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Testimony

**TESTIMONY OF ROY HEMMINGWAY
CHAIRMAN, OREGON PUBLIC UTILITY COMMISSION
BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE**

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I appreciate the opportunity to offer my perspectives on the role of the Federal Energy Regulatory Commission (FERC) and, specifically, its response to the Western power crisis.

I am speaking here today in my role as Chairman of the Oregon Public Utility Commission, but I want to note that my views are shared by Governor Kitzhaber, who has taken leadership on these issues since last fall.

During the last year we have seen a national experiment in energy deregulation go drastically awry. The overseers of that experiment – The Federal Energy Regulatory Commission – have chosen to do little or nothing to avert the worst effects of this crisis. The results have been clear: one of the largest, oldest, most stable utilities in the nation driven to bankruptcy, utilities and governments shouldering massive debt to pay electricity bills, utilities and consumers throughout the West paying prices for electricity at many multiples of its cost of production, industries shut down because of high electricity prices, consumers having to go without the necessities of life, the environment being sacrificed for electricity production.

At the beginning, I want to make three points very clear. First, Oregon believes in competition and markets. Governmental regulation is a poor substitute for the natural regulatory mechanisms of the marketplace, when indeed there is a marketplace with competitive prices. Oregon has embarked on a gradual and flexible opening of retail markets for larger electricity customers, but even this approach is politically in trouble due to the chaos in the Western power market. While I speak, I do not know the fate of Oregon's restructuring effort in the Legislature, where there are significant efforts to delay or repeal the restructuring measure passed in 1999.

Second, Oregon believes in sending appropriate price signals to consumers. Utilities in Oregon and the Northwest have done just that, passing on the higher wholesale prices to retail customers. This crisis has not been brought about by the failure to pass on higher prices, and it will not be alleviated except at great cost by doing so. As a regulator, the thought of passing on to consumers unjust and unreasonable wholesale prices is a task that I do not relish.

Third, Oregon does believe that there is a shortage of electricity in the West. Until recently, the West had experienced a surplus of electricity for well over a decade, and utilities and others were reluctant to build plants in this surplus environment. Despite Oregon's rather easy-to-navigate siting laws, we had few applications until last year. As in California, siting applications and construction have now increased dramatically, starting before wholesale prices were allowed to skyrocket. In Oregon, we have 1,500 megawatts under construction, 3,000 more megawatts in the siting process, and many more in the planning stage. This is in a state with average usage of 5,500 megawatts today, and 10,000 megawatts peak usage.

Much of the shortage of electricity would not have occurred if we had had abundant rainfall in the Pacific Northwest. Since the Northwest hydroelectric system alone produces up to 4,000 average megawatts more electricity when there is abundant precipitation than on average, precipitation plays a great role in electricity planning. Government does not build power plants. It is utilities and competitive enterprises that do so, and they will not build if they believe that they will be selling into a surplus environment. The potential for several good hydro years in a row and a resulting surplus, as we had up until last year, creates a very uncertain climate for investors in power plants, which federal and state regulators must take into account. When we have a drought condition, as we have had this year, there will be shortages in the West, even under conditions where we have adequate generating plants and fuel to run them.

I say all this to emphasize that we who advocate federal intervention in the Western power markets have been doing our part to augment supplies since before this crisis began. We are not against market competition in the electricity business, and we are not advocating repeal of the laws of supply and demand. We are simply asking that the federal government undertake its usual and accustomed role in regulating electricity marketplaces when they are characterized by high prices and inadequate numbers of competitive suppliers

The Federal Power Act was passed in 1935 to give to what is now FERC the power to set "just and reasonable" rates in the wholesale electricity market. Regulation of retail sales was left to the states. The Federal Power Act and the subsequent Energy Policy Act of 1992 were designed to prevent those with monopoly power from enforcing unjust prices in a non-competitive market.

Since last winter, the three West Coast governors have called on FERC to impose under the Federal Power Act cost-plus pricing or some other form of temporary price controls in the Western wholesale power markets. The concern of the states then, as now, is that the extraordinary wholesale prices our utilities, and government agencies, such as the Bonneville Power Administration, are paying to a handful of power marketers are threatening our state economies, straining household budgets, putting people out of work, and causing general business slowdown.

We have been told by the FERC majority that serious temporary price controls would not be imposed for three reasons. All of these reasons fail in analysis.

First, we have been told that wholesale price controls will work against bringing increased supply to the market. When making this argument, FERC seems to confuse long-term supply with the immediate need in the Western power market. As I indicated, Oregon and the other Western states have been stimulating investments in new supply, as well as in energy efficiency. There is no way, however, that the amount of supply that would create a truly competitive market can be built in time to significantly temper the prices utilities have been paying in the wholesale market today. The lead time is too long. The first of the new generation under construction in Oregon will come on line next month, and that plant was started over two years ago. Not enough generation is likely to be able to be brought on line this summer to alleviate the real and contrived shortages in the Western market. The high prices supported by FERC are simply not needed to stimulate investment in new generation.

Theoretically, high wholesale prices should stimulate suppliers in the short term to bring on generation that otherwise would not come to market. However, the prices necessary to support bringing on such generation at a profit are small percentages of the prices that have obtained in the Western power market in the last year. In truth, the unfettered wholesale market favored by FERC has done little to increase supply. Over the last year, the California market in particular has been characterized by record levels of plant outages, despite stratospheric prices. How can anyone believe that these prices are stimulating supplies to be brought to the market when these plant outage rates prove otherwise? Instead, the high prices have had a perverse effect: owners of generation do not need to bring new supplies to the market in order to make record profits, which almost all of the energy suppliers in California have done. Without colluding, the energy suppliers can figure out that not bringing every kilowatt to the market will boost prices and create profits. Only as power prices have declined have we seen lower plant outage rates. Have these price declines been due to mild weather and market restructuring by the State of California? Or have they occurred because there has been a political shift of power in the nation's capital? Only further analysis will tell.

High prices can reflect scarcity of a good or they can reflect sheer market power by a few sellers. We do not need to decide which has caused the current crisis – I believe that they both have. The shortage has given incentive to suppliers not to have all their supplies ready to bring to market. Temporary price controls can eliminate incentive for the owners of existing generation to withhold supply from the market to maximize profits, while still giving all owners of generation a fair, if not handsome, return on investment.

Second, we have been told that temporary price controls will eliminate incentive to reduce demand. Prices at small fractions of what they have been in the Western market will work to reduce demand. In addition, when wholesale prices come closer to the real costs of new power supplies, consumers will have greater faith that these prices are here to stay and will make the investments necessary to reduce demand. But again, as with new power plants, new investments in energy efficiency take time. In Oregon, we are gearing up the programs to make those investments. Ironically the political instability caused by the electricity market failure threatens Oregon's source of funds to carry out energy efficiency investments, because they are tied to Oregon's own deregulation experiment now under political fire.

The Western electricity market crisis has produced the opposite of what is desirable for convincing consumers to make appropriate energy efficiency investments. Consumers need an understandable explanation for what is happening and what the future is likely to be. With all the talk about whether the crisis is real or contrived, permanent or temporary, consumers will not make those investments. Instead, we are left with short-term demand curtailments, which can be effected through governmental and utility action. This has largely been accomplished through shutting down energy-consuming business, slowing the economy in our states.

Third, we are told that wholesale price controls will not be temporary. But with new generation being built all over the West, a truly competitive marketplace may possibly not be far off. With a normal water year next winter in the Northwest, controls could come off by next summer. We seek rate stability until power supplies increase and functioning market conditions prevail, and no longer.

FERC's response to the Western power crisis has been slow and inadequate. The April order went further than before, but it did little to relieve utilities and consumers from the outrageous profits earned by the power suppliers. It created incentive for the suppliers to ensure that supply is tight enough for the least efficient plants to be called into service, ensuring high prices for everyone.

What FERC has wrought in the last year has brought misery to millions of households, business, and investors. For what purpose? To prove a point that uncontrolled markets will eventually bring about a balance of supply and demand, even if at enormous risk of chaos in the Western economy? FERC’s experiment has come at a cost that far exceeds its benefits now or at any time in the foreseeable future.

For 65 years, FERC and its predecessor the Federal Power Administration oversaw conditions that created a stable power market that brought electricity to utilities and consumers at affordable prices and rewarded investors with reasonable rates of return. FERC’s recent ideological devotion to free-market principles in a market that is anything but free and competitive has shattered the public’s faith in the federal government’s willingness and ability to ensure an adequate and affordable supply of power. FERC's actions threaten to bring a political end to appropriate deregulation initiatives around the country. This is a sad legacy, indeed, which I hope will be remedied as swiftly as possible by the Congress.

SUPPLEMENTAL TESTIMONY OF ROY HEMMINGWAY