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At a Hearing on
“Energy Efficiency: Complementary Policies for Climate Legislation”

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Mr. Chairman, Mr. Barton, thank you for the opportunity to be back before this Subcommittee again.

By way of background, ELCON is the national association of large industrial consumers of electricity. We were established in 1976 – in large part due to issues that were being discussed in the context of legislation in 1978, PURPA, that came out of this Subcommittee’s predecessor. For over thirty years we have supported legislative and regulatory policies to promote electricity policies that provide lower cost, more reliable electricity to all consumers. ELCON members come from virtually every segment of the manufacturing community.

I don’t have to tell the Members of this Subcommittee that we are in troubled times. And those times are especially troubling for manufacturers. Since December 2007, roughly 1 million manufacturing jobs have been lost. Some have been lost to foreign lands, where the cost of operations may be less, and some have been lost due to decreased demand as the economy has stumbled so dramatically. But regardless, I have never seen the manufacturing segment of our economy in such bad shape. And, speaking personally, I don’t see a light at the end of this very dark tunnel in the near future.

The poor economy is one reason why manufacturers are so concerned about the emphasis that this Congress and this Administration are putting on energy policy. Roughly ten years ago, before this Subcommittee, an ELCON witness from an automobile company testified that electricity was the largest controllable cost at each of his facilities. Labor and material purchase contracts were national; taxes and other items were fixed; and electricity was thus the largest controllable cost. More recently we have seen manufacturing facilities close in several states with the companies attributing those closings directly to high electricity costs. As this Subcommittee and this Congress debate energy policy, I urge you to think carefully about what the proposed policies will do to electricity costs for consumers, whether industrial consumers will be able to bear those costs or if, instead, they will close additional manufacturing facilities and move operations to lower-cost locations.

My bottom line is rather simple: The overarching principle of government policies and mandates to promote energy efficiency in the industrial sector should be to ‘first, do no harm.’

ENERGY EFFICIENCY

That brings me to the subject of this hearing – energy efficiency and how it complements, or does not complement, an overall climate change policy.

At the outset, I emphasize that ELCON does not doubt that many opportunities exist to improve the energy efficiency of manufacturing processes – and that such improvements would help reduce green house gases.

However, most large industrial facilities are beyond the point where substantial savings can be achieved with plug-and-play measures such as high efficiency light bulbs, insulation or motors. The next level of efficiency gains are achieved when entire industrial processes are retooled or rebuilt, and fuel substitution options are exploited such as CHP. These are big ticket items requiring very large outlays of capital—and not all that capital gets appropriated to purely energy efficiency technologies. In fact it is often very difficult to isolate the energy efficiency “measure” because the technologies are integrated with the entire production process. Further complicating this problem is the current credit crunch.

The cost effectiveness of energy efficiency investments will ultimately depend on how the measures are financed and other competing investments of the company. Competing investments may be health care costs, environmental compliance costs and efforts to promote sustainability, worker training costs, R&D for the next generation of products, etc.

ELCON’s primary objective as an organization representing large industrial electricity consumers has always been to carefully scrutinize policies that mandate utility financing of energy efficiency. The core issue is can utility financing of energy efficiency investments compete with a large industrial’s own ability to raise capital on its own in normal capital markets. In other words, are utilities better banks than banks?

The answer in most cases is no because utility programs include special costs—which are often quite substantial—that other forms of financing do not include, such as lost revenue recovery, revenue trackers such as decoupling or incentive payments to utility managers or shareholders. These extra costs—which are hidden in bills and recovered from utility ratepayers—inflate the effective cost of capital for the use of these funds.

It is a widespread myth that utility “investments” in energy efficiency improvements of their ratepayers are funded the same way as utility investments in new generating capacity. This is not true. To fund new generating plants utilities borrow money or issue stock, or a combination of the two. Customers do not pay until the new generator is actually producing power. However, to fund energy efficiency programs utilities borrow money from their customers—usually all ratepayers—and return the money in the form of financial rebates or other forms of subsidies to only a few of those ratepayers. In return for this banking role, utilities are typically allowed to keep a substantial portion of the funds as an inducement for administering the programs. As mentioned earlier, this can take the form of lost revenue recovery, decoupling or direct incentives to shareholder with ROE adders. In other words, only a fraction of each dollar taken from ratepayers is returned to the ratepayers – and then only to participating ratepayers, not

all. Ratepayers that increased energy efficiency at their own expense still pay for the benefits received by the participants.

Whether ratepayers participate in the programs or not, these hidden costs can make the investments to the customer less cost effective than if they financed the investments without utility aid. From the customer's perspective they are giving utilities money that could have been used for more energy efficiency investments.

Again, I emphasize that industrial consumers are strong advocates – even activists – of cost-effective energy efficiency. In fact, for many manufacturers energy efficiency (or EE) really is the “first fuel.” Such manufacturers are in a constant quest to reduce operating costs to increase competitiveness. They make investments to improve energy efficiency on a regular basis. But, at the same time, large industrial customers have historically not supported legislative or regulatory mandates for utility-implemented energy efficiency as such programs are both costly and not designed in a manner that would achieve maximum efficiency gains.

From the perspective of industrial electricity users, I assert the following:

- Utility-administered programs simply cannot be designed to meet the specific needs of a large industrial facility where energy efficiency improvements are intertwined with complex industrial process and the facility's unique operational characteristics.
- Utility-administered programs tend to emphasize inflexible mandates without considering whether the intended results can be more cost effectively obtained by other means, such as distributed generation or combined heat and power technologies.
- Utility-implemented energy efficiency programs increase electricity rates. Whether or not customer bills are reduced is debatable. However, it is not debatable that the increase in rates reduces the funds available to nonparticipating customers for investing in other energy efficiency projects that may provide greater energy and industrial efficiency.
- Finally, utilities are not better bankers than bankers – even in the current economic climate.

OTHER RELATED ISSUES:

I raise four other related issues often discussed in the context of achieving greater energy efficiency.

Energy Efficiency Resource Standard (EERS)

First is the Energy Efficiency Resource Standard (EERS), proposed by several Members of Congress. An EERS could be enacted jointly with a Renewable Energy Standard or as a stand-alone measure.

ELCON has not taken any formal position on EERSs. We certainly support measures that result in the implementation of cost-effective energy efficiency. However, there are several very basic questions that any EERS raises such as: How is the baseline established? Are factors such as an economic recession or a cool summer, each of which reduces electricity demand, appropriately accounted for? Are factors such as “free riders” and the “rebound effect,” taken into account? Different consumers have different energy efficiency potentials. Are each of these differences appropriately considered?

If an EERS is actually implemented, we strongly urge that industrial facilities be exempt. As I have mentioned earlier, industrial facilities must make cost-effective energy efficiency improvements – the competitive markets requires it. Making these manufacturers subject to artificial mandates will only diminish their ability to increase efficiency.

Revenue Decoupling

The second issue, Revenue Decoupling, is one which the full Committee considered just a few weeks ago in the context of the Economic Stimulus bill. This debate demonstrated the great opposition for federally-mandated Revenue Decoupling from small and large consumers alike.

The argument for Revenue Decoupling is rather straight forward. Electric utilities make more as their sales of electricity increase. Thus, these utilities have a disincentive to implement energy efficiency that would reduce their sales – and hence revenues. There are those who believe that by separating a utility’s earnings from its sales, you remove the utility’s disincentive to promote energy efficiency. We disagree for several reasons.

First, we certainly agree that electric utilities that are required to implement energy efficiency face a potential internal conflict. By far, their main motivation is to increase sales. The energy efficiency portion of their business will be rather small, but significant. However, we believe that revenue decoupling disrupts and distorts the utility’s core business functions – to produce and deliver electricity in an efficient manner – and is not a particularly effective way of promoting energy efficiency. Moreover, there are better ways to deliver cost-effective energy efficiency. As an example, Vermont has one of the most effective energy efficiency programs in the Nation. But Vermont’s method involves the creation of an independent entity, Efficiency Vermont, whose core business is to implement energy efficiency. Thus, there is no basic conflict between the implementation of energy efficiency and the loss of revenues for the utility.

Second, several states have found decoupling to be a failure once policymakers recognize that a cool summer, or a warm winter, or an economic downturn triggers increased revenues to the utility even if no (or limited) energy efficiency gains are realized. We wonder if the current interest in decoupling is driven by a desire for a utility to be made whole during this horrible recession rather than by any altruistic urge to promote energy security.

Third, we question why a regulated public utility that has been given a monopoly service territory by the state should be rewarded for implementing an efficiency program that is required by either federal or state mandate. We believe they have an obligation to serve, and should be

given the opportunity to recover prudently incurred costs and earn a return that reflects the risk they incur – but no more.

Finally, I am often amused when I read about Decoupling's supposed successes. Many proponents of Decoupling hold California up as the poster child for energy efficiency – at least partially because per capita consumption of kilowatt hours is relatively low. But California's relatively mild climate and thus the lack of air conditioning in many homes may be a far greater cause of lower consumption. Additionally, California has implemented an inverted rate structure that may have in and of itself brought about more energy efficiency than Decoupling. Further, accompanying California's implementation of their energy efficiency programs is a state deficit of nearly \$42 billion, an unemployment rate that has skyrocketed to nearly 10 percent, one of the very highest foreclosure rates in the nation, and a greater loss of manufacturers than any state in recent years. I am well aware that California's problems are caused by far more problems than just their energy efficiency programs, but the very high electricity rates at least in part contributed to their problems. It is all related – it is not hard to reduce electricity consumption if you take away your manufacturing base and put people out of work.

Demand Response

Just to emphasize that I am not totally negative, the third issue I raise is Demand Response. Quite simply, this is the ability of a home or business to reduce or curtail its use of electric power during periods of peak demand. The sound bite is that the most efficient unit of electrical generation is the one that is never built.

Demand Response can be very successful in reducing the need for new generation and thus reducing green house gases. In fact, we already are seeing some of the benefits of Demand Response. A FERC representative recently said that with only today's very minimum incentives, Demand Response reduced peak load by 5.8 percent in 2007. Similarly, a representative from the Electric Power Research Institute recently stated that Demand Response and energy efficiency could cut projected peak growth in half by 2030.

Demand Response has been moderately successful to date, with industrial, commercial and residential customers participating. But greater success in achieving Demand Response has been stymied and thwarted, primarily by parties on the supply side that view Demand Response as a threat to their generation revenue. I give two examples. In PJM, the regional wholesale market that now operates in all or parts of thirteen states, a program that many customers found supportive of Demand Response was not renewed, primarily due to utility efforts. And more recently, the North American Energy Standards Board (NAESB) adopted a Demand Response standard that will result in different procedures in each area of the country. This means that those who wish to participate must learn and comply with different standards and regulations for each individual market – a burden that will surely diminish rather increase the amount of Demand Response achieved.

Demand Response is a resource that should be considered along with energy efficiency measures. We simply believe that each kilowatt and kilowatt-hour of avoided consumption is

equivalent to – and much more efficient than – a kilowatt or kilowatt-hour of additional generation. And we believe it should be compensated accordingly.

Combined Heat and Power (CHP)

The fourth issue is that of increased utilization of combined heat and power (CHP) technologies, including the capture of additional waste heat as provided for in the Energy Independence and Security Act of 2005. The manufacturing industries, particularly but not exclusively companies in the pulp, paper, petroleum and chemical sectors, have been leaders in this effort. But I must report that companies planning to increase their CHP production have been disappointed by a recent rulemaking process at the Federal Energy Regulatory Commission (FERC). Specifically, as part of the Energy Policy Act of 2005 (EPAcT), ELCON worked with Members of Subcommittee, led by Representatives Barton, Boucher and others, in drafting compromise language, the intent of which was to continue certain incentives for combined heat and power, as provided for under PURPA, until truly competitive markets were established.

Unfortunately, things simply have not worked out as we expected. FERC's rule in essence discontinued those incentives for any facility operating in one of the FERC-approved RTOs or ISOs. This rule will clearly hinder CHP growth. We believe that Congress intended a more rigorous test to determine if a market is competitive, and we know that several Members wrote FERC noting their disagreement with FERC's rule. We strongly urge Congress to maximize the potential of CHP by either reconsidering the language in EPAcT 2005 to more accurately reflect congressional intent or addressing this issue in oversight hearings on FERC implementation of EPAcT 2005.

CONCLUSIONS

So, in conclusion, I return to where I started. Basic manufacturing in the U.S. is in terrible shape. Despite the well intentioned Stimulus Package, I have seen no projections that manufacturing output will increase in the near future.

Yet, many in Congress and elsewhere seem intent on implementing several new and substantial energy initiatives. All have noble goals. But many will work to the detriment of industrial companies and their employees.

I applaud this Subcommittee for seeking to make our energy market more efficient. But I ask that this Subcommittee, when considering energy legislation, to examine the total impact of its proposals, including its impact on the manufacturing sector. Specifically, I urge you to consider the following:

1. Government policies to promote energy efficiency investments of large industrials should take the form of tax credits or loan subsidies that reduce the capital costs of such investments. Policies should not promote mandatory utility financing that increase capital costs.

2. Government policies and mandates that intend to promote ratepayer-funded energy efficiency investments should recognize and give credit to energy efficiency improvements that large industrial customers have already implemented at their own expense.
3. Large industrial customers should be allowed to demonstrate that they have self-directed energy efficiency programs, and be eligible to opt-out from any obligation to pay tariff based surcharges used to fund utility programs, or alternatively, receive dollar-for-dollar credit to offset or bank revenues collected in any applicable tariff or tariff rider used to fund utility energy efficiency program costs.
4. Large industrial customers that invest in energy efficiency improvements at their own expense are entitled to any energy efficiency certificates (e.g., White Tags™) imputed from such investments.
5. Government policies and mandates that target electric power use reductions should recognize that often the most cost-effective measures to improve energy efficiency require net increases in electricity consumption to offset greater reductions (in terms of BTUs) in the use of natural gas or other fossil fuels.
6. Large industrial customers should not be forced to “borrow” money from a utility to fund energy efficiency improvements at an effective cost of capital that exceeds a participating customer’s own cost of capital.
7. Large industrial customers should not be required to pay for the so-called system benefits alleged from energy efficiency improvements of other ratepayers unless large industrial customers receive credits for comparable system benefits resulting from all energy efficiency investments they made or make at their own expense.
8. Energy policies that force large industrial customers to become “free riders” of utility energy efficiency programs are counter-productive and wasteful.
9. Utilities should not be given special riders or single-issue cost recovery methods to increase rates absent a showing that current procedures for establishing base rates have disadvantaged utilities in any way.
10. Large industrial customers strongly support the development of advanced tariffs and business practices that increase their opportunities to provide demand response for price mitigation and improved reliability.
11. An overarching principle of government policies and mandates to promote energy efficiency in the industrial sector should be to “first, do no harm.”