ELCON REPORT

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IN THIS ISSUE…

FERC TACKLES INCENTIVES FOR NEW TRANSMISSION

FERC Commissioner John Norris has long been calling for FERC to revisit its policy on incentives for building new transmission, so it was no surprise that he raised the issue when speaking at ELCON's Spring Workshop. He noted that it "is difficult to explain FERC's policy," and he suggested that FERC might issue a Notice of Inquiry or hold a Technical Conference on the issue, stating the basic question is "what are we trying to accomplish?"

ELCON has long been active on the transmission incentives issue and has been working with a coalition comprised of consumer groups, state consumer advocates, cooperative and municipal utilities to develop a united position. The group developed a White Paper with recommendations for FERC and presented that paper to FERC Commissioners and senior staff earlier in the year.

Subsequent to the Workshop, FERC issued a Notice of Inquiry (NOI) on transmission incentives. The coalition, with ELCON's support, has filed lengthy comments on a number of transmission issues. Those comments urged that FERC "in reviewing applications for transmission rate incentives should distinguish between those rate policies that reduce utility risk (full recovery of construction work in progress, increased abandoned plant protection, formula rates and accelerated depreciation) and those that enhance utility/developer returns (rate of return adders and hypothetical capital structures). The coalition's comments also asked FERC "to limit the application of return-enhancing incentives like rate of return adders solely to the estimated, and not the ultimate actual costs, of new transmission projects."

In addition, ELCON has filed its own comments on certain issues not fully covered by the coalition.

ELECTRICITY PRICES TO BE IMPACTED BY EPA REGULATIONS

FERC Commissioner John Norris pulled no punches in his Keynote Address to ELCON's Spring Workshop – lower electricity costs in the near future are "just not a realistic picture," he said. Norris cited the need to replace an aging generation fleet, quipping that lots of those "facilities are eligible for AARP membership."

He noted that increased reliability and reduced congestion are the driving forces for new generation, but that the need "to address public policy concerns" – e.g., increasing renewable energy sources – was also a factor. He observed that new generation will also necessitate new transmission and the question of who pays for that transmission is especially troublesome, stating that for him the basic principle is that "the beneficiary pays" [see related article on FERC Order 1000].

Marc Chupka, a principal of the Brattle Group, provided a slightly different perspective. He cited the several EPA rulemakings now "on parallel paths" that will impact the baseload generation fleet. He said that up to one-third of the coal-fired generators may be forced into retirement, but he thought that was "not a big amount on the national level." The problem he foresaw for utilities and merchant generators was that "decisions have to be made before all the rulemakings are finalized."

John Larsen, a senior associate with the World Resources Institute, also did not see the retirement of many coal-fired generators as a major problem, since the price difference between coal and natural gas-fired generators "is shrinking." He agreed with Chupka that the timetable – where decisions will be made before all the facts are available – is troublesome. "We need to have certainty," he said, "so we know where to invest in least cost generation."

L to R: John Lasen, Marc Chupka and Zack Hill

Zack Hill of Alliant Energy, who represented the Midwest Power Coalition, presented a different point of view. Most Midwest utilities are heavily dependent on coal, and EPA's goal, he asserted, "is to make coal more expensive."

He saw EPA's amalgam of regulations aimed at the utility industry as creating winners and losers – as he put it "this will be a big boon for shareholders of some utilities." For CEOs of utilities that are coal dependent, he said, the "biggest nightmare is making the wrong first investment." He said the Midwestern utilities that are part of his coalition are not opposed to reducing emissions – in fact, he stated, emissions have been steadily decreasing. But, he said, the "EPA time frame will be tough to meet."

Lisa Jaeger, an attorney with Bracewell and Giuliani who represents industrial boiler owners on environmental issues, added additional details regarding the impact of EPA's proposed boiler rule imposing standards for the Maximum Available Control Technologies (MACT). Asserting that it will be harmful to today's fleet of coal-based boilers, she said the proposed rule "diminishes and discourages energy diversity."

While EPA has delayed proceedings on a few of the regulations, those utilities most affected are still predicting a "train wreck" due to increased compliance costs. Republicans in the House of Representatives have passed several bills to preclude EPA action – most notably HR 910 to bar EPA from taking action limiting greenhouse gas emissions – but no one expects any of those bills to gain Senate approval. Rep. Ed Whitfield (R-KY), chairman of the House Energy and Power Subcommittee, recently stated that he thought the best chance of reining in EPA was through the appropriations process, but Senate approval of significant funding restrictions will be difficult.

DISAGREEMENT ON BENEFITS OF WIND ENERGY

The impact on consumers of additional renewable energy – in particular wind energy – is clearly in the eye of the beholder.

Speaking at ELCON's Spring Workshop, Jim Dauphinais, a consultant with Brubaker and Associates, stated definitively that wind energy was "not economical" and wind energy producers were "largely driven by the Production Tax Credit."

Michael Goggin of the American Wind Energy Association disputed Dauphinais' conclusion, asserting that the "monetary benefits of wind energy does exceed cost," adding that the "U.S. electricity portfolio needs to be diversified."

Left to right: Michael Goggin and Jim Dauphinais

He also praised wind energy for having no harmful emissions and less price volatility than conventional generation. He downplayed the cost of new transmission that might be needed to transport wind energy to distant end users, pointing out that transmission generally amounts to only 5 to 7 percent of the total electricity bill.

There have been several studies showing the difficulties in integrating wind energy because of reliability concerns. Most assume that back-up generation is needed to supply power during wind shortfalls, and that such generation would be gas-fired. The Interstate Natural Gas Association of America, representing natural gas pipelines, has questioned whether there is adequate pipeline capacity to fill that role and, moreover, whether such pipelines need to be dedicated to providing only back-up power.

WOLAK EXPLAINS MARKET DESIGN OPTIONS

Frank Wolak, a professor at Stanford University and a former market monitor in California, has spent a career analyzing electricity markets and how different structures can affect consumer prices and behavior. And he has come down strongly on the side of markets utilizing locational marginal pricing (LMP) over those using capacity markets as better for consumers.

According to Wolak, LMP markets provide "lower cost dispatch of generation units" while capacity markets result in more installed generation capacity, resulting in "higher costs to consumers." Wolak emphasized that "if suppliers submit offer curves close to marginal costs curves, LMP markets should yield lower cost dispatch than a zonal market." His research showed that consumers in California saved roughly $100 million "as a result of LMP in California." He added that LMP markets can limit harm to market efficiency and system reliability.

He noted that no market can "protect consumers from volatile wholesale prices." He compared "dynamic pricing" with "time-of-use pricing" for consumer impact in the retail markets. With dynamic pricing, he explained, "retail prices vary with real-time system conditions," requiring hourly meters to implement. With time-of-use pricing, "retail prices vary with the time of day, regardless of system conditions." For example, there might be an established high price from noon to 6 pm, even if there was no increase in actual demand. Hourly meters would not be required.

On one hand Wolak has concluded that dynamic pricing is "inevitable," but he also acknowledged that it would be difficult because of "state-level regulatory barriers," primarily the beliefs that "consumers must be protected from short-term price risk" and that "electricity is a right, not a commodity." The National Association of State Utility Consumer Advocates (NASUCA) has long opposed time of use rates, and presumably would oppose dynamic pricing.

GRID RELIABILITY – PAST, PRESENT AND FUTURE

The primary objective of the North American Electric Reliability Corporation (NERC) "is to maintain the security of the grid," stated Gerry Cauley, NERC's CEO, at ELCON's Spring Workshop. He added that NERC needs to be flexible, especially in integrating new technologies into the generation base.

ELCON has long been active in NERC, recognizing that many industrial facilities will be subject to NERC's reliability standards due to on-site generation or other equipment that could impact grid operations. Numerous industrial facilities are in fact on NERC's Compliance Registry and therefore face substantial and costly requirements; other facilities have been named to the Registry but have appealed and been removed.

Cauley noted that one of his early goals as head of NERC is to make the organization more efficient. He acknowledged that there was sometimes confusion, or at least uncertainty, as to who must comply with certain NERC standards. We must "apply the right rule to the right companies," he asserted.

Cauley reviewed the many problems NERC has faced in its four years of existence. He recognized that there had been problems in its relationship with the Federal Energy Regulatory Commission, but he believes that situation "has improved" over the past year.

As head of NERC, Cauley emphasized that he wants the standard-setting process to be as inclusive as possible. He lamented that end users were often underrepresented, and he urged ELCON members to "become active participants."

"Who better to be at the table than the customer?" he asked.

ELCON APPLAUDS FERC'S DEMAND RESPONSE ACTION

ELCON President John Anderson commended the four FERC Commissioners who supported Order 745 on Demand Response, stating that the new policy "is a long overdue fix for one of the more egregious design flaws in the so-called 'organized markets.'"

ELCON had lauded FERC when they put out its first proposed rule on Demand Response, noting that DR could play a significant role in reducing consumption, thus alleviating the need for new generation and providing positive environmental benefits as well.

Recognizing the opposition to the Demand Response rule from many on the supply side, Anderson asserted that "large and small consumers should applaud FERC for standing up to the generators who fought this Order from the beginning. The day-ahead and real-time energy markets will now be subject to competitive forces which will reduce the clearing price in the Organized Markets and mitigate the need for new generation – both of which are in consumers' best interest."

FERC has announced, but not scheduled, an additional Technical Conference on the issue. In addition, FERC has published an "Implementation Proposal" laying out a series of steps it intends to take to encourage Demand Response and fully implement Order 745.

ELCON TO SENATE ENERGY COMMITTEE: CONSIDER ALL OPTIONS – AND THEIR COSTS

In response to the Senate Energy Committee's request for stakeholders' views on a Clean Energy Standard (CES), ELCON responded and recommended that "any CES recognizes and protects domestic manufacturing from being placed at a cost disadvantage as a result of its implementation."

ELCON's submission to the Committee advocated that the definition of a clean energy resource be drafted as broadly as possible. Specifically, ELCON suggested that the focus of developing a clean energy standard be "on reducing Greenhouse Gases (GHGs) and not promoting the adoption of carbon-free resources," which ELCON members believe will likely increase power costs. ELCON also advocated greater utilization of combined heat and power and waste heat recovery, which are included in some state renewable energy programs.

In its statement, ELCON noted that increasing the use of renewable energy, as part of implementing a clean energy standard, would increase the need for transmission and ancillary service costs. ELCON cited a study by ICF International estimating that the "total costs of the natural gas infrastructure to support firming requirements could range from about $2 billion to $15 billion." ELCON also addressed the issue of cost allocation for building new transmission, observing that such an allocation "should be assigned on a capacity (kW) basis, not an energy (kWh) basis," concluding that "to do otherwise would harm the most predictable component of load" and add more costs to manufacturers while violating the "principle of cost-causation ratemaking that underlies fair and efficient electricity pricing."

As the generation mix changes, reliability is also of concern to ELCON members. Several studies have concluded that since renewable energy sources, particularly wind, are highly volatile, increased system reliability will be harder to maintain. ELCON concluded that "a CES should not become an exclusive mandate for less cost-effective variable generation which requires a greater level of subsidies or which poses greater threats to reliability."

Well over 100 entities submitted comments on a CES to the Committee. Afterwards, Chairman Jeff Bingaman (D-NM) and senior staff commented on the diversity of views presented which will make reaching consensus nearly impossible. And staff has commented that it makes little political sense to attack a difficult issue like "clean energy" and make Members cast controversial votes when the chances of the issue progressing in the House are about nil.

In July the Energy Committee reported out several pieces of legislation, including one (S 1000) on energy efficiency. During debate in the Committee the issues of a clean or renewable energy standard did not come up.

NEXT WORKSHOP TO FOCUS ON TRANSMISSION

ELCON's next Members-only Workshop, entitled "Winds of Change in Electric Power Regulation," will be held on October 25 in Chicago, Illinois.

The Workshop will feature a Keynote Address by FERC Commissioner Cheryl

LaFleur updating ELCON members on FERC's transmission related activities.

Industrial users are facing a series of transmission issues at FERC and in other forums, including, to name a few, cost allocation, incentives, bringing power from alternative energy sources to load centers, the operation of the organized markets, and maintaining reliability.

The Workshop will include a pros/cons discussion of "The 'Value' to Industrial Consumers of Multivalued Projects," with speakers from ITC and the MISO Northeast Transmission Consumer Coalition. Other topics include a discussion of the Eastern Interconnection Planning Collaborative and a pro-con session on whether RTOs need a capacity market.

The Workshop will conclude with ELCON's annual State Industrial Group Roundtable discussion where leaders of the various state industrial end user groups relate current and upcoming issues in their states and regions.

ELCON's Workshops are open only to ELCON members and to representatives of companies considering ELCON membership. For more information contact ELCON at 202-682-1390 or elcon@elcon.org.

CHANGES TO DEFINITION OF BULK ELECTRIC SYSTEM CRUCIAL TO INDUSTRIALS

ELCON Vice President John Hughes is part of the team drafting a revised definition of the Bulk Electric System for the North American Electric Reliability Corporation.

A particularly contentious part of the discussion is how to treat behind-the-meter generation as well as radial transmission lines that serve only designated load. ELCON has long advocated that NERC's jurisdiction in drafting reliability standards be confined to facilities that could have a "material impact" on grid reliability, thereby relieving industrials of unnecessary and onerous compliance requirements.

"NERC is charged with protecting the bulk electric system," explained Hughes. "The definition of the bulk electric system should be drafted to include only those facilities that are absolutely essential to grid reliability."

The drafting team expects to have the new definitions approved by the NERC Board in December and presented to FERC early next year.

ANDERSON LINKS JOBS TO POWER RATES

In a speech to the National Association of Regulatory Utility Commissioners (NARUC), ELCON President John Anderson advocated electricity rates that are both fair to all parties and don't drive industrial users to relocate.

Anderson prefaced his remarks by noting that in the "ideal world" there would be "truly competitive electricity markets" establishing prices through supply and demand. But, after years of experience, he has concluded that "the implementation of truly competitive markets is very difficult to achieve." In regions that have not restructured their markets, he asserted that "a model based on the traditional regulatory compact is best for consumers." A major principle of that compact is that fixed costs are allocated based on system peaks and variable costs are recovered in the energy component of rates. He decried the numerous variances from traditional regulation which he said was due, in part, because "policy makers seem to be trying to change consumer behavior."

He said that too often the outcome of such regulatory decisions is that "consumers end up paying more or purchasing less (or both) than they would under more traditional regulation." He said that political decisions that increase operating expenses for manufacturers can cause job josses, citing Illinois' experience when it tried to increase the corporate tax rate and instead ended up negotiating at least 80 "special deals" to reduce corporate tax rates. In the end, Illinois still ended up losing 360,000 jobs. That is why, he concluded, that "when industrials are asked to pay more than their fair share, they must seek relief." Industrial electricity users, he said "would far prefer strict adherence to true cost of service" regulation.

FERC'S TRANSMISSION ORDER "TROUBLESOME"

FERC's recent issuance of Order 1000 on transmission cost allocation is "troublesome" according to ELCON President John Anderson, and ELCON is seeking a rehearing and clarification.

In its filed request, ELCON raised four main points.

First, FERC's Order "still countenances broad socialization of costs in a manner inconsistent with long-recognized ratemaking concepts" while a final rule should be "fully in line with cost causation and beneficiary pays principles."

Second, the Order allows transmission planning authorities "broad discretion" to include "public policy considerations" which ELCON believes presents a "high likelihood of abuse and arbitrary results."

Third, ELCON believes that "Order No. 1000 fails to substantively address comments that the costs of new transmission occasioned by low capacity factor resources such as wind energy should be allocated on a capacity basis."

And, fourth "Order No. 1000 improperly rejects participant funding as an outcome of the regional planning processes."

"Transmission planning and cost allocation are very important issues and needed to be addressed," stated Anderson. "But Order No. 1000 provides a disparate approach and needs both clarification and consistency. We are pleased that FERC chose to address this issue. But we hope that they take a second look at it and realize the trouble that the rule could cause if not modified."

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