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September 17, 2002

The Honorable Jeff Bingaman, Chairman
Committee on Energy and Natural Resources
United States Senate
SD-364 DSOB
Washington, DC 20510-6150

The Honorable Frank Murkowski, Ranking Member
Committee on Energy and Natural Resources
United States Senate
SD-364 DSOB
Washington, DC 20510-6150

Dear Senators Bingaman and Murkowski:

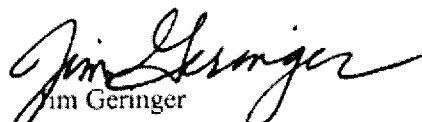
Thank you for scheduling today's oversight hearing on the Standard Market Design Rule (SMD) proposed by the Federal Energy Regulatory Commission (FERC). The hearing is timely and urgently needed. We have enclosed a statement from the Western Governors' Association concerning the SMD for the Committee's deliberations and record.

The sweeping changes envisioned in the proposal have not been adequately justified by FERC for the West as we work to recover from the energy crisis of 2000-2001.

FERC needs to work more closely with the states and other participants in the nation's regional electricity markets to develop both a better understanding of the problems we face and to partner on more practical solutions to those problems. We urge the Congress to direct FERC to take this approach.

Thank you again for conducting this important oversight function. Please contact either of us or the Western Governors' Association if you have any questions on our statement.

Sincerely,


Jim Geringer
Governor of Wyoming

Co-Lead Governor for Energy


John A. Krzhanetski, M.D.
Governor of Oregon

Co-Lead Governor for Energy

Enclosure

cc: Members of the Committee

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**Statement of the Western Governors' Association on the
Federal Energy Regulatory Commission's Proposed Standard Market Design
To the Senate Committee on Energy and Natural Resources
September 17, 2002**

Consistent with the policies of the Western Governors' Association, the following testimony is offered on the Federal Energy Regulatory Commission's proposed Standard Market Design (SMD) rule. We recommend that FERC delay the adoption of the SMD rule in the West. FERC has failed to provide adequate evidence to justify this proposal for the complex electricity problems of the West.

The West has been diligent in instituting changes needed to protect the region from a repeat of the ravages of the 2000-2001 Western electricity crisis – a crisis brought on by the combination of: a failed deregulation scheme in California, most of which was approved by FERC; robust demand growth and limited growth in generation; a severe drought limiting hydroelectric production; and delays by FERC in controlling market abuses. Specifically in the West:

- 12,000 MW of new generation has come on-line since January 2001 and 26,000 MW are under construction. (This compares with an installed capacity in the Western Interconnection of 169,000 MW.) Hydro generation has improved significantly since 2001.
- Demand is down, particularly in the Northwest and California;
- Significant experience has been gained in the structuring of demand response programs.
- A new reliability management organization, the Western Electricity Coordinating Council (WECC), has been put in place, and we urge Congress to do its part by enacting the reliability provisions passed by the Senate. The regional advisory bodies authorized in the Senate-passed bill can provide a vehicle for collective state participation in reliability and, potentially, related regional market decisions.
- A proactive regional transmission planning process has been initiated. Such proactive planning is a requisite for successful financing of new transmission.
- A protocol on collaborative permitting of interstate transmission lines has been signed by all the states in the Western Interconnection and, equally important, by the federal agencies (DOI, USDA, DOE, CEQ). It is believed that the protocol will help the West overcome the historic difficulty of securing necessary federal permits for transmission.
- Three Regional Transmission Associations (RTOs) have been proposed to FERC and are awaiting action review by the Commission. While these proposals are still in development, Western governors have supported the voluntary formation of RTOs where clear benefits to the affected regions are demonstrated.

We are pleased that FERC is finally paying attention to market monitoring, although as FERC has acknowledged the Commission lacks the tools to police the market and penalize market abuses.

FERC's proposed Standard Market Design (SMD) rule proposes significant changes in the electric power system in the West and a major effort by the Commission to expand its authority into areas of traditional state responsibility. Western states have differing views on the need for changes, but we agree on the following:

1. It is unfortunate that **FERC has not developed an empirical record of abuses in the West** that support the changes proposed in the SMD rule. For example, the proposed SMD rule provides only anecdotal examples of discrimination in transmission, but not a compilation of information to demonstrate its case, such as: number of complaints of discrimination by transmission owners; type of discrimination; number of megawatthours affected and cost to consumers; results of FERC investigations of discrimination complaints; and enforcement actions. The dearth of empirical evidence does not bolster the case for SMD in the Western Interconnection.¹
2. **FERC has not evaluated the impacts on consumers of the SMD proposal.** While FERC plans to do an EIS on the proposal, it did not undertake rigorous analysis of the impact of SMD (or for that matter on any substantively different alternative) before proposing the rule. Equally disturbing is that analyses FERC has relied on for its policy decisions have tended to be shallow and do not examine the Western Interconnection in adequate detail to support proposed policy changes.² FERC should significantly upgrade the quality of analysis it uses to make policy decisions and should conduct such analysis for each interconnection, not assume away important differences between the interconnections. These efforts should be completed and released for review and comment prior to any finalization or implementation of the SMD proposal or rule.
3. Prior to moving ahead with implementing SMD in the West, FERC, in cooperation with Western states, needs to **study whether SMD is feasible in the Western Interconnection if non-jurisdictional utilities**, such as municipal utilities, cooperatives, public utility districts, and federal power marketing administrations, which

¹ Some of the targets for reform in the SMD rule are not applicable in the Western Interconnection. For example, the SMD proposal specifically targets the practice of Transmission Loading Relief (TLR) as detrimental to ensuring nondiscriminatory transmission and efficient wholesale power markets. However, the SMD rule fails to note that TLRs are not used in the Western Interconnection.

² For example, FERC's RTO cost-benefit analysis is not rigorous. Key inputs to its modeling effort, such as expected improvement in generation efficiency from RTOs, are merely assumptions not backed-up by quantitative analysis. In the SMD proposal, FERC cites DOE's National Transmission Grid Study (NTGS) when concluding that more transmission is needed. However, the NTGS study says that its model, POEMS, does not represent physical flows over the transmission system and "...because it is national in scope, the model does not consider trade within subregions." Thus, POEMS does not even evaluate Path 15 between northern and southern California. FERC's own December 19, 2001 analysis of transmission constraints provides no detailed back-up information on the analysis.

operate a large percentage of all transmission in the West, **do not participate**. SMD should not be forced on only a limited portion of the transmission grid in the interconnections.

4. **FERC's SMD rule (and perhaps Western RTO proposals) will fail unless the federal government's power marketing administrations participate.** The PMAs must evaluate how the SMD will affect their customers and the economies of the regions they serve. The federal government needs to decide if, and under what conditions, the Bonneville Power Administration and Western Area Power Administration will abide by provisions of the SMD rule or a more applicable Western alternative and join proposed Western RTOs. Because of the major impacts BPA and WAPA have in the West, the federal government needs to consult with the states prior to deciding on the PMA's participation in Western RTOs.
5. FERC should specifically **set aside the Western Interconnection from its SMD rule and concentrate on working with the states to develop RTOs** that address the specific problems in the Western Interconnection. This process should begin with a well-defined and factually-supported statement of the problems in the Western Interconnection (which the western states have already started in the various inter-related efforts identified above). **FERC action on the pending Western RTO applications could serve as a basis for initiating such discussions between Western states and FERC.**
6. Any FERC action on SMD should be done on a region-by-region basis. In the West, **FERC has not made an adequate demonstration to date that would justify implementation of its SMD rule.**

Western Governors believe these areas of agreement across our region should form the basis of Congress' direction to FERC on how the Commission should address Standard Market Design.