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ELECTRICITY MARKETS CHANGING

FERC's newest Commissioner Tony Clark said that utilities were preparing to spend "several billion dollars for upgrades and improvements," including implementation of "smart grid" devices, even before the recent spate of EPA rules and regulations impacting electricity generators. The total increase in electricity costs – which will ultimately be borne by consumers – could amount to one trillion dollars over 20 years.

FERC Commissioner Tony Clark

Jennifer Macedonia of the Bipartisan Policy Center

Speaking to ELCON's Fall Workshop, Commissioner Clark identified rising operating expenses and the current "political environment" as the main drivers behind the "tremendous costs" that he said utilities were facing in the near future. The Commissioner also noted that capacity markets are now "part of the norm" in restructured markets and, despite their shortcomings, he did not see any major changes. In addition, he asserted that the capacity markets are needed to reduce price volatility.

Clark may have hinted at a potential conflict between his views and those of other FERC Commissioners. Noting that some at FERC have favored renewable energy sources as good public policy, he believes the focus should be on "costs and economics." When one resource is favored for political reasons, he charged that "it hurts consumers."

Jennifer Macedonia from the Bipartisan Policy Center also saw many changes in future power markets. In addition to the EPA regulations, she said that changes were due primarily to the scheduled retirements of old coal generators, a low price for increasing quantities of natural gas and flat demand (due in large part to energy efficiency). However, she also saw many constants. She predicted that coal would continue to be the dominant fuel for electricity generation, and that the percentage of generation from nuclear and hydro would remain roughly unchanged.

A potential change in electricity markets could be increased utilization of combined

Joe Allen of Solar Turbines

heat and power (CHP), or cogeneration, as advocated by Joe Allen of Solar Turbines, a manufacturer of cogeneration equipment. According to Allen, CHP presently displaces 241 million metric tons of CO_2 (or equivalent) on an annual basis. This is despite the fact, Allen lamented, that there has been no long-term federal government policy on CHP. In fact, Allen said that the most important step to increasing CHP capacity is making sure that "policy makers understand the benefits that CHP brings to the energy mix." He asserted that increased CHP, 87 percent of which is now at industrial sites, would be consistent with either President Obama's energy objective of "clean energy" or Mitt Romney's policy calling for "energy independence." Although he acknowledged that the President's recent Executive Order on CHP calling for an additional 40 GW of CHP (of less that 40 MW) was beneficial, he maintained that the "United States lacks policy clarity on CHP."

Another component of the changes ongoing in electricity markets was explained by Thomas Berry, a trustee of the North American Electric Reliability Corporation (NERC). He said that presently there are over 2,000 NERC requirements – many requiring extensive compliance time and costs by large industrial electricity consumers. He recognized that NERC's standard-setting process had been the subject of considerable criticism. He agreed that there were problems, and he said that there has been "lots of frustration at NERC Board meetings," adding that the time it has taken to develop some standards is simply "unacceptable." He told the Workshop attendees that NERC leadership is "trying to improve the process" and that his own objective is that standards be "clear, not amorphous."

Thomas Berry, Trustee of the North American Electric Reliability Corporation (NERC)

GAS AND ELECTRICITY MARKETS ARE INTERRELATED – AND HOW

The relationship between gas and electricity markets is complicated and multi-faceted, and it is increasing in importance as America's natural gas supply is growing exponentially due to the availability of substantial new supplies of shale gas.

According to FERC Commissioner Tony Clark, shale gas is a "huge net benefit," though it has also produced the need to build more pipelines. Speaking to ELCON's Fall Workshop, he added that the relationship between the two fuels varies by region. In the Midwest, he said, the issue is "not of critical concern." But, in New England, he said it was very important due to constraints in getting gas to where it is needed. The regional differences have led him to conclude that "one regulatory construct does not work at all," stressing that the "focus has to be on end use consumers and the delivered cost of power."

In addition, he pointed out that gas markets are national, but that electricity markets are "largely regional."

Left: John Shelk, President, Electric Power Supply Association and right: Peter Sheffield, Vice President, Spectra Energy Corporation

How electricity generators purchase natural gas now – and how they should purchase natural gas – was the subject of debate between Peter Sheffield, vice president of Spectra Energy Corporation which owns and operates gas pipelines, and John Shelk, president of the Electric Power Supply Association (EPSA) which represents independent electricity generators.

Sheffield argued that in many regions demand for power is growing, stating it will double in the Northeast by 2025. He asserted that since "natural gas is the fuel of choice," infrastructure investment for new pipelines "is needed now." He insisted that for such investment to occur, generators needed to purchase higher priced firm transportation (FT) contracts for gas, which he said was necessary to ensure reliability. "Every generator needs to be able to run when called upon," he explained.

Shelk agreed that it is in generators' interests to be sure "there is a reliable supply [of gas] every minute" because otherwise "there is no revenue," but he disputed the need for mandatory firm transportation contracts, arguing that the pipelines should invest their capital. As he put it, "they need to have some skin in the game." He added that some FT contracts do not, in fact guarantee supply – the pipelines "have too many outs," he said – and that some generators don't need a firm transportation agreement for natural gas because they buy from suppliers who have already purchased FT contracts.

Left: Dena Wiggins of the Process Gas Consumers Group (PGC) and right: Don Santa, President of the Interstate Natural Gas Association of America (INGAA)

Don Santa, president of the Interstate Natural Gas Association of America (INGAA), the trade association for gas pipelines, elaborated on the increase in natural gas supply. He said gas used to be referred to as a "bridge fuel" but now is called a "foundation fuel." He noted that the projections for a long-term supply of low-cost natural gas have spurred major new investment in industrial projects, including 30 new facilities, 15 expansions, and 5 retrofits. But he said that "we will need more infrastructure," and that the addition of new pipelines faces several "challenges and uncertainties." He categorized the question of how pipelines are paid for as a "contract issue, not a reliability issue," and said that opposition from some environmental groups is growing (he specifically cited the Sierra Clubs "Beyond Gas" campaign). He also said that possible legislation on tax policy, pipeline safety and liquid natural gas could also affect how and when new pipelines are built.

Christopher Smith, Deputy Assistant Secretary for Oil and Gas for the U.S. Department of Energy

Christopher Smith, the Deputy Assistant Secretary for Oil and Natural Gas for the U.S. Department of Energy explained how the Administration's views on natural gas have evolved. He cited two studies by the National Petroleum Council (NPC) as evidence of how perceptions about our natural gas supply have changed. In 2007, he said, the NPC concluded that increased liquid natural gas (LNG) imports would be necessary to meet demand for gas in the future. In contrast, he said, a 2011 NPC report stated that new technologies have reduced the need for LNG, including analyses showing a 100-year supply of domestic gas.

He described the Department of Energy's goals as developing "clear rules and regulations to encourage investment while protecting safety and the environment."

ELCON URGES FERC TO CLARIFY DEFINITION OF "LOCAL DISTRIBUTION" IN BULK ELECTRIC SYSTEM (BES) RULEMAKING

On June 22, 2012, the Federal Energy Regulatory Commission (FERC) issued its long-awaited *Notice of Proposed Rulemaking* (NOPR) on a revised definition of "bulk electric system" or BES. The North American Electric Reliability Corporation (NERC) filed the revised definition with the agency in January. Under NERC *Rules of Procedure*, any electrical facility that is deemed part of the BES may subject the asset's owner, operator or user to registration in the NERC Compliance Registry and subsequently be forced to comply with mandatory NERC Reliability Standards. Thus, any industrial facility meeting the BES criteria could become subject to NERC reliability standards, requiring substantial expenditures in time and money [see related story on potential cost increases]. The revised definition, and an exception process that would add elements to, or remove elements from, the BES definition, was prepared by a drafting team of industry experts in a year-long effort. ELCON's Vice President of Technical Affairs, John P. Hughes, was a member of the drafting team.

In the NOPR, FERC preliminarily approved the definition and exception process but not without some serious concerns. One such concern, for example, was the failure of the NERC drafting team to define "facilities used in the local distribution of electric energy" as required by Section 215 of the Federal Power.

"This was a big win for large industrial facilities," said Hughes, noting that FERC gave "unconditional approval" to two *pro forma* exclusions that exempt behind-the-meter generation with certain characteristics and customer owned or operated reactive power devices.

In comments filed on the BES NOPR on September 4, ELCON urged the Commission to approve the NERC filing but also to establish a separate process for clarifying the definition of "local distribution." Section 215 of the Federal Power Act which authorizes the designation of NERC as the Electric Reliability Organization (ERO) subject to FERC oversight prohibits the inclusion within the BES of any facilities used in the local distribution. While the revised BES definition includes that prohibition, it does not actually define local distribution. Since such facilities are used to directly serve load and may be physically integrated with the load, ELCON is concerned that many industrial facilities will be illegally swept into the BES without a clear and enforceable definition of what constitutes "facilities used in local distribution." ELCON's position has been that these facilities are not necessary for the reliable operation of the interconnected transmission network. A final FERC ruling is expected in late 2012 or early 2013.

ANDERSON CITES POTENTIAL COST INCREASES

ELCON President John Anderson warned that electricity prices for industrial users could increase dramatically due to actions being undertaken by both the Federal Energy Regulatory Commission (FERC) and the North American Electricity Reliability Corporation (NERC).

Speaking at the Council of Industrial Boiler Owners (CIBO) Annual Meeting, Anderson stated that one of FERC's primary policy objectives is to "socialize" the costs of building new transmission necessary to achieve "state-sponsored policy goals." Anderson explained that FERC is promoting additional renewable electricity generation, but that much of this generation is far from where it will be consumed, necessitating the building of considerable new transmission. According to Anderson, FERC will decide who pays for the new transmission, and generally favors spreading the costs over all users, not just those who will benefit from the new transmission. This "could involve the reallocation of many billions of dollars," asserted Anderson.

ELCON has long favored costs being allocated on cost causation principles and has opposed socialization. Anderson was encouraged that the issue was gaining more exposure, noting that the Organization of PJM States recently approved language stating that "no public policy project costs may be allocated recovery from the residents of non-sponsoring states." He urged CIBO members and other industrial users to follow the issue closely and communicate with FERC and other policy makers.

With regard to NERC, Anderson reported that there are several issues presenting high risk to industrial facilities, most notably that NERC could apply its reliability standards to a growing number of facilities with behind-the-meter generation. NERC is engaged in "scope creep," he said, and is attempting to impose its standards on large load at industrial sites [see related story on redefining the Bulk Electric System]. He advised industrial users to pay attention to NERC, because once a facility is NERC jurisdictional, "entities must devote large quantities of resources, both time and money, to ensure compliance and response to audits," among other obligations. ELCON members subject to NERC's standards, he said, "have had to hire additional staff and spend large amounts of money on lawyers and consultants" to stay in compliance. NERC has the authority to level penalties of up to $1 million per day per violation, he noted. "If you have not been placed on NERC's Compliance Registry, you are lucky," he said.

FERC ISSUES NEW POLICY ON TRANSMISSION INCENTIVES

"This is what we've been recommending for several years," proclaimed ELCON President John Anderson in reaction to FERC's recently released Statement of Policy on transmission incentives. "FERC's new policy is definitely pro-consumer."

In particular, FERC issued a revised policy statement on transmission investment incentives, placing a greater burden of proof on transmission developers to justify the need for incentives, especially "adders" based on return on equity (ROE).

The Policy Statement provides that, if applicants seek transmission rate incentives, they must establish that have first taken all reasonable steps to mitigate the risks of the project, including application for risk-reducing incentives (e.g., CWIP). FERC then directed incentive seeking applicants to demonstrate what, if any, "residual risk" is left that can only be addressed with special incentives.

The Policy Statement also restricted those applicants to receiving "adders" only on a specific cost estimate. If the cost of a project is in excess of the project applicant's original estimate, incentives are applied only to the cost estimate, and not to any additional costs.

A Statement of Policy is not subject to rehearing, though parties can ask the Commission for clarification.

ELCON SUPPORTS FERC PROPOSAL ON ANCILLARY SERVICES

In a filing submitted to FERC, ELCON noted that it "broadly supports" the Commission's Notice of Proposed Rulemaking (NOPR) on providing ancillary services. ELCON's comments applauded FERC's proposal, noting "that the proposed revisions to the market based rate policies should provide greater opportunities for sellers of ancillary services to have access to bilateral markets and in particular public utility transmission providers."

ELCON's comments agreed with FERC that under FERC's present policy (based on the *Avista*case) third parties attempting to sell ancillary services often have to provide a market power study demonstrating a lack of market for the particular ancillary service in the particular geographic market. Such data is often not available and thus, according to ELCON's filing, "the effect of the *Avista* policy is to constrain sales of ancillary services to public utility transmission providers outside of the RTO and ISO markets," thus retarding the opportunities for competitive sales of ancillary services.

ELCON wrote that it "supports the proposed revisions as they should reduce barriers to ancillary service providers and increase the supply of needed ancillary service in a timely and cost-effective manner. ELCON

President John Anderson explained that "this will open up a small corner of the electricity market. In that way, the NOPR represents an incremental step, but a useful one, toward the overall objective of ensuring that all resources providing service have access to competitive markets and are compensated in a just and reasonable and not unduly discriminatory manner."

HUGHES FETED FOR 25 YEARS SERVICE

At a dinner following the Workshop, John Hughes, ELCON's Vice President for Technical Affairs, was honored for his 25 years with the association. ELCON Chairman Steve Castracane (Linde) presented Hughes with a memento as a measure of thanks from the membership.

ELCON Chairman Steve Castracane (of Linde Corporation) presents John Hughes, ELCON's Vice President for Technical Affairs, with a memento for his 25 years of service with ELCON

Throughout his time with ELCON, Hughes, who has degrees in both engineering and economics, has been the association's point person in communicating with FERC, and he has also worked on issues relating to NERC and Congress. "John Hughes is truly the heart and soul of ELCON," said ELCON President John Anderson. "Without his input on a variety of often complicated issues ELCON would not have the record of accomplishment that it has today. All of us are very appreciative for his dedication to this organization."

John Hughesbeing honored for his 25 years of service

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