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CONGRESS AVOIDS ENERGY ISSUES – NEXT CONGRESS HAS FULL AGENDA

The 111th Congress concluded its “lame duck” session and finally adjourned without having passed any significant energy legislation.



Not that it didn't come close. In June 2009 the House passed what was then considered a landmark energy/climate change bill (HR 2454). That

legislation included, among other provisions, a renewable energy standard and a cap-and-trade formula for reducing greenhouse gas emissions (GHGs). However, although those issues were addressed in several bills introduced in the Senate, none of the major energy or climate change proposals were ever considered on the Senate floor. And some election analysts have concluded that several Democratic Members of the House were defeated in the 2010 election at least in part because of their support for the climate change bill. Most observers believe that any legislation to reduce GHGs utilizing a cap-and-trade

mechanism is doomed for the foreseeable future.

However, leading energy legislators are already looking forward to the 112th Congress. Several Members of Congress have suggested that smaller bills, focusing on specific features of energy policy, be considered, rather than the large comprehensive bills that were offered over the past two years. Those bills, although intended to provide something for everybody, proved to be too cumbersome to be considered, especially in the Senate. Members tended to hone in on the provisions they opposed rather than ones they supported.



In the 112th Congress, incoming House Energy and Commerce Chairman Fred Upton (R-MI) has announced he intends to hold oversight hearings for DOE, EPA, and FERC. And he established a new Subcommittee on the Environment and the Economy, to be chaired by Rep. John Shimkus (R-IL), which will focus on the impact that various environmental regulations, including those proposed to reduce GHG emissions, will have on the economy and manufacturing. If the Environmental Protection Agency proceeds with its announced intention of issuing regulations on GHGs, this Subcommittee will very busy.



And, should EPA proceed, legislation to stop it will likely be forthcoming. Sen. Jay Rockefeller (D-WV) introduced a bill in 2010 to impose a two-year moratorium on EPA from regulation GHGs from stationary sources, and Rep. Ted Poe (R-TX) introduced similar legislation at the end of the 111th Congress which he admitted was simply a placeholder for future action this year. And incoming Chairman

Upton co-authored an op-ed in the Wall Street Journal outlining various options to stop or slow EPA's regulatory effort. Most observers believe a majority in each house would support denying EPA authority to act, but there are differing opinions as to how to proceed.

Another issue ripe for oversight activity is the effectiveness of the RTOs and ISOs. Senate Energy Committee Chairman Jeff Bingaman (D-NM) has stated on several occasions that he hopes to investigate whether the "organized markets" are providing benefits to large and small consumers, and the creation of a subcommittee primarily devoted to oversight in the House offers yet another opportunity for Congress to act.

Some believe that the Republican majority in the House will consider legislating to establish a "Clean Energy Standard" (CES) rather than the Renewable Energy Standard that was included in both the House-passed HR 2454 and the Senate Energy Committee's bill, S 1462. Instead of simply establishing a minimum amount of energy to be derived from renewable sources, a CES would include other "clean" forms of electricity including that generated from nuclear facilities, clean coal operations, possibly gas, and existing hydroelectric sites. It might also include energy efficiency and Demand Response. It faces several obstacles – it has critics on both the left (who want more renewable energy sources) and the right (who want to avoid government mandates and let electricity be produced as efficiently as possible) and Congressional staff sources have related how difficult it is to draft such a bill.

One topic the Committee or Subcommittee may look at is the Smart Grid. The Obama Administration has repeatedly offered its support for a Smart Grid – although never clearly defining what a "Smart Grid" really is. Through the 2009 "stimulus package" it has poured millions of dollars into utility efforts to support a Smart Grid. ELCON

does not oppose a Smart Grid, but continues to question whether the benefits for consumers will outweigh the considerable costs. Oversight hearings could well address that very question.

Congress also may attack the issue of transmission cost allocation, which they began to approach in the last Congress. As part of the Senate Energy Committee's comprehensive bill, Sen. Bob Corker (R-TN) added an amendment (over Chairman Jeff Bingaman's opposition) basically directing FERC to ensure that those who bear the burden of paying for new transmission receive the benefits. The added Republican strength in the Senate, plus the Republican takeover of the House, will add strength to Sen. Corker's efforts.

Many believe that energy efficiency will be the cornerstone of any energy legislation. And one component of that bill could well be increased encouragement for Demand Response. If Congress considers either an Energy Efficiency Resource Standard or a Clean Energy Standard (or a combination of the two), the treatment of Demand Response, including its compensation formula, will be crucial for ELCON members

And finally Congress may consider legislation to protect the grid from a potential cyber attack. Experts have testified that foreign and domestic "hackers" make repeated and consistent efforts to penetrate the computer network supporting and operating the interstate transmission grid. And, at present, there is a "regulatory gap" in that no Federal department or agency has clear legislative authority to develop procedures to respond to a cyber threat or to enforce any procedures that may be developed. Legislation will be introduced to establish such procedures, though it is uncertain whether there will be stand-alone legislation to protect the grid (such as the bill passed by the House in 2010) or whether omnibus legislation addressing cyber threats to several other industries (e.g., communications, banking, aerospace) will

be considered. ELCON will be working to ensure that the procedures are appropriate, not excessive in scope or cost, and do not usurp what is appropriately NERC's responsibility to develop reliability standards.

ELCON President John Anderson stated that "the 112th Congress has a full energy plate, with both legislative and oversight opportunities. There are a myriad of issues that could be addressed. Congress and the federal agencies have a role to play. We believe that role is to make energy production and use more efficient without burdening consumers with unnecessary costs or excessive regulations."

ELCON CONTINUES PUSH FOR DEMAND RESPONSE

Early in 2010 FERC issued a Notice of Proposed Rulemaking (NOPR) on Demand Response designed to improve the competitiveness of organized wholesale electricity markets and ensure just and reasonable prices.



At that time, ELCON offered its unequivocal support for the proposed rule which allowed Demand Responders to participate in the wholesale markets on a 24/7, year-round basis. And it allowed the Responder to receive the locational marginal value of demand response at any time.

Not surprisingly utilities and the Organized Markets objected to the NOPR, and FERC then released a Supplemental NOPR seeking views on a few additional issues. In its comments, ELCON reiterated its position that the original rule was best suited to encourage Demand Response and that participation at all hours was a crucial component of the NOPR.

ELCON has also organized state, regional and national manufacturing groups to support the Demand Response NOPR, and ELCON, along with those groups, has visited with the FERC Commissioners and senior staff to press the case. In addition, ELCON has worked with several other consumer groups, environmentalists and demand response providers to show the breadth of support for the original rule.

ELCON WARY OF DEFINITIONAL CHANGE

ELCON continues to monitor very closely FERC's effort to change the definition of the Bulk Electric System (BES) and to craft a new definition for a nebulous Bulk Power System.

Earlier in 2010 ELCON filed comments at the Federal Energy Regulatory Commission (FERC) objecting to a Notice of Proposed Rulemaking (NOPR) that would direct the North American Electric Reliability Corporation (NERC) to change the definition of the Bulk Electric System (BES).

FERC's original NOPR would have revised NERC's definition of the BES to "include all electric transmission facilities with a rating of 100 kV or above." Of particular interest to ELCON was the issue of radial lines. The old definition specified that "radial transmission facilities serving only load with one transmission source are generally not included." But FERC's proposed revision would require any of NERC's Regional Entities to seek NERC approval before it "exempts any transmission facility rated at 100 kV or above," although a footnote explains that FERC intends to preserve the existing language for radial lines. In its comments, ELCON noted that radial transmission "warrants far more than the offhand treatment in the NOPR" and that there "should be no doubt whatsoever that the exclusion continues to have full force." ELCON's comments concluded that FERC should "implement regulatory language

clarifying that the general exclusion for radial lines remains effective."

At the same time, various FERC pronouncements have included references to a new category, the Bulk Power System (BPS), which, while undefined, is clearly intended by FERC to be broader than the BES.

ELCON President John Anderson observed that "any voltage threshold test can have extensive – and harmful – unintended consequences. Numerous industrial facilities, which could not possibly have a material impact on grid reliability, have on-site substations which receive power at over 100 kV, either directly from the grid or through a radial line. For FERC to make these facilities subject to stringent reliability rules – while perhaps well intended – will impose serious and unnecessary burdens on these manufacturing facilities. We need to look at the whole situation reasonably. Any new definition of BES or BPS should be drafted after examining real world considerations. Anything less could produce unforeseen havoc."

ELCON CRITICAL OF MISO ALLOCATION DECISION

ELCON President John Anderson said that FERC's decision to accept MISO's cost allocation decision for "Multi Value Projects" would "assign the burden of paying for new transmission to end users who derive little or no benefit."

FERC upheld MISO's proposal to

identify projects it believes will benefit the grid and, in some cases, satisfy state energy mandates (most often power from renewable sources). The allocation plan would then allocate costs for new



transmission to all load in the region (with the exception of exports to PJM). It was strongly supported by the wind energy industry and others who need new transmission to bring power from remote generation sites to population centers.

“Renewable generation should be cost effective,” asserted Anderson. “To impose additional costs on all users in the region is simply unfair. The parties that benefit should pay for the transmission. That has been a guiding principle of cost allocation for years. We are very disappointed to see FERC deviate from that long-standing principle.”

REDUCING CARBON IS PRIMARY OBJECTIVE

The Obama Administration is committed to “get a cleaner generation mix” with less carbon, said Patricia Hoffman, Assistant Secretary of Energy for Electricity Delivery and Energy Reliability. The big question, she stated, is “whether the grid is prepared to handle more renewables.”



The question of the grid’s capability to adapt to a different generation mix was a recurring theme throughout ELCON’s Fall Workshop titled “Controlling the Costs of Clean Energy.” Mark Lauby, the director reliability assessment and performance for the North American Electric Reliability Corporation (NERC) asserted that the electricity “industry is in transition” and the issue of reducing Greenhouse Gases (GHGs) “is high on the worry list.”

Lauby pointed out that over the next ten years significant quantities of wind generation will be placed in the generation

pool. He cited a report from a NERC Task Force on the Reliability Impacts of Climate Change Initiatives (RICCI). That report concluded that:

- The timing of carbon reduction targets will require an unprecedented shift in North America’s resource mix.
- Regional solutions are needed to respond to climate change initiatives, driven by unique system characteristics and existing infrastructure.
- The addition of new resources increases the need for transmission and energy storage and balancing resources.
- Carbon reduction from increasing demand-side management must be balanced against potential reliability impacts.
- Climate change efforts that increasingly depend on distribution system options and applications can, in aggregate, impact bulk power system reliability.

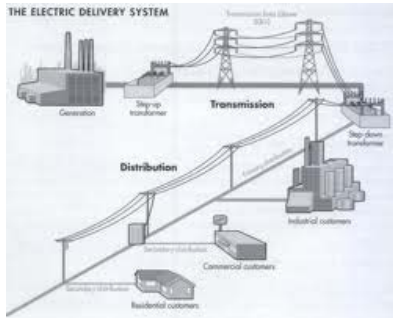
Those points were elaborated upon by Johannes Pfeifengerger, a principal with the Brattle Group. He emphasized that the significant amount of new transmission – he estimated 27,000 miles at a cost \$50 billion – would be necessary by 2018 to accommodate the new wind-based generation. He calculated that transmission costs comprise 20 percent of the total investments needed to add renewable generation. And he emphasized that, aside from situations where new transmission involves only one utility in one State, the socialization of costs is very difficult to utilize or justify. Transmission planning “is done by engineers,” he explained. “And they look at reliability, not economics.”



SMART GRID BRINGS COST AND RELIABILITY QUESTIONS

There is much discussion about a better – or “smarter” – electricity grid, and the Obama Administration has developed and supported a set of objectives to improve the bulk electric system.

First and foremost, said Patricia Hoffman, Assistant Secretary of DOE, is to “get supply and demand in better balance” and “reduce congestion.” A crucial question, she noted while speaking at ELCON’s Fall Workshop, is whether “the grid is prepared to handle more renewables.”



As the Administration seeks to assist in grid improvements, she said that a standard of “no outages” is “an unrealistic expectation.” Rather, the Administration is seeking to provide more “flexibility for consumers” who could be more active in managing their own load.

Speaking for the Obama Administration, Hoffman listed a series of actions undertaken with funds available through the American Recovery and Reinvestment Act (ARRA), including grid improvements, increased energy storage systems, and investments in micro-grids.

Leading the fight for a Smart Grid is the GridWise Alliance headed by Katherine Hamilton. It is, she said, a loose, “democratic” coalition of companies and organizations looking to make the grid “clean and efficient.”

Hamilton emphasized that creating a smarter grid is much more efficient than

building a new generation facility. One major improvement she cited would be reduced “line loss” which she stated was now roughly 5-7 percent of generated power. She also asserted that a smarter grid would bring significant environmental benefits.



Without disputing the potential benefits of a Smart Grid, Paula Carmody, the

People’s Counsel (consumer advocate) in Maryland, objected to those utility plans where consumers bear the costs of implementing a smart grid. The risks of developing a Smart Grid “must be shared,” she asserted.

For example, in Maryland, Baltimore Gas & Electric offered a Smart Grid proposal with a total cost of over \$1 billion. According to Carmody, 80 percent of the benefits went to the supply side, which is why the state Public Service Commission rejected the plan, stating it was a “no lose proposition for the utility.” The Commission directed BG&E to identify the objectives of the Smart Grid, and to develop a financing mechanism where “customers should not bear all of the risks.”

NERC’s reliability guru, Mark Lauby, agreed that the grid will change significantly in the 21st Century and that, from a reliability perspective, “forecasting wind and solar is very challenging.” He believes that the addition of electric vehicles will mandate a “redesigning of the distribution system.”

Simply put, he said that “there are lots of reliability considerations with a Smart Grid” and that NERC would be monitoring the development of a Smarts Grid very closely.

DEMAND RESPONSE FACES UNCERTAIN FUTURE

Audrey Zibelman, president and CEO of Viridity Energy, strongly supports FERC's proposed rule on Demand Response (DR), but, at the same time, she believes it "doesn't go far enough."



Speaking at ELCON's Fall Workshop, she noted the multiple benefits of DR, particularly reliability, security, and efficiency. She also cited statistics from PJM showing that by paying responders \$45 million to engage in Demand Response, PJM saved consumers approximately \$650 million.



Although her company is active in recruiting commercial and residential end users to be Demand Responders, Zibelman recognized that "industrials represent a huge market potential." She lamented that the "rules have not been receptive to treating load the same as generation."

She had mixed views on the National Action Plan on Demand Response developed by a joint public-private sector commission and blessed by FERC. "The policy is there," she said, and she praised the definition of Demand Response as "more than peak shaving." But she noted that there is "no mention of breaking down market barriers outside of the organized markets" and there was insufficient attention paid to rules and contracts.

Mark Lauby, NERC's primary reliability expert, observed that wind-based power is unreliable in that it ramps up and down, often unpredictably. "Wind needs a dance partner," he said, "and Demand Response can play that role."

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