

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

**Midwest Independent Transmission )  
System Operator, Inc. )**

**Docket No. ER11-4337-\_\_\_\_**

**REQUEST FOR REHEARING OF THE  
ELECTRIC POWER SUPPLY ASSOCIATION**

Pursuant to Section 313(a) of the Federal Power Act (the “FPA”)<sup>1</sup> and Rule 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (the “Commission”),<sup>2</sup> the Electric Power Supply Association (“EPSA”),<sup>3</sup> hereby submits this request for rehearing of the Commission’s December 15, 2011 order<sup>4</sup> in the above-captioned proceeding, which conditionally accepted the August 19, 2011 filing<sup>5</sup> by the Midwest Independent Transmission System Operator, Inc. (“MISO”) of proposed revisions to its Open Access Transmission, Energy and Operating Reserve Markets Tariff

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<sup>1</sup> 16 U.S.C. § 825I(a) (2006).

<sup>2</sup> 18 C.F.R. § 385.713 (2011).

<sup>3</sup> EPSA is the national trade association representing competitive power suppliers, including generators and marketers. Competitive suppliers, which, collectively, 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.

<sup>4</sup> *Midwest Indep. Transmission Sys. Operator, Inc.*, 137 FERC ¶ 61,212 (2011) (the “MISO Compliance Order”). EPSA is a party to this proceeding. See *id.* at PP 13, 15.

<sup>5</sup> Midwest Independent Transmission System Operator, Inc., Order No. 745 Compliance Filing, Docket No. ER11-4337-000 (filed Aug. 19, 2011) (the “MISO Compliance Filing”).

(the “Tariff”)<sup>6</sup> in compliance with Order No. 745.<sup>7</sup> Order No. 745 requires, among other things, that certain demand response (“DR”)<sup>8</sup> resources<sup>9</sup> (“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.<sup>10</sup>

EPSA respectfully requests rehearing of two of the Commission’s determinations in the MISO Compliance Order. First, the Commission erred in rejecting, as supposedly beyond the scope of MISO’s Order No. 745 compliance obligation, MISO’s proposal not to pay DR facilitated by behind-the-meter generation (“BTMG”) full LMP. MISO correctly recognized that BTMG represents an increase in supply, rather than “a demand response reduction in energy.”<sup>11</sup> MISO’s conclusion that BTMG does not provide DR through reducing load is

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<sup>6</sup> Except as otherwise indicated, all capitalized terms used herein shall have the same meaning as provided in the MISO Tariff or the MISO Compliance Filing.

<sup>7</sup> *Demand Response in Organized Wholesale Energy Markets*, Order No. 745, FERC Stats. & Regs. ¶ 31,322 (2010) (“Order No. 745”), *on reh’g and clarif.*, Order No. 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”).

<sup>8</sup> 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)).

<sup>9</sup> 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)).

<sup>10</sup> Specifically, Order No. 745 added a new paragraph (g)(1)(v) to section 35.28 of the Commission’s regulations, which requires a DRR participating in an organized wholesale market to be compensated for energy at the full LMP, provided that the DRR has “the capability to balance supply and demand” and when payment of LMP “is cost-effective as determined by a net benefits test accepted by the Commission.” 18 C.F.R. § 35.28(g)(1)(v) (2011).

<sup>11</sup> MISO Compliance Filing at 5 n.16 (*citing* Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2).

consistent with the definition of DR applied in Order No. 745 and with the Commission's statement in Order No. 745-A, which was issued on the very same day as the MISO Compliance Order, that changes to market rules governing the treatment of BTMG "are **properly** considered as part of" an ISO/RTO's compliance filing.<sup>12</sup> 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 from 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 MISO, EPSA,<sup>13</sup> and other commenters that paying BTMG full LMP would result in undue discrimination against wholesale generation, splinter organized markets by encouraging existing wholesale generation to move behind the meter, facilitate gaming and other manipulative practices, threaten reliability, and likely have adverse environmental effects.

Second, the Commission erred in requiring MISO to modify proposed Tariff provisions under which DRRs that fail the net benefits test would be "compensated ... at \$0 because the offered DRR was not 'cost-effective'"<sup>14</sup> as being beyond the scope of this proceeding. The Commission appears not to have understood that MISO was not proposing any changes to the treatment of DRRs that fail the net benefits test, as evidenced, among other things, by the fact

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<sup>12</sup> Order No. 745-A, 137 FERC ¶ 61,215 at P 66 (emphasis added).

<sup>13</sup> See *generally* 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) ("EPSA Comments").

<sup>14</sup> MISO Compliance Filing at 5 (*citing* Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 47).

that its compliance directive refers only to MISO's proposed revisions making such resources ineligible for Revenue Sufficiency Guarantee ("RSG") credits. In addition, the Commission's compliance directive is contrary to law to the extent it requires MISO to modify existing Tariff provisions that it has not proposed to change without satisfying the requirements of Section 206 of the FPA.<sup>15</sup> In any case, MISO's proposal to retain its existing Tariff language is consistent with the plain language of Order No. 745,<sup>16</sup> and, indeed, with the Commission's characterization of the scope of this proceeding. The Commission did not require, and MISO did not propose, any changes to the compensation for DRRs that fail the net benefits test.

For these and other reasons set forth herein, the Commission should grant rehearing of the MISO Compliance Order.

## **I. STATEMENT OF ISSUES AND ERRORS**

In accordance with Rule 713(c)(2) of the Commission's Rules of Practice and Procedure,<sup>17</sup> EPSA hereby lists each issue on which it seeks rehearing of the MISO Compliance Order and provides representative precedent in support of its positions on these issues:

1. The Commission's finding in the MISO Compliance Order that the treatment of BTMG is beyond the scope of MISO's Order No. 745 compliance obligation is arbitrary and capricious, and is not the product of reasoned decisionmaking, because it contradicts its express directive in Order No. 745-A that ISOs/RTOs are permitted to revise any such tariff provisions in their compliance filings, see Order No. 745-A, 137 FERC ¶ 61,215 at P 66, and because the

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<sup>15</sup> 16 U.S.C. § 824e (2006).

<sup>16</sup> See Order No. 745, FERC Stats. & Regs. ¶ 31,322 at 50.

<sup>17</sup> 18 C.F.R. § 385.713(c)(2) (2011).

Commission has failed to articulate any legitimate basis for its decision and has not drawn a “rational connection between the facts found and the choices made.” *Motor Vehicle Mfrs. Ass’n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (“*State Farm*”) (internal citations omitted). See also *Mo. Pub. Serv. Comm’n v. FERC*, 337 F.3d 1066, 1076 (D.C. Cir. 2003) (“*MoPSC II*”).

2. The MISO Compliance Order effectively requires 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*”).
3. The MISO 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 MISO, 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*”).
4. 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. FERC*, 419 F.3d 1194, 1198-1200 (D.C. Cir. 2005) (“*PPL Wallingford*”).
5. The Commission’s rejection, as beyond the scope of MISO’s Order No. 745 compliance obligation, of MISO’s proposal to apply its pre-existing DR compensation provisions to DRRs that fail the net benefits test is arbitrary and capricious, and is not the product of reasoned decisionmaking, because it ignored the Commission’s statements in Order No. 745 that other approaches to compensating such resources may be acceptable, see Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 47 n.115, and because it is not supported by substantial evidence in the record insofar as it is based on the erroneous determination that MISO had proposed

changes to its Tariff that it has not proposed. See, e.g., *Ill. Commerce Comm'n v. FERC*, 576 F.3d 470, 477 (7th Cir. 2009) (“*ICC*”); *MoPSC II*, 337 F.3d at 1072-75.

6. To the extent that the Commission has directed MISO to change existing Tariff provisions that MISO has not proposed to modify in this proceeding, the Commission’s determination is contrary to law because it has failed to satisfy the requirements for ordering such a change under Section 206 of the FPA. 16 U.S.C. § 824e (2006). See also *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 8 (D.C. Cir. 2002) (“*Atlantic City*”).

## 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;”<sup>18</sup> and (2) “dispatch of that demand response resource is cost-effective as determined by the net benefits test.”<sup>19</sup> With respect to the net benefits test, the Commission concluded that the implementation of this test is necessary to “distinguish” between situations in which the overall benefits of the reduced LMP resulting from the dispatch of

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<sup>18</sup> Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2.

<sup>19</sup> *Id.* According to the Commission, this “cost-effectiveness condition,” or “net benefits test,” is necessary to account for the fact that “dispatching demand response resources may result in an increased cost per unit (\$/MWh) to the remaining wholesale load associated with the decreased amount of load paying the bill,” where “customers are billed for energy based on the units, MWh, of electricity consumed.” *Id.* at P 3. To address this “billing rate effect,” the Commission required the use of the “net benefits test,” which is intended “to ensure that the overall benefit of the reduced LMP that results from dispatching demand response resources exceeds the cost of dispatching and paying LMP to those resources.” *Id.* In addition, Order No. 745 also “sets forth a method for allocating the costs of demand response payments among all customers who benefit from the lower LMP resulting from the demand response.” *Id.* at P 5.

DRRs exceed the cost of such dispatch from those in which it does not,<sup>20</sup> and to ensure that, when the net benefits test is met, DRRs are compensated “in a manner that reflects the marginal value of the resource to each RTO and ISO.”<sup>21</sup> The Commission further emphasized that Order No. 745 does not preclude ISOs/RTOs from adopting other approaches to compensating resources that fail this test.<sup>22</sup>

The Commission did not explicitly address the treatment of BTMG, or whether BTMG should qualify as a DR resource. Instead, in Order No. 745-A, which was issued concurrently with the MISO Compliance Order, the Commission noted that existing ISO/RTO tariff provisions address the use of BTMG to facilitate DR, and instructed ISOs/RTOs that “any changes to such rules are properly considered either as part of the individual RTO and ISO compliance filings or separate section 205 or 206 filings, as appropriate.”<sup>23</sup>

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

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<sup>20</sup> *Id.* at P 50. Specifically, the Commission directed each ISO/RTO to determine a monthly threshold price, based on historical data, corresponding to the point along the smoothed supply curve beyond which the benefits to load from the reduced LMP resulting from dispatching of a DRR exceeds the increased cost to Load associated with the billing unit effect. The supply curve analysis is to be updated by the 15th day of each preceding month in advance of an effective date, to allow DR providers and other market participants to plan, while still reflecting current supply conditions. *Id.* at P 79.

<sup>21</sup> *Id.* at P 47.

<sup>22</sup> *Id.* at P 47 n.115.

<sup>23</sup> Order No. 745-A, 137 FERC ¶ 61,215 at P 66.

exceptions, adopted in Order No. 745.<sup>24</sup> In addition, EPSA, along with other groups representing a broad range of interests, sought rehearing of Order No. 745,<sup>25</sup> 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.<sup>26</sup>

## **B. The MISO Compliance Filing**

On August 19, 2011, MISO submitted its revised Tariff sheets in compliance with the Commission's directives in Order No. 745. Under MISO's proposal, a DRR that is BTMG<sup>27</sup> would not be paid the full LMP, because BTMG is "an incremental increase in Energy behind the meters,"<sup>28</sup> and not "a demand response reduction in energy, pursuant to Order No. 745."<sup>29</sup> In response to the

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<sup>24</sup> 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).

<sup>25</sup> 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).

<sup>26</sup> See *Electric Power Supply Ass'n v. FERC*, Petition for Review, Case No. 11-1489 (filed Dec. 23, 2011).

<sup>27</sup> The MISO Tariff defines a "Demand Response Resource" (or DRR) as either a "Demand Response Resource – Type I" ("DRR Type I") or a "Demand Response Resource – Type II" ("DRR Type II"), either of which may be BTMG. See MISO Tariff, § 1.140a, 1.141, 1.142. MISO distinguishes between DRRs that provide DR by reducing the consumption of electricity ("DRR-DR") and DRRs that do not, namely, BTMG. See Motion for Leave to Answer and Answer of the Midwest Independent Transmission System Operator, Inc. at 2, 4, Docket No. ER11-4337-000 (filed Oct. 11, 2011) ("MISO Answer").

<sup>28</sup> MISO Compliance Filing at 5 n.16.

<sup>29</sup> *Id.* at 5 n.16 (*citing* Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2). See also MISO Answer at 4 & n.13 ("the subject Order No. 745 compliance filing only addresses 'DRR-DR', that is, DRR Type I and DRR Type II that reduce the consumption of electricity," and not BTMG). MISO does not propose any changes to the existing rules governing BTMG's compensation and ability to participate in MISO's energy, capacity, and ancillary services markets. MISO Answer at 4-5.

arguments of various protesters that BTMG should qualify as DR and be paid full LMP, MISO explained that “[a] customer that ramps up its BTMG to meet its load is not reducing load; it is satisfying its energy withdrawals from a different generation resource.”<sup>30</sup> In addition, MISO emphasized that “[t]reating BTMG differently than Generation Resources in front of the meter would be unfairly discriminating between these two different generation resource types.”<sup>31</sup> MISO further noted that BTMG could be used to artificially increase DR compensation because “BTMG can be ramped up to inflate a baseline from which a load reduction would be determined and from which LMP credits will be calculated,”<sup>32</sup> and that “[p]aying LMP to DR providers for phantom load reductions does not provide benefits to other buyers in the market,” thereby increasing market inefficiencies and gaming opportunities.<sup>33</sup> Finally, MISO emphasized that allowing BTMG to be treated like a DRR-DR (*i.e.*, a DRR that reduces the consumption of electricity) would “create[] incentives for more generators to move behind the meter, which erode RTO control and endanger reliability.”<sup>34</sup>

To implement the net benefits test requirement, MISO proposed to perform an analysis to determine a Net Benefits Price Threshold (applicable to all cleared DRR energy offers) that would define the LMP where a DRR provides a

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<sup>30</sup> MISO Compliance Filing at 4.

<sup>31</sup> *Id.* In addition, MISO rejected claims by parties that BTMG is more efficient and provides significant environmental benefits, by pointing out that “[m]ost BTMG consists of diesel generators, fuel oil generators or small coal-fired plants, which are not only less efficient than traditional generation but also produce more CO<sub>2</sub> and NO<sub>x</sub> emissions, and therefore are not preferable from an environmental perspective.” *Id.* at 5.

<sup>32</sup> *Id.* at 6.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

net benefit to the market.<sup>35</sup> At the time of settlement, MISO would review each hourly Ex Post LMP at each DRR pricing node, and if the LMP is above or equal to the Net Benefits Price Threshold, then the cleared DRR offers at that node will receive payment of full LMP.<sup>36</sup> With respect to DRRs that fail the net benefits test, MISO would apply the existing DR compensation provisions of MISO's Tariff (*i.e.*, as it existed prior to the MISO Compliance Filing), pursuant to which such DRRs would "be compensated for the offer at \$0 because the offered DRR was not 'cost-effective.'"<sup>37</sup>

### C. The MISO Compliance Order

In the MISO Compliance Order, the Commission conditionally accepted the MISO Compliance Filing, but rejected MISO's proposals regarding the treatment of BTMG and compensation for DR suppliers that do not satisfy the net benefits test. With respect to BTMG, the Commission first noted that Order No. 745 did not alter the definition of DR in the Commission's regulations.<sup>38</sup> The Commission then found that MISO's proposal to "differentiate" between DRRs facilitated by BTMG and other DRRs "is beyond what is required to comply with

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<sup>35</sup> *Id.* at 5. MISO would post the system-wide Net Benefits Price Threshold by the 15<sup>th</sup> of each month for Market Participants to use in evaluating DRR energy offer prices for the upcoming month's Day-Ahead and Real-Time energy markets. The Net Benefits Price Threshold will be constant at every hour for such month. *Id.*

<sup>36</sup> *Id.* (*citing* Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 47).

<sup>37</sup> *Id.* MISO goes on to explain that, under the existing MISO Tariff, DRRs are paid LMP when such resources are deployed, but that load-serving entities are charged LMP, resulting in a net payment of \$0 for the DRRs. *Id.* In addition, MISO proposed Tariff revisions providing that DRRs that fail the net benefits test would not receive RSG make-whole payments, or credits for Day-Ahead or Real-Time RSG "because providing such DRRs with a make-whole payment would be directly contrary to payment of zero dollars to a DRR" that fails the net benefits test. *Id.*

<sup>38</sup> MISO Compliance Order, 137 FERC ¶ 61,212 at P 72.

Order No. 745,<sup>39</sup> and directed MISO to submit corresponding Tariff revisions.<sup>40</sup> In addition, the Commission noted that, if MISO determined that “adjustments to its existing demand response program are necessary based on its operational experience, it may propose appropriate Tariff revisions under FPA section 205.”<sup>41</sup>

The Commission also ordered MISO to modify Tariff provisions, which MISO had not proposed to change, under which DRRs would not have been compensated when the applicable hourly LMP is below the Net Benefits Price Threshold, on the grounds that “the proposed Tariff revisions are beyond the scope of the MISO Compliance Filing.”<sup>42</sup> According to the Commission, Order No. 745 was limited to situations where a DRR can balance supply and demand and satisfies the net benefits test, but “did not extend to situations where the LMP is not greater than or equal to the threshold price,<sup>43</sup> *i.e.*, where the DRR fails the net benefits test. The Commission directed MISO that it would require MISO to submit, in a compliance filing, “Tariff revisions to remove these proposed revisions.”<sup>44</sup> The Commission further claimed that, as a result of its findings and

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<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at P 73.

<sup>42</sup> *Id.* at P 37.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at P 37 & n.86. All of the revised Tariff provisions listed in footnote 86 of the MISO Compliance Order addressed revisions that would have made DRRs that fail the net benefits test ineligible for RSG credits; none of the cited provisions addressed MISO’s proposal to apply to such resources its existing Tariff provisions, which provide that DRR that fails the net benefits test would be compensated at \$0.

compliance directives, MISO's rules governing the compensation of DRRs that fail the net benefits test "will not change."<sup>45</sup>

### III. REQUEST FOR REHEARING

#### A. **The Commission's Finding That The Treatment Of BTMG Is Beyond The Scope Of This Proceeding Is At Odds With The Commission's Clear Statement To The Contrary In Order No. 745-A.**

The Commission declined to address the question of whether BTMG is DR in Order Nos. 745 and 745-A, but made clear that ISOs/RTOs were free to address the treatment of BTMG in their compliance filings. In Order No. 745-A, the Commission explained:

Details associated with the *use* and measurement of [BTMG] to facilitate demand response are already part of some RTO and ISO tariffs, and any changes to such rules are *properly* considered either as part of the individual RTO and ISO compliance filings or separate section 205 or 206 filings, as appropriate.<sup>46</sup>

Nonetheless, when MISO accepted the Commission's invitation to address the issue on compliance, the Commission declared the issue to be "beyond what is required to comply with Order No. 745,"<sup>47</sup> and rejected MISO's proposal without further consideration.

MISO had pre-existing Tariff provisions addressing the use of BTMG. Consequently, MISO's proposed revisions governing the treatment of BTMG were within the proper scope of its Order No. 745 compliance filing. The Commission's assertion to the contrary in the MISO Compliance Order is directly

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<sup>45</sup> *Id.* at P 38.

<sup>46</sup> Order No. 745-A, 137 FERC ¶ 61,215 at P 66 (emphasis added).

<sup>47</sup> MISO Compliance Order, 137 FERC ¶ 61,212 at P 71.

contradicted by the above-quoted statement in Order No. 745-A. The Commission's decision to ignore its own clear directive was therefore arbitrary and capricious,<sup>48</sup> and must be reversed on rehearing.

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

EPSA wholeheartedly agrees with MISO's determination that BTMG should not be paid full LMP. As MISO observed, BTMG is "an incremental increase in Energy behind the meters,"<sup>49</sup> rather than "a demand response reduction in energy, pursuant to Order No. 745,"<sup>50</sup> and "[t]reating BTMG differently than Generation Resources in front of the meter would be unfairly discriminating between these two different generation resource types."<sup>51</sup> While Order No. 745 does not include any directives regarding the treatment of BTMG, MISO's proposal is fully consistent with the Commission's definition of DR therein as:

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<sup>48</sup> See, e.g., *State Farm*, 463 U.S. at 43 (explaining that an agency action is "arbitrary and capricious" where it fails to "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choices made.'") (internal citations omitted); *MoPSC II*, 337 F.3d at 1075 ("[r]eliance on facts that an agency knows are false at the time it relies on them is the essence of arbitrary and capricious decisionmaking.").

<sup>49</sup> MISO Compliance Filing at 5 n.16.

<sup>50</sup> *Id.* at 5 n.16 (*citing* Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2). MISO further explained that "[a] customer that ramps up its BTMG to meet its load is not reducing load; it is satisfying its energy withdrawals from a different generation resource."

<sup>51</sup> *Id.* In addition, MISO rejected claims that BTMG are more efficient and provide significant environmental benefits, noting that "[m]ost BTMG consists of diesel generators, fuel oil generators or small coal-fired plants, which are not only less efficient than traditional generation but also produce more CO<sub>2</sub> and NO<sub>x</sub> emissions, and therefore are not preferable from an environmental perspective." *Id.* at 5.

[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.<sup>52</sup>

MISO relied on this clear language in concluding that BTMG should not be paid full LMP because it does not provide a demand reduction:

[Demand Response Resources] that [are] Behind the Meter Generation (“BTMG”) will not be paid the full LMP, in part, because BTMG is not a demand response reduction in energy, pursuant to Order No. 745, but rather is an incremental increase in Energy behind the meters. See, Order No. 745 fn 2.<sup>53</sup>

This is a fair reading of Order No. 745, as BTMG is **not** a net **reduction** in consumption. Thus, the use of such generation does not provide DR through load reduction, and therefore should not be paid full LMP.

MISO is also correct that payment of full LMP to BTMG would unduly discriminate against wholesale generation. As explained in greater detail in the white paper attached to EPSA’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 as generation in the wholesale market **or** use the generation to serve a customer’s load directly, and receive correspondingly lower compensation.<sup>54</sup> Thus, the 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

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<sup>52</sup> Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.2.

<sup>53</sup> MISO Compliance Filing at 16.

<sup>54</sup> See Hogan Policy Paper at 7-9.

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.<sup>55</sup> In addition, the Commission’s determination would further exacerbate the existing discrimination in favor of BTMG in MISO’s current rules, which permit BTMG to participate in MISO’s markets without being subject to comparable requirements, in particular, those relating to market power mitigation (*e.g.*, must offer requirements).<sup>56</sup>

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.<sup>57</sup> 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 located. MISO’s proposal is consistent with both Order No. 745 and with the FPA’s non-discrimination requirements.

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<sup>55</sup> See *id.* at 9-10.

<sup>56</sup> See generally EPSC Comments at 25-26 (discussing disparate treatment of BTMG and on-grid generators in terms of market power monitoring and mitigation).

<sup>57</sup> See 16 U.S.C. §§ 824d, 824e (2006).

The Commission's holding in the MISO Compliance Order effectively requiring MISO to pay qualifying BTMG<sup>58</sup> full LMP, in addition to the savings from the foregone retail or wholesale purchase costs, is therefore contrary to law because it mandates unduly preferential treatment of BTMG and unduly discriminates against wholesale generators.<sup>59</sup> Moreover, the Commission failed to address, much less meaningfully respond 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 unduly preferential and discriminatory.<sup>60</sup> In failing to respond to these serious objections, the Commission has not satisfied its "fundamental obligation to engage in reasoned decision making,"<sup>61</sup> which necessarily "renders its decision ... arbitrary and capricious."<sup>62</sup>

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<sup>58</sup> That is to say, BTMG that satisfies the net benefits test and that is capable of balancing supply and demand.

<sup>59</sup> 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).

<sup>60</sup> *See generally* EPSA Comments at 16-18 and 24-26.

<sup>61</sup> *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).

<sup>62</sup> *CAPP*, 254 F.3d at 299. *See also* *State Farm*, 463 U.S. at 43 (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).

**C. The Commission’s Finding Regarding BTMG Ignores Evidence That Its Approach Would Encourage Generation To Move Behind The Meter, 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 MISO, EPSA,<sup>63</sup> and other parties that payment of full LMP to BTMG would have a number of adverse consequences. Responding to claims that BTMG should be paid full LMP, MISO explained that such an approach would: “create[] incentives for more generators to move behind the meter, which erode RTO control and endanger reliability;”<sup>64</sup> would facilitate manipulative practices to artificially increase DR compensation,<sup>65</sup> and would have adverse environmental impacts. 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.<sup>66</sup>

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<sup>63</sup> See generally EPSA Comments at 18-20 and 25-30.

<sup>64</sup> MISO Answer at 6.

<sup>65</sup> *Id.* at 6 (noting that “BTMG can be ramped up to inflate a baseline from which a load reduction would be determined and from which LMP credits will be calculated”). In support of the foregoing claims, MISO cited a May 26, 2011 opinion issued by the ISO-NE Internal Market Monitor (“ISO-NE IMM”), which found that “apparent demand reductions created by the operation of [BTMG] should not be treated as demand response,” because the use of BTMG “enables participants to inflate their baselines, thereby increasing the likelihood of payment for non-genuine demand response, and it will decrease market competitiveness.” Memo from Dave LaPlante and Hung-po Chao, Internal Market Monitor, “Opinion on behind-the-meter generation in the proposed Order 745 Transition Rules” at 1-2 (dated May 26, 2011) (“ISO-NE IMM Opinion”), available at: [http://www.iso-ne.com/committees/comm\\_wkgrps/mrktts\\_comm/mrktts/mtrls/2011/jun22011/a3\\_imm\\_memo\\_05\\_26\\_11.doc](http://www.iso-ne.com/committees/comm_wkgrps/mrktts_comm/mrktts/mtrls/2011/jun22011/a3_imm_memo_05_26_11.doc).

<sup>66</sup> 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).

EPSA respectfully submits that MISO's concerns that the Commission's approach would encourage generation to move behind the meter<sup>67</sup> are well founded. As the Commission has repeatedly emphasized, large, centrally dispatched markets offer the most efficient, reliable and competitive markets for electricity.<sup>68</sup> 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

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<sup>67</sup> See MISO Answer at 6 (*citing* ISO-NE IMM Opinion at 1). As explained in the ISO-NE IMM Opinion:

[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 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.

ISO-NE IMM Opinion at 3.

<sup>68</sup> 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).

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

In addition, MISO's concerns regarding the danger of market manipulation by DR providers are also justified. 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."<sup>69</sup>

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<sup>69</sup> Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 95. To the Commission's credit, it 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 the Commission's Office of Enforcement ("OE") Staff 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).

EPSA also shares MISO's concerns that such preferential treatment of BTMG is "not preferable from an environmental perspective,"<sup>70</sup> 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 generation, and would therefore discourage the rational development of cleaner and more efficient wholesale generation.<sup>71</sup> 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"),<sup>72</sup> 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.<sup>73</sup> A proposed settlement with various DR

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<sup>70</sup> MISO Answer at 5.

<sup>71</sup> See EPSA NOPR Comments at 25-26 & 57-62.

<sup>72</sup> *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").

<sup>73</sup> 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

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 without compliance with the RICE NESHAP.<sup>74</sup> 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?<sup>75</sup> The Commission should therefore not require MISO, or any other ISOs/RTOs, to pay BTMG full LMP until these questions have been adequately answered.

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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.

<sup>74</sup> See EPA, *National Emission Standards for Hazardous Air Pollutants for Reciprocating Internal Combustion Engines*, Proposed Settlement Agreement, 77 Fed. Reg. 282 (Jan. 4, 2012).

<sup>75</sup> Although the scope of this proceeding is limited to MISO'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.

**D. The Commission’s Rejection Of MISO’s Determination Not To Compensate A DRR That Fails The Net Benefits Test Rests On The Demonstrably False Assumption That MISO Proposed Revisions To These Tariff Provisions.**

The Commission erred by rejecting, as beyond the scope of this compliance proceeding, MISO’s determination to apply its pre-existing DR compensation provisions to DRRs that fail the net benefits test, pursuant to which such resources do not receive any compensation.<sup>76</sup> The Commission’s determination appears to be based on the erroneous assumption that MISO proposed revisions to its Tariff that MISO did not, in fact, make.

As MISO explains in its compliance filing, it determined that it was appropriate to apply its *existing* DR compensation provisions to DRRs that fail the net benefits test; the only Tariff revisions it proposed in this regard were to make such resources ineligible for RSG make-whole payments. The Commission appears to have misunderstood MISO’s proposal, as is clear from its discussion of MISO’s compliance obligation. There, the Commission orders MISO to submit, in a compliance filing, “Tariff revisions to remove these proposed revisions,”<sup>77</sup> and includes in footnote 86 a list of the Tariff revisions that it has rejected. All of the Tariff provisions listed in that footnote, however, address provisions governing DRRs’ eligibility for RSG credits. To the extent that

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<sup>76</sup> See MISO Compliance Filing at 5. As noted above, such resources are paid LMP when deployed, but the LSE where the DRR is deployed are charged LMP, resulting in a net payment of \$0. *Id.*

<sup>77</sup> MISO Compliance Order, 137 FERC ¶ 61,212 at P 37 & n.86. The Commission’s confusion is further evidenced in the following paragraph, in which it states that its compliance directives will ensure that MISO’s DR compensation practices in hours where the net benefits test is not satisfied “will not change in this proceeding.” *Id.* at P 38. MISO has not proposed to change its compliance practices in this regard, and consequently, no Commission action is necessary to restore or maintain the *status quo ante*.

the Commission relied on the manifestly false factual determination that MISO proposed revisions that it has not proposed, its decision is not supported by any evidence in the record, much less the substantial evidence necessary to survive judicial review,<sup>78</sup> and it must therefore grant rehearing.

Moreover, to the extent that the MISO Compliance Order requires MISO to make revisions to any existing Tariff provisions that MISO has not proposed to change, it is contrary to law. Specifically, Section 206 of the FPA is the only provision of the FPA under which the Commission, acting *sua sponte*, may order modifications to existing Tariff provisions, and the Commission does not claim to have exercised its Section 206 authority. If and to the extent that the Commission acted under Section 205 of the FPA, the MISO Compliance Order is plainly contrary to law, because, as the courts have repeatedly emphasized, the Commission “has no power to force public utilities to file particular rates unless it first finds the existing filed rates unlawful,”<sup>79</sup> something it can do only under Section 206 of the FPA.

In addition, the Commission’s holding ignores its clear statement that Order No. 745 did not make any findings as to whether other approaches to compensating such resources are acceptable.<sup>80</sup> Further, there is no indication in

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<sup>78</sup> See 5 U.S.C. § 706(2)(E) (2006). See also, e.g., *ICC*, 576 F.3d at 477 (explaining that a reviewing court cannot “uphold a regulatory decision that is not supported by substantial evidence on the record as a whole.”); *MoPSC II*, 337 F.3d at 1072-75 (vacating and remanding Commission orders because it found, among other things, that the Commission had failed to articulate the actual reasons for its decision, and the reasons it did cite were unsupported by record evidence, and did not support its decision).

<sup>79</sup> *Atlantic City*, 295 F.3d at 8 (internal citations omitted).

<sup>80</sup> See Order No. 745, FERC Stats. & Regs. ¶ 31,322 at 47 n.115.

Order No. 745 that an ISO/RTO may not revise its existing rules regarding the treatment of DRRs. It is therefore arbitrary and capricious for the Commission to treat its silence on this point as prohibiting ISOs/RTOs from making corresponding changes to the rules governing the treatment of DRRs that fail to satisfy the net benefits test.

Finally, as the Commission correctly notes, Order No. 745 was limited to situations where a DRR can balance supply and demand and satisfies the net benefits test, and “did not extend to situations where the LMP is not greater than or equal to the threshold price,”<sup>81</sup> *i.e.*, DRRs that fail the net benefits test. Notwithstanding the Commission’s assertions to the contrary, this is precisely what MISO has done. MISO’s proposed changes to its Tariff are limited to DRRs that satisfy the net benefits test; the compensation of DRRs that fail this test would be governed by MISO’s existing Tariff provisions. Thus, MISO’s proposal to retain its existing Tariff language is consistent with the plain language of Order No. 745.<sup>82</sup>

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<sup>81</sup> MISO Compliance Order, 137 FERC ¶ 61,212 at P 37.

<sup>82</sup> See Order No. 745, FERC Stats. & Regs. ¶ 31,322 at 50.



