



Five Contrarian Ideas and Seven Important Points: *A Manifesto for Curtailment Service Providers*

Peak Load Management Association

October 20, 2009
Chicago, Illinois

Kenneth G. Hurwitz, Esq.
ken.hurwitz@haynesboone.com
Haynes and Boone, LLP

A Wake-Up Call!

(1)

- *The CSP Industry is at a Critical Juncture*
- Substantial Progress has been Made
 - RTO/ISO Programs
 - Retail Programs
- But federal and state regulatory frameworks are in a state of flux
- Clearly, opportunities to shape the regulatory framework abound

A Wake-Up Call!

(2)

- I believe now is the time to:
 - *Seize the Moment at FERC*
 - Relegate Participation in the RTO/ISO Stakeholder Processes to Priority “Number Two”
 - *Achieve Conceptual Clarity on Pricing Issues*
 - Build Unity within the CSP Industry
 - *Build Alliances with Other Sectors, including Utilities and IPPs*

FERC: The Fierce Urgency of “*Very Soon*” ⁽¹⁾

- A Democratic Majority will soon take hold at FERC and FERC support for DSM will be at its apogee
- Chairman Jon Wellinghoff
 - A committed supporter of DSM both as Commissioner and as Chairman
 - Term expires June 30, 2013
 - Widely seen as the key person who will carry forward the Administration’s energy policy
- Outgoing Commissioner Suedeem Kelly
 - Likely to leave the Commission before the expiration of the current session of Congress in November or December, or sooner if the Senate confirms her replacement before then
 - No names have yet surfaced, but her replacement will be a Democrat
- (In all probability) Incoming Commissioner John Norris
 - 12 days ago, following hearings and a favorable committee vote, the Senate Energy and Natural Resources Committee forwarded Norris’s name to the full Senate
 - Will fill the seat of former Chairman Kelliher, who was not a strong supporter of DSM
 - Norris’s priorities seem closely aligned with the priorities of the Obama Administration and those of Chairman Wellinghoff

FERC:

The Fierce Urgency of “Very Soon” (2)

- Supportive Climate at FERC as to *General Principles*
 - **Staff Report, December 2008 - Assessment of Demand Response & Advanced Metering**- potential demand response contribution from all U.S. demand response programs is estimated to be close to 41,000 MW, or about 5.8 percent of U.S. peak demands
 - **Principle of Comparable Treatment**- FERC has taken numerous actions enshrining the general principle that demand response resources technically capable of providing a service must be treated comparably to supply resources offering that service
 - **ISO/RTO-specific actions**– In 2008 and 2009, FERC issued numerous orders focusing on capacity, ancillary service and other product markets in PJM, ISO-NE, MISO, NYISO, SPP and CAISO
 - **Order No. 719**– Issued in 2008, this Order recognized the benefits of demand response, and required RTOs and ISOs to take actions to ensure comparable treatment of demand response resources
 - **Order No. 890**– Issued in 2007, this Order requires transmission providers to establish an open and transparent transmission planning process that incorporates demand response resources if they “are capable of providing the functions assessed in a transmission planning process, and can be relied upon on a long-term basis.” Para. 479.

FERC: The Fierce Urgency of “*Very Soon*” ⁽³⁾

- FERC has articulated General Principles supportive of Demand Side Resources
 - But important implementation issues remain open
 - *E.g.*, appropriate level of incentives for Demand Resources in various wholesale markets
 - *E.g.*, PJM Economic Load Response Program pricing
- FERC typically indulges its own worst instinct to dodge issues and relegate them to stakeholder processes for resolution
 - *E.g.*, in the PJM Economic Load Response Program pricing proceeding

The Stakeholder Process: *Play But Pray* ⁽¹⁾

- Voting Procedures Vary Among RTO/ISOs
 - But sector voting is typical
- PJM example
 - For a motion to carry, the sum of the proportions of “yea” votes in all of the sectors must exceed .667 times the number of sectors
 - PJM sectors are generation owners, other suppliers, transmission owners, electric distributors and end-use customers
 - As the Commission observed in the Standard Market Design NOPR,
 - Four of these sectors represent interests that would benefit from higher levels of demand
 - Only one sector represents customers or end-users, and none represents demand-side technologies or alternative load control services such as demand resource management
- On many issues, DR is bound to lose
- Moral of the Story – *“Abandon Hope All Ye Who Enter Here”*

Seize the Day! ⁽¹⁾

- Given:
 - *FERC's articulation of supportive principles, especially on comparable treatment of Demand Side Resources*
 - The incipient Democratic majority on the Commission
 - *The structural and functional deficiencies of the Stakeholder Processes*
- It is Time for the CSP Industry to Seize the Day at the Commission:
 - Demand that the Commission clarify conceptual issues
 - *Bring thorny implementation/pay incentive issues to the Commission for resolution*
 - Resist calls to rely on the Stakeholder Processes and aggressively take them to task!

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽¹⁾

- **A major battle is taking place at FERC on the pricing of Economic Load Response Service in PJM**
 - PJM describes ELR as a voluntary program, applicable to energy, that is designed to bring about price responsive reductions in energy usage. Participants bid load reductions in the “Day Ahead” and “Real Time” markets
 - The Program was to sunset; the issue now is the appropriate level of compensation for participants during the continuation of the Program
 - On August 26, PJM proposed to reinstate incentive payments for demand response in the 9% of hours when LMPs are at their highest and to cease such payments when 1,000 MW of new price-responsive demand capability arises in the PJM footprint
 - PJM further proposed that demand response providers should be compensated for their demand response at the LMP price minus the generation price at retail
- **A coalition of demand response providers consisting of Comverge, EnergyConnect, EnerNOC, the PJM Industrial Customer Coalition, Viridity Energy and Wal-Mart Stores East filed comments and a protest**

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽²⁾

- **PJM contends that the purpose of the Economic Load Response Program is, or should be, to address a specific *market failure*, which is that many end-use customers do not pay the market price, or LMP, at retail**
 - *Therefore, PJM contends, the payment to participants under ELR should be LMP minus G (where the customer pays an average cost-based rate for standard offer service at the retail level)*
 - *PJM contends that the payment to participants under ELR should be zero where the retail customer pays LMP at retail*
 - *PJM contends that any payment above LMP minus G (or LMP for LMP customers) is a “subsidy”*
 - *PJM contends that the customer sees a price represented by receiving a payment of LMP minus G and by avoiding the payment of G*
 - *PJM believes that the goal is economic/allocative efficiency*

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽³⁾

- *Demand Response Supporters contend that participants should be paid the full LMP for load curtailments*
- Demand Response Supporters argue that demand response is a *service* that participants provide to the Grid (with measurable benefits)
- *Demand Response Supporters contend that compensation for this service in the energy market should be guided by a simple principle: compensation for a decrement of load reduction should be the same as for an increment of supply – in other words, at LMP*

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽⁴⁾

- A market correction to the retail market or a service to the Grid?
 - Let's try for conceptual clarity!
 - An ELR participant provides a service. He essentially has a contract with PJM – if the load reduction does not materialize, he will pay “damages” in the form of LMP.
 - An ELR participant should be compensated comparably to a market participant who provides an increment of energy supply
 - An ELR participant should also be compensated for at least part of the quantifiable benefits it provides to non-curtailing customers

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽⁵⁾

- A market correction to the retail market or a service to the Grid?
 - What about “allocative efficiency”?
 - PJM’s concern seems to be that, unless G is subtracted from LMP, customers will under-consume electricity and over-consume other items in their market basket of goods (*Microeconomics 101*)
 - Is loss of theoretic customer allocative efficiency **offset and outweighed** by societal benefit of lower LMP in light of the unique attributes of energy markets?
 - **Can** a regulator of wholesale markets price a wholesale service by referring to retail prices? (*FPC v. Conway Corp. et al.*, 426 U.S. 271 (1976))
 - **Should** a regulator of wholesale markets price a wholesale service by incorporating concerns about the retail price?
 - There is a major flaw in retail markets – most customers cannot reduce consumption in response to real time price increases
 - “Subsidizing” those consumers who can vary their consumption in real time can *increase* allocative efficiency

One Clear CSP Industry Priority: *Achieve Conceptual Clarity on Payment/Incentive Issues* ⁽⁶⁾

- A market correction to the retail market or a service to the Grid?
- Does it makes sense to subtract “G”? (*Retail Ratemaking 101*)
 - Energy market subtraction, if any, should be fuel cost and VOM, not the total embedded cost of G, which includes capacity costs
 - Other implementation problems
 - What if retail class cost allocation study shows disparities in class returns?
 - Should G be adjusted to equalize class returns?
 - Different results for residential and commercial and industrial customers?

Build Unity within the CSP Industry! ⁽¹⁾

- Review September 16, 2009 Protest and Comments of Demand Response Supporters
 - *Consists of one pleading drafted by counsel and five separate affidavits*
 - Was unity among the participants achieved before the filing was made?
 - *Draw your own conclusions!*
- How would the IOUs have handled this?

Build Alliances with Other Sectors ⁽¹⁾

- ***Electric utilities routinely oppose the Demand Response sector and Demand Response providers***
 - Why?
 - ***Three major reasons for utility opposition to demand reduction***
 - “Coupling” revenues with units of sales
 - The Great Game of Regulatory Lag
 - » Inter-rate case growth
 - » Inter-rate case fixed cost reduction
 - Bias towards construction of generation or transmission for inclusion in the utility rate base (*2009 State of the Markets Report, ISO/RTO Council, at 24*)
 - Dampened by divestiture/restructuring and reduction in “G” investments
 - Behind the meter competition – keep competitors away from customers

Build Alliances with Other Sectors ⁽²⁾

- **“Decoupling”** is a regulatory term indicating that, through any one of several means, a given energy utility does not derive the portion of its revenues necessary to provide it an opportunity to recover its fixed costs of service on the basis of its unit sales of electricity (*Lesh, June 30, 2009*)
 - *As of December 2008, 10 states had adopted policies that decouple changes in utility revenue from changes in sales volume (FERC Staff Report at ii (December 2008))*
 - Lesh Study found that 12 electric utilities across 17 states have operative decoupling mechanisms in place (*Lesh at 3*)
 - *“Decoupling mechanisms,” for purposes of the count, do not include adoption of SFV rate designs*

Build Alliances with Other Sectors ⁽³⁾

- *Should CSP providers align with electric utilities in state utility commission rate cases to support adoption of decoupling mechanisms?*
 - Potential Benefits?
 - Reduce utility opposition
 - Build support at state utility commission level
 - Costs?
 - Scarce dollars for advocacy
 - Short-run survival versus long-run institutional benefits to CSP industry

Build Alliances with Other Sectors ⁽⁴⁾

- **Independent Power Sector and CSPs** have common interest in efficient markets
 - Order No. 719 determination that existing RTO and ISO market rules that do not allow for prices to rise sufficiently during an operating reserve shortage to allow supply to meet demand
 - Are unjust, unreasonable and may be unduly discriminatory
 - May not produce prices that accurately reflect the value of energy, and, by failing to do so, may harm reliability, inhibit demand response, deter entry of demand response and generation resources, and thwart innovation
 - Commission ordered RTOs and ISOs to modify, where necessary, their market rules governing price formation during periods off operating reserve shortage
- **Was this aspect of Order No. 719 an opportunity to reduce opposition from IPP sector?**
- **Will there be other opportunities?**

Conclusion

- *I have suggested that the CSP Industry:*
 - *Seize the Moment at FERC*
 - Relegate Participation in RTO/ISO Stakeholder Processes to Priority “Number Two”
 - *Achieve Conceptual Clarity on Pricing Issues*
 - Build Unity within the CSP Industry
 - *Build Alliances with Other Sectors, including Utilities and IPPs*
- *I urge you – invest in your future*
- Otherwise, an historic opportunity will have passed you by!