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TESTIMONY OF

GOVERNOR BILL RICHARDSON

STATE OF NEW MEXICO

ON BEHALF OF THE WESTERN GOVERNORS' ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

March 27, 2003

Statement of the Western Governors' Association to the Senate Committee on Energy and Natural Resources

March 27, 2003

Thank you Mr. Chairman and Senator Thomas for your thoughtful proposals to amend federal law governing electric power regulation.

This is an issue of intense interest to Western governors. The region is still recovering from the 2000-2001 Western electricity crisis and there is significant concern about the intended and unintended consequences of the Standard Market Design proposed by the Federal Energy Regulatory Commission (FERC).

In our testimony to this Committee in 2001, we related three areas of agreement among Western governors on federal electricity legislation.

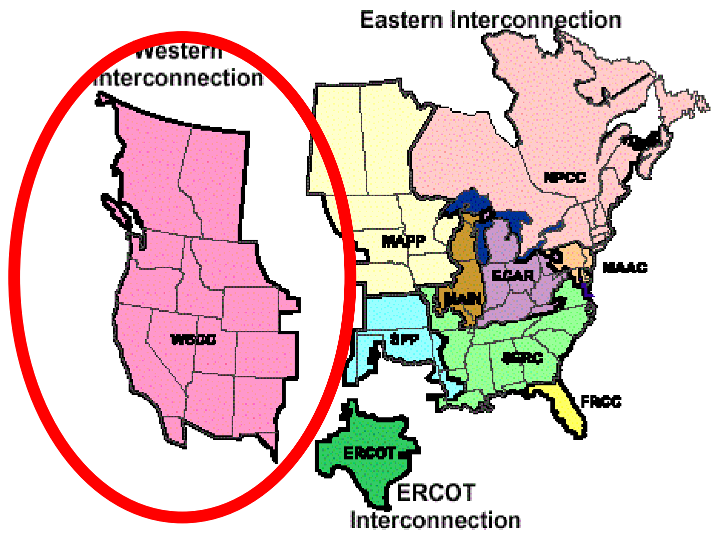
1. Federal electric system reliability legislation needs to be enacted to ensure that present voluntary regional reliability standards can be enforced. Such legislation should recognize and defer to standards developed and enforced in the Western Interconnection. States should have a primary role in overseeing the standards setting and enforcement processes.
2. FERC should not be granted the power of eminent domain for electric transmission line siting, even in a backstop mode. There is no evidence in the West that states have ever blocked the permitting of an interstate transmission project. There is no evidence nationwide that states have systematically abused their responsibilities to balance transmission needs with other public needs in decisions on the siting of transmission facilities.
3. The federal government should not intrude into the retail electric decisions of states. In our testimony to you in June 2001, Western governors opposed federal legislation that would expand FERC's authority into retail electricity decisions. With FERC's release of its proposed Standard Market Design rule in July, our concerns about FERC intrusion into retail electricity decisions have been greatly amplified.

We continue to maintain these positions.

In the following testimony, we provide important background on the unique elements of the Western Interconnection and then offer observations on the 13 topics on which you requested comment.

Unique Elements of the Western Interconnection

In crafting legislation, the Committee should keep in mind that North America is served by three essentially electrically-separate power grids. Within the Western Interconnection, the western states, western Canadian provinces and northwest Mexico are fully integrated. However, there are few ties between the Western Interconnection and the other interconnections. Generators are synchronized within interconnections but not between interconnections.



The geography of the system is important, because it defines the practical maximum extent of power markets and impacts of power outages. An event in British Columbia can cause blackouts in Arizona, but an outage in Arizona cannot impact states in the Eastern Interconnection.

The Eastern and Western grids have developed different features. The Western grid is defined by long distances between generators and customers (load centers). The Eastern grid more resembles a tight-knit network of transmission. As a result, the maintenance of stable system voltage is often the constraining factor in the operation of the Western grid, while the thermal limits of lines is typically the constraining factor in the Eastern grid.

Another reality differentiating the East and the West is the vast ownership of land in the West by federal agencies. This land ownership pattern often creates different transmission facility siting challenges than in the East.

As a result of these differences, institutions and practices[1] to address electric power issues have evolved differently in the West than in the East.

We recommend that federal legislation recognize these electrical, geographic and institutional differences and resist the temptation to adopt federal government-centric, one-size-fits-all solutions. We believe the experience in Western power markets over the past several years has illustrated the limitations of policy made in Washington, D.C. for the West.

[1] For example, the Western industry has relied on rating the capacity of transmission paths under different system conditions and limiting the use of paths to their rated capacities. Because paths are not similarly rated in the Eastern Interconnection, the industry relies on Transmission Loading Relief (TLRs) in the East to force users to cut back power transfers when reliability is threatened.

Regional Energy Services Commissions

The Staff Discussion Draft includes a Subtitle B – "State Coordination" and proposes that states be provided authority to "…enter into agreements to establish Regional Energy Services Commissions (RESC)". This provision would potentially confer upon RESCs 1) authority currently held by states, like transmission siting, and 2) Federal Energy Regulatory Commission authority related to regulation of the wholesale trade of electricity. FERC would have jurisdiction for resolving disputes among RESCs and participating and non-participating states, as well as between RESCs.

The Western Governors commend the Committee for moving from the top down, centralized model proposed by FERC in its Standard Market Design NOPR, to a more regional model. While the Western states have just begun to analyze the pros and cons of the RESC provisions, this change of direction from Washington, D.C., is welcome.

To fully understand the implications of the RESC concept, it would be desirable for Congress to first clarify state and FERC jurisdiction over such issues as the transmission component of bundled retail sales and transmission to serve native load. Such clarification is critical to understanding the scope of Section 404(b) which allows the Commission to "affirm, modify, or set aside such State regulatory order or ruling in whole or in part if the Commission finds that the State regulatory authority's order or ruling would result in undue discrimination in the provision of the transmission of electric energy and/or sale of such energy at wholesale…or results in unjust or unreasonable rates, charges or classifications…"

Our initial review of the Staff Discussion Draft raises numerous questions that need to be addressed before proceeding. For example:

- Why is five percent of U.S. electricity load the minimum threshold for establishing a RESC?
- Can there be one-state RESCs?
- Will multiple RESCs be allowed in the Western Interconnection?
- How are the RESCs to be funded?
- Why would states, which have territory in two regions, be prohibited from participating in RESCs in both regions?
- What are the specific grounds for the Secretary of Energy to disapprove an RESC?
- In Section 403(a), what does "primary jurisdiction" mean?
- Market power review and monitoring functions could reside with the RESC. Where does the responsibility for market mitigation actions reside?
- Section 403(b) provides for the RESC to develop enforcement mechanisms. Where does the authority to implement such enforcement mechanisms reside?
- Is the intent of the Staff Discussion Draft to leave FERC with authority over electricity decisions whenever any state objects to a decision of a RESC or does not agree to join an RESC?
- If an RESC does not address any of the items listed in Section 402(a), would FERC assert jurisdiction under Section 406 regardless of whether or not such functions would otherwise be

under FERC jurisdiction? For example, if an RESC elects not to take one type of action (e.g., recommend preemption of state jurisdiction over bundled transmission service), does Section 406 grant FERC the authority to preempt state law? Or, if an RESC finds that the costs of an RTO exceeds the benefits, can it disapprove an RTO under Section 407? If it disapproves an RTO that is not cost-effective, can FERC assert jurisdiction over the RTO proposal under Section 406?

- What is the role of the RESC in overseeing the operation of an RTO after it has been approved?

Certain features of the RESC proposal, when combined with other provisions in the Staff Discussion Draft, are clearly not acceptable. For example, granting FERC the power to preempt state siting laws unless the RESC assumes the power to preempt state siting laws is a non-starter.

As noted previously, the Western Governors are encouraged by the shift in policy direction represented by the discussion draft. In fact, WGA's existing policy calls on Congress to "allow states to create regional mechanisms to decide regional power issues, including but not limited to, the creation and operation of regional transmission organizations, reliability of the western power grid, transmission system planning and expansion, maintenance requirements and market monitoring". Before proceeding with any provision on regional governance, however, it is important for the Committee to understand how Western states interact today on electricity issues and what steps they have taken to address future regional issues since the 2000-01 electricity crisis.

Interstate cooperation on electricity issues occurs in the West at three levels: among the governors; among the state commissions established to regulate the electricity industry; and among the state energy siting agencies and programs. At the level of the governors, the Western Governors' Association and its energy arm, the Western Interstate Energy Board, address policy issues as directed. This interaction and analysis has included extensive public and private participation and led to a series of policy resolutions and reports on the Western Electricity Interconnection (see "Conceptual Plans for Electricity Transmission in the West" and "Financing Electricity Transmission Expansion in the West: A Report to the Western Governors").

In 1983, the Committee on Regional Electricity Cooperation (CREPC) was formed to facilitate voluntary cooperation among Western state and Western Canadian provincial utility regulatory commissions and energy agencies on issues of common interest. This group has met regularly since that time to address issues and interact with the Federal Energy Regulatory Commission. CREPC has kept the region's commissions and energy agencies abreast of policy, regulatory and technical issues and serves as the primary forum for interstate cooperation on electricity policy issues in the West.

In 2002, the Western Governors and concerned federal agencies entered into a "Protocol Governing the Siting of Interstate Transmission Lines in the West". Under the Protocol, the states and federal agencies agree to collaborate in the review of siting proposals and permit requests from the time of their submission in order to identify and resolve siting issues as quickly as possible. To date, no new transmission proposals have been offered so we have not yet had an occasion to use the process. We are confident that the West's long record of cooperation will help ensure that any future use of the process provided in the Protocol will be successful. It has been the West's experience that federal agency delays are the most significant impediment to siting of transmission lines in the West. The governors believe the Protocol will result in a marked improvement in future siting activities.

Western governors have recognized that additional regional cooperation may be necessary to address increasing demand for electricity, prevent recurrences of the 2000-2001 crisis, and capitalize on the region's vast fossil and renewable energy resources. The governors submitted a proposal for a regional information and planning mechanism with the U.S. Department of Energy in May 2002. Secretary of Energy Spencer Abraham responded positively to the proposal in June 2002 and indicated his willingness to fund the development of such a system, appropriations permitting, in FY 2003. The purpose of this initiative is to ensure that public and private decisionmakers are fully informed about the Western electricity market in order to enhance public interest monitoring and regulation of market activities and to help producers and consumers deal with market fluctuations more effectively than they were able to in the Western electricity crisis.

Furthermore, in December 2002, the governors asked WGA (WIEB) and CREPC to explore and propose a regional decision-making mechanism for their consideration. The Department of Energy has agreed to support this project as well. The purpose of this initiative is to explore how the states might address future interstate policy issues that affect the operation of the Western Interconnection in a more formal manner than the informal, voluntary collaboration provided by CREPC. This initiative is just getting underway.

The Western Governors commend the Committee for recognizing the regional and state nature of the nation's electricity markets. We hope to work closely with you, Chairman Domenici, Senator Bingaman, Senator Thomas and others to reach consensus about this proposal. Given the complexity of the proposal, and the unique aspects of different regions of the nation we find it difficult to express optimism that this proposal could be fully vetted in the apparently very short timeframe before your Committee must act on energy legislation. In the interim, we suggest that Congress should clarify state and FERC jurisdiction over such issues as the transmission component of bundled retail sales and transmission to serve native load, and the Committee should instruct the U.S. Department of Energy and FERC to cooperate with states within the nation's regional electricity markets on the development of appropriate regional governance models, which may vary according to the needs of each region. Through such a program of cooperation and assistance, reliable and economical regional governance mechanisms are much more likely to emerge. As noted, the Western Governors have already directed that a Western model be explored.

Reliability Standards

We are pleased that Senator Thomas' bill includes reliability provisions that will meet the needs of the West and the nation. On behalf of the Western Governors, I would like to thank Senator Thomas, and his staff, again for their leadership and support on this issue. If the Congress takes no other action this year on electricity issues, we urge you to enact these reliability provisions. The proposal in the Staff Discussion Draft to make a Regional Energy Services Commission the regional reliability organization, as opposed to playing an oversight role in the setting and enforcement of reliability standards, is particularly problematic.

Since 1997, Western Governors have urged the enactment of federal reliability legislation to provide a legal underpinning for enforcing reliability standards. As a stop-gap measure, the West has implemented a system of contracts to make standards enforceable. Most control areas in the West have executed the contracts, a few have not. However, such a contract enforcement system is not a long-term substitute for federal legislation.

In 1997, 2001, and again last year, Western Governors called for a new approach to setting and enforcing reliability standards that includes a public process for setting standards, review of standards by states, application of standards to all users of the grid, enforcement of sanctions for non-compliance with the standards, mandatory membership by operators of the grid in regional reliability councils, and joint state/federal oversight of establishing and enforcing reliability standards. In 2000, the governors urged the "organization of regional advisory bodies of affected states and Canadian provinces to advise regional and North American organizations and the Federal Energy Regulatory Commission and appropriate Canadian and Mexican regulatory authorities…FERC should defer to the advice of such regional advisory bodies when advisory bodies cover an entire interconnection."

Through extensive on-going collaborative efforts between the Western states/provinces and the Western electric power industry, three principles have been developed that guide our views of federal reliability legislation.

(1) Deference must be given to standards adopted within and for the Western Interconnection.
(2) The implementation and enforcement of standards must be delegated to the West.
(3) States must have a role in the process.

Over a three-year period, Western states, provinces and industry worked to streamline and consolidate existing industry grid management institutions into one new entity, the Western Electricity Coordinating Council. Western Governors called for the expeditious establishment of the new institution. Last April, the new institution was formed. WECC was designed to rapidly implement the provisions of federal reliability legislation and is prepared to do so as soon as such legislation is enacted.

Through extensive work with the North American Electric Reliability Council (NERC), the central elements of what the West needs are included in the NERC consensus legislation that the Senate passed last year, thanks to Senator Thomas' leadership. The NERC language provides for deference to standards that cover an entire interconnection. It provides for delegation of implementation and enforcement functions to a regional entity, such as the WECC, that is much closer to the issues than a North American body or FERC. It provides for a state advisory role and enables FERC to defer to such advice when given on an interconnection-wide basis. This approach builds on existing technical expertise in the industry and states and does not require the establishment of a large new federal bureaucracy.

The reliability provisions of the Thomas bill meet the needs of the West and we urge their adoption. Given the uncertain future of the Regional Energy Services Commission concept, we recommend that the Committee keep the language in the Thomas bill related to the creation of Regional Advisory Bodies.

Open Access

Western governors believe that all segments of the Western industry, including investor-owned utilities, public power, federal power marketing administrations, power marketers and brokers, and independent power producers, should participate in the competitive wholesale electricity market. Congress should ensure that federal institutions, such as the power marketing administrations, participate in regional efforts to promote wholesale competition. This may include participation in cost-effective Regional Transmission Organizations.

Transmission Siting and Preemption of State Siting Law

We are disappointed that the staff draft proposes to take the Committee down the unproductive path of federal preemption of state electric transmission siting laws. The proposed transfer of these powers from states to RESC's is likewise problematic unless it is truly voluntary and not compelled by threat of federal preemption. The continued emphasis on preempting state siting authority is particularly discouraging given the fact that no evidence has been presented in any forum that we are aware of that justifies granting FERC such preemptive powers, even in a backstop role. Senator Thomas' approach, which focuses on getting the federal government's house in order on transmission permitting, is much more appropriate.

Western governors have a long record of proactively addressing the transmission needs in the Western Interconnection. We recognize that an adequate transmission system is necessary to maintain the reliability of the grid and enable competitive wholesale electricity markets.

The record in the West provides no evidence supporting the need for new centralization of land use decisions that are more properly made in the West based on intelligent tradeoffs of needs and values. We urge the Committee to keep in mind that **no western state has ever denied a permit for an interstate transmission line**. The idea of federal eminent domain for electric transmission is a solution looking for a problem.

The major challenge to siting of transmission in the West rests with federal land management agencies. The federal government owns vast tracts of land in the West (e.g., approximately 83% of the land in Nevada, 65% of Utah, 63% of Idaho, 53% of Oregon, 50% of Wyoming, 46% of Arizona, 45% of California, 36% of Colorado, 34% of New Mexico, 29% of Washington, and 28% of Montana.) If it accomplishes its goals, the preemption language, in fact, may provide a perverse incentive to site more transmission on private lands, further exacerbating the decrease in private lands in the West.

Few new transmission lines have been proposed in the West over the past decade due to increased reliance on natural gas fired generation near load centers and uncertainty created by

FERC policies. The President's Executive Order 13212 directing federal agencies to expedite energy-related projects provides needed direction. However, agencies need adequate resources to execute their responsibilities. States also recognize that timely action is essential in the modern competitive electricity market.

The 2001 WGA "Conceptual Transmission Plan" recommended that all siting review processes be streamlined and coordinated to enable timely construction of transmission lines. State review processes should address both local and Western Interconnection needs, and federal agency review processes should be coordinated internally as well as with State and Tribal authorities. The 2002 report, "Financing Electricity Transmission Expansion in the West", reinforced the need for pro-active transmission planning and collaborative action on transmission permitting as important ingredients for project financing.

We have acted on these recommendations. Last summer, 12 Western governors, including all governors in the Western Interconnection, signed the Protocol Governing the Siting of Interstate Transmission Lines in the West to coordinate and collaborate on the review of proposed interstate transmission lines. We are pleased to report that the Secretaries of Interior, Agriculture, and Energy and the Chairman of the White House Council on Environmental Quality also signed the protocol.

The protocol is a constructive step in recognizing the regional impacts of major transmission additions. When coupled with appropriate direction and funding of federal land management agencies, we believe the Protocol will get the job done. Unlike the approach in the Staff Discussion Draft, our approach does not create new centralized bureaucracy at DOE or FERC. Our approach is to make existing government agencies work, not add new layers of government review. We would be pleased to report to you in a year on the progress made under the protocol.

We urge the Committee to not include eminent domain provisions in its energy bill.

Transmission Investment and Transmission Cost Allocation

Western Governors have not adopted a collective position on transmission investment incentives or transmission cost allocation. However, we would caution that such incentives are not free. The costs of such incentives will be borne by our citizens and businesses.

Western Governors have worked on transmission financing for several years. Beginning with the WGA Transmission Roundtable in May 2001, Western governors have been concerned about the issue of financing new transmission. At our request, in February 2002, Western stakeholders delivered a report to governors on transmission financing titled *Financing Electricity Transmission Expansion in the West*. The report reached consensus on several points, including:

- Confidence in cost recovery, including a reasonable return on investment, is the key to financing transmission expansion.

- Uncertainty over the future structure of the industry and recovery of transmission investment costs have contributed to a lack of investment in recent years.
- Due to the long lead-time required for transmission construction, further investment to expand the transmission infrastructure in the western states may be needed now to bring economic and strategic benefits to customers in the future.
- There are two distinct models for identifying transmission expansion projects, securing the necessary capital investment and providing for the recovery of the investment costs. These are the market-driven model and the total system cost model.
- The two models could co-exist and transmission projects could be financed through a combination of both models. The approach used should be determined on a project-specific basis.

Since the report, each of the nascent RTOs in the West has developed transmission financing approaches. These efforts continue to be refined.

PUHCA

Western governors have not taken a collective position on amendments or repeal of the Public Utilities Holding Company Act.

PURPA

Western governors have not taken a collective position on amendments to the Public Utility Regulatory Policies Act. However, we do note that it seems inappropriate to condition the elimination of the "must purchase" provisions of PURPA on the existence of "competitive wholesale markets" or the existence of retail competition. The existence of competitive wholesale markets remains an issue of much dispute and few states in the West have or are likely to endorse retail competition in the near term.

Net Metering and Real-Time Pricing

Net metering is an appropriate electricity policy. Every state in the West already has some form of net metering. If the Committee retains the provision, it should allow each state PUC to decide the nature of such policy in the context of state law.

Western governors have identified demand response as a critical element for well-functioning electricity markets. During the 2000-2001 Western electricity crisis, many novel demand response programs were put in place. The evaluation of the efficacy of specific programs continues. If the Committee retains the provision, it should allow each state PUC to decide the appropriateness of such policy in the context of state law.

Renewable Energy

Significant progress is being made in the West to expand the generation of electricity from renewable resources. Several states have adopted aggressive Renewable Portfolio Standards. Other states have additional programs in place to increase renewable energy generation like financial incentives and generation disclosure requirements.

Western governors agree on the need to extend and expand the existing renewable energy production tax credit. The credit has been particularly helpful in expanding the development of wind resources in the West. As additional wind generation is deployed, the cost of wind generation decreases. Similar improvements can be expected if the deployment of solar, geothermal and biomass generation technologies accelerates. Although not within the purview of this Committee, we would urge you to work with the Senate Finance Committee to include a production tax credit in final energy legislation.

Although not part of the electricity provisions of pending bills, the governors also support the development of new advanced clean coal technologies.

Market Transparency, Anti-Manipulation, Enforcement

Much has been learned from the Western electricity crisis of 2000-2001. The Committee is to be complimented for focusing on the core FERC functions of market monitoring and enforcement. FERC's performance in these critical areas needs to be improved and should be a higher priority than seeking to expand jurisdiction into areas of state responsibility.

In addition to the reforms proposed thus far, Western governors believe that a robust information and planning system is necessary to ensure that adequate infrastructure is in place to avoid future crises. Comprehensive and up-to-date data are critical to assure resource adequacy. We would encourage the Committee to direct the Department of Energy and FERC to assist the West in developing such an information and planning system.

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