ELCON REPORT
ELECTRICITY CONSUMERS RESOURCE COUNCIL

Number Three 2013

The Electricity Consumers Resource Council (ELCON) is the national association of large industrial electricity consumers. Issues addressed in this issue of the ELCON Report include:

IS THE UTILITY INDUSTRY FACING A DEATH SPIRAL?

Is American's electric utility industry facing a "death spiral" – a period of increased energy efficiency, reduced demand for electricity, challenges from carbon-free renewables, and, at the same time, a crushing demand for investment in new

Above: FERC Commissioner John Norris at the ELCON Members Only Workshop, October 2013

transmission and conventional generation – all without a clear way to fund it?

That purported "death spiral" and whether large electricity consumers should be concerned was the subject of ELCON's Members-Only Fall Workshop in Washington, DC. The Keynote Speaker, FERC Commissioner John Norris, observed that there is "significant transformation" in the delivery of electricity, but he thought it was "not necessarily a death spiral."

Is American's electric utility industry facing a "death spiral"? – The subject of ELCON's Members-Only Fall Workshop.

He elaborated on the numerous changes in how electricity is produced and delivered, as well as changes in how consumers are engaging in decision making regarding their electricity use. He thought that the spate of rules from the Environmental Protection Agency affecting electricity generators as well as the abundant supply of natural gas would have an impact on how power is generated. He also noted that decentralized generation – *i.e.*, power derived from sources other than conventional generation

Above: Richard Caperton of the Center for American Progress

facilities – would result in "an erosion of revenues" for utilities. He added that requests for higher rates could find opposition from unusual coalitions, citing the combined efforts of the Sierra Club and the Atlanta Tea Party to oppose Georgia Power's request for a solar surcharge.

Richard Caperton from the Center for American Progress, a non-partisan but decidedly liberal think tank, also foresaw significant changes in the electricity industry with sales going down and rates going up. He thought large electricity consumers had distinct opportunities in the new markets, suggesting that one choice would be to withdraw from the grid. Fixed costs would then be spread among the fewer customers still accessing power. "The utility death spiral is a threat to people who don't adapt," he asserted, citing Walmart as a company that is changing and now has 150 solar installations as it works toward a 100 percent renewable energy base. "Large users need to out in front," he advised, because "they are best prepared to cut the cord." He concluded that there is a "definite role for ELCON" in the transformed market.

The head of the Energy Information Administration, Adam Sieminski, had a

Above: Energy Information Administration Administrator Adam Sieminski

slightly different take on the new markets. Although he agreed that lower carbon options like wind, biomass and solar would be more prevalent in the new two or three decades, he pointed out that the projected demand rate is relatively flat. "If demand isn't growing very much," he concluded, "it's not going to leave a lot of room for other fuels."

But Rich Glick, a vice president of Iberdrola, Inc., the world's largest renewable energy producer, provided a different perspective. He recognized that the new supply of shale gas forced wind energy producers "to be a lot more competitive," and he said that wind is now cost competitive with new generation from other sources. In fact, he stated that wind is beating natural gas "head to head in some regions," particularly in areas of the Midwest.

He said this was due to several direct and indirect advantages of including wind power in the energy mix, particularly that using wind reduced greenhouse gas emissions, provided a good hedge against fuel price volatility, and allowed natural gas to be used for other purposes, such as transportation, industrial feedstock, and exports. He acknowledged that "tax incentives remain critical," but recognized that both the production tax credit and the investment tax credit now utilized by wind producers would likely be eliminated at some point in the future. He did not think that wind producers could engage in Master Limited Partnerships similar to those used by other energy producers, as some have proposed, because other tax provisions, notably the passive loss rules, would limit their usefulness.

Below: Rich Glick, Vice President, Government Affairs, Iberdrola Corporate Services

John Hughes, ELCON's vice president, technical affairs, offered his view on the discussion, stating that "we've heard the prediction of 'major changes in the utility industry' before, but it's rarely panned out as the soothsayers have suggested."

RELABILITY – OF COURSE – BUT AT WHAT PRICE?

"A reliable supply of power is probably more important than the price of power for most industrial users," said ELCON President John Anderson. "Industrials cannot operate efficient manufacturing facilities without reliable power."

How to best ensure that reliable supply of power was addressed by several speakers at ELCON's Fall Workshop. FERC Commissioner John Norris stated that his objective was to make sure there were appropriate standards and enforcement authority in place to ensure reliability. But he admitted that the Commission has a tendency to "err on the side of over-regulation."

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FERC Commissioner John Norris at ELCON's Members Only Workshop Fall 2013

He also discussed the issue of whether more pipelines were necessary to ensure an adequate supply of natural gas for electric generation. He admitted that new "pipe" was probably necessary in New England, but he cautioned against overbuilding elsewhere. Building new pipelines, he advised, "makes us dependent on one fuel source" for the next 30 to 40 years. He suggested instead that "we maximize the current infrastructure."

But the North American Electric Reliability Corporation (NERC) may have a slightly different view of how to construct and maintain a reliable supply of power, at least according to Bruce Scherr, a member of

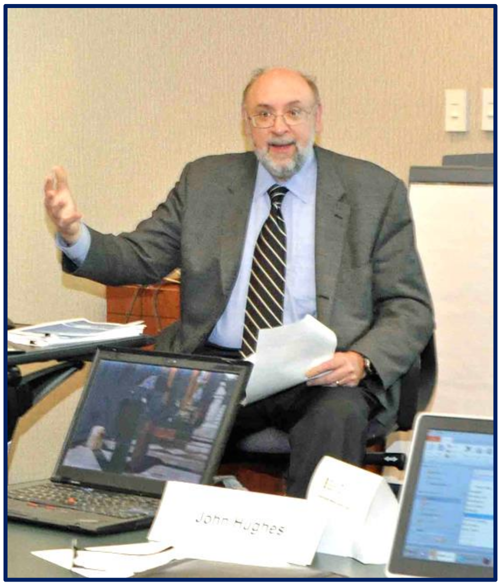
Above, Bruce Scherr, Chairman of the Board and CEO, Informa Economics, Inc., and Member of the Board of Trustees, NERC

NERC's Board of Trustees. He said that NERC's objective was to ensure reliability which "is cost effective," while he thought FERC was striving for reliability "at any cost." But, he assured the attendees, "we can work it out."

Scherr thought that reliability standards should, first, be about solid engineering and, second, be designed to foster good behavior. In his words, "I want to find it, fix it, and go home." Instead, he said, there has been too much emphasis on legalities, which he attributed in large part to FERC directives. "We have to bring FERC along," he stated, and that is "is going to take longer that we would hope."

Above: Caroline Daly, Office of Energy Policy and Innovation (OEPI) of the Federal Energy Regulatory Commission (FERC)

A sometimes overlooked role of FERC on the reliability front is its efforts to address the natural gas-electric interdependency issue which is important given the ever increasing use of natural gas for power generation. Caroline Daly, FERC's point person on the issue, noted that Commissioners Cheryl LaFleur and Phil Moeller have been persistent in pushing FERC to take action. FERC held a Technical Conference in April of this year and later released a Notice of Proposed Rulemaking. She listed the several "misalignments" between the gas and electricity markets, most notably that the gas market begins at 10:00 am Eastern Standard Time and runs 24 hours, while the electricity market is based on local time and varies by region. This sometimes results, she said, in electric generators being unable to secure gas supplies at the end of the "gas day," raising the question of reliability if the generator has no fuel.



Above: Phil Fedora, Assistant Vice President – Reliability Services, Northeast Power Coordinating Council Inc. (NPCC)

Phil Fedora from the Northeast Power Coordinating Council urged ELCON members to "get involved in NERC proceedings and vote." He related that on the issue of re-defining the Bulk Electric System – an issue that is crucial to many ELCON members and other manufacturers – only 71 percent of potential participants actually voted.

"ELCON is the only national association active at NERC," said Anderson, who serves on several NERC Committees. "It is where the rubber hits the road on reliability issues. Industrial users have the opportunity to play role. We should take advantage of it."

LOTS OF ACTIVITY AT STATE LEVEL

While industrial electricity users face a number of challenges in Congress, at FERC, and within NERC, there is always lots of activity at the state level as well.

Five state industrial group attorneys related what is happening "in their neck of the woods" at the annual State Industrial Group Roundtable Discussion following ELCON's Fall Workshop.

In Colorado, Bob Pomeroy reported that utilities are making a number of environmental improvements and that these expenses would likely be borne by ratepayers. Utilities worked with environmental groups in negotiating the closure of roughly 50 percent of Colorado's coal generation, and the result will be a doubling of electricity rates by 2020 and a tripling by 2030.

Below left to right: Mike Mager (New York), Bette Dodd (Indiana), Carrie Tournillon (Louisiana), Diana Vuylsteke (Missouri) and Bob Pomeroy (Colorado) – Introduced by John Hughes, ELCON VP of Technical Affairs

Mike Mager described recent events in New York. When two utilities each announced the retirement of inefficient coal plants, the affected communities objected because of the associated jobs loss. The New York ISO, bowing to political pressure, then announced that the two units would continue to operate, citing the need for reliability. But, according to Mager, the real answer was much simpler – "politics is always important in New York," he said, "but never more so than in the last couple of years."

Bette Dodd from Indiana related what she called the "Boondoggle Case" involving Duke Energy's efforts to build a new generation facility. Dodd said that the first cost estimates were in the range of $1.3-1.675 billion. But after a series of revised estimates, an arrived settlement that was then thrown out due to judicial conflict of interest, and more estimates, the final settlement was for a cap of $2.995 billion, most of which will be funded by higher rates. She called Indiana the "king of the tracker states," stating that each increase in utility costs was added into rates.

In Missouri, the commission by law cannot approve a single issue rate increase – utility requests must be approved by the state legislature. According to Diana Vuylsteke, utilities recently tried to pass an "infrastructure strengthening" bill which would place a number of recent utility expenses in an electricity rate surcharge. Vuylsteke reported that industrials teamed with other consumers to defeat that effort.

For Carrie Tournillon, representing the Louisiana Energy Users Group, the big issue is Entergy's decision to join MISO and to sell its transmission. She was hopeful that MISO will ensure that electricity in Louisiana will now be dispatched more economically.

ELCON SECURES DELAY IN IMPLEMENTATION OF NEW BES DEFINITION

"Without a doubt, the issue that has concerned our members the most over the past year is the new definition of the Bulk Electric System, or BES," stated ELCON President John Anderson. "This NERC/FERC effort to make the BES definition clearer may have started with good intentions, but the definition as developed presents a plethora of implementation problems. We are very pleased that FERC is delaying its implementation for one year."

ELCON members are concerned – to put it mildly – about the new "bright line," developed by NERC at FERC's direction, establishing a kilovolt threshold with those operating above that threshold being considered part of the BES. Being part of the BES virtually guarantees inclusion in the NERC's Compliance Registry. Many industrial facilities – well over one hundred, some estimate over one thousand – have multiple feeder lines at 100 kV or higher that are "looped" (or connected) internally. There are also multiple facilities with substations operating at 100 kV or higher. Setting a bright line at 50 kV or 100kV would bring these facilities into the BES and make those sites subject to NERC reliability standards.

"Industrial facilities should not be subject to reliability standards that were designed for utilities," said Anderson. "These manufacturing sites have taken reliability into account – that is why so many have multiple feeds. If they are subject to NERC rules, audits, and training requirements, the logical response would be to remove the multiple feeds, which in fact would make the facility and the grid less reliable."

ELCON met with FERC Commissioners and senior NERC officials to press the case for a revised BES or, at the very least, a delay in the implementation which was originally scheduled for July 1, 2013. ELCON filed comments at FERC emphasizing how the new BES would dramatically expand the number of facilities covered contrary to what several Commissioners said was intended. In June FERC agreed to delay the implementation for one year to July 1, 2014.

"The extension is a band-aid, not a cure," said Anderson. "But, most importantly, it's a step in the right direction."

ELCON TOUTS BENEFITS OF LARGE COGENERATION

ELCON was joined by five other major industrial associations in asking FERC to "expeditiously initiate consider additional reforms to facilitate and expedite efficient generator interconnections, regardless of size."

ELCON's filing was in response to a FERC docket on the so-called Small Generator Interconnection Agreements and Procedures (SGIA and SGIP). While ELCON and the five associations supported the proposals for small cogenerators (also called combined heat and power, or CHP), they noted many cogeneration "projects are large generators of 20 MW or more" and that "FERC last revised the standard interconnection procedures and agreements for large generators in…2003." ELCON's filing urged FERC "to initiate a Notice of Inquiry to identify existing barriers to the development of large CHP projects."

The filing by ELCON and the other associations cited several barriers to large CHP projects, among them: utilities have the ability to reserve transmission capacity for future native load, thus keep cogenerated power off the grid; the termination of must-buy mandates, which were usually implemented under long-term contracts; and the lengthy process for completing interconnection studies.

ELCON concluded by noting that "CHP lowers demand on the electricity delivery system, reduces reliance on traditional energy suppliers, makes businesses more competitive by lowering their energy costs, reduces greenhouse gas and criteria pollutant emissions and refocuses infrastructure investments toward next-generation energy systems" and that "policies to facilitate more efficient interconnection are essential to realizing the potential contributions that CHP can make."

Joining ELCON were the American Iron and Steel Institute, the American Chemistry Council, the American Forest & Paper Association, the Combined Heat and Power Association, and the Council of Industrial Boiler Owners.

ANDERSON WARNS OF POSSIBLE GOVERNMENT ACTIONS WITH ADVERSE IMPACTS

Speaking to the Annual Meeting of the Council of Industrial Boiler Owners (CIBO), ELCON President John Anderson warned the attendees that "you must watch carefully legislative, regulatory, Administration and court proceedings," because "many expected actions may significantly increase electricity costs" for large manufacturers.

Anderson pointed out that, in addition to Congress, there is significant – and potentially harmful – action being undertaken by the Federal Energy Regulatory Commission (FERC), the Environmental Protection Agency (EPA) and the North American Electric Reliability Corporation (NERC).

Although Anderson praised recent FERC action encouraging Demand Response and placing more stringent requirements on utilities seeking incentives for building new transmission – ELCON strongly supported FERC on these issues – he was particularly concerned about recent FERC actions which made "the integration of green energy" a high priority. Noting that ELCON is fuel neutral – its members want a reliable supply of electricity produced as efficiently as possible – Anderson asserted that "renewable are quite expensive, often not available when and where they are needed, and often not located near load." In addition, FERC has been supporting a "broad socialization of costs" which he called a "movement away from cost causation," resulting in higher prices for large loads like industrial users.

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The EPA has a host of proposed rules on air toxics, coal ash, and cooling water to name a few, but Anderson focused on the recently-issued revised EPA rule on greenhouse gas (GHG) emissions from new power plants. By placing a limit of 1,100 lbs./MWh on new coal units, the rule's effect will, in essence, be to preclude any new coal-fired plants from being built. He acknowledged that the short-term impact will be minimal as long as natural gas prices stay below $7, but he voiced his fears about the next step when EPA limits GHG emissions from existing facilities. These rules are being released in conjunction with a revised Administration estimate for the "social cost of carbon (SCC)," raising the SCC from $21 to $33 per ton of carbon emissions. That change, said Anderson, "makes it much easier to 'justify' the costs of new carbon regulation."

NERC, which sets and enforces reliability standards, is "crucial to industrial users," explained Anderson. ELCON has been active on several NERC committees and has stressed that reliability standards designed for utilities are not necessarily appropriate when applied to non-utility generators such as cogenerators. That is why the proposed change in the definition of the Bulk Electric System is so important (see related article).

In conclusion, he urged manufacturers "to protect your relative competitive positions through vigorous and group actions," noting that ELCON and CIBO often worked together in pursuit of those objectives.

ELCON Members Pool Resources for Effective Interventions

ELCON President John Anderson reported that in 2013 ELCON intervened in 10 FERC dockets, a filing at DOE, and one case in the 7th Circuit. As part of its legal activities ELCON also submitted comments to the North American Reliability Corporation on several issues.

"ELCON has always been active at FERC," stated Anderson, noting that this past year involved filings on the definition of the Bulk Electric System, incentives awarded to utilities for building low-risk transmission projects, and reliability standards, among other issues. In addition ELCON challenged MISO's transmission cost allocation before the Seventh Circuit and submitted a brief to the Department of Energy regarding EIA Form 860 seeking cost-related information from manufacturers.

"By pooling their resources, manufacturers can play a significant role in the regulatory process in a number of arenas," explained Anderson. "If a company were to submit comments to FERC on a stand-alone basis, it could expect to incur legal costs of $10,000 or more for some interventions. By working together, ELCON members save money – on average each FERC intervention cost an ELCON member about $375 – and have the advantage of being supported by a national organization. Our members think that makes it a win-win situation."

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