

BEFORE THE  
UNITED STATES HOUSE OF REPRESENTATIVES

THE COMMITTEE ON ENERGY AND COMMERCE  
SUBCOMMITTEE ON ENERGY AND AIR QUALITY

Testimony of  
GERALD NORLANDER

For

NATIONAL ASSOCIATION OF STATE  
UTILITY CONSUMER ADVOCATES

Regarding Proposed  
H.R. \_\_\_\_\_  
Energy Policy Act of 2003

Washington, DC  
March 14, 2003

**NATIONAL ASSOCIATION OF  
STATE UTILITY CONSUMER ADVOCATES**  
8300 Colesville Road, Suite 101  
Silver Spring, MD 20910  
Tel: (301) 589-6313  
FAX (301) 589-6380  
Email: [nasuca@nasuca.org](mailto:nasuca@nasuca.org)

Website: [www.nasuca.org](http://www.nasuca.org)

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**Summary of Testimony**

NASUCA represents state utility consumer advocates from 42 states who primarily represent the interests of residential utility consumers. The electricity title of the proposed Energy Policy Act of 2003 is opposed by NASUCA because it would allow large, unnecessary, and unjustified rate incentive allowances for owners of electricity transmission lines under the jurisdiction of the Federal Energy Regulatory Commission (FERC). NASUCA estimates that a set of transmission investment incentives currently proposed by FERC, which would be authorized if the bill were enacted, will cost approximately \$13 billion, with no demonstration that such incentives are needed or cost beneficial. Indeed, the bill would provide needless additional compensation providing windfall allowances for utilities who already have performed the very activities the financial incentives are intended to stimulate.

The bill would also eliminate protections of the Public Utility Holding Company Act (PUHCA) and FERC merger review authority, which are existing measures intended to protect consumers from utility holding company abuses and the exercise of market power. Accordingly, NASUCA has concluded that passage of the electricity title of this bill is not in the overall interests of utility consumers, and urges that it be eliminated..

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Chairman Barton And Members Of The United States House of Representatives Subcommittee on Energy  
And Air Quality:

Thank you for inviting me to testify today for the National Association of State Utility Consumer Advocates (NASUCA) regarding the proposed Energy Policy Act of 2003. My name is Gerald Norlander. I am the Chairman of the Electricity Committee of NASUCA, and I am the Executive Director of the Public Utility Law Project of New York, Inc. (PULP).<sup>1</sup> NASUCA is a national association of consumer advocate offices with members in 42 states and the District of Columbia. NASUCA members are charged by their respective state laws with the responsibility to represent consumers in utility proceedings before state and federal regulatory commissions and courts.

Numerous NASUCA members are from states that restructured their wholesale and retail electricity industries, others are from states that have halted or slowed industry restructuring, and still others are from states with traditional vertically integrated utility industry structures. Today, I am speaking on behalf of all NASUCA members in opposition to Title VII of the proposed Energy Policy Act of 2003, the electricity title of the bill. This unified opposition reflects a national consensus of state consumer advocates that the bill, if enacted, would be detrimental to the public interest and interests of retail consumers.

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<sup>1</sup> PULP, a non profit organization representing the interests of low income utility consumers, is an Associate Member of NASUCA , with offices at 90 State Street, Suite 601, Albany, New York 12207.

## **1. Rate Incentives to Promote Capital Investment in New Transmission Facilities are Unnecessary and the Costs are Not Justified.**

Section 7011 of the proposed Energy Policy Act of 2003 bill would add a new Section 215 of the Federal Power Act requiring the Federal Energy Regulatory Commission (FERC) within one year to establish new rules for “incentive-based and performance-based rate treatments to promote capital investment” by electricity transmission utilities, “to support economically efficient markets for the sale of electricity at wholesale.” This language would authorize a pending FERC proposal to increase interstate electricity transmission rate allowances.<sup>2</sup> The bill allows FERC to set the amount of the financial incentives. The pending FERC proposal, made without the benefit of any enabling legislation to change the way electricity transmission rates are set under the Federal Power Act, is to allow automatic increases in the return on equity (ROE) for transmission investments, well beyond the level normally allowed in the development of just and reasonable rates. These ROE “adders” are intended to reward utilities for divesting control over their transmission assets to regional transmission organizations (RTOs), for outright divestiture of these assets to newly created “Independent Transmission Provider (ITP)” utilities, and for construction of new transmission facilities. Control and ownership of the facilities would shift to regional transmission organizations and the new transmission service utilities which would operate new and expanded transmission service spot markets. Cooperating utilities will receive ROE bonuses, well above the normally calculated reasonable rate of return on equity invested, of 200 basis points - 2% - for existing transmission facilities, and 300 basis points - 3% - for new investments in transmission. Nothing in the proposed FERC rule requires any showing that these bonus-conferring

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<sup>2</sup> *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid*, FERC Docket No. PL03-1-000.

actions are cost effective, and nothing in the proposed bill places any upper limit on the rate making incentives.

In response to the FERC proposals for ROE “adders,” NASUCA commissioned an examination of the cost and policy implications, and is filing comments this week in the pending FERC proceeding. I would like to highlight several conclusions of those comments, which are attached to my testimony as an exhibit:

- NASUCA calculates the cost of the current FERC initiative, if fully utilized by transmission owners, will cost consumers over \$13 billion, or approximately \$711 million per year for the 19 year time horizon in the FERC proposal. This is a conservative estimate of the potential cost of these investment incentives, and it virtually offsets the putative \$725 million per year benefit of forming Regional Transmission Organizations, a benefit estimate that is controversial for its optimism.
- The \$13 billion incentive is unnecessary and will provide no incremental benefit in many areas where transmission owners already have agreed to turn over control of their systems to regional transmission organizations (RTOs) or independent system operators (ISOs).
- If Congress seeks to encourage national adoption of the system proposed by FERC, such ROE incentives may only impede that result. States that have not approved divestiture of transmission facilities owned by state-regulated utilities may be more reluctant to do so if automatic cost increases are the result, without any clear, offsetting benefits.

### **PUHCA Should Not be Repealed**

Section 7043 of the bill would repeal the Public Utility Holding Company Act (PUHCA). PUHCA is a statutory bulwark against reassembly of vast utility holding company empires, abuse of captive

ratepayers to subsidize failing unregulated ventures, and inappropriate transactions between regulated utilities and unregulated affiliates. NASUCA has adopted the following resolution on this subject:

“in considering action affecting regulation or the structure of the electric industry, including PUHCA repeal or reform, Congress should require federal regulatory agencies to: 1) prevent abusive or preferential affiliate transactions, 2) continue oversight and protection over corporate and market structure to prevent abuses to consumers and competition, 3) disallow costs which are not prudent and reasonable from wholesale rates, 4) exercise sufficient regulatory authority to prevent ratepayers from bearing any risk of utility diversification and to prohibit cross-subsidies between regulated and nonregulated subsidiaries....” NASUCA Resolution 1996-04, *Urging the Congress and Federal Agencies to Address Market Power as a Component of Any Federal Restructuring Action.*

The Enron debacle and its aftermath reveals the recurring tendency of holding companies in financial trouble to look to regulated affiliates as a source of credit, cash, or other resources, all at the expense of captive utility consumers. The bill would eliminate current PUHCA ownership restrictions on non geographically contiguous utilities, would limit state and federal regulatory agency access to books and records of the holding company to the costs of regulated entities, would require a showing of necessity for regulators to examine holding company books, and could make much information regarding holding company affiliate transactions, obtained in regulatory proceedings, confidential. PUHCA remains an essential consumer protection which should be vigilantly enforced, not repealed. A copy of NASUCA’s resolution on PUHCA is attached.

## **FERC Merger Review Authority Should Not be Repealed.**

Section 7101 of the bill would repeal Section 203 of the Federal Power Act, which includes FERC review of proposed utility mergers. The rationale for the repeal is that review of a merger of electricity utilities is performed by other agencies and that any further review by FERC would be redundant. FERC review of mergers of electricity utilities under its jurisdiction should be preserved. There is a growing understanding that the nature of electricity and evolving electricity markets may permit the subtle exercise of market power, without overt collusion, even by entities with market shares typically allowed by regulators in other industries. Many of the benefits projected by FERC in its efforts to create broader geographic markets for electricity, at significant expense, rest upon the assumption that flaws in existing markets will be mitigated if buyers can find more sellers in the expanded trading areas. If, however, industry consolidation is allowed to occur simultaneously with costly expansions to marketing areas, that goal may be frustrated if mergers result in a concentration and reappearance of market power. FERC should have continued authority to scrutinize and reject proposed electric industry mergers, under evolving standards for measuring market power in electricity markets, and Section 203 of the FPA should not be repealed.

## **Reliability**

Subtitle C of the bill addresses the issue of system reliability by allowing FERC to recognize a standards-setting Electric Reliability Organization. At the present time, reliability standards for the bulk electric grid system are set by a voluntary organization, the North American Electric Reliability Council. Placing the development and review of electric system reliability on firmer statutory ground has been supported by NASUCA as an independent measure in recent years. In 1998 NASUCA adopted the following resolution, in recognition that the cooperative and voluntary underpinnings of NERC standards

need strengthening, particularly in areas where competitive concerns may weaken traditional cooperation among utilities, and thus threaten reliability:

\* \* \* \* NASUCA supports efforts to develop a national reliability organization that will continue the vital functions now performed by NERC, and will do so in a manner that is competitively neutral and recognizes the paramount concerns of consumers in a reliable electric system;

\* \* \* \* NASUCA supports efforts to establish an independent Board of Directors that will govern NERC (or any successor national organization) in a competitively neutral manner that will benefit all consumers and that will not be dominated or controlled by any particular industry participant or segment;

\* \* \* \* NASUCA supports federal legislation that would clarify FERC authority to review the reliability requirements imposed by NERC (or any successor national organization) and to ensure that such requirements are adopted and implemented in a manner that benefits all consumers \* \* \* \* NASUCA Resolution 1998-07, *Urging the Establishment of an Independent Board to Govern Electric Reliability Matters and the Enactment of Federal Legislation to Ensure FERC Jurisdiction Over the Actions of Such a Board in the Future.*

The provisions in Section 7031 are consistent with NASUCA's position regarding reliability. Their inclusion, however, is not sufficient justification to enact any of the other remaining provisions of the electricity title of the proposed Energy Policy Act of 2003.

## **Conclusion**

In conclusion, the bill would allow large and unwarranted rate allowances for owners of existing electricity transmission lines and facilities under FERC jurisdiction. Ultimately these allowances will be translated into rate increases borne by end-use consumers unless the increased allowances are demonstrated to be cost effective. NASUCA has shown in the attached comments regarding FERC's pending transmission incentive proposals that the proposed ROE adders may cost \$13 billion, are unnecessary windfalls for utilities that have already done the acts intended to be induced, and are not likely to be cost effective.

The bill would eliminate longstanding protections of the Public Utility Holding Company Act (PUHCA) intended to protect consumers from utility holding company abuses, and would eliminate existing authority of FERC to review proposed utility mergers. In light of recent instances of energy market manipulation, holding company abuses, and the possibility of further industry consolidation in the aftermath of major losses incurred by energy generation and trading companies, it is clear the consumers need continued, not less, protection from the exercise of market power in the electricity markets under FERC jurisdiction. For these reasons, NASUCA has concluded that passage of the Electricity title of this bill is not in the interests of utility consumers. NASUCA therefore urges that the electricity title be eliminated.

I want to thank Chairman Barton and the subcommittee again for permitting me to share NASUCA's views on these important issues. I would be happy to answer any questions you may have at this time.

**Attachments To**

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- 1. NASUCA Comments in *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid* , FERC Docket No. PL03-1-000.**
- 2. NASUCA Resolution 1996-04, *Urging the Congress and Federal Agencies to Address Market Power as a Component of Any Federal Restructuring Action.***
- 3. NASUCA Resolution 1998-07, *Urging the Establishment of an Independent Board to Govern Electric Reliability Matters and the Enactment of Federal Legislation to Ensure FERC Jurisdiction Over the Actions of Such a Board in the Future.***