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THE ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON)

BEFORE THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

ON ELECTRIC GRID RELIABILITY AND THE ELECTRIC RELIABILITY

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Mr. Chairman, I am John Anderson, president and CEO of the Electricity Consumers Resource Council, or ELCON. ELCON is the national association representing large industrial consumers of electricity. Our members are all multi-state, mostly multi-national, corporations from all segments of the manufacturing community that have facilities in every region of the country. The common denominator of ELCON's members is that each company uses a lot of electricity in its industrial operations.

I begin by thanking you, Senator Thomas, as well as Chairman Domenici and Senator Bingaman for the opportunity to testify.

At the outset, I observe that the participants at today's hearing clearly illustrate the problem that today's large and small consumers face when dealing with the reliability issue. Too many policy makers view reliability as a regulatory or utility issue. They overlook the fact that it is consumers who are most affected by the reliability – or the lack of reliability – of the interstate electricity transmission grid.

Consumers are the ones who suffer most when power is lost. By way of illustration, the 2003 Midwest-Northeast Blackout caused billions of dollars in total damage. Residential consumers lost perishable food and experienced major disruptions to their daily lives. Some, with medical difficulties, were impacted far worse. Industrial consumers lost significant business opportunities and suffered substantial financial loss from damaged equipment and lost production. To emphasize, we have documented that the 2003 Blackout shut down at least 70 auto and auto parts plants, over 30 chemical and petrochemical facilities, at least eight oil refineries, and roughly a dozen steel mills, including one where the inability to cool the furnace produced irreparable damage, driving the company into Chapter 11.

And the power does not have to be completely shut off for industry to experience substantial negative financial impacts. There are manufacturing processes, such as Intel's chip-making operations – and I have visited their facility in Albuquerque – where even in the slightest blip in electric service, a blip that is not even noticeable to the naked eye, can cause millions of dollars in lost product.

The irony is that not only do consumers suffer most from power failures, they also have to pay for both the construction and expansion of the transmission grid as well as for the operation of the Electric Reliability Organization, or ERO. In fact, the EPAct specifically states that the ERO should be funded completely by electricity end users. To make matters even worse, consumers probably will have little say in the governance of the ERO.

Make no mistake about it, reliability is a consumer issue, though it is often not presented this way.

That is why we as consumers opposed for so long the fact that participation in the North American Electric Reliability Council was restricted, basically, to utility employees. And that is why, when the opportunity became available, ELCON staff and member company representatives were among the first non-utility representatives to volunteer to serve on NERC committees.

ELCON staff were also active in the stakeholder group that met for roughly ten years to draft the framework language that eventually became the reliability section of last year's Energy Policy Act. Throughout the drafting process, we as consumers pressed for a strong, top-down organization. We supported mandatory and uniform reliability standards throughout the nation with minimal, if any, regional variation. We opposed efforts calling for deference to regional groups, because we believe that such deference undercuts the concept of national standards and results in standards that can vary significantly across North America. We believed that too often reliability was addressed without considering the impact on commercial markets. And we advocated a governing system that would allow consumers and other non-utility stakeholders to be fairly represented and play more than a token role.

As consumers, we place a high value on a reliable electricity transmission grid, and we supported the final language, even though I still believe it could have been improved,

Having worked with NERC members and NERC staff for many years, I value their experience and their expertise. I have always believed that NERC would be named the statutorily sanctioned ERO and ELCON supports that designation.

As NERC prepares to assume its new role, we are facing a number of important decisions about how standards will be developed and who will be subject to those new standards. As these decisions are made, ELCON believes it is essential that NERC's rules fully implement the statutory requirements enacted last year calling for fair and equitable representation.

Earlier this month, ELCON filed comments at FERC regarding the application of NERC for certification as the ERO. In those comments, which were supported by several other industrial associations, we made the following points:

- The ERO should be a strong, top-down organization that implements uniform standards throughout North America

- Only industrial users that truly can materially impact the bulk power system should be subject to registration and to the NERC reliability standards
- NERC’s committee membership, structure, and sector definitions should be rationalized and end use consumers should be given far greater voting weight
- The Board of Trustees should not be self-perpetuating and should be responsive to NERC membership
- The relationship between NERC and the Regional Entities should be clarified
- The assessment and use of fees deserve careful consideration
- Compliance enforcement must be independent and uniform

I address each of these points in more detail below.

The ERO Should be a Strong, Top-Down Organization that Implements Uniform Standards Throughout North America

ELCON agrees with FERC’s directive in Order 672 that “a strong ERO with primary responsibility for performing all reliability functions is the preferred model for ensuring Bulk-Power System reliability.” We also agree with the FERC Order which goes on to say that “the statute assumes a strong ERO.”

The end result should be uniformity across North America to the maximum extent feasible. Industrial users believe that, starting with the threshold applicability determinations, NERC’s rules and standards should establish clear, uniform and equitable criteria. Too much deference to the regions undermines this principle.

Only Industrial Users That Truly Can Materially Impact the Bulk Power System Should be Subject to Registration and to the NERC Reliability Standards

To reiterate what I said earlier, industrial customers not only want, they demand a truly reliable bulk power system. However, if the Electric Reliability Organization is to be run efficiently, it should impose its standards only on those facilities that can truly – or materially – impact the bulk power system. If the standards are applied too broadly, i.e., to facilities that cannot have a material impact, there will literally be thousands of facilities that will be ERO-jurisdictional for no sound reason, leading to an ERO that is stretched way too thin in its ability to effectively enforce its standards.

The proposed requirements for entities to register in the compliance registry represent just such a situation. NERC’s current registration proposal has the potential to sweep hundreds or even thousands of industrial facilities under the jurisdiction of the ERO and the regional entities, even though these facilities can have no material impact on bulk-power reliability.

Simply having a substation on a manufacturing facility's site does not make that manufacturer able to materially impact reliability. Putting all, or even most, of such facilities on the compliance registry would result in a loss of focus within NERC and would impose costly and unnecessary requirements on these facilities as they would be required to comply with standards on such issues as training, site inspections, and even information system security.

Let me be clear. I am not suggesting that no industrial facilities should be required to register. There are facilities – in particular facilities with extensive on-site generation from which they sell power onto the grid – that can have a material impact on reliability. They should be subject to NERC's reliability standards. But only a small percentage of manufacturing facilities meet the "material impact" threshold.

As a representative of industrial users, some of which generate on-site, we suggest two guiding concepts.

First, any entity demonstrated to be able to materially impact the reliability of the bulk power system, irrespective of other considerations, should register. But others should not have to register.

And, second, consistency between regions and across the nation with respect to which entities are registered is absolutely essential.

Manufacturers are very concerned about the proposal that allows any third party to nominate an industrial facility (or any other entity) to the registry, if the third party believes that the facility was inappropriately excluded. No facility that could indeed materially impact the reliability of the bulk power system should be excluded from the registry. However, the question is where does the burden of proof lie?

Under NERC's proposal, the burden of proof is placed on the nominated facility to prove – via what could be a lengthy and costly procedure – that it should NOT be on the registry. This is sort of like being assumed guilty until you prove yourself innocent. We disagree. The burden of proof for third party nominations should be on the nominator, not on the nominated facility in question. The nominator should clearly demonstrate that the nominated facility can materially impact the bulk power system before that facility is required to register.

Industrial users are also concerned about a timing issue. NERC has not yet become the official ERO, and, even after such certification, NERC standards will be subject to FERC review and approval. We are therefore concerned that NERC and the regions are registering entities at this time, even though FERC's current schedule does not call for its approval of NERC's Version 0 and Version 1 reliability standards until at least late summer. We believe that it is premature to actually begin the compliance registry process until after FERC approval has been granted. Of course, NERC should be developing the criteria that it will propose to use to register entities once it has been granted ERO status. But the actual registration should not start until NERC has been approved by FERC as the ERO in the United States.

This sequencing problem is compounded since the corresponding rules of each of the regional entities, which are charged with implementing the registration process, are also not approved. In fact, under current procedures, these rules will be submitted to FERC and posted for public comment only after NERC has been certified as the ERO. Yet, as we speak, some regional entities are actively compiling their own registry list of bulk power system users.

Again, industrial customers do not oppose ongoing efforts to plan for implementation of the compliance registry. However, any and all action should be deferred for any entity or facility that has not voluntarily registered.

NERC's Committee Membership, Structure, and Sector Definitions Should be Rationalized and End Use Consumers Should Be Given Far Greater Voting Weight

NERC proposed to establish different stakeholder processes for each of its two major policymaking committees. The Member Representatives Committee (MRC) that will elect the Board of Trustees and vote on any changes to the Bylaws would have twelve voting segments; the Registered Ballot Body (RBB) that will approve proposed reliability standards would have nine segments. We believe that having two voting bodies, with two different methods of allocating votes, is unnecessary, confusing, inefficient, costly, and potentially discriminatory. The structures of the stakeholder segments should be identical.

Manufacturers strongly prefer the nine-segment approach proposed for the RBB. It has been demonstrated to work and work well in the establishment of NERC standards. Interestingly, NERC itself proposed in Draft I of its ERO application to use the RBB segments for both the RBB and the MRC. After heavy lobbying by the regions, NERC chose to change the segments for the MRC in the final ERO application.

In the 12-sector MRC allocation, end-use consumers would have a vote share of approximately 11 percent (4 out of 33-37 members), while in the RBB segment structure, end-use consumers have approximately 22% of the total vote. This is particularly ironic since the statute requires that all costs of the ERO be allocated equitably among end-use consumers. In addition, the MRC approach would give the regions at least 22 percent of the votes, even though the regions, in reality, are simply functional extensions of the NERC itself. We believe the regions should have only non-voting status and recommend that the RBB approach be used throughout.

Also, in the interest of establishing a more efficient ERO, ELCON proposes that NERC merge its present Operating Committee and Planning Committee into a single committee. We suggest that this new committee be named the Technical Advisory Committee, or TAC, and the TAC basically oversee the activities of each of NERC's new six program committees.

The Board of Trustees Should Not Be Self-Perpetuating and Should Be Responsive to NERC Membership

The proposed structure of the Board of Trustees opens the possibility that membership could be self-perpetuating and, equally distressing, that it is open to charges of conflict of interest.

We suggest that the number of MRC representatives on the Board nominating committee be increased from three to at least five, and at least two of these be representatives of large and small end-use customers. As I mentioned earlier in my testimony, it is consumers who bear the brunt of any lapse in reliability. Consumers should have a much larger say in the governance that has been proposed by NERC in its application.

In addition, the provision calling for the Board to establish the compensation levels for its own Members must be changed to avoid potential conflicts. A better option is to authorize the MRC to determine compensation for Board Members.

The Relationship Between NERC and Regional Entities Should be Clarified

One of the most difficult tasks facing the “new” NERC will be to establish relationships with the Regional Entities that reflect the statute and the intent of Congress.

In the past, the Regional Reliability Councils were the actual owners of NERC. They funded NERC and, accordingly, they had considerable autonomy in implementing NERC standards which were, under the old regime, only voluntary.

But that regime is over. It was ended by last year’s EAct. We believe that the new NERC should be a strong, top-down organization. NERC may, appropriately, “delegate to regional entities the responsibility for determining whether entities are in compliance...and for imposing penalties for noncompliance.” But, again per NERC’s application, “to the maximum extent possible, regional difference will be addressed through the NERC reliability standards development process.” We advocate even stronger language to ensure consistency and uniformity among and between the regions.

We agree with NERC’s application and FERC Order 672 stating that there are only two reasons for regional differences: (1) a regional difference that is more stringent than the overall standard, and (2) a regional standard necessitated by a physical difference in the bulk power system. No other differences should be approved.

The Assessment and Use of Fees Deserve Careful Consideration

Consistent with the strong, top-down approach we advocate, NERC’s application to be the ERO states that “NERC shall review and approve each regional entity’s budget for adequacy in meeting the requirements of its delegated authority.” Industrial users are concerned about the potential for cross-subsidization and duplication, which would be both costly to consumers and inefficient from the perspective of NERC’s operation.

We believe that regional entities should be the collection agents, but NERC and FERC must provide the necessary guidance and control to ensure that, for ERO funding purposes, there is no double billing. The regional entities must account for instances in which NERC funding costs are already included in the rates of any transmission providers’ Open Access Transmission Tariffs (OATTs), as is currently the case for many utilities. If a layer of new billings is simply added without the elimination of the present costs in the tariffs, some consumers will have to pay

twice. The burden of proof should be on the entity collecting the funds to demonstrate that each OATT does not already include a funding mechanism for the ERO and regional entities.

ELCON also believes that FERC must scrutinize the ERO's and the regional entities' costs very carefully. They should not replicate the high budgets that we are now seeing – and paying for – in the RTOs and ISOs, where we contend that costs greatly exceed expected benefits.

The first draft of NERC's proposed budget for 2007 calls for an increase of at least 20 percent over the 2006 budget. In addition NERC staff has indicated that there are several expensive "new tools" that may be recommended for implementation. While industrial users support all means and procedures necessary to ensure a reliable grid, and we recognize that even the slightest improvements to reliability entail a concomitant cost, reliability at any cost is never justified. This, again, highlights the need for more consumer involvement, since consumers will pay the bills and consumers will suffer the consequences of any outage.

Compliance Enforcement Must be Independent and Uniform

We do not believe that the compliance proposals in the proposed Rules of Procedure ensure that the compliance will be independent and/or uniform. It must be made very clear that compliance enforcement should be independent of the entity that is being enforced. No employee should be allowed to audit, monitor, etc., any entity from which that employee is paid. FERC should audit NERC and NERC should audit the regions.

Moreover, to promote uniformity, the proposed Rules of Procedure should specify that NERC compliance staff shall participate in all audit teams for all regional entities. The application says only that NERC compliance staff may participate.

Conclusion

As I have stated repeatedly throughout my testimony, reliability of the interstate electricity grid is, first and foremost, a consumer issue. Accordingly, ELCON has been active in both NERC proceedings and FERC proceedings to put forward, as constructively as possible, the objectives and concerns of consumers as NERC is designated the new ERO and as NERC begins to develop and implement reliability standards in that context.

We support a strong, top-down approach that leads to an efficient NERC. That new NERC needs to include the views of consumers both in the development and enforcement of reliability standards and in the development of its budget and operating procedures.

I appreciate that the Senate Energy Committee has chosen the reliability issue as one to exercise early congressional oversight, and I hope that such oversight continues. For consumers, grid reliability is simply too big an issue to ignore.