



Some Thoughts On An Alternative Funding Mechanism For NERC/ERO

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Purpose for Funding Mechanism:

The mechanism is proposed to fund the North American Electric Reliability Council (NERC). NERC assists all segments of electric industry to assure an adequate, reliable, safe, economic, and environmentally acceptable electric service for the benefit of electric customers and the general public of the United States. NERC is a New Jersey not-for-profit corporation within the meaning of Section 501(c)(6) of the United States Internal Revenue Code of 1954.

Background:

NERC's membership is comprised of 10 Regional Reliability Councils (RRCs). The RRCs fund NERC. The RRCs collect dues and other assessments from their members (primarily utilities). To the extent such costs are flowed through retail rates, end-use customers ultimately pay the costs of the RRCs, and thus NERC. The equity of such a funding mechanism is questionable. Some utilities are members of RRCs and charge retail rates that include a reliability organization funding component. Others do not include such a charge in their retail rates.

ELCON believes that the current funding mechanism is inefficient (in that the funds have to pass through several layers of entities from end-use customers to utilities to RRCs to NERC) and perhaps duplicative and/or unfair or discriminatory. There is also a potential conflict of interest between NERC and the RRCs. A new funding mechanism is needed – with or without legislation.

To further complicate the issue, the structure of organizations involved in reliability functions (at least within the U.S.) is in a state of flux. NERC is an organization covering most of North America – attempting to transition into an Electricity Reliability Organization (ERO) once legislation is enacted in the U.S. There presently are ten RRCs, although there is considerable discussion about combining at least some of them. There are several Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) in parts of the U.S., some of which conduct, or may conduct in the future, some reliability functions. The footprints of the RRCs are inconsistent with the

footprints of the RTOs and ISOs – where RTOs and ISOs exist. In fact, we are experiencing “footprint chasing” where some of the RRCs try to change their footprint to coincide with an RTO – only to find that the RTO’s footprint changes yet again. In some areas of the country there are RRCs, but no RTOs or ISOs. Further, the assignment of responsibilities to entities that will actually implement and enforce the various critical reliability functions is far from clear, resulting in duplication of costs and efforts.

End-use consumers understand and accept the fact that they pay the prudently incurred costs of all of these organizations. However, increasingly, end-use customers are concerned that if extreme care is not taken, there could be considerable duplication of responsibilities – and thus costs higher than necessary.

Objectives for Approving a New Funding Mechanism:

ELCON believes that key objectives of any funding mechanism should be carefully identified and followed. Various lists of objectives have been proposed by several organizations.

For example, FERC stated in approving the GRI funding mechanism the following objectives:

- Balancing of costs among all classes of service, areas, pipelines and producers.
- Spreading the funding over the broadest possible base of jurisdictional and non-jurisdictional services, and
- Ensuring that no party bears a disproportionate share of the costs.

Further, the NERC Funding Task Group Report developed a set of “Objectives” in its January 19, 2001 report to the NERC Board.¹ These Objectives were:

- Command widespread acceptance within the industry
- Equitably align expenses to consider all users and associated beneficiaries
- Recognize the limitations of current funding tariffs
- Be flexible and robust enough to address further changes expected as the industry continues to deregulate
- Provide adequate funding programs that can transition to the post-legislation funding method
- Can be supported by a simplified, yet timely, billing, collection, and audit process that has minimal impact on all parties involved

ELCON recommends a few additional objectives including:

¹ Funding Task Group Report, Agenda Item 5c, NERC Board of Trustees Meeting, February 12-13, 2001, page 11.

- Assure an efficient collection process by collecting the funds as close to the end-use customers as practical.
- Minimize duplication of efforts and costs.
- Follow well established cost causation principles.

ELCON offers a proposed funding mechanism (below) that we believe meets (or at least is consistent with) all of the stated objectives. We believe that this methodology should be implemented before legislation is so far as the timing of enactment is highly uncertain..

ELCON also points out a funding-related issue that is often discussed or proposed by others that we believe should NOT be implemented. Specifically, NERC is funded today by the ten Regional Reliability Councils (RRCs). The RRCs also are NERC’s only “members.” ELCON believes that since the RRCs both write the checks to cover the costs of NERC (even though end-users eventually pay) and have the sole designation of “member,” the RRCs have had a disproportional influence over the structure, operations and policies of the organization. Once the funding is placed directly on end-use customers, ELCON believes that there should be no barriers or restrictions on participation by anyone with interest in the electric industry. We are thus strongly opposed to either the designation of “membership” to any participant or the imposition of any membership fee or other mandatory charge required for participation in the ERO by any individual or organization.² Any such fee would constitute a “poll tax” or a barrier to participation for some segments or industry participants. All end-users should pay the approved costs of the ERO through the mechanism described below. Those individuals and organizations that choose to actually participate in the operation of the ERO should not have to pay a second time – no matter the amount.

Suggested Budget Process and Funding Mechanism for Regional Organizations:

ELCON recommends that as RTOs continue to be formed and become operational in North America – and assuming that NERC is ultimately certified as the ERO and thereby acquires the statutory basis to enforce compliance with its Reliability Standards and to sanction violators – that the ten Regional Reliability Councils (RRCs) be phased out and replaced with three Interconnection-wide Regional Councils (IRCs).³ The continued

² We do not oppose the concept of “membership” as long as membership is open to anyone, there are no benefits of membership, and there are no dues, fees or any other financial commitment required to become a member.

³ ELCON Comments on the Future Role of Regional Councils, Submitted to the Regional Managers Committee (RMC) in response to RMC Chairman Ed Schwerdt’s Letter to NERC stakeholders, July 30, 2004, page 2. Specifically, ELCON recommended that: (1) NERC should become the plenary authority for compliance monitoring and enforcement including recommending sanctions for violations, conducting readiness audits, and for maintaining the registration and certification procedures; (2) RTOs should have the responsibilities currently exercised by RRCs for coordination of planning and operations – except the Reliability Authority function. Where RTOs do not exist, the IRC should establish an independent shadow

existence of RRCs, particularly with footprints that do not coincide with RTOs or ISOs, fosters inefficiency and higher costs.

ELCON recognizes that all of the reliability-related functions currently conducted by one or more of the RRCs should not be shifted to the IRCs. Instead, some reliability assurance functions should be retained solely by NERC with others allocated to the RTOs. It will clearly take some time to transition from today's structure of NERC and the ten RRCs to a new structure.

ELCON thus recommends the following transition process:

- A definite transition period is established – not to exceed three years. During this transition, NERC and the RRCs should agree to “do no harm” in terms of taking new actions that might exacerbate the situation fostered by overlapping responsibilities for reliability management.
- During the transition, both the NERC/ERO and the ten RRCs are funded through a FERC-administered process as outlined below (in the U.S.).
- FERC approves the allocation of functions between the NERC/ERO, the RTOs, and the IRCs (in the U. S.).
- Following the transition, the ERO and the IRCs should receive funding through the FERC-administered process (for the U.S.). Following the transition, any remaining RRCs should also be funded through the FERC-administered process with the explicit recognition that end-use customers are now directly paying the costs of the RRCs. End-use customers thus should represent a significant part of the RRCs governance and budget approval process.

Suggested Budget Process and Funding Mechanism:

ELCON believes that it might be some time before reliability legislation is enacted into law in the U.S. However, ELCON also believes that the funding issue is of such great importance that it should be addressed now.

With this in mind, ELCON offers a funding proposal that we believe can be implemented prior to the passage of legislation. We also offer some thoughts on funding after the legislation has been enacted.

planning and operations committee for performing these reliability assurance functions with the intent that such activities would ultimately be transferred to an RTO; and (3) IRCs should be the Reliability Authority for each interconnection and retain the reliability assessment function and other services such as generation and transmission protection audits, dispute resolution, education and training, and emergency-related functions.

*A Funding Proposal to be Implemented **Before** the Enactment of Reliability Legislation:*

ELCON proposes that (in the U.S.) FERC immediately moves to implement a funding process as described below:⁴

- NERC prepares its budget with oversight and administration by a standing committee of the NERC BOT and with Stakeholder Committee input.
- Regional organizations (RRCs and IRCs) prepare budgets to recover the costs of implementing functions delegated by NERC for regional implementation. The regional organizations submit these budgets to NERC for payment. It is essential to combine the NERC and the regional organizations' budgets to avoid duplication and assure a "top down" chain of authority.
- NERC submits the total budget to FERC, including both the NERC and the regional costs of delegated functions for public comment and approval.
- FERC amends each OATT to include the FERC-approved NERC surcharge (including the designated regional costs) and assessment obligations.
- Transmission Providers who administer FERC's Pro Forma Open-Access Tariff (OATT) become Collection Agents for the purpose of assessments of the NERC Surcharge.
- Collection Agents that are ISOs or RTOs assess the NERC Surcharge to each load-serving entity served by the ISO or RTO within the footprint of the ISO or RTO.
- Collection Agents that are not ISOs or RTOs assess the NERC Surcharge to their end-use native load, plus that Collection Agent's firm requirements wholesale sales to public utilities/load-serving entities that are not Collection Agents. Inclusion of both the native load and the firm wholesale sales are critical to assure an equitable allocation of costs to all end-use customers.
- Guidelines must be established both to assure inclusion and avoid double counting associated with cross-boundary sales for resale.

Similar regulatory mechanisms must be developed for all Canadian entities.

*A Funding Proposal **Following** the Enactment of Reliability Legislation:*

⁴ ELCON would like to see the same funding mechanism following the enactment of legislation, but suggests that it might be inconsistent with the proposed legislative language (see below).

The proposed U.S. reliability legislation provides that an entity seeking to qualify as the Electric Reliability Organization (ERO) should have rules that:

“...allocate equitably reasonable dues, fees, and other charges among end users for all activities under the legislation.”⁵

While ELCON would like to see the funding mechanism outlined above continue after the implementation of legislation, we question whether that funding proposal complies with this legislative mandate. We are concerned that the legislative language’s provision requiring the ERO, not FERC or Canadian regulators, to have rules that allocate equitably the costs *to end-users* may, in essence, require the ERO, a non-governmental entity, to allocate costs to end-users.⁶ This amounts to giving a limited amount of retail ratemaking authority to the ERO. We point out this concern to highlight problems with the legislative language and suggest that the language be changed before implementation, even if the amount of the charge is relatively small.⁷

A proposal that could be workable and *might* be consistent with the legislative language is as follows:

- NERC prepares its budget with oversight and administration by a standing committee of the NERC BOT and with Stakeholder Committee input.
- Regional organizations (RRCs and IRCs) prepare budgets to recover the costs of implementing functions delegated by NERC for regional implementation. The regional organizations submit these budgets to NERC for payment. It is essential to combine the NERC and the regional organizations’ budgets to avoid duplication and assure a “top down” chain of authority.
- The ERO assesses each state their proportionate share of the total FERC-approved ERO costs. (After Provincial approval, the ERO would also assess each Canadian Province their proportionate share of the total costs.)
- Each state’s regulatory commission or local government with retail ratemaking authority would be responsible for allocating those costs to all load-serving entities in that state.
- Each load-serving entity would pay its share of the total state cost directly to the ERO and recover those costs in its retail rates. The state regulatory authorities must assure that the LSEs collect the costs from end-users in an equitable manner.

⁵ Proposed section 215(c)(2)(B) of HR 6 in the 108th Congress.

⁶ This authority might also be considered a form of taxation. This raises the question whether Congress can delegate such authority to a non-governmental organization. Even if so, we suggest that Congress proceed cautiously in this area.

⁷ To emphasize the level of costs, NERC’s Funding Task Group Report to the NERC Board of Trustees in January 2001 states: “... the cost per kWh of the current NERC Budget on a North American (U.S. and Canada) basis is less than 0.0005 cents, or less than a nickel per year for the average residential customer using about 10,000 kWh per year.”

We emphasize that such a process would be difficult to equitably implement in states in which the state PUC does not have jurisdiction over all load serving entities. Additionally, the ERO would have to monitor literally thousands of load-serving entities to see that each pays its allocated amount. Due to the complexity of such a mechanism, we envision such a plan as quite inefficient.

Thus, ELCON strongly suggests that the proposed legislative language be changed to allow a FERC-approved collection mechanism such as that outlined above.

Assessment Methodology:

ELCON believes that reliability is much more closely related to peak demand than to energy consumption. Thus, cost causation principles suggest that assessments to recover the ERO's and the regional entities' costs should be allocated on a kW, not kWh, basis. We recognize that a transition is required since costs are now allocated using Net Energy to Load – which is more or less a kWh allocation. As an alternative, we propose:

- Assessments should be based on current allocations for a specified transition period (*e.g.*, one to two years). The intent is to maintain revenue neutrality until new calendar-year baseline is established. This means that the surcharge will continue to be based on Net-Energy-to-Load sales in the prior calendar year for the transition period.
- Following the transition period, the allocations should be calculated as a demand-related surcharge based on contributions to system peak in the prior calendar year.

The Electricity Consumers Resource Council (ELCON) is the national association representing large industrial consumers of electricity. ELCON was organized in 1976 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.



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