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ON
H.R. 2915, THE AMERICAN TAXPAYER AND WESTERN AREA POWER ADMINISTRATION CUSTOMER PROTECTION ACT OF 2011
BEFORE THE

SUBCOMMITTEE ON WATER AND POWER
COMMITTEE ON NATURAL RESOURCES
U.S. HOUSE OF REPRESENTATIVES

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Chairman McClintock, Ranking Member Napolitano, Members of the Subcommittee, thank you for inviting me to testify before you today in support of H.R. 2915, the American Taxpayer and Western Area Power Administration Customer Protection Act of 2011. I am William Yeatman, assistant director of the Center for Energy and Environment at the Competitive Enterprise Institute. We are a non-profit public policy organization dedicated to advancing the principles of limited government, free enterprise, and individual liberty. CEI specializes in regulatory policy. We accept no government funding and rely entirely on individuals, corporations and charitable foundations for our financial support.

My testimony is organized in two sections. The first explains why I believe that the Western Area Power Administration Section 402 Transmission Infrastructure Program ("WAPA loan authority") is too risky for American taxpayers, especially in light of our nation's current deficit problems. In the second section, I explain the potential unintended consequences of policies like the WAPA loan authority that are meant to promote renewable energy.

I. The WAPA Loan Authority Is Too Risky for Taxpayers

Environmentalist Public Policy Is a Poor Substitute for the Profit Motive

Investment banks and venture capitalists have a singular purpose: To earn a worthwhile return on their capital investments. This is a powerful incentive for wise fiscal management. It is their resources that are at stake, and foolhardy investments will lose money. Thus, private sector financing is subject to market discipline that provides powerful incentives for sound money management.

By contrast, the WAPA loan authority has nothing to do with the profit motive. Rather, the purpose of the program is to lend taxpayer money to transmission projects that advance environmentalist public policy, to the benefit of special interests—in this instance, renewable energy developers. Specifically, the American Recovery and Reinvestment Act created the

WAPA loan authority for the purpose of "delivering or facilitating the delivery of power generated by renewable energy resources constructed or reasonably expected to be constructed."

At a fundamental level, public policy imposes much less discipline on capital allocation than does the profit motive. To some extent, the WAPA loan authority's mandate to facilitate green energy must compete with the taxpayer's interest in ensuring recuperation of the original investment. This reality is reflected by the fact that the Western Area Power Administration needs to certify only a "reasonable" expectation of repayment before it can lend taxpayer money through the WAPA loan authority. Private sector financing, unencumbered by public policy goals to promote green energy, has a higher threshold for repayment than a mere "reasonable" chance.

As such, the WAPA loan authority lends money as would an investment bank or a venture capitalist, but it is subject to entirely different incentives that render it inherently riskier relative to private sector financing.

WAPA Loan Authority Lending Is a Moral Hazard

This discrepancy in riskiness between private sector lending and financing by the WAPA loan authority is increased by the fact that the American Recovery and Reinvestment Act allows for the forgiveness of loans if they cannot be repaid. Whereas private sector lenders suffer direct financial harm if their loans default, the WAPA loan authority is under no such constraints, because the American taxpayer in general—rather than only the Western Area Power Administration or its customers—are on the hook. This is a moral hazard conducive to fiscal mismanagement.

Investment Banking Is outside the Western Area Power Administration's Core Competencies

Another reason for concern is that lending money to facilitate green energy projects is well outside the core competencies of the Western Area Power Administration. In effect, it has been tasked with creating an investment bank from scratch. The history of much more established loan programs for clean energy projects suggests that there is a long learning curve.

For example, the Department of Energy's Loan Programs Office was created by the 2005 Energy Policy Act, in order to facilitate the development of low-carbon energy technologies. Since its inception, the Loan Programs Office has been red-flagged repeatedly by federal watchdogs[i]—most recently for betting almost half a billion dollars on Solyndra, Inc., a California-based solar power components manufacturer that declared bankruptcy in August. The Department of Energy's Loan Programs Office has had six years to build capacity, and it is still plagued by problems. By comparison, the WAPA loan authority was established in less than three months.

The American Recovery and Reinvestment Act's Priority on Speed Is Conducive to Rash WAPA Loan Authority Lending

The WAPA loan authority is made even riskier by the American Recovery and Reinvestment Act's mandate to rush money out the door. In enacting this legislation in February 2009, Congress's primary purpose was to jumpstart an economy made moribund by a global recession.

The WAPA loan authority has explicitly adopted this purpose—that of speedily spending taxpayer money. As noted by the promulgation of the WAPA loan authority in the Federal Register, "The Purpose of the Recovery Act, which authorized this Program, *is to stimulate job-creation in the near term*[ii]." [Italics added] Later in the same notice, it stated, "The [WAPA loan authority] anticipates a combination of new transmission construction and upgrades to existing infrastructure…*in order to meet the objectives of the Recovery Act to create jobs in the near term and rapidly develop infrastructure to deliver renewable resources*[iii]." [Italics added]

To this end, the WAPA loan authority announced its first loan just seven months after the enactment of the American Recovery and Reinvestment Act. In the words of WAPA loan authority Manager Craig Knoell, this timeline was "amazingly fast[iv]." However, the WAPA loan authority's mandate to spend quickly coexists uneasily with wise fiscal management. Rushed investments tend to be rash investments, which are almost always poor investments.

This was evidenced recently evidenced by the high-profile July bankruptcy of Solyndra, Inc, the recipient of the first loan guarantee subsidized by the American Recovery and Investment Act through the Department of Energy Loan Programs Office. An ongoing investigation by the House Energy and Commerce Subcommittee on Oversight and Investigations suggests that this loan was rushed in order to quickly demonstrate results from the American Recovery and Reinvestment Act[v]. Notably, the Solyndra loan was closed 10 months before the next such loan guarantee; in the 10 months thereafter, 10 loan guarantees were issued[vi]. Serious questions remain whether the rushed schedule compromised due diligence.

Private Financing Is Not a Limiting Factor to Renewable Energy Development

In testimony before this Subcommittee during a March 2009 hearing, Western Area Power Administrator Timothy Meeks justified the WAPA loan authority as a means to break "a vicious cycle," whereby, "a lack of funding has been the weak link in building transmission and the lack of transmission has been the weak link in the development of renewable generating resources[vii]."

This supposed impetus for the WAPA loan authority was contradicted by testimony at the same hearing from Edward M. Rahill, CEO of ITC Holdings, Inc, the nation's largest independent transmission company. He indicated that there are no constraints on private sector financing to link renewable energy projects to the nation's electricity grid. He testified,

> "Despite the current and recent turmoil in the credit markets, ITC and its subsidiaries have been successful in every debt and equity financing related to the ongoing operating company investments and acquisitions since ITC was founded in 2003. Even in the current environment, ITC has not found access to the debt or equity markets to be

> difficult….Financing new transmission is not the problem that needs to be overcome in order to build transmission to provide greater market access for renewable resources[viii].”

If the private sector is already financing transmission adequately, then the WAPA loan authority is not necessary. At best, it is duplicative, and therefore crowds out market mechanisms that allocate capital more efficiently. At worst, it is financing only those projects that have been spurned by the market, which suggests they are a bad bet.

Too Risky for Private Lenders, Too Risky for Taxpayers

WAPA loan authority loans are riskier than private sector financing. As such, they should also be too risky for public sector financing. In light of America’s current deficit problems, now is not the time to unduly chance taxpayer money on the success or failure of novel renewable energy technologies.

II. Unintended Consequences

The WAPA Loan Authority’s Mission Is at Odds with Affordable and Reliable Electricity, Especially in light of Pending/Final Regulations from the Environmental Protection Agency

The Western Area Power Administration’s 17,000 miles of high voltage transmission lines are a component of the nation’s interconnected electricity grid. At any given time, the power that enters the system must equal the power that leaves the system. Supply must equal demand, on a second to second basis, or else the system breaks down and the lights go out.

This balancing feat is a complex engineering challenge, and it is made much more difficult by the incorporation of renewable energy. Unlike conventional energy sources, which can “ramp” electricity generation up or down predictably due to fuel stored onsite, renewable energy production is variable and unpredictable. After all, the wind doesn’t always blow and the sun doesn’t always shine.

The primary solution to the reliability challenges engendered by the intermittent nature of renewable energy is to back up wind and solar generation with conventional energy generation, primarily natural gas fired power plants, as they are able to “ramp” up and down the fastest.

However, at the same time that the Obama administration is trying to incorporate as much renewable energy into the grid as quickly as possible, it is also implementing environmental regulations that will radically alter the nation’s electricity market by dramatically reducing demand for coal-fired electricity. Unfortunately, the addition of renewable energy and the subtraction of coal power work to the detriment of the system’s reliability and affordability.

A significant portion of the nation’s coal-fired power plant fleet is expected to be shuttered, due to an array of pending and final Environmental Protection Agency regulations—including the Cross-State Air Pollution Rule, the Utility Maximum Achievable Control Technology

requirement under Hazardous Air Pollutants program, the Regional Haze Rule, and the regulation of greenhouse gases under the Clean Air Act. According to the Edison Electric Institute, the breadth and speed of EPA regulations could lead to the retirement of up to 90,000 megawatts of coal-fired electricity generation[ix]. And a preliminary assessment by the Federal Energy Regulatory Commission Office of Electric Reliability showed 40,000 MW of coal-fired generating capacity "likely" to retire, with another 41,000 megawatts "very likely" to retire[x].

Something must replace this lost power, and the most plausible alternative is natural gas. The Fukushima Daiichi disaster in Japan helped galvanize opposition to nuclear power, and it is difficult to foresee a near to medium term scenario whereby that industry increases its market share in the United States. A significant expansion of the hydropower industry is also difficult to imagine, thanks to entrenched environmentalist opposition to new dams. The only alternative is natural gas. Accordingly, it is reasonable to expect that there will be a profound shift in baseload electricity generation away from coal and to natural gas.

Thus, the current administration is pushing variable renewable energy, which requires backup conventional energy production, primarily natural gas, in order to maintain system reliability. At the same time, the administration is implementing regulations that will shutter a significant amount of coal-fired electricity generation, which will likely lead to a precipitous increase in natural gas generation. These are two potentially enormous sources of demand for gas, occurring simultaneously. Of course, when demand increases, prices follow. The result is likely to be expensive electricity.

There are additional reliability concerns. It is always a challenge to site a new power plant, be it conventional or renewable. In the short term, therefore, there is no guarantee that sufficient new generation will be built to accommodate the expected loss of coal-fired generation. As a result, it is possible that natural gas "peaker" power plants—those that are designed to "ramp" up and down quickly—will be reassigned for baseload generation. This would reduce the flexibility of the grid and make it much more difficult to maintain system reliability as greater amounts of renewable generation are incorporated.

Environmental Harm

Presumably, the purpose of promoting renewable energy is to mitigate the environmental consequences of conventional energy generation. Ironically, recent evidence suggests that adding wind power—the predominate form of renewable energy—into the power supply actually *increases* air pollution.

Demand for intermittent renewable energy is not set by market forces, but by government mandates. Thirty states have renewable energy productions quotas, known as Renewable Portfolio Standards, which require ratepayers to use fixed percentages of renewable energy. As a result of these mandates, most utilities operate their wind energy generation on a "must take" basis. This means they add wind power whenever it is available. As wind power is added to the

power system, conventional energy generators like coal and gas fired power plants must "ramp" down. However, fossil fueled generators, and coal power plants in particular, operate much less efficiently when they are "ramped" up and down, and this causes more emissions of air pollution.

A recent study by Bentek, a Colorado-based energy market information company, found that in Colorado and Texas electricity markets, the incorporation of high amounts of wind energy into the grid actually increased emissions of sulfur dioxide and nitrogen oxides[xi].

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[i] In a 2007 report, the Government Accountability Office questioned, "whether this program [the Department of Energy Loan Programs Office] and its financial risks will be well managed" See p. 4: http://www.gao.gov/new.items/d07339r.pdf
In a 2008 report, the Government Accountability Office stated that, "The Department of Energy is not well positioned to manage [the loan guarantee program] effectively and maintain accountability." See: p.1 http://www.gao.gov/new.items/d08750.pdf
In a February 2009 report, the Department of Energy Inspector General warned that, "[I]n a number of critically important areas, the [Department of Energy] had not fully developed and implemented controls necessary to successfully manage the program." See p. 2: http://energy.gov/ig/downloads/department-energys-loan-guarantee-program-innovative-energy-technologies-ig-0812
In a July 2010 report, the Government Accountability Office noted that 50% of the conditional loan guarantees it examined had been issued before full reviews were conducted. See p. 8: http://www.gao.gov/new.items/d10627.pdf
In a March 2011 report, the Department of Energy Office of the Inspector General, 15 out of 18 loan guarantees issued by the Loan Programs Office lacked "pivotal" information regarding risk ratings. See p. 2 http://www.recovery.gov/Accountability/inspectors/Documents/IG-0849.pdf

[ii] Federal Register Vol. 74, No. 92, 14 May 2009, 22733
[iii] Ibid., 22734
[iv] Western Area Power Administration website, "About TIF," http://ww2.wapa.gov/sites/western/recovery/Pages/default.aspx
[v] For information on the investigation, see: http://energycommerce.house.gov/hearings/hearingdetail.aspx?NewsID=8897
[vi] The Department of Energy posted a timeline of Section 1705 loan guarantees on its website, available here: https://lpo.energy.gov/?page_id=134
[vii] Statement of Timothy J. Meeks before Subcommittee on Water and Power, 10 March 2011, p. 4, http://naturalresources.house.gov/UploadedFiles/MeeksTestimony03.10.09.pdf
[viii] Statement of Edward M. Rahill before Subcommittee on Water and Power, 10 March 2011, p. 2 http://naturalresources.house.gov/UploadedFiles/RahillTestimony03.10.09.pdf
[ix] Edison Electric Institute, Potential Impacts of Environmental Regulation on the U.S. Generation Fleet, January 2011, p. v, http://www.pacificorp.com/content/dam/pacificorp/doc/Energy_Sources/Integrated_Resource_Plan/2011IRP/EEIModelingReportFinal-28January2011.pdf
[x] FERC Chairman Jon Wellington, Commissioner John Norris, Commissioner Cheryl LaFleur, letter to Sen. Lisa Murkowski, 1 August 2011, p. 2 http://murkowski.senate.gov/public/?a=Files.Serve&File_id=0942ce17-3b12-4643-99ba-8fe2f5a7680a
[xi] Bentek, How Less Became More…Wind, Power and Unintended Consequences in the Colorado Energy Market, see: http://docs.wind-watch.org/BENTEK-How-Less-Became-More.pdf