Testimony of Lon L. Peters[1]
On Behalf of Washington Consumer-Owned Utilities

Public Generating Pool:
Cowlitz County PUD, Douglas County PUD,
Grant County PUD, Pend Oreille County PUD, and Seattle City Light
and
Snohomish County Public Utility District
Tacoma Power
Washington Public Utility Districts Association

Before the Northwest Energy Caucus Oversight Hearing on RTO West
March 12-13, 2002

My name is Lon L. Peters. I am a consulting economist located in Portland, Oregon. Today, I am appearing on behalf of a coalition of publicly-owned utilities in the state of Washington, ranging in size from Seattle City Light with 350,000 customers to Wahkiakum County PUD with 2,000 customers.[2] These utilities have worked together to sponsor this testimony.

BPA Should Not Join RTO West

These long-time participants in regional energy markets have come to the conclusion that the Bonneville Power Administration should not join a Regional Transmission Organization (RTO). There are several reasons for this conclusion, which I will explain further below.

1. The establishment of RTO West will create crippling amounts of uncertainty for several years, and risk the successes of the region's power industry.
2. The costs of RTO West are almost certain to outweigh the benefits to the region, when both are properly and completely calculated.
3. RTO West will spawn tremendous amounts of controversy in the region, at a time when we can least afford to waste efforts on such unproductive debates.
4. After the spillover from California's failed experiment in 2001, the Northwest cannot risk another economic shock to its electricity infrastructure, which is likely with yet another experiment in regulatory reform.
5. BPA and Northwest investor-owned utilities (IOUs) have not provided a demonstration that Northwest consumers or the Northwest economy will be better off due to the proposed RTO West.
6. The Northwest power industry already meets the broad objectives of national energy policy, including non-discriminatory transmission access.
7. The critical issues involved in the establishment of an RTO have been debated for years in the region, without any consensus emerging on solutions. Creating an RTO

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[2] A complete listing of the 23 members of the Washington Public Utility Districts Association is attached to this testimony.

will not make these issues any easier to address, but will create significant risks if the solutions chosen by the RTO fail.

8. Finally, the lights will not go out just because we don't have an RTO. Existing institutions can address problems as they arise, in a much more cost-effective and less risky manner.

RTO West Will Create Uncertainty and Increase Risk

As the Filing Utilities have struggled to find consensus within their group, the proposal for RTO West has become more and more complex, as exceptions and special rules are offered, and constantly revised, to address potential cost-shifts and other equity concerns. As much of this complexity is still conceptual, and thus even harder to understand, the details will be left to an unformed and unknown institution to decide at some later date. We simply don't know if any current transmission contract rights and cash-flows will be protected or ensured in the shift to the proposed RTO West system. Any assurances in these areas are entirely unreliable, given both the complexity of the structure and the risk that FERC will require a never-ending series of changes. We do know that RTO West will open the door to huge amounts of regulatory risk, caused by constant changes in the rules of the game and the likelihood of repeated interventions by FERC. We have good reason to believe that significant portions of the current pricing proposal will be rejected by FERC, or will not work as intended, and will cause massive cost shifts and more controversy as the pricing model is rebuilt, perhaps over and over. We do know that the Filing Utilities are already constructing "re-openers" on the congestion management proposal that will undermine what fragile compromises are promised and open the door to more uncertainty and controversy. We do know that similar institutions tend to have significant cost overruns and little, if any, accountability to the consumers who are ultimately paying the bills.

In addition, RTO West is likely to reduce, not enhance, reliability. A report from BPA's own consultant (Schweitzer Engineering Labs) states that "it could be a long time before RTOs, utilities, investment analysts, advisors, and FERC get everything figured out to the point where investors are again comfortable buying stock in utility transmission assets."[3] Of the 48 likely impacts of an RTO on reliability analyzed by Schweitzer, an RTO was found likely to reduce reliability in 36 cases and have no effect in seven more. In fact, RTOs get the worst scores in those areas where RTO proponents are often most vocal: building new transmission capacity and enhancing grid security. Furthermore, consolidation of control areas under an RTO would make it easier for a single catastrophic failure to bring down the entire system, unlike today, where multiple control areas provide security and protection against such widespread failures because the control area operators watch out for each other.

Uncertainty and risk will not support needed investments in transmission infrastructure; investors do not like regulatory uncertainty, and higher prices will be paid by consumers to compensate for these new risks.

[3] "Assessing the Reliability Impact of a Regional Transmission Organization (RTO)", February 22, 2002, page 5.

The Costs of RTO West Will Exceed the Benefits to the Northwest

Based on the information we have today, the cost-benefit ratio of RTO West for the region is almost certain to be negative, and perhaps astoundingly so: the costs to Northwest consumers will exceed the benefits. Instead, RTO West will most likely create both a small number of winners and a large number of losers, which will spark enduring and significant controversies.

The total estimated costs of setting up and operating RTO West are not yet available, but we have good reason to believe that whatever estimates are offered will be far too low. Already, the benchmarking analysis conducted by the consultants to RTO West suggests that the annual costs of RTO West (between $125 million and $145 million) are likely to be almost twice as high as previously thought. Remember what was promised in California: regulatory reform would significantly lower energy costs. In contrast, the surcharge alone on California customers due to the ISO now exceeds in some cases their payments for transmission service before the ISO was formed, and energy costs in California have skyrocketed beyond anyone's imagination. We should be extremely cautious about a Northwest experiment that runs exactly the same risks.

On the other hand, the promised benefits are largely illusory, or will flow primarily to interests outside the region. The analysis by consultants hired by RTO West suggests about $350 million in "benefits" to the Northwest. This sum is composed of about $250 million in "avoided congestion costs" and about $100 million in higher profits earned by owners of thermal generation plants in the region because they are shipping more energy out of the region. The first alleged benefit is simply a sham: consumers in the Northwest do not currently pay for transmission congestion in the amounts and methods estimated by the computer models, and so will not avoid these costs just because RTO West is formed. Even if consumers did pay the costs estimated by the computer, they would also receive rebates in equal amounts, because of the way power rates are normally set. Any reduction in these "congestion payments" due to RTO West would be completely offset by an equal reduction in the rebates, so consumers would be no better off in the end. The second alleged benefit will only redound to Northwest residents to the extent that they own the thermal generation units that are pumping more energy out of the region. To the extent that those plants are owned by individuals outside the Northwest, some (perhaps much) of the $100 million in higher profits will "leak out" of the region. Meanwhile, Northwest citizens will enjoy the regional and local environmental impacts of the extra thermal generation, 40 percent of which will apparently be coal-fired.[4]

Another major shortcoming in the cost-benefit analysis is that it does not address the risks of market power. Consumers in the Northwest will spend the next several years

[4] See "Final Report Presented to RTO West Filing Utilities - RTO West Benefit/Cost Study", March 5, 2002, TABORS CARAMANIS & ASSOCIATES, Table 6, p. 20. We have asked for the data to help identify who owns the thermal generation in the Northwest that is likely to be exported to California and Canada.

paying for the spillover of the costs of the California experiment, at least part of which involved the exercise of market power. It is hard to conceive of prices in the Northwest falling much from current levels; it is quite easy to believe that prices could spike again as they did in 2000 and 2001, taking huge amounts of income and wealth out of consumers' pockets. The proposals from RTO West to date have almost completely ignored the potential for the exercise of market power, especially in the area of congestion management. The formation of a "market monitor" will not be of much help, given the likelihood of a long lag between detection and consequence. Indeed, the need for a congestion management system and market monitors only reinforces our concern that the RTO's decisions will not avert energy and transmission shortages, and that prices will spike once again.

RTO West Will Spawn Endless Waves of Controversy

Despite the description of the RTO West process as "collaborative", the reality has been somewhat different, which does not bode well for the future. Last fall, the Filing Utilities decided that they were unable to gain consensus with other regional stakeholders on the resolution of the difficult issues, so they retreated, in some cases to locations outside the Northwest, to set up their own "collaborative". The result is a package of proposals that masks disagreements within the Filing Utility community: the RTO West white papers only become shorter and vaguer, the more effort is put into them. This is truly an example of "less is more": less collaboration, less certainty and less agreement up front, but more RTO autonomy, more uncertainty, and more controversy later on.

There is no clear base of support within the region for RTOs in general: opinions range from "FERC is making us do this", through lukewarm support combined with attempts to erect barriers against the costs and risks, to outright opposition. Even independent power suppliers have expressed concerns with significant parts of the current package. If RTO West is not responsive to Northwest interests, but merely a step toward a west-wide RTO, the controversies can only spread over time.

We urge you to look at the actions of the participants in this exercise, and not just to the promises on paper. If the Filing Utilities think this is such a good idea, why have they given themselves the right to retain existing contracts and convert to RTO service on a contract-by-contract basis? Why are BPA's customers pressing for a full ten-year "company rate period"? Could it be that they are (reasonably) concerned about costs being shifted to them? Why are BPA's utility customers signing up for 30 year transmission contracts, unless they believe that such contracts will provide protections against the RTO? Why have many of these customers pressed BPA to provide Scheduling Coordinator services that save them the trouble of doing business with RTO West? These are not ringing endorsements of an RTO, but clear attempts to avoid the significant downside risks. When these attempts fail, for example because the protection of pre-existing contract rights turns out to be another sham[5] or because FERC insists on changes, it is easy to imagine all of the parties flying back to Washington, D.C. to get Congressional attention, as happened in the West Coast energy crisis of 2000-01.

Existing Institutions Provide a Better Alternative than RTO West

Instead of a untested, expensive, risky, and disruptive RTO, institutions already exist to address the problems that inevitably arise in an interconnected power system. For example,

- NERC, the WSCC, control area operators and, more recently, the Pacific Northwest Security Coordinator have successfully addressed reliability issues through difficult events over the years;
- Congress could authorize funding for new transmission construction (e.g., additional BPA borrowing authority or a federal loan program), organized by existing systems of coordinated planning;
- business can be conducted under open-access tariffs that evolve to meet new needs;
- existing web-based computer systems can continue to reduce transactions costs, while meeting security needs;
- retail access programs (e.g., in Oregon) effectively send wholesale price signals directly to those individual end-users who seek out this option, without interference from existing transmission institutions; and
- business practices (e.g., interconnection rules and scheduling provisions) can continue to evolve toward greater standardization.

As a simple comparison, the current estimate of RTO West costs ($125-145 million per year) would be more than enough to amortize a billion dollars of new investments in transmission infrastructure. In most if not all cases, the claimed benefits of RTO West can be achieved through existing institutions without the costs and risks of the RTO, but with existing standards of accountability to regional citizens.[6]

[5] In BPA's current open-access tariff, the "contract" represents only three pages out of 137. The remainder would be subject to the RTO West "cataloging" process, with completely unknown effects.
[6] Again, BPA's own reliability consultant reached the same conclusion regarding "on-line voltage and dynamic security tools".

Conclusions

Experiments in regulatory policy have been known to fail, sometimes causing tremendous shifts in wealth and income with no discernable improvements in the performance of markets. (Recent examples are to be found in the drawers marked "California" and "Montana".) The formation of RTO West appears to fit an agenda promoted by extra-regional interests that would extract wealth and income from the region for the benefit of those extra-regional interests. The experiment called "RTO West" has the clear potential to have exactly the same effects. Too much is at risk:

- the reliability of our system may easily suffer;
- investments in needed infrastructure will undoubtedly be delayed;
- market power may be unleashed or institutionalized;
- uncertainty will definitely increase the cost of capital;
- costs will most likely be shifted and new costs will be incurred;
- benefits within the Northwest will be as scarce as hens' teeth.

Almost all Northwest consumers are currently paying significantly higher power bills because of the spillover of California's problems in 2000 and 2001. Unemployment rates in the Northwest are already higher than the national average. This is not a time to embark on yet another experiment that has the clear risk of triggering another increase in power costs, causing further damage to the regional economy.

National energy policy should not be allowed to dictate solutions that are plainly not in the interests of Northwest citizens. In its current form, the RTO West proposal will even not meet the primary goals of national energy policy. The Northwest delegation should inform the BPA Administrator that the interests of the Northwest are better served if the agency steps out of this newest experiment in regulatory change, does not participate in future filings by RTO West at FERC, and instead turns with its customers to addressing the most important objective of the region's energy industry: meeting the obligation to serve in the most reliable and economical manner.

Thank you.

Summary of the Likely Costs and Alleged Benefits of RTO West

Costs to Northwest Residents	
1. Set-up and operations of RTO West	$125 million to $145 million per year
2. New Scheduling Coordinators	Unknown cost
3. New metering requirements	Unknown cost
4. New liability policies	Liability coverage requirements at least $300 million; premium unknown
5. New creditworthiness standards	Unknown cost
6. Institutionalized market power	Unknown cost, but could be massive
7. New stranded costs	Unknown cost; depends on what commitments the RTO makes
8. Decreased reliability	Likely; see the Schweitzer report for BPA, which considered 48 impact areas, and rated 36 of them "negative"
9. Shift in costs from extra-regional payers	Easily $100 million, if the pricing model fails
10. Increased transmission line losses	Unknown, but exports are expected to increase by 1,000 aMW
11. Congestion management reserve fund	Unknown cost
12. Retention of Paying Agent	Unknown cost
13. New power and transmission exchanges	Unknown cost
14. Increase in regulating margin requirements	Unknown; maybe RTO West will avoid California's mistakes, maybe not

Alleged Benefits to Northwest Residents	
1. Avoided congestion costs	Zero (computer model alleges $250 million, but no one pays these costs now)
2. Higher profits to owners of thermal generation	$100 million (40% is coal); some of this will "leak out" of the region
3. Reliability	Not likely; see the Schweitzer report (#8 above)
4. Greater "visibility" of the grid	Unknown; could be negative if RTO West makes mistakes
5. Control area consolidation	Unknown; probably negative
6. Single OASIS, tariff, business practices	Modest; also, these can be accomplished without an RTO

Washington Public Utility Districts Association

Asotin County PUD
Benton County PUD
Chelan County PUD
Clallam County PUD
Clark Public Utilities
Cowlitz County PUD
Douglas County PUD
Ferry County PUD
Franklin County PUD
Grant County PUD
Grays Harbor County PUD
Kittitas County PUD
Klickitat County PUD
Lewis County PUD
Mason County PUD #1
Mason County PUD #3
Okanogan County PUD
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