U.S. Appeals Court Faults Long-Standing FERC Market-Based Rates Policy

In December, the United States Court of Appeals for the Ninth Circuit issued two important decisions reversing long-standing FERC policies regarding the granting of market-based rates and the appropriate "public interest" standard that FERC should use in determining what rates are "just and reasonable" as required by the Federal Power Act.

Consistent with a position that ELCON has taken in numerous documents, the two decisions emphasize that the fundamental purpose of FERC’s rate-making authority under the FPA is to protect consumers. In addition, the Ninth Circuit stated that FERC cannot assume that contracts agreed to under a supplier's FERC-granted, market-based authority are pre-approved and therefore just and reasonable.

The cases stemmed from the West Coast power crises of 2000 and 2001. Wholesale electric power buyers in California, Nevada and Washington appealed to FERC that the contracts they had signed during that time should be invalidated since the prices agreed to were the result of market power exercised by suppliers.

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ELCON Sees Need to Explore All Alternatives To Organized Markets, Even Re-Regulation

The consumer benefits of "organized markets" are so questionable that all alternatives -- even a return to traditional, cost-of-service regulation -- should be explored, ELCON said in a newly released paper, "Today's Organized Markets -- A Step Toward Competition or an Exercise in Re-regulation."

ELCON President John Anderson described the new paper as a "significant refinement" to one released in 2005 entitled, "Problems in the Organized Markets." Today's organized markets (PJM, NYISO, ISO-NE and MISO) are neither competitive nor advancing the cause of competition, according to ELCON.

Both ELCON papers put forth seven preconditions for competition:

- Prices must be established through an interaction of supply and demand. Today, except in isolated instances, consumers cannot react to high prices by reducing consumption. True competition cannot be achieved

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ELCON Fall Workshop
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Siting Issues, Global Markets Focus of Workshop Session

One result of the many changes that have occurred in social, environmental and energy attitudes over recent decades is that "it's not going to be easy to build anything -- and when we do it will be expensive," according to Diane Munns, a Commissioner on the Iowa Utilities Board and the 2006 President of the National Association of Regulatory Utility Commissioners (NARUC).

"Today's energy markets are very different from those of 30 years ago," she said in remarks at ELCON’s Fall Workshop, "Your Next KWh -- Options in Muddled Markets."

For one thing, energy markets are now global, and consumers -- especially manufacturers -- are competing for energy resources with still-developing countries like China and India. Domestic security is another new and important issue that impacts energy use. And, Munns said she believes that the NIMBY ("not in my backyard") movement (accompanied by NIMTO -- "not in my term of office") has gained considerable momentum.

Carbon and climate change issues have gained general acceptance by the popular press, which then affects energy use, she said. Finally, she said market uncertainty for electricity is a factor that

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Consumers Express Dissatisfaction

By Joe Marone, Chairman, ELCON

Remember the 1970s movie "Network" about a television anchorman more than a little upset how his news show was being run? At one point in a broadcast he simply stops and yells, "I am mad as hell and I am not going to take it any longer."

He didn't stop there. He urged other citizens to exclaim the same thing. Soon, he had followers. You would see people opening a window or stopping on the street -- generally disrupting their normal routines -- to proclaim how fed up they were.

The mass discontent went beyond the way the news was broadcast and hit at the way people felt life in general was going. It was a tidal wave of vocal frustration.

When I look at how consumers are reacting to today's electricity markets, especially consumers in the so-called organized markets like PJM and the ISOs in New York and New England, I sense the same kind of groundswell. Consumers of all sizes, from the smallest homeowner to the largest manufacturer, are outraged with the massive electricity rate increases that have been proposed in state after state. They are, in fact, as mad as hell.

And they do not intend to take it any longer.

Electricity is an absolutely essential product in today's economy. Given the ever rising importance of computers, even the slightest hiccup in power supply can wreak havoc -- not just in a major manufacturing facility but in homes as well.

Confidence in our electricity system -- in the generation companies, in the delivery companies, and in the state and federal regulators -- is falling fast. Outrageous rate increases are a major part of the problem. Several have been in the 50-70 percent range and at least one has been 100 percent. Every time this happens, outrage explodes and confidence drops. These rate increases are not solely the result of "restructuring" or "deregulation" or even the high price of natural gas. To a large degree they are the result of poorly implemented restructuring. I do not believe our current organized market system is sustainable for a prolonged period of time.

I still believe in the potential for competition. But we will never achieve true competition as long as we have today's so-called "organized markets." They ought to be called "poorly organized markets."

An important point is how these so-called organized markets operate and make decisions. Each has a governing process. And each recognizes that consumers should be part of the process. But none of the markets gives consumers more than 20 percent of the vote, so consumers are marginalized when it comes to making decisions.

I propose that we change the governance and operation of these markets so that they reflect what consumers seek, not simply what suppliers are willing to provide. Lower rates and reliable service top my list, and, I suspect, others' lists. I would also like to see more innovation and product offerings and, in general, more customer focus. That's not what the markets and the suppliers are offering at present.

In order to have "true competition" -- which I believe would benefit consumers -- we need greater reliance on long-term bilateral contracts, more active use of the demand side and not just reliance on the supply side, and a congestion-free transmission system that doesn't reward those who own transmission and maintain constraints. But none of this will be achieved as long as we have a market governance system that is heavily skewed toward the supply side.

In economic theory, the problems in a competitive market are short-term, and should be corrected by market forces. Today's electricity markets are not competitive so the problems are not self-correcting. In fact they are self-perpetuating. As long as the governing structure for these markets minimizes consumers input, the markets will continue to benefit only suppliers.

We need to make changes now. To mix metaphors, I see a train wreck coming on the transmission grid, and this nation's consumers -- industrial, commercial and residential -- cannot afford for that to happen. I believe that consumers are already as mad as hell about electricity markets. I do not believe that they will take it for that much longer. And I am truly afraid of what happens next.

Joe Marone is Director, Power Purchasing, Occidental Chemical

ELCON Welcomes Five New Members

ELCON is pleased to announce five new members involved in a range of industrial operations. Rio Tinto is one of the world's leading mining and exploration companies, with operations involved in finding, mining and processing metals and minerals essential for making thousands of everyday products that meet society's needs and contribute to improved living standards. Products include aluminum, copper, diamonds, energy products, gold, industrial minerals and iron ore. For more information, visit http://www.riotinto.com/.

Valero Energy Corporation is a Fortune 500 company based in San Antonio with approximately 22,000 employees and assets valued at $33 billion. The largest refiner in North America, Valero has an extensive system with a throughput capacity of approximately 3.3 million barrels per day. The company's geographically diverse refining network stretches from Canada to the U.S. Gulf Coast and West Coast to the Caribbean. For more information, visit their website at http://www.valero.com/.

Gerdau Ameristeel is the fourth new member involved in a range of industrial operations. For more information, visit their website at http://www.riotinto.com/.
Election Results Will Affect Energy Policy

The November elections results giving Democrats a majority in both the House and Senate will undoubtedly have an impact on energy policy in the next Congress.

In the 110th Congress, the House will comprise 233 Democrats and 202 Republicans (a gain of 29 for Democrats), while the Senate will number 51 Democrats and 49 Republicans (a net Democratic pick-up of six). Democrats will chair all committees and subcommittees in both houses and will control the floor agenda.

In the House, Rep. John Dingell (D-MI) will resume his chairmanship of the House Energy and Commerce Committee, a position he held before the Republican takeover of the House in 1995. It appears likely that Rep. Rick Boucher (D-VA) will chair the Subcommittee on Energy and Air Quality, though the subcommittee title might change.

Both Members are generally regarded as moderate Democrats, and each has significant manufacturing in his district. Rep Boucher is a leader in defense of cogeneration should any PURPA amendments be proposed.

Rep. Dingell has a long history of conducting congressional oversight over department and agencies within his committee’s jurisdiction. It seems nearly certain that, as chairman, he will be calling officials from the Department of Energy and the Federal Energy Regulatory Agency before his Committee to press them on carrying out statutory intent. Rep. Dingell is also well known for sending long letters (sometimes called "Dingellgrams") to department and agency heads asking for details as to why particular actions were taken or how statutory interpretations were arrived at.

One issue that may surface in the House Committee is the operation of Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs). During the last Congress, nine Democratic committee members sent a letter to then Chairman Joe Barton (R-TX) asking for hearings to determine, among other things, whether RTOs and ISOs were providing consumer benefits commensurate with their costs. Rep. Barton took no action, but either Rep. Dingell or Rep. Boucher might initiate hearings at the full committee or subcommittee level, respectively.

Sen. Jeff Bingaman (D-NM) will return as chairman of the Senate Committee on Energy and Natural Resources, a post he held earlier when the Democrats controlled the Senate. He is a long-time supporter of legislation to increase the use of renewable fuels, and he seems likely to press this issue in the next Congress.

Efforts may be seen in both houses to address carbon emissions and global warming. In the Senate, jurisdiction is divided between the Energy Committee and the Committee on the Environment and Public Works, the latter to be chaired by Sen. Barbara Boxer (D-CA). While enactment of legislation seems a long shot -- simply because Congress usually takes several Congresses to reach consensus on controversial issues -- legislative and oversight hearings are probable.

Although legislative action on electricity per se does not seem likely, efforts to increase renewable energy and to curb carbon emissions would certainly affect electricity generation. If such legislation begins to progress, there may be opportunities to add other issues such as cogeneration and transmission funding.

Markets Must Be Fixed, Moeller Says

Newly confirmed FERC Commissioner Phil Moeller told ELCON that his service at FERC will be governed by a strong belief in the need for competitive markets. Other industries -- telecommunications, airlines, natural gas, and trucking --- have benefited from competition through lower prices and other consumer benefits, but in electricity, "markets are not working as well as they should," he said. The electricity markets now operating "must be fixed."

Noting that Order 888 is now 10 years old, Moeller said a priority of FERC Chairman Joe Kelliher will be to review the order and see how it can be improved. That effort will probably involve "40 to 50 issues," he explained.

"We have regional markets with very different characteristics," he said. FERC's job is "to send the right signals" to encourage new generation and new transmission which would "alleviate a lots of problems."

U.S. Sen., Rep. Seek GAO Probe of MISO

In September, two Members of Congress asked the Government Accountability Office (GAO) to "investigate whether ISOs and RTOs actually reduced, or even increased, the costs of wholesale electrical power throughout our country."

Rep. Jim Oberstar and then-Sen. Mark Dayton (both D-MN) specifically focused on the Midwest ISO (MISO), noting that "utilities throughout Minnesota are experiencing continually rising costs from their participation" in MISO and that "participants in MISO markets have noted their concerns over the high costs of doing electricity business throughout the MISO region."

The two members attached four pages of questions for GAO to address in its investigation. They centered on "whether the benefits consumers obtain from MISO’s operations outweigh the costs incurred."

In addition to a number of general questions about cost effectiveness, the attachment included requests for detailed cost information from calendar years 2001 through 2005.

ELCON President John Anderson commented, "We hope that GAO looks at this issue very closely -- there is no reason for consumers to pay one cent for the operation of RTOs and ISOs if they are not receiving any benefits."

There is no target date for completion of the GAO study.
Siting Issues
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must be considered by both suppliers and end users.

A slightly different view was given by Howard Gruenspecht, Deputy Administrator of the Dept. of Energy’s Energy Information Administration (EIA), who noted that "electricity is a product you make a million different ways." The life of a coal-fired electricity generation facility is quite long, and, "You just don't shut those things down," he said.

Gruenspecht said one of the biggest changes in electricity markets has to do with the objectives of industrial users. For years, manufacturers supported competition, believing that cheaper power would displace inefficient generation and that a fixed price was better than one set by cost-of-service regulation, he said. Now, manufacturers are looking at carbon-based fuels and trying to determine their most efficient use.

Michael Kagan, chief commercial officer for Constellation NewEnergy, offered Workshop attendees some guidance on how to buy power in a transitional market. Buyers have "lots of options," including deciding on a fixed or blended price, buying power or building generation on-site, choosing between short and long-term contracts, offering to participate in demand response markets, and determining whether to buy through a broker, hire a consultant, or simply purchase from the retail supplier, he said.

He advised end users to align their energy procurement strategy with their overall business strategy, and to exercise "discipline" in following that strategy. "You cannot afford to try to time the market," he stated, and those who depart from their strategy in hopes of achieving short-term savings usually do not succeed.

Kagan conceded that today's organized markets need improvements. He suggested that Workshop attendees communicate their dissatisfaction to FERC and to the board members of RTOs and ISOs.

Coal Described as Likely Fuel of the Future

Coal “is hot again,” Nick Guarriello, past president and CEO of R.W. Beck, Inc., told ELCON’s Workshop. He called development of additional clean coal technologies "crucial," predicting coal will remain the base fuel for roughly 50 percent of the generation base.

He forecast that for the period 2005-25 new generation will be approximately 47 percent natural gas and 42 percent coal.

The natural gas part of that outlook was supported by Howard Gruenspecht, deputy administrator at the Department of Energy’s Energy Information Administration, who predicted that natural gas use will increase as a base fuel for electricity and facilities to import and process liquid natural gas -- though very expensive -- will be built over the next 10 to 20 years.

Guarriello argued that coal will remain prominent in the near future because it does not have the high costs associated with natural gas, it is abundant, and it is "made in the USA."

Coal has historically had "low fuel price volatility," he said. Coal plants that are proposed, planned, or under construction number more than 100, he said.

He added that Integrated Gasification Combined Cycle (IGCC) production will increase in the coming years. Although IGCC requires a higher capital investment than conventional coal-based generation, it has a lower variable cost and a better heat rate, he said.

These views were echoed by Herb Kosstrin, a principal and senior director at R.W. Beck. He offered that IGCC would help lower emissions, use less water, and recapture CO2.

He indicated he found it amusing that utilities are still referring to gasification as "an emerging technology" since manufacturers have been using it for at least 20 years. A facility in South Africa initiated use in the 1950s, he noted.

Anand Gangadharan, president of NOVI Energy, a major consulting company specializing in innovative fuel solu-
The electric power industry is "the leader" in CO2 and greenhouse gas emissions, and the biggest reductions in emissions will come from the electricity industry, not transportation, according to Howard Gruenspecht, deputy administrator of the Energy Information Administration (EIA) at the Department of Energy (DOE), told ELCON's Fall Workshop.

Diane Munns, a member of the Iowa Utility Board and a co-chair of the National Action Plan for Energy Efficiency (NAPEE), a joint DOE/EPA effort, also expressed concern at the Workshop about achieving environmental improvements in the electric utility sector, especially during a time of increased demand. Both conservation efforts and further development of coal reserves will be needed, she indicated.

Munns discussed one of the most controversial recommendations in the National Action Plan, in which utility profits would be "decoupled" from their revenue stream by "breaking the relationship between generation and revenue." Utilities basically would be guaranteed a specific profit level even if revenues were reduced due to conservation or efficiency efforts.

Too often energy conservation efforts are undertaken "half-heartedly," Munns said. She noted that the National Action Plan, was developed by "lots of people interested in efficiency." A prevailing view was that utilities have no incentive to support energy efficiency or conservation, since such action would reduce utility revenue and therefore reduce profits. Hence decoupling.

ELCON members have voiced strong opposition to decoupling, pointing out that manufacturers have already made significant efforts to achieve energy efficiency for competitive reasons, and that higher payments to utilities would harm the nation's manufacturing base.

Additional views were offered by David Kathan, senior economist in the Office of Energy Markets and Reliability at the Federal Energy Regulatory Commission. Kathan summarized a recent FERC staff report (which he emphasized was not a Commission report) on demand response and how it could be used to achieve conservation objectives.

Among the paper's recommendations: (1) markets should use the "inherent characteristics" of demand response to increase its use, (2) markets should develop better demand response "forecasting tools," and (3) demand response should be viewed as a "permanent" solution.

Kathan admitted there are multiple regulatory barriers to increasing use of demand response, although there are few, if any, technical barriers. He specifically cited the "disconnect" between retail pricing and wholesale markets, the disincentives for utilities, the need for further research, particularly on cost effectiveness, and better coordination of federal and stated regulatory authority.

Environmental, Efficiency Objectives Seen Guiding Markets

He advised looking into "combination projects" where manufacturers could work with local governments to "connect" joint objectives. In seeking out "unlikely allies," Gangadharan noted that manufacturers offer a thermal local that might be able to utilize locally generated organic waste as a fuel. This can ease sitting and permitting processes. He suggested manufacturers fully explore new opportunities and new technologies, and that "social connectivity" is important.

Clockwise from above: Howard Gruenspecht, DOE Energy Information Administration (EIA); Nick Guarriello, R.W. Beck, Inc.; and David Kathan, FERC Office of Energy Markets and Reliability
ELCON Activities Before The Federal Energy Regulatory Commission

FERC'S PURPA Role Criticized

ELCON and 26 other national and state organizations and associations representing environmental, industrial and consumer groups joined in issuing a statement opposing FERC's recent rule on the Public Utility Regulatory Policies Act (PURPA).

The rule, issued under the Energy Policy Act of 2005 (EPAct) in October, provides the framework for utilities to be relieved of their obligations under PURPA to purchase cogenerated power. FERC ruled that utilities in any of the four organized markets are presumed to be in compliance with the criteria in EPAct and are relieved of PURPA requirements, though a cogenerator or other qualifying facility covered by PURPA can challenge that finding.

The opponents of the rule wrote that it "does not represent the best options open to the Commission to achieve desirable policy objectives and it does not interpret the statute as Congress intended."

Specifically, the joint statement noted that despite an ongoing statutory directive in PURPA for FERC to "encourage" cogeneration, under the new rule "existing cogeners will have less incentive to maintain or increase generator, and potential cogenerators will have increased risks when considering new facilities. The result will be less cogeneration."

The joint statement also noted that when Congress added an amendment to PURPA in EPAct, "it could have referenced the so-called 'organized markets' but it did not."

ELCON and the American Forest and Paper Association developed the statement and secured supporters. Other signers include the American Chemistry Council, the American Iron and Steel Institute, the Natural Resources Defense Council, the Union of Concerned Scientists, the Environmental Law and Policy Center, and eight state industrial groups.

The joint statement concluded by urging that "FERC recognizes the benefits of cogeneration...as well as the intent of Congress." FERC should release a revised rule "that will encourage more energy diversity and be consistent with statutory intent," the opponents wrote.

ELCON and several other groups filed for a rehearing of the PURPA rule (see related story).

Application of the Mobile-Sierra doctrine was erroneous since FERC had "no opportunity" to review the contracts to determine whether they were just and reasonable before they were signed. In rejecting review after the fact, "FERC neither performed the full scope of 'just and reasonable' review nor revisited the market circumstances in which the agreements were entered to determine whether those circumstances were sufficiently functional that they were likely to yield long-term contracts within the 'just and reasonable' range," the court said.

In short, the decision calls into question FERC's basic authority to permit suppliers to charge market-based rates. If advance regulatory analysis and approval of specific price and contract information are required, the process will undoubtedly be unworkable since the Commission does not now have -- and never will have -- resources to make such determinations in advance. Thus, the future of competitive wholesale markets under FERC jurisdiction is now in question.

Although the decision is not binding outside the appeals court's jurisdiction, "The potential impact of the Ninth Circuit decision cannot be overstated," said ELCON President John Anderson. "While we support the concept of competitive markets, the rates in those markets should reflect the forces of competition and not be the result of market power or dysfunctional markets. We will be watching FERC's reaction to this ruling as well as the progress of similar cases in other circuits very carefully."
ELCON Joins Redispatch Coalition

ELCON is participating in the Transparent Dispatch Advocates (TDA), a broad-based coalition with the common ground that the appropriate use of redispatch, undertaken in a transparent and non-discriminatory manner, can work to improve both availability and nondiscriminatory access to the grid.

Redispatch is defined as the readjustment of generation output schedules or demand side management, generally to relieve transmission congestion. ELCON and the other members of the TDA believe that redispatch and conditional firm service are complementary alternative products that can help to address the current deficiencies in the availability of long-term, point-to-point service.

As part of the TDA, ELCON filed comments at FERC in conjunction with the Electric Power Supply Association, the American Wind Energy Association, and the Natural Resources Defense Council, among others, urging FERC to make transparent redispatch and conditional firm service part of any revised Open Access Transmission Tariff.

Explore Alternatives

Without an active participation of demand interacting with supply.

- New capacity must be encouraged through market forces, not administrative re-regulation. Capacity "markets" -- both those already implemented and those proposed in the organized markets -- are inconsistent with true competition. They take billions of dollars from consumers without ever having been shown to create incentives for new generation.

- Market entry and exit should be determined by market forces. Market forces must be allowed to discipline inefficient suppliers. When regulatory support systems (often in the name of "reliability") prop up inefficient generators, the market forces attempting to force efficient construction and operation of generation assets are negated.

- Consumers must be able to hedge future prices with long-term bilateral contracts. Truly competitive markets will never exist until considerable liquidity exists in forward markets. Such contracts would provide price certainty.

- There must be an adequate transmission infrastructure. The present transmission system is hindered by a number of significant congestion points. Moreover, the joint ownership of generation and transmission encourages discrimination and gaming and should be discouraged, if not eliminated.

- Market power must be mitigated. Suppliers with local market power can "game" the markets at the expense of consumers. Competitive electricity markets require truly independent market monitors that are not advocates of any particular market design.

- Finally, and in conjunction with all of the above conditions, wholesale price caps and bid mitigation measures may be relaxed. Price signals can and should serve as the primary means to encourage investment. After other necessary conditions have been achieved, price caps and other mitigation measures may be relaxed.

Governance is a major flaw in today's markets, according to Anderson. "The flaws in these markets are not self-correcting," he said. "Not one market allocates consumers more than 20 percent of the vote. For the most part, today's markets are run by suppliers to benefit suppliers. It is no wonder that not one bona fide consumer group has anything good to say about today's markets."

ELCON's paper recommended three next steps. First, states that have not yet restructured should not do so; second, today's organized markets must be fixed; and, third, if today's organized markets cannot be fixed, all options should be explored, including a return to traditional regulation.

Before release of the paper, ELCON met with all five FERC Commissioners to communicate its views. Anderson emphasized that "we recognize that fixing the markets is not a simple process. There is no silver bullet for FERC to use that will solve all the problems. We want to work with FERC and with the organized markets to correct what we see are a multitude of shortcomings. In a competitive market, when consumers are not satisfied, suppliers listen. But in these markets suppliers don't even communicate with the consumers."
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 policies 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: Air Liquide • Alcoa • Anheuser-Busch Companies, Inc. • BOC Gases • BP • Chevron • Corning, Inc. • DaimlerChrysler • Delphi Automotive Systems • Dow Chemical Co. • E.I. du Pont de Nemours & Co. • Eastman Chemical Company • ExxonMobil Power and Gas Services, Inc. • Ford Motor Company • General Motors Corporation • Gerdau Ameristeel • Honda • Honeywell • Intel Corporation • Johns Manville • Lafarge • Monsanto Co. • Occidental Chemical • Pioneer Chemical LLC • Praxair • Procter & Gamble • Rio Tinto • Shell Oil Products • Smurfit Stone Container Corp. • Solutia, Inc. • Tate & Lyle • Valero Energy Corp.

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