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REGULATORS AND MARKET ADMINISTRATORS QUESTION DEMAND RESPONSE PROPOSAL

Last week (October 13, 2010) was the deadline for further public comments on the Federal Energy Regulatory Commission's (FERC) controversial notice of proposed rulemaking on demand response (DR) compensation in the independently-administered organized wholesale power markets. Specifically, comments were due on a supplemental proposed rulemaking to add a "net benefits test" and address cost allocation issues prompted by the original proposal on which a technical conference was held by FERC staff on September 13, 2010.

FERC's initial proposal would result in double payment for demand response resources by requiring Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) to pay the full locational marginal price (LMP) in addition to the savings from avoided electricity use. A group of Federal and state regulators as well as the independent competitive wholesale market administrators submitted comments once again raising concerns with FERC's proposed rule to establish a generic compensation approach for DR participating in organized wholesale electricity markets. It is telling that the organizations tasked by FERC with administering well-functioning, competitive markets continue to oppose FERC's "double recovery" proposal. In addition, a number of regulators have now voiced concerns a number of times over mandating a preferential uniform method of compensation across all RTOs. These concerns include negative market impacts that occur from overcompensating demand response resources at the full LMP without an offset for the savings from avoided electricity use, compounded by FERC's discussion of a "net benefits test" that further distorts wholesale and retail impacts.

Comments from Federal and State Regulators

- "[T]here is no need for a net benefits test so long as FERC utilizes efficient prices in compensating demand response providers, because efficient prices will elicit efficient levels of demand response. Efficient price signals also will encourage efficient investments in demand response technologies. The proposal to implement a net benefits test as a screen arises as a policy issue only if FERC sets inefficiently high compensation levels for demand response (i.e., compensation that does not deduct the cost of the power that the demand response provider is reselling)... We encourage FERC to adopt efficient pricing for demand response compensation. If FERC does so, it can avoid the need to devise administrative means to trim excess demand response." *Federal Trade Commission (FTC), p. 1*
- "The Supplemental NOPR cites public comments that support full LMP as the compensation level for demand response and also support a net benefits test. Those comments implicitly recognize that the payment of full LMP constitutes overcompensation for demand response providers who pay flat retail rates." *FTC, p. 4*
- "Any unnecessarily large incentives for demand response have a cost. The amount of any incentives will be recovered from other consumers. While the discussion of a "net benefits" test has focused on the potential for additional demand response to lower prices in energy markets, lower energy market prices do not necessarily mean lower total costs to consumers." *Public Utilities Commission of Ohio Commissioner Paul Centolella, pp. 9-10*

Comments from Independent Market Administrators

- “[O]vercompensating DR will result in an artificial market construct in which LMP is suppressed below the price at which generation resources will voluntarily bid into the energy market. This will not only reduce the economic efficiency of the wholesale market, it will also unfairly shift the costs resulting from the inefficient curtailment to those retail customers who do not participate in DR (typically small residential and commercial customers).”
Midwest ISO, p. 3 (MISO serves 40 million consumers)
- “The Midwest ISO does not support the adoption of a [net benefits test] to determine when to compensate DR providers. Such a test is both unnecessary in a competitive wholesale market and the very antithesis of one. In fact, a [net benefits test] may distort the decision of when to procure DR.” ***Midwest ISO, p. 9***
- “Finally, analysis of long-run capacity market impacts shows that capacity price increases from the suppression of energy prices driven by paying demand response the full LMP can fully offset energy price reductions, making consumers worse off in the end. This result casts doubt on whether the proposed rule in the March NOPR would serve the objective of reducing consumer energy expenditures.” ***ISO New England, p. 15 (ISO-NE serves 14 million consumers)***
- “When the market is competitive and a proper compensation rate is utilized, it is not necessary to do any detailed accounting of direct (vs. administrative) demand response costs for the purposes of a net benefits test, because if demand response is properly compensated, demand response is offered into the wholesale market at its true cost (i.e., the opportunity cost of foregone energy consumption).” ***ISO New England, p.18***
- “The [New York] ISO continues to believe that the LMP-G approach provides an efficient incentive for demand resources to participate in the wholesale markets, and that a requirement to pay LMP would impose unnecessary costs on customers, create distorted incentives, and hinder the introduction of other clean technologies by suppressing real time prices.” ***New York ISO, p. 3 (NYISO serves 19 million consumers)***
- “Establishing a one size fits all final rule in this proceeding could force the ISO to adopt a fundamentally different design for demand response compensation in order to address issues and concerns that may arise in other parts of the country but that are not relevant to California. The Commission should permit the California ISO to build on its existing efforts to develop demand response in California in coordination with the California Public Utilities Commission rather than compelling the ISO to abandon the progress made to date.” ***California ISO, p. 4 (CAISO serves 30 million consumers)***
- “Considering what is known about the various jurisdictions in which RTOs and ISOs operate, as well as the differing regulatory treatment of demand response resources at the retail level, the level of demand response available is better maximized by RTOs and ISOs incorporating such resources into their specific market(s).”
Southwest Power Pool, pp. 3-4 (SPP serves 7 million consumers)

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