

Testimony

Testimony of
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 Before the
 Committee on Governmental Affairs
 United States Senate

June 20, 2001

Introduction

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Good morning. I thank Senator Lieberman and the members of this Committee for holding this timely and important hearing and for inviting me to testify.

As Washington's Attorney General, I have several roles relevant to the subject of this hearing.

I am here because this is an issue which has deeply impacted the citizens of my state and its economy and I am very concerned that we, and other western states, have been the victims of unlawful antitrust or unfair business practices.

My Office also has a statutory role as "Public Counsel" -- an advocate for consumers and small business utility ratepayers in regulatory proceedings before the Washington Utilities and Transportation Commission and in disputes with the federal government. As such, we have already submitted comments to the Federal Energy Regulatory Commission (FERC) in response to its April 26 Order.

My Office is a public advocate for the environment, and we monitor the delicate balance between our natural resources and our state's energy needs.

Finally, we provide counsel to Washington's Utilities and Transportation Commission. That Commission also filed comments before FERC in response to its April 26 Order and in numerous other proceedings.

This morning, I speak to you in all of these capacities. And I

speak as well for my colleagues in California and Oregon who have joined me in the multistate law enforcement investigation that I will describe shortly.

The Impact Of The Energy Crisis On The West

This is a west-wide crisis, and I am happy to see that, after months of extraordinarily high prices in the west-wide wholesale market, FERC has recognized it as such.

Why are the Attorneys General of Washington, Oregon, and California working together to investigate this market? The phenomena in the wholesale market since June 2000 do not appear to be the function of natural market forces, and this energy crisis has severely impacted the citizens of our states.

This crisis is not just about legal proceedings and economic theory. It is about real people in the Pacific Northwest who have been adversely impacted in a variety of ways. What impact have these problems had on the people of Washington?

Our utilities, especially our publicly-owned utilities, have paid hundreds of millions of dollars for power. For example, Seattle City Light has paid \$312 million to buy power on the open market in the last year, compared to a normal year in which it spends \$50 million. Seattle consumers' rates were raised by 42% since January, and they expect another rate increase in October of up to 22%. Snohomish County Public Utility District (serving the Everett area) went through its entire \$30 million reserve fund within one week and also had to increase rates 35%, with more increases expected in the fall. Both of these utilities had to issue new bonds to cover this unexpected debt.

These increased costs reverberate through the economy and society. Schools must divert funds from needed educational programs to purchase power, and we have idled or shutdown major industries. Georgia-Pacific shut down its Bellingham plant and idled 420 workers, citing power costs as a reason. Because prices have been so high, it is cheaper for the Bonneville Power Administration to buy back power from its aluminum company customers than to serve them.

And we are experiencing these results despite Herculean efforts

on the part of our utilities and public officials to promote energy efficiency. In Washington, Governor Locke and the Commissioners of our Utilities and Transportation Commission have been taking a leadership role in asking our citizens and businesses to implement energy efficiency measures. Washington State has a strong conservation ethic, and we would like that ethic to be a national one. It can reduce the demand for electricity and thereby cut costs to help the economy. And it will help the environment in the process.

The Multistate Antitrust Investigation

The Attorneys General of California, Washington and Oregon have launched a multistate law enforcement investigation into the causes of the exorbitant prices charged to companies and public utilities serving west coast consumers.

What raises our concerns? In the past year we have seen:

Wholesale market rates for a kilowatt-hour of electricity skyrocket from \$30 to \$300, even up to \$3,000 at times during the past year. What caused these sudden, massive price hikes? Was it natural market forces or some form of unfair business practice or collusive activity?

Sudden, unplanned maintenance outages at generating plants in California, to the point where 40% or more of the generation capacity has been consistently offline, compared to historical averages of under 10%. What caused so many competing generating plants to suddenly go offline at the same time? Was it due to valid maintenance problems or some concerted effort to reduce capacity?

Prices remaining high 24 hours a day, even though power is being purchased for offpeak hours. Why can prices stay so high when demand is reduced? Is it a normal market response, or due to some agreement not to lower prices?

Transmission capacity restraints during crucial times, further exacerbating high prices and availability of power. What caused these constraints? Were the companies exchanging confidential data in a joint effort to create transmission problems?

Suspicious activity in the California natural gas market, including claims that companies may have collusively agreed to suppress construction projects, or may have engaged in other practices designed to favor their affiliates. Were these problems the result

of collusion or attempts to monopolize the pipeline market?

Together, the Attorneys General are seeking an explanation for why these things occurred. If we find evidence of violations of the state or federal antitrust, unfair business practices, or criminal laws, we will take the companies, and any culpable individuals, to court and seek the maximum penalties. In Washington, we would ask for monetary payments from the power companies and the maximum amount of civil penalties allowable by law, which in Washington state is a half million dollars per company per violation and one hundred thousand dollars per person per violation. In California, a criminal grand jury is also being convened in early July to determine if criminal activity took place. That grand jury will be exploring state RICO or other criminal violations, including false claims under California law.

Let me note something else about our investigation. We have received tremendous cooperation from our local utilities, the California ISO, and relevant trade organizations. In sharp contrast, we are having difficulty getting access to the power generators' records. California issued civil investigative demands (CIDs) in February. It is now June, and the states still do not have the documents we need. The companies objected to turning over most of their documents, and they refused to authorize other Attorneys General to look at their records. The Attorney General of California was forced to go to court to seek an order directing the companies to turn over the documents. We await the court's order. The companies also refused to let the California Attorney General share the documents with other state agencies, despite his statutory right to do so. These companies apparently did not want the states to work together on the investigation and didn't even want California agencies to work together.

So, Oregon and Washington have issued separate CIDs for these records, and we will go to court in Washington State if necessary to enforce our subpoenas. Some of the generators are still resisting. They insist that have not done anything wrong, yet they won't cooperate. Incredibly, some claim there is no relationship between anything they may have done in California and the prices of energy the Pacific Northwest utilities paid on the open market, or that we don't have authority to investigate! Clearly these companies are willing to

deny the very fact that our western energy market is interrelated, something everyone else in the country acknowledges.

One of the generators, Duke, at its request, came to visit both me and Oregon Attorney General Myers in our respective offices a week before we issued our CIDs. At that meeting the attorney pledged cooperation and purported to speak on Duke's behalf. Only a few days later, he sent letters to Attorney General Myers and to me saying he could not even accept service on his clients behalf! This is consistent with Duke's tactics with Attorney General Lockyer. In California, Duke proposed a settlement with California's governor, to try to resolve the dispute. However, Duke specifically conditioned the meeting on the General Lockyer ending his antitrust investigation. General Lockyer refused.

Two other generators, Reliant and Mirant, were also served with CIDs. When first contacted by my staff for its response, Reliant's attorney first told us he couldn't even talk to us. When we finally got through to someone who would talk to us, he said Reliant's business has nothing to do with Washington, even though he admitted they make sales to our purchasers. Similarly, Mirant is also contesting our ability to investigate.

We find these representations and tactics incredible and will be asking a judge to order compliance if the companies refuse to cooperate. The companies assert that they want to be cooperative, but actions speak louder than words.

Additionally, all three states will be issuing requests to important traders, such as Enron, very soon. We hope that we can get assurances of their cooperation up front. However, we are also aware that Enron tried to walk away from some of its long term contracts with California purchasers and the Attorney General was forced to bring an action to achieve relief.

My question for the companies is: What do you have to hide? If you haven't done anything wrong, let us see your records on an unconditional basis, in a way that's responsive to our questions. Let's get what happened out in the open.

At the same time that we are pursuing our antitrust investigation; however, we are also realistic. Unfortunately, such law enforcement investigations often take months, if not years, to complete, and it only works in the generators' favor to

delay matters further. This power crisis began in June of 2000, and the western states have suffered tremendous harm. Yet, it is unlikely that we can achieve a remedy through the courts under the antitrust laws anytime soon. (For example it took us four years to investigate and litigate the *Tobacco* lawsuit; it took us seventeen to sue and settle with the oil companies in the *Petroleum Products* case.)

Furthermore, the antitrust and unfair business practices laws do not address every kind of market manipulation. Thus, reliance on those laws and remedies to quickly solve the problems created by this crisis may not be satisfactory. There's also a chance that we could investigate and find that what the companies did was reprehensible, but not illegal under the antitrust laws. Nevertheless, we will diligently pursue this matter on behalf of our citizens and we will do so until we are satisfied that we know the truth. In the meantime, we will also pursue every other available remedy allowed under state or federal law.

Protecting Ratepayers – FERC's Obligation

Let me now turn to my role as Public Counsel for the ratepayers of the Washington State. The energy issues facing the Congress and FERC are complex. But amidst the complexities is a simple, straightforward principle: FERC has a statutory duty to ensure that rates in the wholesale market are "just and reasonable." Historically, "just and reasonable" rates were ensured by setting rates based on costs. If the seller's costs increased, then FERC authorized higher rates; if costs decreased, then FERC required (and was obligated to require) lower rates.

In recent years, FERC implemented "market-based" rates based upon a presumption that such rates would increase efficiency in the production of electricity and ultimately lower the cost of electricity to the consumer. FERC determined that market forces can provide ratepayer protection as well as cost-based rates. And if, as has been the case, the "market" does not ensure "just and reasonable" rates, then FERC has a statutory *duty* to either revert to cost-based pricing or to establish safeguards so that the "just and reasonable" standard is met. It may not, I submit, just sit on its hands and wait for the broken market to right itself.

Though FERC has failed to fulfill its statutory mandate in a

timely manner, on Monday, it announced some action to impose protections in the west-wide market. It expanded the scope of its California price mitigation plan to the entire Western States Coordinating Council and to spot market sales of electricity 24 hours per day, 7 days per week--- not just during times of reserve emergencies. It also extended the "must-offer" provisions of its mitigation plan to the WSCC but, importantly, continued its exemption for hydroelectric power. However, we need to analyze this Order carefully over the next week. With the permission of the Committee I request some reasonable time to submit supplemental written comments.

For today, my most important point is that the effectiveness of this Order must be monitored very carefully. I cannot say today whether the remedies it contains will or will not satisfy FERC's statutory duties to provide "just and reasonable" rates. If rates are not reasonable, then FERC must revise its remedies – immediately. Our consumers of electricity cannot afford further delays in obtaining just and reasonable rates to which they are entitled. Our economy, and our environment, should not suffer further.

So, this Committee must look ahead to implementation of this Order over the next weeks and months, and also ahead to the market beyond the life of this Order – after summer 2002. In the past decade, FERC's role has shifted from a setter of rates to an enforcer of marketplace rules. As we know from other federal and state agencies that enforce marketplace rules, this is a resource-intensive task, and this Committee should make sure FERC has the necessary resources to do the job.

In addition to looking ahead, this Committee must look backward as well. The availability of refunds for certain sales to California with no provision for refunds on similar sales outside of California seems like a legal anomaly that should be resolved. I look forward to hearing from the Commissioners of FERC on this point and hope the Committee does as well. Because FERC has recognized this as a west-wide problem, Consumers west-wide must be made whole. That is the thrust of our multistate law enforcement investigation, and it should be the work of FERC as well. And because such law enforcement cases often take years, I urge FERC to ensure that past market injustices are remedied for all customers throughout the west.

In summary, let me encourage this Committee in its oversight role to:

- × Monitor carefully the implementation of FERC's Order. Judge its effectiveness by FERC's statutory duty – to ensure just and reasonable rates.
- × Ensure FERC has the resources and guidance to monitor and investigate rates that may be unreasonable, to enforce its Order and any subsequent orders designed to make markets work, and to provide refunds to make all consumers whole.
- × Make sure that there is a long-term solution to our energy problems. This Order expires in summer 2002. We need to ensure that the energy policy at that time will ensure just and reasonable rates.

Protection of Our Environment

In addition to protecting ratepayers, FERC must be vigilant to make sure that energy efficiency and protection of the environment are essential parts of any solution, both long-term and short-term.

Because of some unique factors in the Northwest, the high cost of power impacts sectors of the economy in other ways. Washington, like other northwest states, is uniquely dependent on hydroelectric power. Approximately 80% of Washington locally generated power is from hydropower. In a normal rain year, supplying our local needs would not be a problem. But this year, we are experiencing a water shortage; a drought. Rainfall is the lowest in 20 years. The combination of low rainfall and earlier than normal snow melt mean that we may face critical shortages in the late summer and early fall.

The high cost of power has placed additional demands on the Columbia River system to generate power, sometimes to the detriment of the competing demands for that water. Irrigators, industries, and cities have had to live with less this year, with disproportionate impacts on our agricultural communities.

And, of course, one cannot discuss the Columbia River without discussing fish. Salmon are a critically important part of native

ecosystems and the culture of Washington State, especially to the Native Americans, whose culture and economy are strongly connected to the salmon.

But our salmon are in real trouble. The American Fisheries Society has identified 214 native naturally spawning pacific salmon in western states that are at serious risk -- 67 of these stocks are in the Columbia and Snake River Basin. The continued survival of these salmon is inextricably linked to the hydroelectric power system.

Under the best of circumstances, the operation of the Columbia River power system exacts a significant toll on the salmon. Water used for electric generation has a major impact on fish mortality. In the absence of less harmful alternatives, we are left to balance the utility of the system against the harm to the species. We, as a state and a nation, adopt laws, such as the Endangered Species Act, that are reflective of the balances we have struck.

As our hydro system is stretched for every available kilowatt, the salmon in the Columbia River face increasing challenges. These challenges implicate state and federal legal obligations under laws such as the Endangered Species Act, test the balances that we have reached, and challenge the veracity of the information we relied upon in reaching those balances. We in Washington State are stepping up our efforts to conserve energy and protect salmon. At the same time, we must be assured that the harms the hydropower system already imposes on salmon are not exacerbated by artificially driven manipulations of flow and power generation.

So, I want to remind this Committee that these issues, these "antitrust" and "FERC issues," are not just about legalities and about economic theories of competition. They implicate the day-to-day lives of our citizens, our businesses, our schools, and our environment. As we move forward, we must keep these interests -- truly the public interest in the broad sense of the word -- in mind.

Conclusion

This energy crisis has had a tremendous impact on my state's citizens, businesses, economy, and environment. It is a west-wide problem. Although we will continue with our law enforcement review, FERC is uniquely situated to continue to

look at this energy market and provide appropriate remedies. We ask this Committee to make sure that, in the end, FERC fulfills its mandate that energy rates be "just and reasonable."

Thank you again for the opportunity to appear before this Committee.

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