

# ELCON REPORT

ELECTRICITY CONSUMERS RESOURCE COUNCIL

2010

Number Two

## IN THIS ISSUE...

- **FERC supports full compensation for demand response (Page 1)**
- **ELCON joins other major associations to challenge FERC reliability directive (Page 2)**
- **ELCON takes lead on pushing FERC for metrics in RTOs and ISOs (Page 3)**
- **FERC questioned on proposal to change rules on utility affiliates (Page 4)**
- **Status quo for QF reporting requirements is OK by ELCON (Page 5)**
- **House subcommittee approves bill to protect grid from cyber attacks (Page 5)**
- **ELCON part of push for cogeneration incentives (Page 6)**
- **Source neutrality key to integrating renewable power onto grid (Page 6)**

## FERC PROPOSES UNIFORM DEMAND RESPONSE RULES

On March 18, FERC issued a Notice of Proposed Rulemaking (NOPR) on Demand Response seeking to improve competitiveness in organized wholesale electricity markets. ELCON President John Anderson called FERC's action "a very positive step." Many ELCON members and other manufacturers have the potential to contribute to a demand response program (as do smaller consumers, usually through an aggregator) but have been hampered by cumbersome RTO or ISO procedures and/or inadequate compensation tariffs.

FERC currently allows each RTO and ISO individually to set the rules and procedures for compensating Demand Response Resources (DRRs) in their own markets and they have done so in different ways. FERC has now concluded that the compensation in some markets is insufficient and has discouraged achieving the full potential of demand response.

Accordingly, FERC has recommended in its NOPR that ISOs and RTOs that include DRR provisions in their proposed tariffs must pay for demand response according to a uniform, prescribed formula, specifically that the tariff must pay the market price at all hours for demand response undertaken in response to price signals. FERC asked that those filing in response to the NOPR address a series of questions about compensation levels and timing

ELCON will be filing comments in support of the NOPR. In addition ELCON is one of the founders and coordinators of an ad hoc coalition comprised of industrial and residential end users, environmentalists, and service curtailment providers that are working jointly to show the breadth of support for the proposed rule.

Anderson note that “for years everyone realized that a kilowatt hour of reduced consumption was equivalent – and in some ways environmentally superior – to a kilowatt hour of increased generation. Now FERC has taken the lead by proposing a rule that should result in significant improvements in utilizing the vast potential that demand response resources offer.”

## **ELCON JOINS IN OPPOSING FERC DIRECTIVE**

**E**LCON has joined with the other major electricity industry trade associations (EEI, APPA, NRECA, and others) in seeking to intervene in a FERC proceeding relating to NERC’s Rules of Procedure. Many ELCON members have facilities on NERC’s Compliance Registry, thus making them subject to NERC standards as well as the significant penalties for violations of those standards. NERC’s Rules of Procedure have been developed through a stakeholder process, and ELCON is an active participant on several NERC committees.

According to the Energy Policy Act of 2005, which gave FERC the authority to name an Electric Reliability Organization, or ERO (and FERC, in fact, named NERC to fill that role), the ERO would draft reliability standards through a process reflecting

public comments, due process, openness and balance of interests. As the request for intervention said, if FERC disagreed with a proposed NERC standard, FERC could “remand – not rewrite – proposed standards.” FERC could also “order NERC to propose standards or modified standards that address specific matters raised by the Commission.” But the statute seemed clear that FERC was not to draft standards itself.

But in March, in an unprecedented move, FERC took two steps which, if approved, would dramatically change the relationship between NERC and FERC.

First, FERC directed NERC to modify its Rules of Procedure to basically mandate that when FERC issues a directive regarding a NERC-approved reliability standard, “the participants in NERC’s Standards Development Process do not have the discretion to simply ignore the directive or develop provisions to a new or revised Reliability Standard.” The filing by ELCON et al noted that, to the contrary, according to statute, “FERC can approve a proposed Reliability Standard or can reject and remand a Reliability Standard, but it cannot develop a Reliability Standard; only the ERO has such authority.” In its press release, FERC implied that NERC must comply with FERC directives. It cited a NERC attempt to develop a standard requiring each transmission and generator owner to determine the ratings of its facilities, to which FERC directed NERC to make specific changes. FERC, in its release, said critically that it had issued the directive in 2007 and NERC has not yet complied with it.” Second, FERC stated that they were “now reevaluating” NERC’s definition of the bulk power system, resurrecting a point of contention that is several years old.

ELCON and the other associations objected to FERC's approach. As their filing stated, "FERC can direct NERC to address a specific matter and FERC can direct that NERC submit a standard to FERC in response to that directive." But "what FERC cannot and should not do is issue directives that essentially tie NERC's hands in how that standard should be drafted or modified.

ELCON President John Anderson stated clearly that "if FERC's proposed changes to NERC's Rules of Procedure are adopted, it will dramatically change the way reliability standards are developed. Congress, in enacted the 2005 Act, specifically noted that

FERC's expertise is in ratemaking. That is why it authorized a separate entity with different expertise to develop standards."

## ELCON TAKES LEAD ON METRICS FOR ORGANIZED MARKETS

In 2008 the Government Accountability Office (GAO) issued a report, requested by several members of Congress, which concluded that FERC had no means of measuring the costs and benefits of RTOs and ISOs and that it had no means of comparing the effectiveness of the various markets. GAO recommended that FERC work with all stakeholders "to develop standardized measures that track the performance of RTO operations and markets."

ELCON and ELCON members have asserted for many years that there are problems in the organized wholesale electricity markets. But without some standardized means of measurement – i.e., "metrics" – there is no

way to determine what benefits consumers are receiving vis-a-vis the costs, nor is there any way to compare the effectiveness of one market to another.

FERC undertook action to respond in late 2009, and ELCON was among a select group of stakeholders to be asked by FERC to join in an informal session where senior FERC staff shared their draft metrics proposals. Early in 2010, FERC held a Technical Conference on ISO and RTO responsiveness, and ELCON President John Anderson was invited to participate as the only representative from manufacturing sector.

At the Technical Conference, Anderson detailed why, in the views of ELCON members, the organized markets are not "competitive," as some market participants had claimed. "In a competitive industry, when there are inframarginal revenues equivalent to making profits, then there's an attraction of new entrants," explained Anderson. "And new entrants come and drive the costs, the prices down to where they're once again equal to costs." But, he said, that has not occurred.

Anderson later sparred with Commission Chairman Jon Wellinghoff, asserting that we "need generator-specific data to show whether entities are making the billions that some people say they're making."

Wellinghoff replied that, even if companies were making "billions of dollars," metrics would not show whether "consumers are still better off."

ELCON quickly communicated to FERC that their proposed metrics were inadequate and that it was clear that personnel from the organized markets had significant – perhaps even inappropriate – input into their development. ELCON, along with the

American Public Power Association (APPA), provided specific recommendations to FERC.

Those recommendations focused on generator revenues and costs, long-run market outlook, market monitoring and mitigation, and congestion.

“Without metrics in some form, we have no way to analyze the benefits that consumers are supposedly receiving in the organized markets,” emphasized Anderson.

“Generators and regulators cannot just assert that the markets are benefiting consumers – especially when so many consumers are expressing an opposite point of view. FERC needs to set up a structure where they can do the analysis that is necessary. That’s why GAO recommended that FERC establish some mechanism for metrics.”

## ELCON URGES “CAUTION” ON CHANGING RULES FOR AFFILIATES

**E**LCON urged FERC to “exercise caution” in amending the regulations governing ownership by utilities in “affiliates.”

That recommendation was in response to a FERC Notice of Proposed Rulemaking (NOPR) which would allow a utility holding company to acquire over ten percent, but less than 20 percent, of an affiliated public utility. In a FERC press release titled “FERC Proposes Greater Certainty for Investment in Utilities,” the Commission stated that, under the proposed rule, the holding company would have to file a form with FERC

affirming that the holding company will “not change or influence the control of the public utility.” The NOPR follows a FERC workshop held in late 2008.

In its comments, ELCON focused on FERC’s responsibility, under Section 203 of the Federal Power Act, to ensure that electric rates in wholesale markets are “just and reasonable.” ELCON acknowledged that there “is a potential benefit from the elimination of unnecessary regulatory barriers to the making of needed investment in generation and transmission infrastructure.” However, ELCON noted that the “guiding purpose of the Federal Power Act is to achieve ‘just and reasonable’ rates by, among other things, preventing the accumulation of either horizontal or vertical market power and improper affiliate transactions.”

ELCON President John Anderson summed it up this way. “This isn’t the biggest issue before FERC,” he said, “but if they are going to take it up it could, conceivably, have a significant impact. The threat of market power – which results in higher rates – is always prevalent. We certainly know the utility industry’s track record. That’s why we recommended that they go slow and exercise caution. This is a classic example of where expeditious action could let the genie out of the bottle where he could cause all sorts of unintended and unexpected mischief.”

## ELCON CALLS FOR RETAINING QF REPORTING REQUIREMENTS

In response to FERC's Notice of Inquiry (NOI) seeking input on expanding the Commission's Electricity Quarterly Report (EQR) to include additional market participants, ELCON filed comments urging that "Qualifying Facilities" (QFs) continue to be exempt.

Many ELCON members operate cogeneration facilities on-site as an integral part of their manufacturing operations. Most large cogeneration operations are QFs under the Public Utility Regulatory Policies Act governing how they can sell power onto the grid. A change in reporting requirements could be burdensome to those facilities.

In its NOI, FERC identified three new categories of generators that it proposed be included in the EQR – federal facilities, municipalities, and electric cooperatives that meet certain criteria. It did not identify QFs, but FERC allowed that it is also "considering other refinements" of the filing requirements.

A FERC order originally issued in 2006 exempts most QFs from the EQR requirements. ELCON recommended that the status quo be continued, observing that FERC's objective in expanding the requirements was "to identify situations that indicate the possible exercise of market power." John Anderson, ELCON president, explained "that cogenerators and other QFs cannot and do not raise market power concerns – that is why they should not be subject to the new requirements."

## HOUSE COMMITTEE APPROVES BILL TO PROTECT GRID FROM CYBER ATTACK

The House Energy and Commerce Committee unanimously approved legislation (HR 5026) establishing procedures to protect the electricity grid from cyber attacks and other threats to reliability.

The issue is important to ELCON members and other manufacturers for at least two reasons. First, as large electricity users, manufacturers need to know that the grid is reliable. If the grid is truly vulnerable to cyber attacks – as many experts allege – large users support action to counter those attacks. And, second, many industrial facilities, particularly those with large generation units on-site, are viewed as having a material impact on the bulk power system and are on NERC's Compliance Registry. Some of those facilities may have to take specific actions should a cyber threat to the grid be detected.

The issue was first raised early in 2008 when then FERC Chairman Joe Kelliher testified before a different congressional committee stating that there was a "regulatory gap" in that no federal department or agency had direct authority over the bulk power system should it be threatened by cyber attack. The North American Electric Reliability Corporation, as the electric reliability organization under FERC jurisdiction, has the responsibility of drafting reliability standards, but its lengthy and inclusive processes works against the speedy response needed if there were an imminent threat.

For roughly two years, ELCON has been part of a select group of electricity industry

stakeholders working with Congress and NERC to draft legislation addressing this issue. During that time frame, Members of the Energy and Commerce Committee heard a top secret briefing from the Department of Defense and other federal government security agencies outlining the very serious threats that they believed were menacing not just the grid but other critical facilities, such as military bases, on a regular basis.

Many Members of the Committee wanted to grant a federal agency, rather than NERC, authority to develop appropriate procedures given the potential threat to national security. This would break precedent, since historically FERC has had authority only over the interstate transmission system and not over any aspect of the distribution networks. In the end, compromise language was reached where FERC “to the extent practicable in light of the urgency of the need for action,” must “consider recommendations from NERC” when developing procedures to protect the grid cyber threats and vulnerabilities.

“We all want to protect the grid from the possibility of a cyber attack,” said ELCON President John Anderson. “We believe that responsibility should lie primarily with NERC but we understand the political imperatives at work here. Members of Congress have real fears about the safety of the grid, and we appreciate their desire to fully protect it.”

## **ELCON JOINS IN PUSH FOR COGENERATION INCENTIVES**

**E**LCON joined nearly 100 other associations and organizations in asking Congress to expand “the overly limited tax incentives for CHP and recycled energy.” Specifically, the group, which included business, labor and environmental organizations, asked Congress to pass legislation (S 1639, HR 4455 and HR 4144) to allow any cogeneration project to receive a 10 percent tax credit for its first 25 megawatts. Present law limits that credit to projects smaller than 50 megawatts total and provides a credit for only the first 15 megawatts. In addition, the group urged Congress to pass other legislation (HR 4751) to provide a 30 percent tax credit for CHP projects with efficiencies over 70 percent.

The letter cited a study by the Oak Ridge National Laboratory finding that “a large-scale expansion of CHP could provide 20 percent of US generating capacity by 2030, generate \$234 billion in new investment, and create nearly 1 million new highly skilled, technical jobs throughout the US.”

## **ELCON PROPOSES SOURCE NEUTRALITY FOR ENERGY SOURCES**

**A**s FERC begins to study how best to provide variable energy sources (VERs) access to the interconnected electric grid, ELCON members believe that the approach adopted by FERC will have a definite impact on rates and reliability. Therefore ELCON offered three principles to be used as the foundation for forthcoming policy.

Specifically, ELCON said that FERC policy ought to be guided by (1) Source Neutrality, (2) Price Signals, and (3) Cost Causation.

In comments submitted to FERC, ELCON observed that VERs, such as wind farms, have “ceased being a novelty and relatively minor element of utilities’ resource mix.” Rather, such energy sources “may soon reach aggregate name-plate ratings comparable to traditional supply-side resources.”

Regarding Source Neutrality, ELCON pointed out that other forms of energy resources, including CHP and demand response, also face discriminatory practices with respect to transmission availability. As ELCON’s comments stated, “many non-traditional resources – such as CHP, waste-to energy technologies, demand response, and distributed generation – have encountered various regulatory barriers that interfere with cost-effective adoption of the technologies.” Therefore ELCON recommended that “impediments to open access transmission service for all resources need to be eliminated to facilitate the efficient, least-cost development of infrastructure and ensure that the reliability of the grid is maintained – consistent with environmental law.”

For Price Signals, ELCON asserted that “no resource technology should be shielded from price signals with respect to location decisions.” ELCON’s comments further noted that while “VERs use a free fuel that also does not emit any recognized air pollutants or greenhouse gases...the tradeoffs are its extreme intermittency, location constraints and limited dispatchability” which, ELCON observed, “pose considerable risk to the operation of the grid.” Therefore, ELCON recommended that “the negative tradeoffs should be

imposed on the owners and operators of VERs as their costs of doing business; they are not an unfair burden that needs preferential treatment in regulatory policies or rates.”

And, regarding Cost Causation, ELCON asserted that “VERs should be assigned all costs that the technology imposes on the system.” ELCON’s comments added that “public policy considerations also argue in favor of cost causation because those who are allocated costs based on actual, demonstrable benefits they need are less likely to object than those are allocated costs based on an assumption that they will receive some general, unquantifiable benefit.” And ELCON concluded that “socialization of costs simply increases the coalition of interests that will oppose potentially beneficial system upgrades.”

ELCON President John Anderson emphasized that ELCON is not for or against increased utilization of VERs. “The VERs are what they are,” he said. “Policies that increase costs for large or small consumers may be based on the best intentions, but we all know where that road will eventually lead us. Rather, let all energy resources compete on a level playing field. That will produce the fairest – and most cost-effective – results for all consumers.”