

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Demand Response Compensation)
In Organized Wholesale Energy) Docket No. RM10-17-000
Markets)

**POST CONFERENCE COMMENTS OF THE
ELECTRIC POWER SUPPLY ASSOCIATION**

The Electric Power Supply Association (“EPSA”)¹ submits these comments pursuant to the Federal Energy Regulatory Commission’s (“FERC” or “Commission”) August 2, 2010 Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference, which established a date for submittal of post-technical conference comments in the above captioned proceeding.² The staff-led technical conference was held on September 13, 2010, with two panels confined to discussions of only the two specific issues raised for comment in the Supplemental NOPR: (1) if the Commission were to adopt a net benefits test for determining when to compensate demand response (“DR”) providers the full Locational Marginal Price as proposed, what, if any, requirements should apply to the methods for determining net benefits; and, (2) what, if any, requirements

¹ EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These Suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue. EPSA is an active participant in this proceeding. See Comments of the Electric Power Supply Association, Docket No. RM10-17-000 (filed May 12, 2010) (the “EPSA Initial Comments”); *also* Reply Comments of the Electric Power Supply Association, Docket No. RM10-17-000 (filed June 30, 2010) (the “EPSA Reply Comments”).

² *Demand Response Compensation in Organized Wholesale Energy Markets*, Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference at P 19, 132 FERC ¶ 61,094 (August 2, 2010) (“Supplemental NOPR”). The Supplemental NOPR follows the Notice of Proposed Rulemaking issued in this proceeding, *Demand Response Compensation in Organized Wholesale Energy Markets*, 75 Fed. Reg. 15,362 (Mar. 29, 2010), 130 FERC ¶ 61,213 (2010) (“NOPR”).

should apply to how the significant costs of the subsidies for DR in the NOPR are allocated among other consumers, who would primarily and disproportionately be residential customers.³ These are but two of the many questions, issues and concerns raised and documented by a diverse set of stakeholders in this proceeding. However, thus far only these two questions have been subjects for a technical conference and a Supplemental NOPR in this proceeding, leaving a long list of other critical matters as yet unanswered or unaddressed.

EPSA has previously stated its full support for the role properly compensated DR can and should play in wholesale energy markets. The stated premise of the NOPR as discussed at the technical conference and elsewhere is payment of equivalent compensation to DR as is paid for power supply because DR is, or if it is, an equivalent service to that of traditional generation supply.⁴ For sake of discussion, EPSA is willing to assume, but does not concede, this functional equivalency. However, even with that assumption, a fundamental flaw

³ *Supplemental Notice of Technical Conference and Notice of Comment Date*, Docket No. RM10-17-000 (August 27, 2010) ("Conference Notice"). The Conference Notice scheduled the technical conference for September 13, 2010 (the "September 13 Technical Conference"), with post-conference comments due on or by October 13, 2010.

⁴ Chairman Jon Wellinghoff noted at the beginning of the September 13 technical conference, "[T]he presumption here is that there should be equivalent compensation for equivalent services, and that's where the Commission started here. We started with giving the full LMP to Demand Response for bidding into these markets. And I still believe that's the correct result. It's a presumption. It's a presumption certainly that is subject to being rebutted." *Demand Response Compensation in Organized Wholesale Energy Markets*, Transcript at pp. 7-8, lines 20-25 and 1-2, Docket No. RM10-17-000 (Sept. 13, 2010) ("Transcript") (Chairman Jon Wellinghoff). While Chairman Wellinghoff said the following day in an address to the Alliance to Save Energy that no one at the conference had rebutted the stated presumption, unfortunately doing so was not within the limited agenda of the conference, although EPSA would welcome the opportunity to discuss and rebut the presumption for the extensive reasons outlined here and in other filings in this proceeding. Craig Canno, "Wellinghoff firm on equal treatment for demand, supply-side resources," *Electric Power Daily* (September 15, 2010). See also: Lynn Doan, "Wellinghoff: I'm a 'soldier' fighting in an 'epic' battle for demand response," *SNL* (September 14, 2010); and "Wellinghoff: Epic Battle," *Energy Washington NewsRoom Blog* (September 14, 2010).

of the NOPR, not corrected by the Supplemental NOPR, is that it fails to require DR providers to operate under the equivalent regulatory requirements applicable to power suppliers in all relevant markets (energy, capacity and ancillary services) to justify “equivalent” payment in energy markets even if they are functionally equivalent. Absent explicit equivalent regulatory treatment of DR being required by the NOPR, and adjustments as necessary and appropriate to other tariff provisions now applicable to generation (e.g., market mitigation such as the three pivotal supplier test), paying full LMP in all hours to DR as proposed by the NOPR amounts to a decidedly discriminatory, unjustified and unsustainable subsidy that will undermine, not strengthen, the organized wholesale electricity markets within the Commission’s jurisdiction. EPSA does not make this assertion lightly. The Commission should be aware of the monumental mistake it would be making if it proceeds to a final rule based on the NOPR without addressing these concerns.

Far from being a carefully crafted comprehensive regulatory proposal that addresses regulatory equivalency, economic impact, and other critical issues as identified by EPSA and others in this docket, the NOPR’s proposed tariff language as it stands even after the Supplemental NOPR is breathtaking in its brevity:

Each Commission approved independent system operator or regional transmission organization that has a tariff provision permitting demand response resources to participate as a resource in the energy market by reducing consumption of electric energy from their expected levels in response to price signals must pay to those demand response providers, in all hours, the market price for energy for these reductions.⁵

⁵ NOPR at p. 31, see proposed regulatory text to amend Section 35.28 to add new paragraph (g)(1)(v), “Non-discriminatory open access transmission tariff.”

EPSA respectfully submits that the two narrow questions in the Supplemental NOPR and the constrained discussion at the technical conference barely scratch the surface of the depth and breadth of the inquiry necessary to reach a well-reasoned and factually supportable result in this proceeding. As noted below, certain of these unasked questions implicate broad negative impacts to the electric industry and the U.S. economy as a whole. Nonetheless, EPSA appreciates the opportunity to provide comments on the two issues raised in the Supplemental NOPR before turning to the many outstanding issues not yet fully addressed by the Commission and why it is essential that the Commission address them with broader public participation prior to issuing a final rule.

As to the usefulness and type of net benefit tests which may be utilized to determine when to pay full LMP to DR providers, EPSA believes that such a test cannot overcome the problems inherent in the initial DR compensation proposal. Simply developing a test to limit the application of full LMP payments for DR (such as to certain hours) does not avoid overpaying DR and the cascading negative impacts on wholesale electricity markets that will result. The very need to discuss a potential “net benefits test” exposes the foundational flaws in the NOPR.⁶

On the question of how the costs of DR should be allocated, EPSA does not have a proposal or recommendation. As was the case with the discussion at the technical conference of some type of net benefits test, consideration of a cost allocation scheme is necessary only because overpaying DR the full LMP without

⁶ As noted by Ohio Public Utilities Commissioner Paul Centolella at the technical conference, “The Net Benefits test reflects a recognition that paying full LMP may over-compensate Demand Response and increase costs to consumers.” Transcript at p. 141, lines 6-12.

an offset creates substantial uplift costs that then need to be allocated to other consumers. As EPSA and numerous parties have stated previously in the record of this proceeding, and will not belabor here, use of a DR payment mechanism that accounts for the avoided cost savings from consuming less electricity from the grid when DR is called upon (so-called “LMP – G” or the market price minus the generation component of the retail electricity rate) properly compensates DR⁷ without adding the complexities associated with administering a cost allocation scheme.

EPSA reiterates its desire to be a constructive part of the ongoing dialogue on DR compensation. Rather than being wedded to the payment of full LMP in all hours with only cursory tariff language as proposed in the NOPR, a better course of action is to first inquire as to why the “equivalency” being sought between demand and supply could not be achieved by a straightforward approach based on allowing DR providers to bid into organized wholesale markets (energy, capacity and ancillary services) under the same terms and conditions as those that apply to power suppliers, thereby truly following the “equivalent payment” principle. The Commission has not undertaken that inquiry and should do so before concluding that the NOPR’s subsidy approach is a necessary and appropriate payment for DR that is within the Commission’s jurisdiction and meets the Federal Power Act’s test of being just and reasonable and not unduly discriminatory or preferential.

⁷ EPSA Reply Comments, fn 70, citing numerous and diverse initial comments filed in this proceeding which support an offset to LMP in order to achieve an economically efficient and proper price for economic DR. Additionally, William W. Hogan, “Implications for Consumers of the NOPR’s Proposal to Pay the LMP for All Demand Response,” p. 2, Attachment 1 to the EPSA Initial Comments, Docket No. RM10-17-000, (filed May 12, 2010).

In addition to a full discussion of how DR can and should participate in the organized wholesale energy markets in a truly equivalent manner to generation, there are key issues which call out for a broader examination than has occurred to date. EPSA respectfully suggests that the following questions and issues are among those that need to be addressed by the Commission on the record with opportunities for public comment on the Commission's conclusions as they were not adequately addressed under the terms of the Supplemental NOPR and the technical conference.

- (1) On what basis does the Commission claim legal jurisdiction to order the payment of full LMP to DR, particularly in light of the concession by DR providers at the technical conference that they are not actually selling energy into energy markets but providing an ill-defined "service"? This should include on what basis DR providers have a right under the Federal Power Act to just and reasonable compensation in light of the *EnergyConnect* order⁸ discussed in more detail in previously filed EPSA comments. This legal analysis should also address whether it is proper for the Commission to use the NOPR to circumvent state jurisdictional retail market design through a federal wholesale pricing mechanism as stated at the technical conference is the aim of the NOPR.⁹
- (2) Given the statements at the technical conference noted above on the Commission's desire to use a standardized wholesale payment mechanism to address Commission displeasure with certain state-jurisdictional retail policies, does the NOPR conflict with Congressional intent in requiring the Commission to develop a National Action Plan for Demand Response that limits the Commission's role to collecting and disseminating information on diverse state and regional DR mechanisms without mention of developing a uniform rule for all organized power markets?
- (3) The NOPR implies without any factual foundation or analysis that current Commission-approved wholesale rates, market rules and mitigation procedures that apply to generation are no longer just and

⁸ 130 FERC ¶ 61,031 (2010) ("EnergyConnect")

⁹ See: Remarks of Chairman Wellinghoff, who stated: "I have no assurances as to when the states will put in dynamic retail prices with the controversies that are going on, all the political problems with getting those in place. I think the only way we are going to get this technology in place and we're going to move forward with it is to move forward with it in the wholesale markets." Transcript, p. 234, lines 5-11.

reasonable.¹⁰ Similarly, there is no factual foundation for the NOPR's claim that existing market structures have hindered the development and use of DR in organized markets.¹¹ As concluding that such existing rates, rules and procedures are no longer just and reasonable is a predicate to justifying the NOPR, does the Administrative Procedure Act require a meaningful opportunity for interested parties to comment on or rebut any evidence the Commission is relying on to reach that conclusion since to date none has been made public? If so, the failure of the Commission to provide such an opportunity could complicate rather than accelerate achievement of the NOPR's goals by subjecting a flawed final rule to lengthy and successful legal challenges.

- (4) How would the NOPR impact clearly FERC-jurisdictional entities that depend on revenues from wholesale energy markets, capacity markets and ancillary services markets to operate existing power plants and build new ones based on market price signals? The one-sided discussion at the technical conference was about avoiding payment to certain types of generation supply sources through artificial suppression of wholesale power prices without any opportunity to discuss how doing so could result in unjust and unreasonable prices for generation suppliers that would negatively impact resource adequacy and thus reliability.
- (5) In the same vein, there was a disconnect at the technical conference between the stated desire by some to artificially supplant peaking generation with DR and the Commission's interest in other proceedings in making sure that the very same peaking resources are available to balance intermittent renewable resources such as wind.¹²

¹⁰ NOPR at P 13: "As we have gained experience with these programs, we are concerned that the current compensation levels **appear** to have become unjust and unreasonable. Providers may submit price and quantity bids into the organized wholesale energy markets and the market clears at the marginal resource yet they fail to compensate demand response at levels that reflect the marginal value of the resource being used by the RTO or ISO to balance supply and demand. The current wholesale compensation levels **may** therefore be leading to under-investment in demand response resources, resulting in higher, and unjust and unreasonable, prices in the organized electricity markets. To help ensure that wholesale prices in ISOs and RTOs remain just and reasonable, we are proposing to require each ISO and RTO to pay the LMP to demand response providers participating in the organized wholesale energy markets." (Emphasis added.)

¹¹ NOPR at P 9: "After several years of observing demand response participation in ISO and RTO markets with different, and often evolving, demand response compensation structures, the Commission is **concerned** that **some** existing, inadequate compensation structures have hindered the development and use of demand response." (Emphasis added.)

¹² See, for example: Transcript, p 173, lines 9-10, Ms. Angela Beehler of Wal-Mart states: "We decrease the need for some ratepayer funded peaker plants." In contrast, Mr. Stephen Sunderhauf of Pepco Holdings, Inc. states: "[T]he development of DR market standards should be undertaken with explicit examination of the impact of these program standards on the reliability of RTOs." Transcript, p. 57, lines 14-17. Of note, in a thinly disguised attempt to distract from the

- (6) The relationship between wholesale energy markets and capacity markets was not addressed at the technical conference even though it is the aggregation of revenues from all wholesale markets that is intended to ensure adequate compensation for traditional supply resources. If DR resources are to participate on a footing equal to traditional supply resources, this relationship should hold true for them as well.¹³ In fact, DR resources currently participate in ISO/RTO capacity markets extensively, though they are not allowed to set the LMP clearing price, and unlike generation are able to do so without bid price caps, offer mitigation, or Peak Energy Rent deductions (and comparable energy offsets)¹⁴ that apply to generation resources in certain organized markets. Through that difference alone, DR already receives the value of certain peak energy margins without any obligation to reduce load in many of those hours. These important revenue streams, as well as those from the emergency and ancillary service markets, should be taken into account in this proceeding if true equivalency is the real objective of the NOPR rather than subsidies that give rise to the net benefits and cost allocation questions in the Supplemental NOPR.¹⁵

subsidies that residential consumers would pay to larger entities such as Wal-Mart under the NOPR, Ms. Beehler confused generation plants in vertically-integrated states with the peaking plants in restructured states actually at issue in this proceeding to incorrectly imply "ratepayer" benefits from the NOPR. The description "ratepayer funded" applies to vertically-integrated states not to restructured states. In restructured states the risks placed on ratepayers in vertically-integrated states are largely shifted to suppliers, which is good for consumers including Wal-Mart. In organized wholesale markets the substantial investments necessary for reliability hinge on accurate price signals reflecting supply and demand, not on any one entity's assertion that "some" resources are or are not needed. This is why an explicit detailed examination of the NOPR's impact on reliability is required.

¹³ As has been noted in numerous initial and reply comments, the NOPR has deemed consideration of the capacity (or other) markets as outside the scope of this proceeding which focuses only on the Day Ahead and Real-Time energy markets. "Apart from these [other ISO/RTO] programs, wholesale customers and qualifying large retail customers may bid demand response directly into the day-ahead and real-time energy markets, certain ancillary service markets and capacity markets. Demand response providers participating as resources in the day-ahead and real-time energy markets are the subject of this proceeding." NOPR at P 7 (citation omitted).

¹⁴ For instance, in ISO New England DR sold as capacity is not required to rebate a Peak Energy Rent (PER) from their capacity payments as do all other capacity sellers. Additionally, DR is able to receive the full capacity clearing price without any PER deduction from the clearing price whether the DR provider reduces its load in an hour or not. This is not comparable to any other capacity seller, including generation, and represents a preferential ability to recover greater fixed costs than other resources in the capacity market. As a result, far from being "equivalent payment for equivalent service," the NOPR treats DR in this circumstance *better* than generation.

¹⁵ Additionally, concerns were raised at the technical conference regarding the impact on prices in capacity markets stemming from the suppression of energy prices by subsidized DR resources. Bob Ethier of ISO New England stated, "To the extent that paying these resources, and getting them engaged in the market reduces LMPs, that is going to have carry-on effects into the capacity market. Those effects are easy to describe. For example, generation gets money from both the energy and the capacity markets. To the extent that energy market revenues decrease, they're

- (7) The NOPR's proposed tariff language would pay full LMP to DR in all hours regardless of market and operational conditions. Is there a saturation level of DR inconsistent with reliable grid operations? This is particularly important given the physical and financially interconnected nature of the assets within the wholesale markets that would be forced to over-compensate DR, and thus incentivize more DR than economically efficient, which could produce excessive amounts of DR. While the saturation issue is being discussed within individual organized markets,¹⁶ the NOPR is proceeding without benefit of those discussions and without any requirement for organized markets to take steps to avoid saturation.
- (8) On the flip side from saturation, is there a fatigue factor that limits the practical willingness of DR resources to participate, particularly with a favorable change in economic conditions as the economy grows making at least some DR less practical, but only after the distorted price signals from the NOPR indicate to traditional supply side resources that they are not necessary? While generation resources take varying amounts of time to be built or come back on line once mothballed or retired, supply is steel in the ground available for decades. By contrast, while DR may be able to respond quickly in some unknown quantities, at the same time those engaging in DR can quickly decide that reducing demand is not in their economic interest, leaving a major resource gap not easily filled once policymakers create uneconomic conditions for generators.
- (9) There is nothing in the proposed tariff language to address other practical concerns such as lack of clear measurement and verifiability metrics; how to avoid gaming the baselines against which DR would be measured and paid; requiring the grid operator to be able to dispatch the DR in the same manner as generation for DR to qualify for "equivalent" payment; and differentiating between specific types of DR products (not just any reduction from expected levels as in the NOPR) based on differing technical capabilities such as time of use limitations and response/ramping times.

going to increase the amount that they need to recover from the capacity market before they either enter the market, or before they retire from the market and de-list." Transcript, p. 24, lines 10-19. Despite this independent expert testimony on the unseverable link between capacity and energy markets, as noted the NOPR expressly proposes to change energy market rules while excluding impacts on capacity market revenues and issues.

¹⁶ For example, PJM stakeholders are considering a range of potential modifications to PJM market rules to address concerns identified in a May 2010 PJM staff study analyzing the level at which demand response ceases to provide the level of system reliability upon which PJM operations relies. The study, "Demand Resource Saturation Analysis," developed by the Resource Adequacy Planning Department may be found on the PJM website at: <http://www.pjm.com/~media/committees-groups/committees/mrc/20100518/20100518-item-05-dr-saturation-report.ashx>.

- (10) Would the proposal to institute a standard pricing approach for DR create further disparities or seams between and among the various organized and bilateral markets? Since the NOPR will apply only to those states in an organized market but not to those states outside of an organized market, creating uplift costs and how to allocate them to cover the DR subsidies in some states but not others, how will the NOPR impact relative electricity rates in states covered by the proposal and those not covered? How will such impacts affect relative economic competitiveness of various states? This was not discussed during the technical conference's panel on cost allocation.
- (11) The NOPR is being considered at a time of high unemployment and low economic growth. The NOPR does not distinguish between types of demand reductions in determining what actions by electricity users would qualify for the full payment of LMP in addition to the savings from avoided costs. In fact, by its terms, the proposed tariff language would broadly apply to "reducing consumption of electric energy from their expected levels in response to price signals." The impact of a national policy that rewards and incents inefficient reductions in electricity use that in turn results in lower economic activity should be carefully analyzed and its impacts explicitly considered.
- (12) How does the NOPR relate to or impact ongoing stakeholder discussions and FERC proceedings involving DR as mandated by Order No. 719 in MISO and ISO-NE as the NOPR only terminated such discussions in PJM? Given that equivalency of all supply resources broadly defined to include DR is the stated goal of the NOPR, why does the NOPR not address scarcity pricing for all resources in the organized markets on an equivalent basis?

At this stage, with the array of these and other fundamental questions being raised by a diverse set of stakeholders beyond the power generation sector, but not addressed either in the NOPR, the Supplemental NOPR, or the technical conference, EPSA recommends that the Commission revert this proceeding back to the Notice of Inquiry stage where it should have started to do the basic analysis and actually develop the record necessary to justify a generic final rule on DR compensation. Alternatively, EPSA recommends that the Commission fashion a new proposal that squarely and fully addresses the legal and economic concerns stated by the majority of commenters in this

proceeding.¹⁷ As of the September 13 technical conference the record to date does not support moving forward with a final rule predicated on a NOPR that ignores serious negative consequences that will follow for organized markets and the economy at large for decades to come.

I. CONCLUSION

WHEREFORE, for the foregoing reasons, EPSA respectfully requests that the Commission consider these comments in determining further action in this proceeding. As discussed in detail herein, the record in this proceeding is insufficient and lacks a sound basis for the Commission to proceed to issuance of a final rule without major modifications. Although numerous comments have been filed by many diverse parties, a Supplemental NOPR has been issued, and a technical conference convened, there remain many unanswered questions and serious concerns regarding the significant impacts sparked by the NOPR.

Consequently, EPSA recommends that the Commission allow for further development of the record through issuance of a NOI or promulgation of a new proposal, either of which should be accompanied by a Commission staff white paper providing the necessary underlying technical and economic analyses to support further consideration of the complex issues surrounding the appropriate compensation of DR resources. EPSA looks forward to continuing this dialogue

¹⁷ A new proposal is not without precedent, for example, see Docket No. RM07-1-000. In that proceeding, the Commission first promulgated a January 2007 NOPR (118 FERC ¶ 61,031) proposing to relax the Standards of Conduct so that certain categories of employees could share information. Upon further consideration and review of the comments in the record, the Commission published a second NOPR in March 2008, which stated: "After giving consideration to these comments and to our own experience in enforcing the Standards, the Commission believes it to be necessary and appropriate to modify the approach proposed in the initial NOPR." (122 FERC ¶ 61,263) It was the second NOPR upon which the final rule, Order No. 717 (125 FERC ¶ 61,064), was based.

and working with all interested parties to craft an approach that is truly beneficial to the wholesale electricity markets and the consumers they serve.

Respectfully submitted,



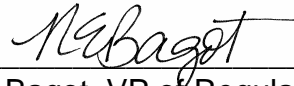
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October 13, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the Comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., October 13, 2010



Nancy Bagot, VP of Regulatory Affairs