Council, or ELCON, the national association of large industrial users of electricity. ELCON members represent nearly every segment of the manufacturing community and have operations in every state.

ELCON was established in 1976, and ELCON member companies pride themselves on being among the original proponents of open and competitive retail and wholesale electricity markets. We compete in open markets to sell our products. Since we purchase nearly every other raw material or component needed to manufacture our products in competitive markets. Why shouldn't we be able to purchase electricity in competitive markets as well?

We recognize that a functioning and competitive wholesale market is necessary to support retail competition which is slowly being implemented in states throughout the Nation. We continue to believe that retail competition can benefit all consumers if markets are truly open and consumers are free to choose among suppliers who are actually competing. Unfortunately too many states (California being prime among them) purport to establish free and open retail markets but in reality have simply created the appearance of competition, while operating in the traditional regulatory mode.

The legislation before us today, HR 3406, addresses wholesale markets. On behalf of ELCON and its member companies, I compliment Chairman Barton for introducing this bill. While I believe that the legislation represents progress, it has certain shortcomings that would deny wholesale electricity markets from realizing their full competitive potential.

Take, for example, the linked issues of regional transmission organizations (RTOs), transmission siting, and the repeal of the Public Utility Holding Company Act (PUHCA), all of which affect market power. 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 possess and exercise market power – that is monopoly power – I cannot emphasize too strongly that some regulation is needed to ensure that the owners of transmission systems do not use their government-granted monopoly power to the detriment of real competition and consumers.

That is why RTOs are so important. FERC's actions to date recognize that the scope and configuration of RTOs are essential to their operation. RTOs must be large enough to mitigate market power. Their governance must be truly independent and not subject to undue influence from vested interests. I believe that the language in HR 3406 is harmful in that it constrains FERC's ability to objectively analyze a regional market and ensure

that each proposed regional transmission organization will, in fact, facilitate the most efficient movement of power and increase competition in wholesale markets.

The two tests proposed in this bill as a means of demonstrating adequate scope and configuration of an RTO are both flawed. Asking an RTO to conduct a cost-benefit study is an invitation to litigation – litigation that will be based only on dueling – and probably inconclusive – cost-benefit analyses. This will not resolve the issue quickly, nor will it necessarily resolve the issue properly. The “generation sufficiency” test is based on a faulty premise; it would encourage smaller rather than larger RTOs and, furthermore, it is simply not workable for several reasons. Sufficient generation within an RTO is an irrelevant factor. In an optimally constructed wholesale market, we would have large seamless RTOs where power can flow not only within but between RTOs so that the most efficiently produced electricity can reach the greatest number of consumers. A generation sufficiency test invites monopoly transmission owners to exclude from an RTO new, more efficient generation facilities once the generation sufficiency test is met. It also fails to consider both load increases and generation changes that could transform generation sufficiency to generation insufficiency. I could go on, but we see no reason to hamstring or otherwise restrict FERC as it looks at proposed RTOs under the guidelines it promulgated in Order 2000.

Similarly, the language in HR 3406 could restrict FERC as it continues its efforts to provide guidance on market design and operation. This is an issue of vital interest to large industrial users. In fact, six ELCON members, including my own company,

recently submitted affidavits to FERC as part of an ELCON filing in FERC's docket on market design, pointing out that the model now utilized by the PJM-ISO, while favorable in many ways, should not necessarily be used as the sole template for "best practices" throughout the Northeast and the Nation. At a minimum, the existing flaws in PJM should be fixed before its platform is extended to the entire Northeast region. FERC, under the able Chairmanship of Pat Wood, needs the opportunity to be flexible and creative. HR 3406 would constrain and inhibit FERC in its current market design docket.

Turning to incentive rates (Section 401), let me reiterate what ELCON has previously stated before this Subcommittee. There is no demonstrated reason – other than the greed of monopoly transmission owners – to provide incentive rate-making for the construction of new transmission. The Subcommittee, in an earlier proceeding, heard from a Goldman Sachs analyst that investment in transmission is low risk and that traditional rates of return are sufficient. The recently released Winter Assessment by the North American Electric Reliability Council (NERC) stated that transmission capacity for this coming winter is adequate. There may be specific areas where new transmission is necessary to alleviate congestion. Path 15 is an obvious example. But simply giving the monopoly transmission owners a higher return on transmission will not motivate them enough to relieve congestion that is now protecting their high-cost generation. If FERC believes incentive rates are necessary – a decision that can and should be made on a case-by-case basis – they have sufficient authority under present law. But I have seen no study or documentation to support this far-reaching proposal to implement across-the-board

“incentives.” Such a provision will produce higher electricity prices for all consumers and may not relieve transmission congestion where it is truly needed.

Rather than simply requiring incentive rates, first remove governmental impediments. One way to remove impediments is to offer a federal right of eminent domain for the siting of transmission lines. There is no reason that the siting of new transmission lines should be treated differently from the siting of new natural gas pipelines. The language in HR 3406, by providing federal backstop, is a good, though incomplete, first step.

Turning to PUHCA repeal, this statute is the only federal consumer protection statute for electricity consumers. No *bona fide* consumer group supports the repeal of PUHCA without adequate replacement provisions. We believe that there should be clear authority vested in the 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, PUHCA repeal should not be effective until states have retail access or until competition on a nation-wide basis is otherwise achieved. ELCON and ELCON members find the language in HR 3406 lacking in this regard.

ELCON witnesses and others have long defended before this Subcommittee the Public Utility Regulatory Policies Act (PURPA), including the need for back-up power in non-

competitive states (which we are pleased is included in this bill. I will make the case – very briefly – from a slightly different perspective. Utilities claim PURPA has resulted in higher rates for consumers. By definition, this cannot happen as long as PURPA is implemented correctly. In fact industrial users value PURPA as having brought competition to the electricity marketplace. Any higher prices, if there were any, were the result of state-approved actions and of poor decision-making by utilities. To repeat a point ELCON witnesses have made previously: PURPA did not create above market contracts for utilities. In fact utilities have more above-market contracts with other utilities than they do with PURPA qualifying facilities. It is worth noting that only utilities, not consumers, are seeking the repeal of PURPA’s purchase and sale provisions.

ELCON members believe that legislation should address demand side issues as well as supply side issues. We view the inclusion of a “Price-Responsive Demand Program” in Section 103 as generally positive. But we question the need to set a “5 percent” target, which we fear would create yet another federal program rather than developing a robust customer load response (CLR) market. There is no magic or “correct” number for CLR. Individual consumers should be able to compare the value of continuing to consume electricity to manufacture their products with the value of being paid to reduce their consumption of electricity. We hope that this Section will not result in traditional Demand Side Management responses, which have historically resulted only in added costs for consumers and relatively little reduction in overall demand and virtually no reduction in system peaks. We believe that consumers – large and small – if given sufficient information and appropriate market-based incentives will adjust their electricity

consumption accordingly. No target or any other artificial threshold is necessary or desirable.

A final note on reliability. For nearly five years ELCON has worked with NERC to craft language creating a new reliability organization that recognizes both changes in the transmission system and changes in the electricity stakeholder community. We lately have worked with the Gas Industry Standards Board (soon to be renamed the North American Energy Standards Board) as they too attempt to provide structure and guidance to our interstate electricity grid. We at ELCON have a simple objective: one organization charged with setting standards for both reliability and commercial practices and retail and wholesale standards (because we believe that they cannot be separated). That organization should be overseen by FERC. The organization's standard-setting practices should be truly fair, open, balanced and inclusive. The new language proposed in HR 3406 may be too prescriptive to achieve that goal.

In conclusion, Mr. Chairman may I compliment you and your staff for a valuable document. I appreciate the time that you and your staff have spent with industrial users. Although we do not believe that this bill, in its present form, contains all of the answers, it offers a sound structure from which to proceed when the Subcommittee begins markup. May I observe that the State of Texas has conferred on our Nation its President, the chairman of the FERC, and the chairman of this Subcommittee. Seldom is a single state the source of such potential for the improvement of our country's electricity market.

And, as always, Mr. Chairman, we thank you for your continuing interest in making electricity markets more competitive.

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