FERC's SMD Proposal, While Good, Can Be Even Better, ELCON Says

ELCON commended the Federal Energy Regulatory Commission (FERC) for its proposed Standard Market Design (SMD) rules aimed at creating uniform and nondiscriminatory transmission practices, but said the proposal could go even further. Summing up the comments, ELCON Executive Director John Anderson said "the SMD concept is great, the proposed rule is certainly positive, but we are still suggesting several ways to make it even better."

ELCON and allied industrial groups submitted lengthy comments on the proposal, reflecting its importance in moving markets toward real competition. (See related stories.)

"Industrial users have long sought large, seamless markets that we believe will benefit anyone who is buying or selling electricity," Anderson said. "A standard market design -- having consistent rules from region to region -- is essential."

The lynchpin of the proposal is arguably FERC's recommendation to place all transmission customers under the same tariff and rule. "Robust regional markets can't exist if they are subject to a series of different transmission rates and surcharges," Anderson said. "That would discourage, not encourage, competition, and it would balkanize markets."

ELCON agreed with FERC's assertion that "unduly discriminatory transmission practices have continued to occur and inconsistent design and administration of short-term energy markets has resulted in pricing inefficiencies."

ELCON's comments also pointed out
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2002 Ends Minus Energy Legislation

In the end, the clichés abounded. Much ado about nothing. Wait 'til next year. It's déjà vu all over again.

Congress did not enact any significant electricity restructuring legislation (or any significant energy legislation for that matter) in 2002.

Theories abound as to why the conference committee seeking a comprehensive energy bill (HR 4) produced only a bill on pipeline safety. Some claim a comprehensive approach was doomed from the start -- that a large group of stakeholders contributes not greater support but rather a base of greater criticism. Others say that while there are real problems in the electricity market, they have not produced a crisis or a consensus on how to solve them. Still others look at the divisions in American society and see the same con-

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Waiting for Supply to Meet Demand

By Carol Hyams Guthrie, ELCON Chair

As I approach each new year, too often my expectations for electricity and electric markets resemble that old French expression: the more things change, the more they stay the same.

But this coming year, I don't think that's the case. I believe the groundwork laid in the past year or two portends major change in electric markets over the next 12 months.

You might ask why.

I don't expect Congress to raise itself from its lethargy, find the solution to our energy needs, and pass far-reaching legislation to create functioning and competitive electricity markets.

I don't expect FERC -- which is now down to three commissioners -- to find the political muscle it has been lacking to finalize its recently proposed Standard Market Design.

And, I certainly don't expect any more states to enact plans for retail competition.

I know that many market observers and political pundits look at the "Enron debacle" and the "California fiasco" and simply assert that any short-term increase in competition is not going to happen.

I have a different, more optimistic, perspective.

I sense some major attitude shifts among market participants that I believe cannot be reversed. Previously intransigent utilities recognize that the market is changing and are reacting accordingly. In different ways, utilities that three years ago could not have spelled competition are now hiring aggressive and competent sales and marketing personnel.

I see a market that is changing -- maybe not dramatically, but still changing -- on a regular basis.

One of the advantages of ELCON membership is the ability to network with other major corporate energy managers on a regular basis. Another benefit is regular meetings with FERC commissioners and staff as well as informative presentations by knowledgeable industry experts.

The one constant message I get from all these sources -- and what I have derived from my personal experience -- is the increased number of options available to corporate energy purchasers. And these options are constantly increasing as utilities, generators, and marketers all gain experience in newly competitive forums.

I know it is a cliché, but the genie of competition just won't fit back into the non-competitive bottle. Even as some companies close their energy marketing operations -- voluntarily or involuntarily -- other entrepreneurs out there are ready and eager to step in.

It is not surprising to me that some companies have failed. Selling energy in competitive markets at the wholesale or retail level is a new exercise without a proven path to economic success. Innovation often breeds success, but it can breed failure as well.

But the simple fact is that there is a market out there with participants willing and eager to purchase. It may take a while, but I am convinced that this market, like all markets, will develop a model of functioning so that supply meets demand. And I know that there is substantial demand.

All of this makes sense to me, at least in part because of my company's membership in ELCON. From the presentations at the ELCON Seminar to the discussions at our ELCON workshops to the conversations between ELCON members, I feel prepared for change. I know that electricity markets are in transition, and I know I have to be prepared in order for me and my company to operate in that transition.

I believe, based on my years of experience, the best way to do that is to maintain my participation in ELCON.

Carol Hyams Guthrie is General Manager, Electric Market Strategies, ChevronTexaco
Market Uncertainty, Volatility Loom Large at ELCON Annual Seminar

Consistent with the overall theme of the 20th Annual Seminar, the topics of market uncertainty and volatility received lots of attention, and from various perspectives.

FERC Chair Pat Wood gave perhaps the pithiest analysis, stating that "congestion causes uncertainty," going on to say that market uncertainty then causes investment uncertainty. That view was echoed by Alliant Energy CEO Erroll Davis who told industrial users in attendance that, in dealing with market volatility, utility executives "share your pain."

He added that the utility industry needs money "to invest at reasonable rates" in order to cope with increasing demand and to restore consumer confidence.

Consultant Richard Tabors agreed and provided more detail. In order to cope with market volatility, he said, "end users need the ability to schedule consumption." The problem, he pointed out, is that residential consumers have a difficult time adjusting consumption according to supply and demand. He noted that real time pricing is critical, and he said that a crucial component in coping with volatility is "the need to get the demand side in the equation."

Arthur Gelber, an energy management expert, explained why it is so difficult to deal with volatility in electricity markets.

Some Still See Hope for Energy Legislation

Although most observers of electricity markets believe that the movement to retail competition is stalled, if not dead, several speakers at the 20th Annual ELCON Seminar presented a contrary view.

Francis Shields, an energy management consultant from Accenture, said that North American energy markets were at a "critical nexus." Most people, he said, viewed California's experiment with retail competition as indicative but he did not.

Retail competition is part of the solution, he said. "Bring it on."

Scott Harvey, a consultant from LECG, offered half an endorsement. He said that for meaningful retail markets to develop, customers must have the ability to react to price changes. He said he didn't believe that residential users would be able to benefit from retail competition, but he thought that "big industrial customers should have access to a bid market."

Another consultant, Richard Tabors, also voiced belief in competitive retail markets, but he asserted that consumer confidence was a necessary prerequisite for retail competition to succeed.

"Where will consumer confidence come from?" he asked.

He did not have an answer -- stating that neither FERC nor state utility commissions were likely sources. The financial community might be the ultimate solution, he said, but he did not see them assuming the role in the near future.

NARUC Exec Sees SMD Good Points

FERC's proposed rule on Standard Market Design (SMD) was an issue of concern to both speakers and participants at the 20th annual ELCON Seminar in October. Keynoter David Svanda, a member of the Michigan Public Service Commission and president-designate of the National Association of Regulatory Utility Commissioners (NARUC), voiced a note of caution but also saw a good deal to like.

Svanda, who opened the seminar, said he viewed the single transmission tariff as the most important provision since it would eliminate "pancaking," which he said he considers essential. He also spoke positively about having nondiscriminatory grid management through the establishment of independent transmission providers.

Svanda's position was something of a contrast to that of several other state commissioners -- especially from the Northwest -- who have voiced their opposition to the SMD proposal.

At the same time, without echoing the Northwest commissioners' criticisms or philosophical opposition, Svanda did suggest moving cautiously when he stated that a regional approach to market design might be preferable to the national approach put forth by FERC.

Another voice of support for the concept of SMD came from Dale Landgren, vice president of the American Transmission Company. He put it simply, stating, "whole markets cannot work without a solid infrastructure."
No Energy Legislation
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flucting goals echoed in Congress: greater exploration for energy sources versus prohibitions on disturbing natural resources; greater federal oversight of interstate energy markets versus a larger state role.

Politically, energy issues are short-term problems with long-term solutions. If a legislator/candidate cannot point to recent improvements, and an opponent can raise mythical future problems, there is no point in legislating.

This brings us to 2003. Although the new Republican majority in the Senate is probably good news for industrial energy users (pro-supply exploration legislation probably good news for industrial energy new Republican majority in the Senate is no point in legislating.

The Administration may fulfill its pledge to expand areas permitted for oil and gas exploration. Nuclear issues, including renewal of the Price-Anderson Act, remain unresolved. A number of tax provisions were left undone. And, sentiment exists to create some research and development incentives.

On the electricity front, some of the more contentious sub-issues such as a renewable portfolio standard and global climate change are now off the table. But, most of the other issues on which Congress could not reach agreement remain. These include issues related to SMD (RTOs, tariffs, transmission funding, interconnection) as well as reliability, PUHCA and PURPA. The differences on these issues are not so much along party lines as regional. They were so great last year that the House Committee on Energy and Commerce opted not even to consider electricity, while the Senate leadership took the energy bill directly to the floor instead of going through the Energy Committee, where everyone knew agreement could not be reached. The slight change in Senate membership -- and change in majority party -- will not likely change that situation.

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provide limited antitrust exemption.

"We met for well over six months," recalled ELCON Executive Director John Anderson. "Unfortunately, we got into the Christmas tree mode. Everybody wanted to hang an ornament. We all endorsed the final product, but we knew it wasn’t very pretty."

For example, ELCON did not like granting regional bodies deference in FERC’s decision-making process for fear it would balkanize markets.

The proposal, soon dubbed the "consensus" language on reliability, enjoyed wide support, although ELCON and others conditioned their support on making it part of a comprehensive electricity bill.

"At first some of us were hoping reliability would be attached to a retail customer choice bill," noted Anderson. "Later we hoped it would be part of a bill that clarified regulatory jurisdiction over transmission. But none of those bills ever got any traction."

The stakeholders continued to meet and added minor modifications to the originally agreed-upon language. In 2000, when the 106th Congress was coming to a close, the Senate passed a slightly modified version of the original consensus language in a bill sponsored by Sen. Slade Gorton (R-WA). The bill passed by voice vote with minimal debate on the Senate floor. Almost all of the original stakeholders supported it.

But the House did not act, so the bill died. By the beginning of the next Congress, there were several new variables in the "reliability" equation.

As the volume of commercial transactions on the grid grew, congestion increased. "It became clear that how so-called reliability standards were implemented was very important," explained Anderson. "When industrial end users found themselves on the wrong side of a bottleneck, their supply of power was jeopardized. And when NERC ordered Transmission Load Relief, or TLRs, as the remedy -- which they did with increasing frequency -- the supply of power was reduced and many large users could not receive the power they had contracted for. Nobody considered the commercial impact. The focus was on maintaining reliability. But industrial users can tell you that virtually every decision affecting reliability of the grid has some commercial impact."

At roughly the same time, the Gas Industry Standards Board (GISB), a voluntary organization that had been developing and issuing non-binding standards for the gas industry, offered to develop electricity standards as well. It renamed itself the North American Energy Standards Board (NAESB).

The Federal Energy Regulatory Commission asked NERC and NAESB to develop a plan to work in unison. After months of negotiation, a memorandum of understanding was signed in 2002. ELCON was intensely involved in the drafting process.

In the just-finished 107th Congress, the contentiousness of the electricity restructuring debate was a major reason the conference committee on the energy bill (HR 4) failed to reach consensus. This year, narrower legislation, such as a "reliability" bill, may be all that Congress has the time or inclination to address. In addition, some congressional staff have pointed out that grid reliability may have a new meaning -- in terms of homeland security.

"What we have to do," said Anderson, "is reconvene the stakeholders and start anew. Discard all those old Christmas ornaments and see if we can't agree on a simple tree." He added, "Certainly, we have to consider antitrust and enforcement. But I don't think the legislation needs to include governance, procedure, or deference. My inclination is to put as little as possible in the legislation and let FERC make the crucial decisions as the markets develop. If we keep the bill small, we have a chance of getting it enacted this Congress."

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Apply Margin Assessment Screen To RTO Sales, ELCON Says

The Federal Energy Regulatory Commission’s new “supply margin assessment” screening tool to identify companies that have excessive market power should be applied even to sales made into regional transmission organizations (RTOs), ELCON told FERC in comments.

RTOs are still undeveloped, and their own market-monitoring functions are after-the-fact safeguards, ELCON said. FERC had proposed exempting sales into RTOs from screening if the RTOs had approved market-monitoring and mitigation functions.

"There is too great a risk that the generators and other suppliers can abuse the fledgling and imperfect RTOs that now exist as a shield to escape the more searching screen for market power that FERC proposes to adopt," the comments said.

Companies identified by the screen as having excessive market power would be required to take mitigation measures to reduce their power.

ELCON commended FERC for dropping earlier, simplistic screening mechanisms (e.g., defining companies with market power on the basis of their market share). The SMA screen instead would take into account transmission constraints and would focus on whether a seller is "pivotal" in a market. "Pivotal" would be defined as a seller that had capacity exceeding the market’s supply margin (i.e., surplus capacity above peak demand).

ELCON said it "strongly supports" FERC efforts to use the proposed standard market design (SMD) rules to address market power but that that could take years. The comments noted, "The single most important act that FERC can take to moderate market power of generators is to structure market rules and transmission tariffs to develop the demand side of the market."

SMD Proposal
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that FERC is well within its statutory authority on the single transmission tariff. "Not only is the Commission’s proposal for a single transmission tariff necessary to remedy remaining discrimination," asserted Anderson, "but we believe that the Commission has the authority and the duty to redress discrimination by placing all uses of the transmission system under a common set of rules and market standards."

Anderson praised FERC for including the issue of demand response in its proposal rule. "Industrial consumers are pleased that demand response is considered as a resource in the SMD tariff," he said. "We believe that there should be symmetry between supply and demand. In the market, each kilowatt hour of reduced consumption has the same impact in mitigating congestion as a kilowatt hour of increased supply."

"ELCON is not advocating classic demand-side management programs," Anderson pointed out, but rather that "the demand side be treated just like the supply side in electricity markets. This is neither rocket science nor science fiction, just Economics 101."

ELCON also included significant comments on "remedying undue discrimination against loads and customer generation."

Other Issues

ELCON also addressed FERC’s proposals on market power mitigation, bidding rules and governance. "We compliment FERC for its bold approach to market power mitigation," said Anderson. "Market monitoring -- truly scrutinizing the market and market participants to anticipate market abuse -- is a very important role that we hope will get greater emphasis in FERC’s final rule."

Treating the demand side like the supply side is neither rocket science nor science fiction, just Economics 101.

Similarly, Anderson said, "FERC should relook at its proposals for bid-based markets. We believe the Commission has an obligation to define the expected outcomes of bid-based markets and to specify acceptable and unacceptable bid behavior. FERC's proposed process assumes that bids will be related to costs. But we assume that any monopolist's bid should be looked at with great scrutiny."

"I want to compliment FERC on its proposal for grid governance," added Anderson. "They recognize that both supply-side and demand-side participants should have equal standing."

"ELCON members wish FERC well," concluded Anderson. "Electricity is an interstate commodity. Electrons do not stop at state lines. We need federal rules to make large markets work for consumers. We appreciate FERC offering this proposed rule. We know there will be changes. We think it is good. We believe it can be made even better."

ELCON Welcomes Three New Members

ELCON welcomes three new members covering a range of industrial operations.

ExxonMobil, formed in 1998 by the merger of Exxon and Mobil, is involved in almost every aspect of the energy and petrochemical business. ExxonMobil conducts business in almost 200 countries and territories around the globe and has established a new definition for world-class
ELCON Activities Before The Federal Energy Regulatory Commission

A Load Is Not a Load-Serving Entity, ELCON Says in SMD Comments

When a retail customer eligible to shop for power begins to do so, it faces enormous hurdles -- in part because the system does not recognize the entity for what it is. This was illustrated in ELCON’s and its allies’ SMD comments by the example of a Delaware industrial company that lost its electricity contract and could not find suitable alternative suppliers. (See box.) Because no provisions exist for a load entity to self-serve in the PJM Interconnection, the company was forced to become a FERC-licensed power marketer and a PJM member, which created numerous hurdles and hardships.

The lesson? Loads should not have to pretend to be load-serving entities (LSEs) or power marketers in order to gain access to markets, ELCON said.

FERC should modify its rules to differentiate among LSEs and "loads." Loads do not have many of the responsibilities of load-serving entities such as a state-mandated obligation to serve. By clarifying the relevant provisions in the SMD tariff, loads will not be encumbered with LSE-type responsibilities.

For example, loads (unless they have specifically elected to be treated as LSEs) should not be required to submit load forecasts to the RTO or ITP, fund studies to accommodate expected load growth, be penalized the same way as LSEs over resource adequacy shortcomings, or have to be certified as some form of LSE to obtain transmission service.

The comments pointed to other variations in how industrials generate and use power. Some industrial facilities keep all the power they generate behind the meter. Others are active participants in wholesale markets. For some, the power is an integral part of the industrial process and cannot be differentiated from the product. For others, generation can be increased or decreased in response to market forces. And, not all on-site generation is owned by the industrial host; sometimes, third parties may own or operate part or all of the power production operation.

For generation demand that remains on-site -- which ELCON described as "behind the meter" -- FERC should "recognize the retail meter as the terminus of regulatory oversight."

"FERC has no jurisdiction over power that never has and never will leave the site," stated Anderson. "That power plays no role in wholesale markets and has no impact on the interstate grid. For this power we say to FERC -- emphatically -- hands off."

"FERC certainly has jurisdiction over market-participating load," said Anderson. "In fact, we urge FERC to take some very specific action."

Those actions include 1) modifying the SMD tariff to ensure the nondiscriminatory treatment of market-participating loads, 2) making sure the SMD rule takes into account the unique operating characteristics of customer generation, and 3) making bidding and dispatch rules flexible in recognition of the limited or intermittent dispatchability of generators integrated with industrial processes. E

Canceled Contract Leads to Maze of Issues

Company’s experience illustrates need to differentiate

When an industrial electricity user had its electricity contract canceled by the local utility and was unable to find a suitable alternative supplier, the company decided to self-generate at its Delaware facility. There are no provisions for a load entity to self-serve in PJM, so the company was forced to become a FERC-licensed power marketer and a PJM member, register as a load-serving entity (LSE) in the state of Delaware, and set up a 24-hour scheduling operation, all to serve a single manufacturing facility.

The PJM membership and LSE certificate involved rigorous application processes, including credit approvals, selection of an Electric Distribution Company (EDC) supplier, and identification of scheduling entities.

Delaware requires an LSE to have a minimum of two customers before issuing a certificate. PJM had no such requirement but would not proceed with the membership until this hurdle was cleared. The company had to ask the state to remove this requirement, which it did.

As various issues emerged with Continued next page
the application of PJM's tariff, PJM consistently referred the company back to the incumbent EDC for resolution. PJM will administer whatever the parties agree to on issues such as FTR allocation, active load management (ALM) credit ownership, and others.

The company could not reach agreement with the EDC on the FTR allocation issue and was forced to file a complaint with FERC. The company reached agreement with the EDC on the transfer of ALM credits but PJM would not act or give an opinion on the issue until it received a written commitment from the EDC allowing the transfer to the company. These credits were earned under the PJM-administered ALM program and should have been readily transferable.

The company continues to have an issue with the EDC regarding next-day settlements. The EDC contends that it alone can do next-day settlements and that it will do them based on forecasted loads. Its present forecast is about 10 MW higher than actual load, which will force the company to overpay its bill from PJM by about $250,000 per month and then wait 45-60 days for the settlement process to refund the money without interest. The company believes that the PJM tariff allows the LSE to enter its own next-day settlements, but PJM's position is that it will do whatever is jointly agreed to by the company and the EDC. E

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ELCON and its allies supported the following concepts and provisions in FERC's SMD proposal:

- All transmission customers should be placed under the same tariff and rule -- arguably the most important single element in the proposal and one supported by ample statutory authority.
- Bundled retail customers should be placed under the interim tariff.
- Independent transmission providers (ITPs) should be created, but they cannot own transmission assets. Independent transmission companies (ITCs) cannot be ITPs because they have a conflict of interest associated with transmission asset ownership.
- Demand response should be included as a resource in the SMD tariff.
- Recovery of embedded transmission costs should be allowed through an access charge mainly on load; rate pancaking should be eliminated.
- Standardized treatment of capacity benefit margin should be allowed.
- The regional planning process should be encouraged -- along with some form of interconnection-wide planning authority.

In some areas, ELCON and allies urged going further:

- ITPs should be required to offer several types of congestion revenue rights (CRR).
- A "bright line" should be established to differentiate between transmission assets subject to ITP operational control and distribution facilities.
- The criteria for market abuse should be clarified.
- The ITP governance proposal should be refined to ensure, among other things, that load-serving entities do not participate as loads in the stakeholder process. E

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New ELCON Members

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scale and efficiency. For more information, visit http://www2.exxonmobil.com.

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WHAT IS ELCON?

- DATE ORGANIZED: January 15, 1976

- WHO WE ARE: The Electricity Consumers Resource Council (ELCON) is the national association representing large industrial consumers of electricity. ELCON was organized to promote the development of coordinated and rational federal and state polices that will assure an adequate, reliable and efficient supply of electricity for all users at competitive prices. ELCON's member companies come from virtually every segment of the manufacturing community.

- MEMBER COMPANIES: A.E. Staley Manufacturing Company • Air Liquide • Alcan Aluminum Corporation • Anheuser-Busch Companies, Inc. • BOC Gases • BP • Central Soya Company, Inc. • ChevronTexaco • Delphi Automotive Systems • E.I. du Pont de Nemours & Co. • Eastman Chemical Company • ExxonMobil • FMC Corp. • Ford Motor Company • General Motors Corporation • Honda • Honeywell • Intel Corporation • International Paper • Lafarge • MG Industries • Monsanto Co. • Occidental Chemical • Praxair • Rockwell Automation • Shell Oil Products • Smurfit Stone Container Corp. • Solutia, Inc. • Weyerhaeuser • Williams Energy Services

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