

other things, that certain demand response (“DR”)⁸ resources⁹ (“DRRs”) that participate in an organized wholesale energy market administered by an independent system operator (“ISO”) or a regional transmission organization (“RTO”) be paid the full locational marginal price (“LMP”) for energy.

EPSA respectfully submits that the Commission erred in accepting PJM’s proposal to treat behind-the-meter generation (“BTMG”) as DR and to make BTMG eligible for full LMP compensation. PJM’s conclusion that BTMG provides DR is inconsistent with the definition of DR applied in Order No. 745. Moreover, the Commission’s holding is contrary to the FPA’s non-discrimination requirements insofar as it mandates that generation located behind the meter is to be paid differently than generation located in front of the meter. In addition, the Commission’s determination is arbitrary and capricious insofar as it ignores the serious concerns raised by EPSA¹⁰ and other parties that paying BTMG full LMP would result in undue discrimination against wholesale generation, splinter organized markets by encouraging existing wholesale generation to move behind

745-A, 137 FERC ¶ 61,215 (2011) (“Order No. 745-A”). See also *Demand Response Compensation in Organized Wholesale Energy Markets*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,656 (2010) (the “NOPR”).

⁸ In Order No. 745, the Commission retained its existing definition of DR as “a reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy.” Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2 (*citing* 18 C.F.R. § 35.28(b)(4)).

⁹ The Commission also defined a “demand response resource” as “a resource capable of providing demand response.” *Id.* (*citing* 18 C.F.R. § 35.28(b)(5)).

¹⁰ See generally Comments of the Electric Power Supply Association, Docket No. ER11-4106-000 (filed Aug. 12, 2011); Comments, Motion for Leave to Answer and Answer of the Electric Power Supply Association on Order No. 745 Compliance Filings, Docket No. ER11-4106-000 (filed Sept. 23, 2011) (the “EPSA Answer”). The Commission accepted the EPSA Answer. See PJM Compliance Order, 137 FERC ¶ 61,216 at P 12.

the meter, facilitate gaming and other manipulative practices, harm competition, threaten reliability, and likely have adverse environmental effects. For these and other reasons set forth herein, the Commission should grant rehearing of the PJM Compliance Order.

I. STATEMENT OF ISSUES AND ERRORS

In accordance with Rule 713(c)(2) of the Commission's Rules of Practice and Procedure,¹¹ EPSA hereby lists each issue on which it seeks rehearing of the PJM Compliance Order and provides representative precedent in support of its positions on these issues:

1. The PJM Compliance Order permits BTMG to be paid full LMP, and is therefore contrary to law, because it will result in unduly preferential treatment of BTMG and unduly discriminatory treatment of wholesale generation. *See, e.g.,* 16 U.S.C. §§ 824d, 824e (2006); *Elec. Consumers Res. Council v. FERC*, 747 F.2d 1511, 1515-16 (D.C. Cir. 1984) ("ELCON").
2. The PJM Compliance Order is arbitrary and capricious, and is not the product of reasoned decisionmaking, because the Commission failed to address the serious and legitimate objections raised by EPSA and other parties that BTMG should not be treated as a DRR and that doing so will result in undue discrimination against wholesale generation. *See, e.g., Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001) ("CAPP"); *Moraine Pipeline Co. v. FERC*, 906 F.2d 5, 9 (D.C. Cir. 1990) ("Moraine Pipeline").
3. The Commission's determination regarding that treatment of BTMG is arbitrary and capricious, and is not the product of reasoned decisionmaking, because the resulting undue discrimination against wholesale generators will incentivize wholesale generation to move behind the meter, harm competitive markets, facilitate gaming and other manipulative practices, threaten long-term reliability, and have adverse environmental impacts. Moreover, the Commission has not responded meaningfully to these serious objections to its proposed approach. *See, e.g., PPL Wallingford Energy LLC v.*

¹¹ 18 C.F.R. § 385.713(c)(2) (2011).

FERC, 419 F.3d 1194, 1198-1200 (D.C. Cir. 2005) (“*PPL Wallingford*”).

II. BACKGROUND

A. Order No. 745

In Order No. 745, the Commission held that DRRs participating in ISO/RTO-administered wholesale energy markets must be paid the full LMP, provided that: (1) the DR resource “has the capability to balance supply and demand as an alternative to a generation resource;”¹² and (2) “dispatch of that demand response resource is cost-effective as determined by the net benefits test.”¹³ The Commission did not explicitly address the treatment of BTMG, or whether BTMG should qualify as a DR resource.

EPSA filed extensive comments in the Order No. 745 rulemaking proceeding, detailing the substantial – indeed, fatal – legal, economic, technical and practical infirmities in the approach proposed in the NOPR and, with very few exceptions, adopted in Order No. 745.¹⁴ In addition, EPSA, along with other groups representing a broad range of interests, sought rehearing of Order No.

¹² Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2.

¹³ *Id.*

¹⁴ See generally Comments of the Electric Power Supply Association, Docket No. RM10-17-000 (filed May 13, 2010) (“EPSA NOPR Comments”); *id.*, Attachment 1, William W. Hogan, Implications for Consumers of the NOPR’s Proposal to Pay the LMP for all Demand Response (“Hogan Policy Paper”); Reply Comments of the Electric Power Supply Association, Docket No. RM10-17-000 (filed June 30, 2010).

745,¹⁵ and following the issuance of Order No. 745, filed a petition for review of Order No. 745 in the Court of Appeals for the District of Columbia Circuit.¹⁶

B. The PJM Compliance Filing

On July 22, 2011, PJM submitted its revised Tariff sheets in compliance with the Commission's directives in Order No. 745. PJM's pre-existing market rules provided that DR is to be compensated at LMP, less certain deductions for generation and transmission charges. To comply with Order No. 745's requirement to pay DR full LMP, PJM proposed to remove the references to these deductions in Section 3.3A.5 and 3.3A.6 of its Operating Agreement.¹⁷

With respect to the treatment of BTMG, PJM's existing Tariff currently provides that "On-Site Generation" (or BTMG) is eligible for DR compensation. PJM proposed to revise these Tariff provisions to provide that, for BTMG to be eligible for LMP-based compensation, it "should not have been operating except to support the Economic Load Response event," (*i.e.*, an event in which a DRR is deployed),¹⁸ meaning that any related energy market credit would be limited to

¹⁵ See Joint Request For Rehearing of the Electric Power Supply Association, *et al.*, Docket No. RM10-17-001 (filed Apr. 14, 2011); Request For Rehearing of the Competitive Supplier Associations, Docket No. RM10-17-001 (filed Apr. 14, 2011).

¹⁶ See *Electric Power Supply Ass'n v. FERC*, Petition for Review, Case No. 11-1489 (filed Dec. 23, 2011).

¹⁷ See PJM Compliance Filing at 21.

¹⁸ Answer of PJM Interconnection, L.L.C. to Comments and Protests at 17-18, Docket No. ER11-4106-000 (filed Aug. 29, 2011). Specifically, PJM proposes to add to Section 3.3A.2.02(i) of Schedule 1 of the PJM Operating Agreement – which currently provides the currently provides that an "On-Site Generator shall be used solely to enable an Economic Load Response Participant to provide demand reductions in response to the [LMP] in the Real-time Energy Market and/or the Day-ahead Energy Market" – the following language at the conclusion of this subsection (i): "and shall not otherwise have been operating." PJM Compliance Filing, Attachment G, Revisions to the Schedule 1 of the PJM Operating Agreement (redlined), § 3.3A.2.02(i).

the amount of a customer's metered load that is reconstituted to reflect the BTMG output seeking credit as wholesale energy sales.¹⁹

C. The PJM Compliance Order

In the PJM Compliance Order, the Commission conditionally accepted the PJM Compliance Filing, including PJM's proposed revisions to treat BTMG as DR and to make it eligible for LMP-based compensation.²⁰ In doing so, the Commission rejected the arguments of EPSA and other parties that BTMG does not constitute a reduction in load and therefore should not be paid full LMP.²¹ According to the Commission, under PJM's existing Tariff, a customer with BTMG "that reduces its metered demand by running its [BTMG] is eligible for demand response compensation for this reduction,"²² and "Order No. 745 did not require the elimination of such payments."²³

¹⁹ Just as wholesale electric generators do not receive wholesale energy market payments for the portion of their real power output used to satisfy generator station service demand, it is appropriate that BTMG not be paid when it is used to offset energy purchases. For example, if a customer's facility is consuming 1 MW and BTMG is made available for dispatch from 0 to 3 MW, the customer should be required to buy back 1 MW to meet its behind the meter load if it is going to be paid at wholesale for the full 3 MW of BTMG. Conversely, if the customer is seeking to avoid energy purchases to satisfy its 1 MW of load, it should only be compensated by PJM for the 2 MW net BTMG that remains after it has used the first MW to satisfy its own behind the meter load.

²⁰ PJM Compliance Order, 137 FERC ¶ 61,216 at P 90.

²¹ *Id.* at 94.

²² *Id.*

²³ *Id.* The Commission also rejected, as beyond the scope of this proceeding, EPSA's request that the Commission analyze the impact of BTMG on organized markets and DR programs. *Id.* at P 95.

III. REQUEST FOR REHEARING

A. The Commission's Finding Regarding BTMG Unlawfully Mandates Unduly Preferential Treatment Of BTMG And Unduly Discriminatory Treatment Of Wholesale Generators.

The Commission should grant rehearing of its determination to accept PJM's proposal insofar as it treats BTMG as DR and permits BTMG to be eligible for full LMP compensation. While Order No. 745 does not include any directives regarding the treatment of BTMG, PJM's proposal is flatly contradicted by the Commission's definition of DR therein as:

[A] reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy.²⁴

BTMG represents an incremental increase in energy supply, and it **does not** reduce consumption. Thus, the use of such generation does not provide DR through load reduction, and therefore should not be paid full LMP.

Moreover, payment of full LMP to BTMG unduly discriminates against wholesale generation. As explained in greater detail in the white paper attached to EPISA's comments on the NOPR, under the Commission's approach, a customer with BTMG can use the unit's output **both** to serve its own (unreduced) load **and**, at the same time, sell the output as price-responsive DR. By contrast, a generator located in front of the meter would have to either sell the output in the wholesale market as generation **or** use the generation to serve a customer's load directly, and receive correspondingly lower compensation.²⁵ Thus, the

²⁴ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2.

²⁵ See Hogan Policy Paper at 7-9.

Commission's approach not only subsidizes BTMG-based DRRs that are less efficient and more polluting than other generators, but the subsidy ensures that these units will run more frequently when installed behind the meter than they would if installed on the ISO/RTO side of the meter because the BTMG unit will be "cost-effective" whenever its costs are ***less than or equal to LMP plus the retail rate***, whereas the wholesale generator in front of the meter would be dispatched only when its costs are less than or equal to LMP.²⁶ In addition, the Commission's determination would further exacerbate the existing discrimination in favor of BTMG in PJM's current rules, which permit BTMG to participate in PJM's markets without being subject to comparable requirements, in particular, those relating to market power mitigation (*e.g.*, the must offer requirement).²⁷

The FPA requires the Commission to ensure that jurisdictional participants in the wholesale markets are treated fairly and equitably and that prices in those markets are just, reasonable, and not unduly preferential or discriminatory.²⁸ Moreover, under the FPA, the Commission may not tolerate, much less mandate, undue discrimination against wholesale generation in order to incent and subsidize generation that is not part of the wholesale market. ISO/RTO rules and requirements must therefore apply equally to all generators that participate in the markets they administer, without regard to which side of the meter they are

²⁶ See *id.* at 9-10.

²⁷ See *generally* EPSA Answer at 25-26 (discussing disparate treatment of BTMG and on-grid generators in terms of market power monitoring and mitigation).

²⁸ See 16 U.S.C. §§ 824d, 824e (2006).

located. Thus, PJM's proposal is not consistent with either Order No. 745 or with the FPA's non-discrimination requirements.

The Commission's holding in the PJM Compliance Order to permit PJM to pay qualifying BTMG full LMP, in addition to the savings from the foregone retail or wholesale purchase costs, is therefore contrary to law because it mandates undue preferential treatment of BTMG and unduly discriminates against wholesale generators.²⁹ Moreover, the Commission failed to address, much less respond in any meaningful way to, the objections to the Commission's approach raised by EPSA and other parties that BTMG should not qualify as DR and that payment of full LMP would be undue preferential and discriminatory.³⁰ In failing to respond to these serious objections, the Commission has not fulfilled its "fundamental obligation to engage in reasoned decision making,"³¹ which necessarily "renders its decision ... arbitrary and capricious."³²

²⁹ 16 U.S.C. §§ 824d, 824e (2006). See also *ELCON*, 747 F.2d at 1515-16 (finding rate design to be unduly discriminatory where the Commission and the filing utility failed to provide evidence justifying differences in rates to otherwise similarly situated customers that resulted in high-load factor customers subsidizing low-load factor customers).

³⁰ See generally EPSA Answer at 16-18 and 24-26.

³¹ *Moraine Pipeline*, 906 F.3d at 8 (finding that the Commission failed to satisfy its "fundamental obligation to engage in reasoned decision making" by failing to respond to petitioner's argument).

³² *CAPP*, 254 F.3d at 299. See also *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (finding that an agency decision is arbitrary and capricious when it "entirely failed to consider an important aspect of the problem [or] offered an explanation for its decision that runs counter to the evidence before the agency.") (internal citations omitted).

B. The Commission’s Finding Regarding BTMG Ignores Evidence That Its Approach Would Encourage Generation To Move Behind The Meter, Facilitate Manipulation, Harm Competition, Threaten Reliability, And Have Adverse Environmental Impacts.

The Commission’s determination that BTMG must be paid full LMP is also arbitrary and capricious, and is not the product of reasoned decisionmaking, insofar as it ignored the serious concerns raised by EPSA that payment of full LMP to BTMG would have a number of adverse consequences. In its answer, EPSA explained that payment of full LMP to BTMG would encourage generation to move from in front of the meter to behind the meter, facilitate gaming and other manipulative practices, harm competition, threaten reliability, and would have adverse environmental effects.³³ The Commission’s decisions to brush these arguments aside as beyond the scope of the proceeding, rather than responding to them on their merits, renders its determination arbitrary and capricious.³⁴

EPSA respectfully submits that the concerns that the Commission’s approach would encourage generation to move behind the meter³⁵ are well

³³ See generally EPSA Answer at 16-30. As part of this discussion, EPSA relies on the conclusions reached in the May 26, 2011 opinion issued by the ISO-NE Internal Market Monitor (“ISO-NE IMM”). See Memo from Dave LaPlante and Hung-po Chao, Internal Market Monitor, “Opinion on behind-the-meter generation in the proposed Order 745 Transition Rules” (dated May 26, 2011) (“ISO-NE IMM Opinion”), available at: http://www.iso-ne.com/committees/comm_wkgrps/mrks_comm/mrks/mtrls/2011/jun22011/a3_imm_memo_05_26_11.doc.

³⁴ See, e.g., *PPL Wallingford*, 419 F.3d at 1199-1200 (vacating and remanding orders for Commission’s failure to respond to “answer objections that on their face seem legitimate”) (internal citations omitted).

³⁵ The ISO-NE IMM Opinion, which is quoted in the EPSA Answer, explains these concerns as follows:

[I]t may appear that the behind-the-meter generation has met the Commission’s net benefits test and therefore increases market competitiveness. This is too narrow a view of competitiveness, because larger and more efficient

founded. As the Commission has repeatedly emphasized, large, centrally dispatched markets offer the most efficient, reliable and competitive markets for electricity.³⁶ The LMP-based energy market design was premised on all resources supplying energy receiving the same price. Paying LMP to loads for “phantom load reductions” (and also avoiding the LMP charges that would have been incurred), and worse yet, paying BTMG full LMP, while allowing it to also sell that energy to the behind-the-meter load, disrupts these efficiencies, and will encourage the development of generation behind the meter, displacing wholesale generation, in order to obtain the higher prices received by BTMG (*i.e.*, full LMP plus the savings from any foregone retail or wholesale purchases). The approach adopted in the PJM Compliance Order thus threatens to frustrate the Commission’s long-standing policy of promoting the development of ISOs/RTOs by creating perverse economic incentives that would fracture these centrally

generators have similar incentives to move behind the meter. If large generators begin to locate behind the meter of industrial and commercial customers, it would not only distort the wholesale price but makes it more difficult for the distribution and grid operators to protect contingencies caused by failures of behind-the-meter generators. Additionally, if behind-the-meter generation continues to receive this favorable treatment it will stifle investment in more efficient generation technologies in the wholesale market and raise prices to all customers over the long run, the opposite result from that which would occur in a competitive market.

EPSA Answer at 20 (*quoting* ISO-NE IMM Opinion at 3).

³⁶ See generally *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, FERC Stats. & Regs. ¶ 31,281 (2008); *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999). See also *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 235 (2007); *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31,241 at P 20 (2007).

organized markets into a patchwork quilt that destroys the economic efficiency and reliability assurance that they currently provide.

In addition, EPSA's concerns regarding the danger of market manipulation by DR providers are justified and find support both in Order No. 745 and in investigations conducted by the Commission's Office of Enforcement ("OE") Staff. In Order No. 745, for example, the Commission acknowledges the potential for manipulation of the baseline, concluding that "demand reductions that are not genuine may be violations of the Commission's anti-manipulation rules."³⁷

The Commission also ignored EPSA's concerns that such preferential treatment of BTMG would have adverse environmental impacts because it would promote the operation of **less** efficient, more polluting BTMG, which is not subject to the same environmental laws and emissions controls as wholesale

³⁷ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 95. The Commission has, in fact, penalized at least one DR provider for violating the anti-manipulation rules. See *North Am. Power Partners*, 133 FERC ¶ 61,089 (2010) (order approving stipulation and consent agreement between OE and North America Power Partners ("NAPP") to resolve violations of the Commission's anti-manipulation rule and PJM's tariff provisions, including a civil penalty of \$500,000 and disgorgement of more than \$2.25 million, plus interest, in unjust profits). See also *In re Joseph Polidoro*, 138 FERC ¶ 61,018 (2012) (order approving stipulation with NAPP employee pursuant to which he agreed to a two-year ban from participation in PJM's DR markets and to pay a civil penalty of \$50,000). The Commission has also issued public notices that Commission Office of Enforcement Staff has preliminarily determined that participants in ISO-New England Inc.'s Day-Ahead Load Response Program ("DALRP") violated the Commission's anti-manipulation rule by artificially inflating their baseline loads and misrepresenting their load profiles to fraudulently collect DALRP payments. See Staff Notice of Alleged Violations (Jan. 25, 2011) (notice of alleged violations by Lincoln Paper and Tissue, LLC); Staff Notice of Alleged Violations (Jan. 25, 2011) (notice of alleged violations by Competitive Energy Services, LLC); Staff Notice of Alleged Violations (Jan. 25, 2011) (notice of alleged violations by Rumford Paper Company). A recent audit of a major DR provider also identified a number of instances of alleged noncompliance with ISO/RTO requirements. See, e.g., *EnerNOC, Inc.*, Docket No. PA11-20-000 (Jan. 13, 2012) (unreported) (releasing audit report).

generation, and would therefore discourage the rational development of cleaner and more efficient wholesale generation.³⁸ This concern appears to have been borne out by efforts of DR providers to loosen regulations for the operation of BTMG under Environmental Protection Agency (the “EPA”) regulations, including their successful efforts to persuade the agency to amend its National Emissions Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines (the “RICE NESHAP”),³⁹ which changed the operating limitations of existing stationary compression ignition reciprocating internal combustion engines (“RICE”) to permit these units to run for longer periods in order to participate in emergency DR programs.⁴⁰ A proposed settlement with various DR providers threatens to make the situation even worse, by further increasing the annual number of hours during which such resources would be permitted to run

³⁸ See EPSA NOPR Comments at 25-26 & 57-62.

³⁹ *National Emissions Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines*, Docket No. EAP-HQ-OAR-2008-0708, 75 Fed. Reg. 9648 (Mar 3, 2010). (“RICE amendment”).

⁴⁰ See EPA, *National Emission Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines*, Notice of Proposed Rulemaking, 75 Fed. Reg. 75937 (Dec. 7, 2010). In its petition for reconsideration of this EPA action, the State of Delaware Department of Natural Resources & Environmental Control (“Delaware DNR&EC”) urged the agency to reconsider the amendment allowing RICE units to run as emergency DR, noting that in Delaware the RICE units represent a block of up to 127.5 MWs and that, in a three-hour period, they would emit between 315% - 530% more emissions than a new combustion turbine of similar size. See The Delaware Department of Natural Resources and Environmental Control's Petition for Reconsideration at 5, EPA Docket No. EPA-HQ-QAR-2008-0708 (April 30, 2010). The Delaware petition further points out that for these RICE units to run as DR, “such operation occurs exactly when conditions leading to the formation of ground-level ozone are at their worst. This is the type of use that would be allowed under EPA’s modified definition of emergency stationary RICE.” *Id.* at 3.

without compliance with the RICE NESHAP.⁴¹ While EPSA does not presently know the range of environmental emissions of BTMG, such information should be calculated and analyzed before going down the path of increasing such BTMG by paying it full LMP as if it were a DR resource. There is a glaring lack of information on the extent of the situation, e.g., what types of generation comprise BTMG and what is the environmental impact of BTMG in comparison to comparable generators in front of the meter?⁴² The Commission should therefore not require PJM, or any other ISOs/RTOs, to pay BTMG full LMP until these questions have been adequately answered.

⁴¹ See EPA, *National Emission Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines*, Proposed Settlement Agreement, 77 Fed. Reg. 282 (Jan. 4, 2012).

⁴² Although the scope of this proceeding is limited to PJM's implementation of Order No. 745's requirements concerning energy market compensation, the subsidization of BTMG and the associated – and, to date, unanswered – environmental questions are not so limited. When BTMG masquerades as DR and thus receives the same compensation as traditional generation without assuming the same performance obligations or otherwise being subject to the same regulations as it would if it were in front of the meter, it places unjustified downward pressure on clearing prices, with the result that otherwise economic new and existing generation capacity may not be dispatched. This negatively impacts whether new generation is built and/or causes otherwise economic existing generation to exit the market prematurely. The overall environmental implications of this have not been studied or quantified by FERC and/or the EPA despite numerous requests by EPSA of each agency but are likely to be substantial, especially if the BTMG that is displacing wholesale generation is based on diesel engines as strongly appears to be the case.

