

Testimony of

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Mr. Chairman and committee members, it is an honor to appear before this committee. Thank you for this opportunity to share the views of the electric cooperatives of Arkansas pertaining to regulation of financial transmission rights ("FTR"), congestion revenue rights ("CRR") and other related components of providing electric transmission services to our consumer-owners. I would also like to thank our home state senator, Senator Blanche Lincoln, who since becoming Chairman of the Agriculture Committee has taken an intense interest in this issue, and we appreciate her efforts to craft a common sense global fix to this issue.

Seventeen Arkansas electric cooperatives provide electric power to approximately 468,900 consumer-owners in Arkansas, and another 29,229 in adjoining states. Electric cooperatives provide service to 62 percent of the land area, and 74 of the 75 counties in Arkansas. The electric cooperatives in Arkansas provide service on a not-for-profit basis to some of the poorest service territories in the nation. Nation wide, electric cooperatives provide electric power services to approximately 42 million consumer-owners in 47 states.

Arkansas Electric Cooperative Corporation ("AECC") is a generation and transmission cooperative that provides power supply and transmission delivery service to the 17 distribution cooperatives in Arkansas. AECC provides transmission service to its native load within three separate transmission control areas: Entergy, American Electric Power ("AEP") and the Southwestern Power Administration ("SWPA"), an agency of the Department of Energy. AEP and SWPA operate within the Southwest Power Pool ("SPP"), a regional transmission organization ("RTO") under the regulation of the Federal Energy Regulatory Commission ("FERC"). AECC strategically determined it was in its member's best interest to share in the utilization of the transmission systems of Entergy, AEP and SWPA to prevent duplicating infrastructure. Therefore, AECC is a transmission dependent utility relying on fair and equitable access to the transmission grid through the SPP RTO..

Cost pressures on transmission delivery services are constantly increasing. The physical cost of AECC providing transmission service to rural Arkansans increased 60.8 percent from 2004 to 2009. That is a compounded annual increase of 9.97% per year. Managing transmission costs is vital to meeting our goal of providing reliable electric service at the lowest possible cost, and helping to improve the quality of life for rural Arkansans.

The intention of many of the derivatives regulation reform proposals being proposed in Congress, including the financial reform bill that passed the U.S. House of Representatives (H.R. 4173), to protect market participants is certainly laudable. In fact, we believe the CFTC should continue to look for market manipulation in the bilateral OTC natural gas and power markets. These investigations occur after transactions have been made and should not impede the smooth running of FTRs and CRRs. However, we feel that derivatives regulation proposals should respect the fact that the inclusion of RTO FTRs and CRRs, which are more closely attached with the physical service reliability requirements of providing electricity, is not appropriate as they do not fit the characteristics of other commodities for which legislative proposals would regulate. We are concerned that proposed legislation could inadvertently make it difficult and more expensive for AECC to deliver power in an RTO market.

Most RTOs operate both a real-time and day-ahead market for electric power. These markets establish locational marginal prices (“LMPs”) for energy based on the bid price of the last unit dispatched to meet load in the RTO region. The level of congestion in different parts of the transmission system can change hourly; therefore, the cost of power generated and consumed in different parts of the system can vary greatly and is extremely volatile. That volatility is challenging for utilities because the LMPs not only establish the cost of power for utilities buying energy out of the market or selling energy into the market at any particular location, the LMPs also establish the cost for utilities that generate with their own power resources to deliver that power to their consumers. Utilities are paid the LMP price for energy they generate at one point of the system, and simultaneously pay the LMP price for energy at the point where it is withdrawn to serve their consumers. Thus any difference in the LMP between the “source” of the power, and the “load sink”, change the cost of delivered power due to congestion incurred for delivering through the RTO-managed transmission system. Congestion costs for a utility are determined by a positive difference between the cost paid to serve their load at a location minus the revenue received for power generated at a different location.

In order to help utilities hedge congestion cost risk, the FERC requires RTOs that operate real-time and day-ahead LMP markets, to make FTRs or CRRs available to market participants. By virtue of payments for physically firm network transmission service, load serving entities like AECC are annually allocated certain financial revenue rights by the RTO in order obtain FTRs or CRRs. FTRs and CRRs are monthly, annual or other periodic financial instruments that entitle holders to congestion revenues along a particular transmission path. These FTR and CRR revenues help offset the costs incurred by utilities to deliver energy over the congested transmission paths. As load profiles change and sources of supply change over time, these unbundled financial instruments can be bought and sold to align a market participant’s congestion protection with the ever changing congestion exposure that results from the need to use frequently changing transmission paths. Consequently, FTRs and CRRs were created to help market participants maintain balance over time between the financial costs of providing transmission service with the requirements of providing physically reliable transmission service in a constrained and congested transmission system.

As previously discussed, AECC participates in the SPP RTO. The SPP is currently evaluating and designing how it will develop the FTR or CRR market for its area of responsibility. Other RTOs such as the PJM and Midwest Independent System Operator (MISO) already operate congestion rights markets. Even though the FTRs and CRRs have been separated from the physical cost of delivery, they remain an integral part of the overall cost of service.

The electric cooperatives of Arkansas and cooperatives across the country are concerned that proposed legislation would place regulation of FTRs and CRRs under the regulatory oversight of the Commodities Futures Trading Commission (CFTC). Oversight by the CFTC would fragment load serving entities' ability to manage their transmission costs. The FERC comprehensively regulates all jurisdictional wholesale sales and jurisdictional interstate transmission service, pursuant to the Federal Power Act, as an integral part of the overall electric market structure. Sections 205 and 206 of the Federal Power Act give FERC authority to ensure that the rates, terms and conditions of all jurisdictional wholesale sales of power and all jurisdictional transmission service in interstate commerce are just and reasonable. In order to fulfill that duty, FERC has required RTOs to file tariffs at FERC governing every aspect of their markets. The design, operation and governance of RTOs financial rights, and the obligations of parties who participate in the markets, and the means which the RTOs monitor the markets for market power and market manipulation, are all filed at FERC, and bought and sold pursuant to FERC filed tariffs. Mismanagement of the markets by the RTOs and misconduct in those markets by participants are both subject to penalties from FERC. An exception to this FERC regulation is in Texas. In the State of Texas a single grid operator called the Energy Reliability Council of Texas (ERCOT) operates a day ahead and real time market and administers CRR's to hedge congestions. The ERCOT is overseen by the Public Utility Commission of Texas (PUCT) who serves the single regulator for commercial power and transmission markets in Texas.

AECC believes keeping all components of transmission costs regulated by a single entity will ensure lower overall cost for its members. If the FTR and CRR markets are allowed to be regulated by an entity outside of the FERC (or PUCT in Texas), market participants could be forced to maintain multiple backup credit facilities (credit facility for FERC physical transactions and credit facilities for FTR/CRR market). A weakened economy and constrained capital resources at financial institutions are already resulting in higher cost credit support facilities. Another factor to consider is that market participants in a FERC regulated market are mostly entities of the utility sector serving end-use load. The credit risk for utility market participants is generally less than a market that has a higher concentration of counterparties that trade speculatively. One way to eliminate and avoid counterparty risk is to force participants to provide cash collateral sufficient to cover the full exposure of all trades executed. But this option increases cost to end-use utility consumers and idles large amounts of cash making it more difficult for utilities to maintain capital expenditures on infrastructure to provide reliable electric service.

In conclusion, on behalf of 468,900 electric cooperative consumers in Arkansas and approximately 42 million electric cooperative consumers throughout the nation, the electric cooperatives believe it is in the best interest of utility consumers to ensure regulation of FTRs and CRRs remain under the regulatory authority of the FERC and the PUCT in Texas. RTO markets and RTO-created products are integral to the RTOs regulatory reliability mission. FERC and the PUCT should also maintain jurisdiction over physical forward transactions, whether or not those transactions ultimately result in physical forward delivery or are booked out. There are other energy hedging products that are available for use by the general public. These are appropriately regulated by the CFTC but the FTR and CRR markets should remain under the oversight of the FERC or PUCT in Texas. In my opinion, the global fix prescribed by Senator Lincoln could help keep the cost of providing electricity to Arkansas consumers as well as electric consumers across the nation lower.

Mr. Chairman, thank you for the opportunity to share our concerns with you and the Committee on Energy and Natural Resources.