

Statement of

Mark Mazur

Acting Director, Office of Policy

U.S. Department of Energy

before the

Subcommittee on Energy and Power

Committee on Commerce

United States House of Representatives

May 13, 1999

Summary of Testimony
Mark Mazur
Acting Director, Office of Policy
U.S. Department of Energy
before the
Subcommittee on Energy and Power
Committee on Commerce
U.S. House of Representatives
May 13, 1999

Comprehensive Electricity Restructuring Legislation – The Administration supports congressional enactment of comprehensive electricity restructuring legislation. Electricity restructuring and retail competition will: (1) lower electric rates, (2) make American businesses more competitive, (3) spur the innovation of new products and services and (4) reduce the emissions of traditional air pollutants and greenhouse gases.

Need for Federal Action – Federal legislation is essential to complement and maximize the efficiencies associated with restructuring efforts at the state level. On April 15, 1999, the Administration submitted its proposed restructuring legislation – the Comprehensive Electricity Competition Act – to Congress. This legislation touches on a variety of issues which we believe can only be properly addressed at the Federal level.

Role of Federal Utilities After Restructuring – The four power marketing administrations (PMAs) and the Tennessee Valley Authority (TVA) have played an important role, and continue to do so, in providing affordable electricity to certain areas of the country. However, there are certain barriers that make it difficult for retail competition to flourish in the regions served by the PMAs and TVA that can only be addressed in Federal legislation.

Power Marketing Administrations – One of the primary concepts behind the Administration's approach on restructuring is that all transmission facilities should be subject to similar requirements in order to provide for effective, efficient and reliable competitive markets. The three PMAs which own and operate transmission facilities are exempt from most of the provisions of the Federal Power Act. The Administration's bill proposes to subject the PMA transmission facilities to Federal Power Act review with certain minor exceptions to take into account other statutory and treaty obligations.

Tennessee Valley Authority – TVA is the sole supplier of power in the Tennessee Valley. The Administration's bill is designed to break down the barriers in the Tennessee Valley in order to allow other power suppliers to compete for customers. In addition, we also would subject TVA transmission facilities to Federal Power Act review with certain minor exceptions to take into account other statutory and treaty obligations.

Introduction

Good morning, Mr. Chairman and members of the Subcommittee. My name is Mark Mazur and I am the Acting Director of the Office of Policy at the Department of Energy. The Department welcomes the opportunity to testify today about the role of Federal utilities in competitive electric markets.

On April 15, Secretary Richardson transmitted the Clinton Administration's proposed Comprehensive Electricity Competition Act to the House and the Senate. This legislation contains the Administration's vision for a restructured electric industry. We believe that consumer choice and competition among power suppliers will (1) lower electricity rates, (2) make American businesses more competitive, (3) spur the innovation of new products and services and (4) reduce the emissions of traditional air pollutants and greenhouse gases.

Mr. Chairman, we are pleased that the Subcommittee on Energy and Power is holding hearings on electric restructuring. Twenty-one states either have implemented or are in the process of implementing restructuring programs. A number of other states are considering similar action. While the states are and should be leading the way on retail competition, Federal legislation is essential to complement the states' efforts and address those issues which can only be resolved by the Federal government. The Administration believes that restructuring legislation is needed sooner, rather than later, and we want to work with you and the members of your Committee on a bipartisan basis to get the job done. I understand that Secretary Richardson will be testifying on the Administration's proposal, as a whole, at a later time. I will limit my testimony today to the Department's views on the role of Federal utilities in a restructured

environment.

The four Federal Power Marketing Administrations (PMAs) – the Bonneville Power Administration (BPA), the Western Area Power Administration (WAPA), the Southwestern Power Administration (SWPA) and the Southeastern Power Administration (SEPA) – which are subject to Department of Energy oversight, and the Tennessee Valley Authority (TVA), which is generally self regulated, will continue to perform their important functions, even after restructuring. However, the Administration supports certain statutory changes to allow for competition to properly develop in the regions served by TVA and the PMAs.

After providing some brief background information on the PMAs and TVA, my testimony will focus on the regulatory changes which the Administration believes are necessary to ensure that Federally-owned transmission facilities promote competitive markets. Thereafter, the testimony will provide the Administration's views on the role of the PMAs and TVA in the sale of power subsequent to industry restructuring.

Background

Bonneville

The Bonneville Power Administration markets wholesale¹ electrical power and operates and markets transmission services in the Pacific Northwest. The power comes from 29 Federal dams, one non-federal nuclear plant, and various renewable resources. BPA serves a 300,000 square mile area including Oregon, Washington, Idaho, Western Montana, and parts of Northern California, Nevada, Utah, and Wyoming. In addition, Bonneville's transmission system exceeds

¹BPA also sells retail power to 15 Direct Service Industrial (DSI) customers as provided by statute. 16 U.S.C. 839c(d)(2)(A).

15,000 circuit miles, provides more than three-fourths of the region's high-voltage transmission capacity, and includes major transmission links with Canada and other regions within the United States.

Bonneville's rates currently are developed through a formal regional process pursuant to certain ratemaking standards and filed with the Federal Energy Regulatory Commission (FERC) for approval or remand under those standards. One of BPA's primary duties is to establish power and transmission rates to repay "the Federal investment in the Federal Columbia River Power System over a reasonable number of years after first meeting the Administrator's other costs."² These other costs include (1) amounts attributable to efforts to mitigate harm to and enhance fish and wildlife populations in the Columbia River Basin (BPA has pledged to spend over \$400 million annually on this effort) and (2) over \$7 billion in Washington Public Power Supply System and other Bonneville-backed debt. At the end of FY 1998, Bonneville's outstanding Treasury repayment obligations was approximately \$6.6 billion.

Bonneville is obligated by statute to sell power to the preference customers – public bodies and electric cooperatives -- as well as the residential and small farm customers of investor-owned utilities in the Pacific Northwest. BPA also has been selling power to the DSIs, primarily aluminum companies, in the Northwest. BPA may also sell surplus outside the region at market prices.

²16 U.S.C. 839e(a)(2)(A).

Other PMAs

The remaining three power marketing administrations all market power generated at dams constructed pursuant to the Reclamation Acts and the Flood Control Act of 1944. WAPA markets approximately 10,000 MW of hydro power capacity from Federal dams located in the Colorado, Missouri and California's Central Valley River basins to parts of 15 states. WAPA also owns and operates transmission lines over 16,000 miles across the West. SWPA markets 2,000 MW of capacity from Federal dams located in Oklahoma, Arkansas, Missouri and Texas to parts of six states and also owns and operates almost 1,400 miles of transmission. SEPA markets a little more than 3,000 MW of capacity from dams located throughout the Southeast to customers in parts of nine states. SEPA owns no transmission facilities.

As marketers of Federal power, WAPA, SWPA and SEPA must satisfy certain statutory and regulatory requirements. They must give a preference in the sale of power to municipalities and other public bodies or agencies, and to electric cooperatives. Once the appropriate Administrator develops power or transmission rates consistent with governing statutes and regulations, the Secretary approves the rates on an interim basis, and FERC conducts a review of the rates to determine whether they are the lowest possible to customers consistent with sound business principles and whether the revenues generated by the rates are sufficient to recover the costs of producing or transmitting the electric energy and to pay back a significant portion of the Federal investment in the dams which provide the hydro power.

Tennessee Valley Authority

The TVA Act of 1933 requires TVA to provide electric power, flood control, navigational control, agricultural and industrial development and other services to virtually all of Tennessee

and parts of six surrounding states. In 1959 Congress amended the TVA Act to create the so-called “TVA fence” by limiting TVA to sales of electricity to its own wholesale requirements customers and certain industrial retail customers inside its service territory and to short-term economy exchanges with the fourteen surrounding utilities with whom it already did business. While TVA’s power sales outside the TVA region are limited, contractual arrangements between TVA and its distribution customers and certain provisions in the Federal Power Act essentially restrict other utilities from selling power in the TVA region.

TVA owns 28,000 MW of generation capacity³ and owns and controls 17,000 miles of transmission in the TVA region and supplies power to 159 municipal and cooperative retail distributors in its service territory. Unlike the PMAs, TVA meets all of the power needs of the region it serves. The distributors purchase power pursuant to contracts that require the distributors to acquire all their power from TVA. These contracts also give TVA the right to set retail rates and a number contain ten-year notice provisions for termination. TVA also sells power directly to 68 large industrial and Federal customers.

TVA is governed by a three member board of directors, appointed by the President and confirmed by the Senate. TVA is not subject to either Federal or State regulatory commission jurisdiction, except to limited Federal Power Act review for energy transmitted through the TVA service territory but not consumed inside the territory. In addition, TVA, as a Federal agency, is exempt from the antitrust laws.

³TVA’s generation mix is approximately 11% hydroelectric, 28% nuclear and 61% fossil fuel.

Transmission

The Administration believes that one of the most critical elements of competitive wholesale and retail electric markets is an open, efficient and reliable interstate transmission system. Under current law, most cooperative and municipal utilities, as well as TVA and the PMAs, are exempt from most Federal Power Act regulation of transmission services. Although the reciprocity provisions of FERC Order No. 888 address, to some extent, non-jurisdictional transmission entities, we believe it is preferable that transmission services provided by all utilities, whether publicly or privately owned, are subject to similar rules and requirements.

The Administration's proposed comprehensive electricity competition legislation would subject transmission facilities owned by municipal, cooperative and all Federal utilities, including the PMAs⁴ and TVA to Federal Power Act review. In addition, we also would authorize FERC to require these utilities to turn over operational control of these transmission facilities to an independent regional system operator in order to ensure that competitive markets adequately develop and flourish. For example, Bonneville owns 75 percent of all the high voltage transmission lines in the Pacific Northwest. If access to BPA's transmission facilities is not provided to competitors on a nondiscriminatory basis and efficiently priced, competition can not adequately develop in the Northwest.

The Administration's proposed legislation does, however, recognize that the unique structure of the Federal utilities requires slightly different regulatory treatment than that accorded

⁴Since the Southeastern Power Administration does not own transmission facilities, the provisions of the Administration's legislation regarding transmission do not apply to SEPA.

other utilities. For instance, TVA and the PMAs are obligated by statute to recover a sufficient amount in rates to offset their related costs, including debt repayment. Our proposal would require FERC, in setting transmission rates for TVA and the PMAs, to ensure that amounts collected are sufficient to cover transmission costs. In addition, the PMAs operate within a variety of other statutory and regulatory requirements. For example, operations of dams may reflect environmental concerns that could impact transmission services. The Administration's legislation would require FERC to take these constraints into account in regulating the rates for transmission services.

We also believe it is important to recognize that the standards pursuant to which Bonneville and the other PMAs have been setting transmission rates differ with Federal Power Act standards. It is possible that some PMA customers will see higher transmission costs and some will have their costs reduced under the revised regulatory system. Consistent with FERC practice, we believe that increases should be phased in over a reasonable period if implementing them all at once would be problematic.

Bonneville and, to a lesser extent, the other PMAs, are also faced with the problem of having to pay the costs of future fish and wildlife remediation programs associated with the Federal dams. These costs are generally recovered as part of the power rates charged by the PMAs and, under most estimates of future market conditions, the PMAs are expected to be able to recoup all of their generation costs in power rates. However, if market rates are equal to or are less than PMA cost-based rates, an alternative cost recovery mechanism would be needed to avoid shifting the responsibility for payment of these costs to the United States Treasury. The Administration has proposed that FERC be given the authority to approve a limited transmission

surcharge mechanism and that surcharge would be applied on a competitively neutral basis to the extent BPA and the other PMAs are unable to recover sufficient amounts in generation rates to pay all the costs attributable to the power side of operations. This surcharge would be treated as a loan from customers which would be paid back when power costs fall below market rates.

Power Sales

PMA Preference Power

Although the rates for most power sales will be established by the market subsequent to restructuring, there will still be a role for cost-based preference power. Preference power has helped to provide affordable electricity to developing areas of America. While we expect the benefits of competition to reach all regions of the country, the Department is concerned that a sudden shift from cost-based to market-based ratemaking for PMA power could have a deleterious effect on consumers in the regions served by the PMAs.

In addition, the amount of power sold by WAPA, SWPA and SEPA in comparison to total power sales in the regions they serve is negligible and will not impact competition. While Bonneville's role in the Northwest power market is much more substantial, the fact is that the BPA's resources are finite. As electricity demand in the region continues to grow, the role of new suppliers will increase and competition should flourish, especially if the Administration's proposed legislative changes to the Bonneville transmission system are made.

Mr. Chairman, some critics contend that the preference customers of the PMAs will have an unfair advantage in a competitive marketplace because they will be able to take the relatively low-priced power they receive from the PMAs and turn around and sell it in the competitive marketplace. However, there are both legal and contractual restrictions that prevent a preference

power customer from reselling power generated at a Federal dam to a consumer located outside of the preference power customer's service territory. The Department intends to continue to be vigilant to ensure that the use of preference power adheres to legislative and contractual requirements.

TVA's Power Sales Activities

Certain provisions of TVA's contracts with the municipal and cooperative distributors and Federal law can act as barriers to competition. Even if the states and the municipal and cooperative utilities were to provide their consumers the opportunity to choose among competing power suppliers, these barriers could prevent meaningful competition from occurring. As a result, the Administration's comprehensive electricity restructuring legislation includes several provisions designed to break down these barriers to allow for vigorous competition to take place in the Tennessee Valley. These provisions draw heavily on the work of the Tennessee Valley Electric System Advisory Committee, which was commissioned by the Department in November 1997 to provide advice through a regional consensus building process.

Consistent with the target date for retail competition of January 1, 2003, the Administration's bill would remove the statutory and contractual obstacles that currently prevent other utilities from selling power in the Tennessee Valley. We have proposed that the Federal Power Act be amended to provide FERC with the authority to order TVA to provide transmission access to generators and marketers seeking to sell power inside the TVA region. In addition, TVA would be required to renegotiate its existing full-requirements contracts with its distributor customers within one year of the date of enactment in order to allow the distributors to purchase power from other sources after January 1, 2003, and to shorten the contract terms.

Because TVA can expect to lose some load as a result of these changes, the Administration also is proposing that TVA be permitted to mitigate its stranded costs through power sales outside the TVA region. To the extent TVA is not able to fully mitigate its stranded costs with power sales outside the region, FERC would be authorized to permit TVA to recover its stranded costs from departing customers until October 1, 2007.

The Administration recognizes that some are opposed to allowing TVA to acquire new customers by selling power outside the TVA region. We believe, however, that it is important that TVA be permitted to mitigate stranded costs by selling excess power and capacity. Our proposal contains several important restrictions on TVA's ability to compete for customers outside the Tennessee Valley. First, TVA would not be able to add new capacity to serve customers outside of the Tennessee Valley because the TVA Act only authorizes TVA to build new capacity to meet the power needs of the Tennessee Valley. In addition, TVA would, for the first time, be subjected to injunctive penalties under the antitrust laws in order to help level the playing field between TVA and potential competitors. Furthermore, TVA would be prohibited from competing for retail customers outside of the TVA region. In this regard, we believe the proposed legislation appropriately balances the concerns of TVA and other market participants, while promoting a competitive market in the TVA region and in other regions of the country.

Conclusion

Mr. Chairman, we believe that our approach, as outlined in the Administration's proposed legislation, goes a long way toward providing a competitive environment in the areas served by the Federal utilities that is appropriate for the 21st century. I would be glad to answer any questions which you or the other Committee members may have.